Whether Family Settlement possess legal binding force and would it amount to transfer under the Taxing statutes

Statutes referred :

1. Income Tax Act
2. Transfer of Property Act
3. Hindu Succession Act

Brief facts :

Settlement Deed(Deed) has been entered into by two families who are brothers in relation say A(elder brother) and B(his wife) and X(younger brother) and Y(his wife). The Deed consists of settlement in respect of three properties details and shares held by the family are as follows :

a) Property 1 (residential) - : A+X
b) Property 2 (commercial) -: A(42%) + B(7.5%) + X(42%) + Y(7.5%)
c) Property 3 (Residential) -: A+B

Now they want to settle the dispute amongst them by a mutual settlement.

The question arises as to whether the Deed shall be binding upon the parties and would it amount to transfer under the taxing statues.

Explanantion

1. The Settlement Deed possess legal binding force and shall be binding to the parties to the extent of lawfulness and has been ruled by the Apex Court in the case of ***Kale & Ors Vs Deputy Directors of consolidation & Ors.- AIR1976SC807***. *It* was held as follows :

    1. Family arrangement-Its object and purpose-Principle governing-if should be registered-Oral arrangement-If permitted-If would operate as an estoppels
    2. Registration Act. s. 17(1)(b)-Family arrangement if should be compulsorily registered.

    "The rules were laid down as follows :(A) The object of a family arrangement is to protect the family from long drawn litigation or perpetual strife which mars the unity and the solidarity of the family. A family arrangement by which the property is equitably divided between the arious contenders so as to achieve an equal distribution of wealth, instead of concentrating tho same in the hands of a few, is a milestone in the administration of social justice. Where by consent of the parties a matter has

been settled, the courts have learned in favour of upholding such a family arrangement instead of disturbing it on technical or trivial grounds. Where the courts find that the family arrangement suffers from a legal lacuna or 1 formal defect, the rule of estoppel is applied to shut out the plea of the person who being a party to the family arrangement, seeks to unsettle a settled dispute and claims to revoke the family arrangement under which he has himself enjoyed some material benefits.

(B) (i) The family settled must be bona fide so as to resolve family disputes.

(ii) It must be voluntary and not induced by fraud, coercion or undue influence;

(iii) It may be even oral, in which case and registration is necessary;

(iv) Registration is necessary only if the terms are reduced to writing but where the memorandum has been prepared after the family arrangement either for the purpose of record or for information of court, the memorandum itself do not create or extinguish any rights in immovable property and, therefore does not fall within the mischief of s. 17(2) of the Registration Act and is not compulsorily registrable;

(v) The parties to the family arrangement must have some antecedent title, claim or interest, even a possible claim in the property which is acknowledged by the parties to the settlement. But, even where a party has no title and theother party relinquishes all its claims or titles in favour of such a person and acknowledges him to be the sole owner, then, the antecedent title must be assumed and the family arrangement will be upheld by the courts;

(vi) Where bona fide disputes are settled by a bona fide family arrangement. Such family arrangement is final and binding on parties to settlement."

2. Taking into consideration various judgments of Higher Courts we find that the Term HUF is a much wider term than a Hindu Coparcener and it was differentiated by the Apex court in famous judgment of ***Commissioner of Wealth-tax, West Bengal III Vs. Smt. Champa Kumari Singhi and Ors., AIR1972SC2119***. The said portion of the judgment has been reproduced hereinunder as : "*The only other provision in the Act in which the expression "Hindu" undivided family" occurs is Section 20. It deals with assessment after partition of a Hindu undivided family. Under Section 3 of the Act it is the Hindu undivided family which is one of the assessable entities. It should be distinguished from a Hindu co-parcenary which is a much narrower body than the Joint family. A Hindu joint family consists of all persons lineally descended from a common ancestor, and includes their wives and unmarried daughters. A Hindu co-parcenary includes only those who acquire by birth an interest in the joint co-parcenary property, being the sons, grandsons and great grandsons of the holder of the joint property. Thus*

there can be a joint Hindu family consisting of a single male member and widows of deceased coparceners……."Hindu undivided family" did not mean a Hindu co-parcenary but was a wider expression which would take in the widowed mother and the widowed aunt of the assessee in that case. No contrary view seems to have been expressed in any other case subsequently and it appears that it is for the first time that the Calcutta High Court in the judgment under appeal has upheld the contention that a Jain undivided family cannot fall within the expression "Hindu undivided family". It will not be out of place to mention that indisputably ever since income tax laws have been in force no distinction has ever been made between a Jain undivided family and a Hindu undivided family and a Jain family has always been assessed as a Hindu undivided family. Even in the forms prescribed for making returns of Income tax no such differentiation or distinction has ever been made.

3. The Bombay HC in the case of ***K. Y. Patel Vs. Commissioner of Income-tax [1995]214ITR793(Bom)*** reiterated the same ruling as follows : *"assessee converted his private property consisting of shares into property of HUF – assessee claimed that dividend were not taxable in hands of assessee as they were not received by him but by Hindu Undivided Family (HUF) – whether provisions of Section 64 (2) applicable – according to assessee expression (HUF) means family comprising individual, his wife and minor children of which assessee was 'karta' – expression HUF not to be given restricted meaning – HUF consists of all persons lineally descended from common ancestor and includes their wives and unmarried daughters – it is much wider body than HUF coparcenary which includes only those persons who acquire interest by birth in joint property"*

4. Now we shall consider that whether it amounts to transfer or not. Various courts have held that it shall not amount to transfer, if the property is of HUF, as has been laid down under the case of ***Commissioner of Income-tax Vs. A.N. Naik Associates and Anr. and Rangavi Realtors and Anr 2004]265ITR346(Bom).*** it was held that *"The Division Bench of the Karnataka High Court considered the expression of "transfer" under Section 2(xxiv) of the Gift-tax Act, which defines "transfer of property" as any disposition, conveyance, assignment, settlement, delivery or other alienation of property. The Division Bench noted that the Act was self-contained and the definition of "property" is to rope in artificial devices which may include mere agreements or arrangements, intended to confer gifts, which may not however, fall under the normal meaning of "transfer" as gifts and the definition of "gift" in Section 2(xii) to include many transactions which could not ordinarily be described as transfers of property and has a wider import than the meaning given to "gift" in Section 122 of the Transfer of Property Act. The court after considering various judgments, held that the decisions which hold that there is no transfer of property when there is a distribution of assets on dissolution*

or when an asset is allotted to a partner on his retirement from the firm, will be inapplicable where an asset is brought in by the partner into the partnership."

5. The Madras HC in a recent judgment has held that rearrangement of property held jointly making it as HUF shall not amount to transfer in spite of the fact that some new title is given to the other party on which there was no claim of the said party.

The Commissioner of Income Tax Vs. Kay ARR Enterprises, R. Jayanthi and K. Rajagopal (HUF) [2008]299ITR348(Mad)

"Capital gains--Transfer of shares for realignment of interest was of family arrangement--There was a transfer of shares between the assessee firm and the partners, who were family members. Certain new shares were acquired in exchange of old shares and as also against some consideration in cash. Assessee claimed that transfer was consequent to family arrangement. AO concluded that there was indeed a transfer involved and thus, subjected the capital gain tax. It was held that re-arrangement of shareholdings in the company was done to avoid possible litigation among family members and was a prudent arrangement which was necessary to control the company effectively by the major shareholders to produce better prospects and active supervision or otherwise there would be continuous friction and there would be no peace among the members of the family. Such family arrangement could not be concluded as any other dealings between strangers, as it was for the interest of the family. Therefore, such a realignment of interest by way of effecting a family arrangement among the family members would not amount to transfer so as to attract capital gain tax.

Tribunal found that the re-arrangement of shareholdings in the company to avoid possible litigation among family members was a prudent arrangement which was necessary to control the company effectively by the major shareholders to produce better prospects and active supervision or otherwise there would be continuous fraction and there would be no peace among the members of the family. Such a family arrangement intended either by compromising doubtful or disputed rights or by preserving the family property or the peace and security of the family by avoiding litigation or by saving its honour cannot be concluded as any other dealings between strangers, as such a family arrangement is for the interest of the family and for the harmonious way of living. Therefore, such a realignment of interest by way of effecting a family arrangement among the family members would not amount to transfer. [Para 6.1] The Tribunal has rightly found that the impugned transfer of shares by way of family arrangement would not attract capital gains tax, as the same is a prudent arrangement to avoid possible litigation among the family members and is made voluntarily and not induced by any fraud or coercion and, therefore, cannot be doubted. In view of the settled propositions of law, that the Tribunal was justified in arriving at the conclusion that the family arrangement among the assessees does not amount to any transfer and hence, not

exigible to capital gains tax. Accordingly, finding no substantial question of law arises for our consideration in these appeals, the same are dismissed."

Conclusion

After going through the judgments, we can opine that if the properties are held jointly by the parties and no partition has taken place, the same shall be considered as HUF under the Income Tax and no liability shall arise for capital tax. So in our case we must carefully examine that who is holding what share of the property and in what capacity and also it is pertinent to note that who and how the tax liabilities are paid off in respect of such properties.