TAX PLANNING AS TO CAPITAL GAINS

*Bal Krishna**

IN THE present tax structure, tax planning is a must for the assessees. Tax burdens are quite heavy and sometimes confiscatory in nature. An assessee can arrange his affairs in such a way, that if possible he may not be required to pay tax, or his liability be reduced to the minimum. However, this arrangement must be, without violating legislative injunctions of taxing statutes, by lawfully circumventing them.[1] The observation of

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*M. Com., LL.M., Lecturer, Panjab University, Chandigarh.

1. In *C.I.T.* v. *A. Raman & Co.*, 67 I.T.R. 11 (1968), Shah, J., observed :

> Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented. (*Id.* at 17).

In *Attorney-General* v. *Duke of Richmond & Gordon*, (1908) 2 K.B. 729, Farwell, L.J., observed :

> The argument that his motive is to escape duty appears to me wholly irrelevant, because a man is perfectly justified in avoiding and escaping the duty which will arise in the future but which has not yet attached to any property which he possesses. (*Id.* at 743).

In *Commissioners of Inland Revenue* v. *Angus*, 23 Q.B. 579 (1889), Lord Esher, M.R., observed :

> The Crown, however, must make out its right to the duty, and if there be a means of evading the stamp duty, so much the better for those who can evade it. It is no fraud upon the Crown, it is a thing which they are perfectly entitled to do. (*Id.* at 593).

In *In re Central Talkies Circuit*, 9 I.T.R. 44 (1941), it was observed : "[A]ny one is entitled to conduct his affairs within the law so as to avoid incidence of taxation...." (per Beaumont, C.J., *id*. at 51).

In *Duke of Westminster* v. *Commisioners of Inland Revenue*, 19 T.C. 490 (1934) Lord Tomlin observed :

> Every man is entitled if he can to order his affairs so that the tax attaching under appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. (*Id.* at 520).

Again in *Jiyajee Rao Cotton Mills* v. *C.I.T.*, 34 I.T.R. 888 (1958) (S.C.) it was observed :

> Every person is entitled so to arrange his affairs as to avoid taxation but the arrangement must be real and genuine and not a sham or make-believe....(*Id.* at 897).

Jagadisan, J., in *Aruna Group of Estates* v. *State of Madras*[2] amply explains this point :

> Avoidance of tax is not tax evasion and it carries no ignominy with it for, it is sound law and, certainly, not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum.[2a]

From the above, it follows that the assessee can legally resort to tax planning. Tax planning is actually lawful avoidance of tax liability by taking advantage of various exemptions, concessions and loopholes in the tax laws without violating the provisions of law.[3] But if the assessee violates the provisions of law for taking advantage of tax exemption it will be a tax evasion and not tax avoidance and would entail penalty.

As to capital gains, there is a lot of scope for tax planning because of the fact that the provisions contained in sections 45 to 55-A of the Income-tax Act, 1961 are quite clumsy and very brief and the assessee can easily take advantage of the loopholes and lacunae in them. It is, therefore, proposed to find out how best one should arrange his affairs so that he may be required to pay less and less tax on his capital gains. To begin with, it becomes necessary to briefly summarise a few relevant provisions of the Act relating to capital gains.

Statutory provisions

Section 45 of the Income-tax Act, 1961 is the basic section relating to capital gains which provides for the charge of capital gains tax. According to this section any profits or gains arising from the transfer of a capital asset affected in the previous year shall be chargeable to income-tax under the head 'capital gains' and shall be treated to be the income of the previous year in which the transfer took place. Now the question arises what is the meaning of the term 'capital asset.' Section 2(14) of the Act provides an answer to this question. According to section 2(14) 'capital asset' means property of any kind held by an assessee, whether or not connected with his business or profession. However, this sub-section provides that following shall not be regarded as 'capital asset' for the purposes of capital gains tax :

(*i*) Stock in trade, consumable stores or raw materials, *etc.*, are not in the definition of capital asset because in most situations they will get surplus resulting on their disposal, and the income they will get will be taxable otherwise.

(*ii*) All agricultural land, other than agricultural land situated within

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2. 55 I.T.R. 642 (1965).

2*a*. *Id.* at 648.

3. R. Santhnam, *Tax Planning in Respect of Capital Gains* 4 (1976).

the municipal limits. If the agricultural land is situated within the municipal limits of towns having population of more than 10,000 persons then although it is agricultural land, the surplus resulting from the disposal of this agricultural land will be liable to capital gains tax. So land situated within 8 kilometres of certain specified towns will be liable to capital gains tax on its transfer. By notification in the official gazette a number of towns have been so specified by the government.

(*iii*) 6½ per cent Gold Bonds, 1977 or 7 per cent Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the central government are exempted from capital gains tax when they are transferred.

After determining whether an asset is 'capital asset' or not it is to be seen whether in fact it has been transferred by the assessee. The liability of tax will arise only when 'capital asset' is transferred. Section 2(47) of the Income-tax Act defines the term transfer in relation to 'capital assets' thus :

> "transfer", in relation to capital asset includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law.

This definition extends the scope of the transfer as it is ordinarily understood and includes within its ambit the cases of extinguishment and compulory acquisition.

Capital assets have been classified under two heads :

1. Short-term capital assets.

2. Long-term capital assets.

According to section 2(42A), short-term capital asset means a capital asset held by an assessee for not more than thirty-six months[4] immediately preceding the date of its transfer. From this it follows that all capital assets which are held for a period of more than thirty-six months shall be regarded as long-term capital assets. The gain arising from the transfer of a short-term capital asset is known as the short-term capital gain and the gain arising from the transfer of a long-term capital asset is known as the long-term capital gain. This classification is important because the mode of taxation of capital gains varies according to the type of capital asset

4. Twenty-four months relevant to the assessment years 1969-70 to 1973-74.
Sixty-months relevant to the assessment years 1974-75 to 1977-78.
Thirty-six months from the assessment year 1978-79.

transferred.[5]

Steps for tax-planning

As noted in the previous paragraph, capital assets may be short-term or long-term and the mode of taxation also varies with the type of asset transferred ; planning can be made as to date of transfer, as to transferring asset in parts and taking the benefit of the provisions relating to set-off and carry forward of losses.

(*a*) As long-term capital gains are taxed at concessional rates, as a measure of tax planning capital asset should not be transferred before the expiry of 36 months from the date of its acquisition, so that the gains therefrom may be regarded as long-term capital gains.

(*b*) But if the assessee has income under other heads also and he expects a loss from the sale of capital asset, he should dispose it of before 36 months so that loss from it may be regarded as the short-term capital loss and such a loss can be set-off from his income under other heads. This is possible because of the provision contained in section 71 (3).

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5. In case of assessees other than companies :

Where gross total income includes long-term capital gains, the following deductions are admissible for the purpose of computing the total income :

(*a*) in case where the gross total income (including capital gains) does not exceed rupees 10,000 or where the long-term capital gains does not exceed Rs. 5,000. The whole of such gains.

(*b*) in other cases :—

(*i*) in respect of long-term capital gains relating to land or building or any rights therein. The first Rs. 5,000 of such gains plus 25 per cent of the balance thereof;

(*ii*) in respect of long-term capital gains relating to any other capital assets. The first Rs. 5,000 of such gains in so far as such deduction has not been availed of under clause (*b*)(*i*) above, plus 40 per cent of the balance thereof.

The above concessions are granted under section 80T of the Act. It may be noted that short-term capital gains are treated *at par* with the ordinary income and taxed in the same way as the other income of the assessee is taxed.

In case of companies :

Short-term capital gains are treated *at par* with the ordinary income taxed in the same way as the other income of the company. According to section 115 of the Income-tax Act, the long-term capital gains are taxed at the following rates :

(*a*) Long-term capital gains relating to land and building or any rights therein :

(*i*) in case of widely-held companies having taxable income not exceeding rupees one lac (other than long-term capital gains) 40 per cent.

(*ii*) In other cases 50 per cent.

(*b*) Long-term capital gains relating to other assets 40 per cent.

(*c*) A loss from a long-term capital asset can be set-off against long-term capital gains.[6] If there remains any balance, the same will be carried forward for not more than four assessment years provided it is more than Rs. 5,000.[7] As a measure of tax planning as assessee who has suffered a loss from the sale of a long-term capital asset, which is less than Rs. 5,000, should sell some other long-term capital asset in the same assessment year so that the loss is set-off against the profit from the sale of other long-term capital asset. To illustrate the point, suppose 'A' who owns shares in company X and in company Y, wants to dispose of his shares. He is holding the shares in both the companies for the last 5 years. 'A' sells his shares in company X at a loss of Rs. 4,500. 'A' cannot set-off this loss against his income under other heads. 'A' also cannot carry-forward this loss, because it is less than Rs. 5,000 and, therefore, this loss will be ignored. But if 'A' sells shares in company Y in the same assessment year, at a profit of Rs. 9,500 he will be able to set-off his loss from the sale of shares in company X form this profit, and the balance Rs. 5,000 will be exempt under section 80T. Thus, his liability would be nil.

(*d*) Again an assessee, other than a company, as a measure of tax planning should dispose of his long-term capital assets by splitting them in parts in several years, so that he may be able to claim basic exemption of Rs. 5,000, several times. This can be done by disposing of the capital asset just at the end of a year and again next day in the next year. For example 'A' who owns shares in company X wants to sell them and he expects to make a profit of Rs. 15,000. If he sells all the shares in one year, he will be subjected to capital gains tax. But if he sells one-third of shares on 31 March and again one-third on 1 April and other. one-third again on 1 April in the next year, he will not be required to pay any tax on his capital gains.

Transfer

The definition of the term transfer in section 2(47) takes within its ambit sale, exchange, extinguishment or compulsory acquisition. Section 47 of the Act provides a list of transactions which are not regarded transfers for the purposes of capital gains under section 45.

Clause (*i*) of section 47 provides that 'any distribution of capital assets on the total or partial partition of a Hindu undivided family' shall not be regarded as transfer. This clause can be of great help in tax planning by the Hindu undivided families and their members. It has been held in *Hari Hari* v. *Commissioner of Agricultural Income-tax*[8] that a partition cannot be held by the tax authorities to be invalid merely because it results in or is effected to ensure avoidance of tax.

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6. S. 70 (2) (*ii*).
7. S. 74 (1) (*a*) (*ii*).
8. 48 I.T.R. 791 (1963).

Section 64 of the Income-tax Act which deals with the clubbing of income is applicable to an assessee whose status is of an 'individual' and is not applicable to the Hindu undivided families,[9] and, therefore, if a Hindu undivided family transfers property to its members and they make capital gains by the sale of that property, that shall not be clubbed with the income of the Hindu undivided family and thus liability can be split up among several persons who would be able to claim basic exemption of Rs. 5,000, each if it is a case of the long-term capital asset.

For example a Hindu undivided family has shares in company X which it acquired for Rs. 1,00,000 only three years back. The present market value of the shares is Rs. 1,50,000. If the Hindu undivided family itself sells the shares it will be required to pay capital gains tax on Rs. 50,000 subject to the exemptions contained in section 80T. But if it effects partition as to this capital asset only and that is permitted as partial partition to the property is allowed and the members can save the capital gains tax. Therefore, as a tax planning measure the Hindu undivided family may transfer those shares to its ten members and those members as individuals may sell the shares. The cost of acquisition in their hands shall be the same as was of Hindu undivided family. The profit of each of the member would be Rs. 5000 which is exempted under section 80T. Thus, the members of the Hindu undivided family would not be required to pay anything by way of tax.

In case of short-term capital assets the Hindu undivided family can transfer those assets to such members who have no other source of income. And thus as short-term capital gains are taken as 'income under any other head, such member of the Hindu undivided family shall be able to claim basic exemption of Rs. 10,000 from the assessment year 1978-79 onward.

Section 47 (*iii*) provides that "any transfer of a capital asset under a gift or will or an irrevocable trust" shall not be regarded as transfer for the purposes of capital gains tax. But section 64 of the Act provides that :

(1) In computing the total income of any individual, there shall be included all such income as arises directly or indirectly—

(*iii*) ... to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart;

(*iv*) ... to a minor child not being a married daughter of such individual, from assets transferred directly or indirectly to the minor child by such individual otherwise than for adequate consideration....

Section 64 foils an individual's attempt to avoid or reduce the incidence

9. *Hirday Narain* v. *C.I.T.*, 57 I.T.R. 363 (1965); *Narendra Lal* v. *C.I.T.*, 93 I.T.R. 534 (1974).

of tax by transferring the asset to the spouse or minor child[10] by including income of the spouse or minor child in the income of the individual who transferred the asset. In *Sevantilal's* case[11] the Supreme Court held that this section applies to capital gains which arise out of the transfer of such assets, as it applies to income arising from assets so transferred to individual's spouse or minor child. But income arising from accumulated income or accretions to the assets are not included in the income of the individual who transferred the asset. For example 'A' transfers a house to his wife 'B' without consideration. The house is let out for the rent of Rs. 500 per month. This transfer to the wife will not be taxable as capital gain of 'A' because of section 47 *(iii)*. But the income by way of rent received by the wife 'B', shall be included in the income of 'A'. But suppose 'B', the wife, regularly invests the money in the purchase of shares, and sells those shares at a profit. This profit, *i. e.*, capital gain shall not be included in the income of her husband 'A'. This is supported by the case of *Popatlal Bhikamchand* v. *C.I.T.*[12] where it was held that the dividend received by the son on the bonus shares, which were issued to him in respect of his shareholding which he got from his father, cannot be included in the father's income because that income did not arise from the 'asset transferred' but from accretion.

Again, as a measure of tax planning if a cash gift is made by an individual to the spouse or minor child and with that a capital asset, say, a building is purchased and after a few years that building is sold at a profit. The capital gain therefrom which has accrued to the other spouse or minor child shall not be included in the income of the individual who had made a cash gift. The reason is that there is no proximate connection between the income derived by sale of the building and the cash gift made by the individual.[13]

Again, if a capital asset is gifted to a minor child, it should be sold after the child attains the age of majority or in case of daughter, she is married. If it is sold after the child attains the age of majority or the daughter is married, the capital gains arising from such asset shall not be included in the income of the individual who made the transfer. This is because same relationship must exist at the time when the gift is made and also at the time of transfer.[14]

Further as a measure of tax planning an individual instead of making a gift may advance money to his spouse. The spouse with that money may purchase capital asset. Later on if the spouse sells the capital asset,

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10. *Sevantilal Maneklal Sheth* v. *C.I.T.*, 68 I.T.R. 503 (1968).

11. *Ibid.*

12. I.T.R. 577 (1959).

13. *C.I.T.* v. *Pelleti Sridevamma*, (1977) I.T.J. 7; see also *C.I.T.* v. *Prem Bhai Parekh*, 77 I.T.R. 27 (1977).

14. *Philip John Plasket Thomas* v. C.I.T., 49 I.T.R. 97 (1963); *Vinodkumar Ratilal* v. *C.I.T.*, 100 I.T.R. 564 (1975).

the capital gains thereform will not be taxable in the hands of the individual who advanced the money. And the spouse after sale may return the money to the other spouse.

According to section 47 (*iv*) any transfer of a capital asset by a company to its subsidiary company is not regarded as transfer for purposes of capital gains tax. This clause can be used as a tax planning device by a company having a subsidiary and transferring the asset through the subsidiary company. Suppose Singh Private Ltd. owns a building which was purchased by it for Rs. 3,00,000 and its present market value is Rs. 23,00,000. If it is sold in the market, by Singh Private Ltd. there will a be capital gain of Rs. 20,00,000 and the tax payable by the company would be fifty per cent of the capital gain which comes to Rs. 10,00,000. Singh Pvt. Ltd. can have its subsidiary company M Pvt. Ltd. with a paid up share capital of Rs. 12,00,000. It then transfers this building to M Pvt. Ltd. This transfer of building to M Pvt. Ltd. shall not be taxable because of section 47 (*iv*). Now, suppose M Pvt. Ltd. sells that building for Rs. 23,00,000. This company by sale of building will make capital gains of Rs. 20,00,000. This is because according to section 49 of the Act the cost of acquisition of the asset to the subsidiary company shall be deemed to be the cost for which the previous owner (parent company) acquired it. Thus, on this M Pvt. Ltd. will be required to pay tax of Rs. 10,00,000. After paying the tax, M Pvt. Ltd. pays Rs. 23,00,000 to Singh Pvt. Ltd. After payment of the price of the building, the financial position of M Pvt. Ltd. is as under:

Share capital	Rs. 12,00,000
Cash in hand	Rs. 2,00,000

As the financial position of the company shows, it has only one asset with itself *i.e.* cash in hand of Rs. 2,00,000. Therefore, no one will buy its shares for more than Rs. 2,00,000. Now suppose Singh Pvt. Ltd. sells its shares for Rs. 2,00,000, there will be short term capital loss of Rs. 10,00,000 and that would be treated as ordinary loss of the company on account of shares. Suppose Singh Pvt. Ltd. has profit from its business of Rs. 12,00,000. Out of this profit it can deduct this loss of Rs. 10,00,000 and would be required to pay tax on Rs. 2,00,000 only. Thus, its tax liability would be considerably reduced.

Cost of acquisition

Section 49 of the Act deals with the cost of acquisition of capital assets. According to this section cost of acquisition of the asset shall be deemed to be the cost for which the previous owner of the property acquired it. Section 71' (3) of the Act provides that where capital gains relating to short-term capital assets is a loss and the assessee has income assessable under any other head of income, the assessee shall be entitled to have such loss set-off against the income from other heads of income. This clause read with section 49 can be used as a measure of tax planning for reducing the tax liability even to nil. These provisions can be applied in this way.

Suppose X owns M Pvt. Ltd. company. From this company he has made profit of Rs 3,00,000. He had started N Pvt. Ltd. with a paid up share capital of Rs. 6,00,000. In the very first year he suffers a loss of Rs. 2,50,000 in N. Pvt. Ltd. X as a measure of tax planning can close N Pvt. Ltd. by selling its shares to M. Pvt. Ltd. Now, M Pvt. Ltd. sells those shares for Rs. 3,50,000/-. This is the maximum amount which N Pvt. Ltd. can get for those shares, looking to the financial position of N Pvt. Ltd. Now the cost of those shares to M Pvt. Ltd. was 6,00,000 *i.e.* that which was of the previous owner N Pvt Ltd. and as it has sold those shares for Rs. 3,50,000, it has suffered a loss of Rs. 2,50,000 on shares which it can set off under section 71 from its income under other heads, *i.e.* 3,00,000 and thus save tax on Rs. 2,50,000 and pay tax only on Rs. 50,000.

Goodwill

Section 45 of the Act makes it very clear that there must be 'profit or gain' that is chargeable to tax. The concept of profit or gain arising from transfer or sale necessarily implies that there is something received in excess of the cost of the capital asset which is transferred or sold. Profit or gain arising from sale has a necessary reference to the difference between the cost price of the asset and the sale price of the asset.

Now the question is whether the goodwill which is a self-generated asset, but a capital asset, when it is sold will attract liability under the head capital gains. Bombay High Court in *C.I.T.* v. *Home Industries and Company*[15] has held that it will not be chargeable to capital gains tax because there is no cost of the acquisition of the self-generated goodwill. While deciding this, the court relied upon *Rathnam Nadar's* case[16] and *E.C. Jacob's* case.[17]

As a measure of tax planning while selling the business it must be specifically mentioned that this much amount is being charged for goodwill, so that no tax be imposed on that amount.

Enhancing the cost of acquisition

Hindu undivided family can be used as a device for reducing tax liability as to capital gains by enhancing the cost of acquisition in the hands of a coparcener who gets property at the time of partition in such a way that one member is given the property and other members are given compensation in lieu of their share at the market value of

15. (1977) 1 I.T.J. 484.
16. *C.I.T.* v. *K. Rathnam*, 71 I.T.R. 433 (1969).
17. *C.I.T.* v. *E.C. Jacob*, 89 I.T.R. 88 (1973).

the property. As is observed by R. Santhnam:

> The amount of compensation representing the market value of assets taken over could thus be added to the cost of acquisition of the asset by the member who received the property on partition. The advantage is that the addition to the cost in such a case would help the assessee to reduce the capital gain arising on its subsequent sale or transfer and thus reduce also incidence of tax thereon.[18]

It is submitted that this device of tax planning is of doubtful utility because section 49 clearly says that the cost of acquisition of the asset shall be the cost for which the previous owner of the property acquired it. It means that compensation paid by the Hindu undivided family shall not be the cost of acquisition but the cost at which the Hindu undivided family acquired the asset and, therefore, it appears that this device would not work.

Substitution of fair market value

As a measure of tax planning the assessee should substitute fair market value as on 1 January 1964 in place of its actual cost of acquisition. That is permitted by section 50 of the Act. By doing this, tax liability can be reduced to a considerable extent. The option is with the assessee and he must exercise it when it is for his benefit. To illustrate, suppose 'A' acquired a capital asset on 1 January 1940 for Rs. 2,000 only. Its present market value at which it can be sold is Rs.80,000. Now if he sells it he will be making a capital gain of Rs. 78,000. But in place of its original cost of acquisition 'A' can subsitute fair market value as was on 1 January 1964. Suppose on 1 January 1964 fair market value of that asset was Rs. 60,000. The assessee can treat the cost of acquisition at his option as Rs. 60,000, and thus if he sells for Rs. 80,000, the capital gain from the sale thereof shall be only Rs. 20,000 and not Rs. 78,000. Thus, tax burden can be reduced considerably by exercising the option available under this section.

Exemptions

Sections 53, 54, 54-B, 54-D and 54-E deal with the exemptions from tax of capital gains if requirements laid down in those sections are satisfied.

Section 53 exempts capital gains arising from the transfer of house property for a consideration not exceeding Rs. 25,000. According to this section where a capital gain arises from the transfer of one or more capital assets, being building or lands appurtenant thereto, such gain shall

18. *Supra* note 3 at 78.

be exempted from tax, notwithstanding anything contained in that section, if all the following conditions are satisfied:

(*i*) the income of the transferred property before the date of the transfer was chargeable under the head 'income from house property';

(*ii*) the full aggregate value of the consideration for which the transfer is made, does not exceed Rs. 25,000; and

(*iii*) the aggregate of the fair market value of all capital assets, being buildings or lands appurtenant thereto the income of which is chargeable under the head 'income from house property' owned by the assessee immediately before the transfer, does not exceed Rs. 50,000.

This section can be used as a tax planning device by an assessee who has small buildings or land appurtenant to them, by disposing of one building for an amount less than Rs. 25,000. For example 'X', who owns two houses valued at Rs. 48,000, sells one of them for Rs. 24,000, which he had purchased in 1966 for Rs. 6,000 only. His capital gains of Rs. 18,000 from this sale shall not be taxable because he satisfies all the requirements laid down by the section.

Where a capital asset being a building or land appurtenant thereto, income of which is chargeable under the head 'income from house property', which was being used mainly for the purpose of residence of the assessee or his parents, is sold and replaced by another building, section 54 gives some relief in the liability of capital gains tax. In order to avail of this exemption, the following conditions have to be fulfilled :

(1) the transfer of a capital asset should be one to which the provisions of section 53 are not applicable;

(2) the capital asset must be used mainly by the assessee or his parent for his own or the parent's own residence for two years immediately preceding the date of transfer of the asset;

(3) income of such capital asset was chargeable under the head 'income from house property'; and

(4) the assessee must have purchased within a period of one year after that date or constructed within a period of two years, house property for the purpose of his own residence.

If the capital gains exceed the cost of new asset only, the excess will be charged as capital gains and if capital gains are equal to or less than the cost of the new asset, no tax will be levied on the capital gains.

As a device of tax planning the assessee may sell his house and invest the money wherever he likes, so as to have earnings on that money. Now to avail of this exemption the assessee must construct a new house within a period of two years from the date of transfer. For doing this he can borrow money from the Life Insurance Corporation of India or any other governmental agency at cheaper rate of interest and also he will be entitled to exemption from 'income from house property' for the interest which he will be paying under section 24 (*1*) (*vi*). This is possible in the light of the decision of Delhi Bench of the Income-tax-Appellate Tribunal in *Income-tax Officer Dist. IV* (7), *New Delhi* v. *Shri Vidya Prakash Talwar*,[19] where the question was whether the sale proceeds of the first property should necessarily be invested in the second one. The tribunal held that : "there is no condition in section 54 that for investment in a new house, the sale proceeds of the first house were to be applied."

Section 54 presents an interesting problem of interpretation. The problem is, whether the benefit of this section can be availed of by the Hindu undivided family as a measure of tax planning? This section provides that an assessee shall be entitled to the benefit of this section if the building "was being used by the assessee or a parent of his mainly for the purposes of his own or the parent's own residence'! Do these words narrow down the meaning of the term assessee? Companies may not be able to reside in a house but Hindu undivided families can. Will Hindu undivided families cease to be eligible for the benefit merely because the alternative condition, *viz*, residence by a parent, cannot be satisfied in their case? There is no judicial pronouncement on this point nor the department has clarified the position. As to partnership firms it was held in *K.I. Viswambaran and Others* v. *C.I.T.*[20] that a firm cannot claim benefit of this section because a firm can have no personal residence. Some departmental officers are taking the view that only individuals (who can have parents) are entitled to the relief. It is submitted that Hindu undivided families stand on different footing from companies or firms and must be given benefit of this section. The rule of interpreting the provisions of this section have been stated by Desai, J., of the Gujarat High Court in *C.I.T.* v. *Natu Hansraj*[21] thus :

> It is well settled that words of a statute, when there is doubt about their meaning, are to be understood in the sense in which they best harmonise with the subject of the enactment and the object which the legislature has in view. Their meaning is found not so much in a strictly grammatical or etymological propriety of language nor even its popular use, as in the subject or in the occasion on which they are used, and the object to be attained.[22] The expression used in a statute should ordinarily be understood in the sense in which they best harmonise with the object of the statute and which effectuate the object of the legislature.[23] It is necessary, therefore, to read section 54 in the context of the subject-matter and its setting in the scheme of capital gains and the object of

19. Tax (1973) 35 (6) - 65.
20. 91 I.T.R. 588 (1973).
21. 105 I.T.R. 43 (1976).
22. See *Workmen of Dimakuchi Tea Estate* v. *Management of Dimakuchi Tea* Estate, A.I.R. 1958 S.C. 353.
23. *New India Sugar Mills* v. *Commissioner of Sale Tax*, A.I.R. 1963 S.C. 1207.

exemption and then to ascertain the true import of the relevant part thereof.[23a]

Applying this rule of construction, it is submitted that the Hindu Undivided family is entitled to the benefit of this section as a measure of tax planning.

As tax planning measure the assessee, who has acquired capital asset within the specified period in section 54, is advised not to sell the new property before the expiry of three years from the date of acquisition of that property. If he sells before the expiry of three years the sale will result in huge capital gains as, for computing the capital gains in respect of new property, the cost thereof will be reduced by the capital gains of the old property.

The definition of 'capital asset' in section 2 (14) provides that agricultural land situated within the municipal limits or within 8 kilometres of the limits of notified municipalities will be regarded as capital asset and gains arising from the sale of such land will be liable to capital gains tax. Section 54-B provides exemption in respect of gains from the sale of such land to the extent they are reinvested in agricultural lands within two years. As noted earlier this new land should not be sold before the expiry of three years from the date of acquisition, so that the exemption obtained is not forfeited by excluding the capital gains from the cost of acquisition.

Section 54-D provides for exemption from tax in respect of capital gains arising from transfer by way of compulsory acquisition of rights in land or buildings if the assessee had been using the said asset for any industrial undertaking belonging to him and has within three years, purchased, any other land or building or rights in land or building for the purpose of shifting or re-establishing the said undertaking or setting up another industrial undertaking. The exemption will be to the extent the capital gain is utilised for such purpose.

Another important exemption is provided in section 54-E which was inserted by section 13 of the Finance (No. 2) Act, 1977. This section exempts from liability to capital gains tax the amount of capital gains which is derived by the assessee from the transfer of any of his long-term capital assets if the full value of the consideration for the transfer is reinvested in investments which are listed in explanation I to section 54-E as 'specified assets'. Accordingly, if the full value of the consideration for the transfer is invested or deposited by the assessee in any of the following investments within a period of six months from the date of transfer of the capital asset, the assessee would be exempt from capital gains tax in full regardless of the amount of such capital gains. The specified assets are :—

23a. *Supra* note 21 at 49.

(*i*) securities of the central government or a state government;

(*ii*) saving certificates as defined in clause (*c*) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959);

(*iii*) units in the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(*iv*) debentures specified by the central government for the purposes of clause (*ii*) of sub-section (1) of section 80L;

(*v*) shares in any Indian company which are issued to the public or are listed in recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and any rules made thereunder;

(*vi*) deposits for a period of not less than three years with the State Bank of India established under the State Bank of India Act, 1953 (23 of 1955) or any subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959) or any nationalised bank, that is to say, any corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) or any co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).

In order that exemption given by this section is not lost, the assessee as a tax planning measure should hold the new asset for a period of three years.

Conclusion

This is not an exhaustive list of measures for tax planning as to 'capital gains'. These are only random thoughts. Given a deeper thinking and consideration to the provisions of the Act, in detail many more measures can be thought of which can go a long way in helping the taxed community.