IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "C", MUMBAI
BEFORE SHRI G.S.PANNU VICE PRESEDENT,(AS THIRD MEMBER)

SHRI D. KARUNAKAR RAO, ACCOUNTANT MEMBER, AND

SHRI AMIT SHUKLA, JUDICIAL MEMBER,

SH. PAWAN SINGH JUDICIAL MEMBER AND

SHRI RAJESH KUMAR ACCOUNTANT MEMBER

ITA No. 4964/Mum/2013
(Assessment year : 2010-11)

Perfect Thread Mills Ltd 201, Millenium Plaza Behind Sakinaka Telephone Exchange, Andheri Kurla Road, Andheri (E), Mumbai-72 PAN: AAACP6449E	vs	DCIT, 8(2), Mumbai
APPELLANT		**RESPONDEDNT**

Appellant by	Shri Sunil Hirawat
Respondent by	Shri Awungshi Gimson, CIT-DR

Date of hearing	21-08-2019
Date of pronouncement	05-09-2019

ORDER UNDER SECTION 255(4) OF THE INCOME TAX ACT, 1961

This appeal was initially heard on 29-07-2015. The Hon'ble Members, who constituted the bench, have passed the following dissenting orders:-

PER P. KARUNAKARA RAO, AM:

This appeal filed by the assessee on 1.7.2013 is against the order of the CIT(A)-17, Mumbai dated 29.4.2013 for the assessment year 2010-2011. In this appeal, assessee raised the following grounds which read as under:

"1. On the facts and in the circumstances of the case, the Ld CIT (A) has erred in upholding the order passed by the Ld DCJT, which is bad in law and against justice and liable to be quashed.
2.(a) On the facts and in the circumstances of the case and in law, the Ld CIT (A) has erred in upholding the order passed by the Ld ACIT, who has erred in disallowing the deduction of Rs. I,48,24,633/- being claimed as expenses while determined the capital gain.
(b) The Ld CIT (A) has failed to appreciate the fact that the sale of land area was effected by Kotak Mahindra Bank Ltd (KMBL) and out of the sales consideration received by them they had deducted the said amount towards principal amount of loans as the bank had existing overriding title on the company's assets.
(c) The Ld CIT (A) has failed to appreciate the judicial pronouncement of Hon'be Calcutta High Court in the case of Gopee Nath Paul & Sons vs. Deputy CIT [2005] 278 ITR 240 where it was held that on the sale of firm's business as a going concern the amount paid to banks to have the charge lifted was treated the expenses in relation to transfer. "

2. Briefly stated relevant facts of the case are that the assessee is a manufacturer of cotton / polyster sewing and industrial threads and also engaged in processing of cotton yarn. Assessee is in this business for a long time and filed the return of income for the year under consideration declaring the total loss of Rs. 64,93,9277-. After completing the scrutiny assessment u/s 143(3) of the Act, the total income is determined at Rs. 49,25,990/-. In the assessment, AO made adjustment to the claim relating to capital gains and made addition of Rs. 2,14,50,679/-. This is the point of contention before the Revenue Authorities as well as in Tribunal. The facts relating to this issue are given in the following paragraph.

3. Assessee took a corporate term loan of Rs. 306 lakhs from M/s. Kotak Mahindra Bank Ltd (KMBL) during the Financial Year 2008-2009 relevant to the assessment year 2009-2010. The loan was repayable in 36 monthly installments and the assessee complied with the repayment schedule and repaid the loan till July 2009. However, assessee became a defaulter from August 2009 onwards.

The bank (KMBL) classified the company's account as NPA (Non-performing Asset) on 21.11.2009. In this regard, a notice was served on 30.11.2009 as per the provisions of section 13(2) of Securitization and Reconstruction of Financial Assets of Security Interest Act (SARFAESI) on the assessee company and its personal guarantors viz Mr. H.S. Bapna and Mrs. Urmila Bapna. The total outstanding liabilities at that point of time is 3,40,61,488/-. On 7.1.2010, the bank took over possession of the factory land of the assessee admeasuring 6,883.517 sq mts. Land was sub-divided into 7 plots and 6 of these sub-plots were sold by the bank in March, 2010. The bank received directly the consideration amounting to Rs. 2,18,00,262/-. The bank adjusted the said realization against the loan of the assessee ie a sum of Rs. 1,48,24,633/- was adjusted against the principal segment of the loan. Rs. 69,75,629/- was adjusted against the interest segment of this loan. Assessee claimed this interest liability as an allowable expenditure in the accounts of the assessee. Accordingly, the net amount of Rs. 1,48,24,633/-, which was appropriated towards principal segment of the loan was shown in the computation of capital gains arising of those 6 plots of land. However, the said amount was claimed as deductible u/s 48 of the Act along with the indexed cost of acquisition and improvements (Rs. 3,43,583;- and other incidental expenses of Rs. 6000 relating to sales). The manner of computation given by the assessee in the return of income is extracted as under:

Long Term Capital Gains:

Total amount of sale consideration received by M/s. Kotak Mahindra Bank Ltd against principal amount of Loan out of sale proceeds of company's land taken possession by them under SARFAESI ACT		*Rs. 2,18,00,262/-*
Less	***Acquisition***	***Improvements***
(i) Cost of land -		
Year of acquisition / improvements	*1981-82*	*2006-2007*

Cost of acquisition / improvements	*47,201/-*	*37,178/-*		
Index of year of acquisition / improvements	*100/-*	*519/-*		
Index for AY 2009-2010	*632/-*	*632/-*		
Indexed Cost (Rs.)	*2,89,310/-*	*45,273/-*	*3,43,583/-*	
(ii) Incidental Expenses for above sale			*6 000/-*	
(iii) Amount adjusted by Kotak Mahindra Bank Ltd against principal amount of Loan out of sale proceeds of company's Land taken possession by them under SARFAESI ACT			*148.24.633/-*	*1,51,74,218/-*
Long Term Capital Gains				***66,26,046'/-***

4. In the assessment, AO issued a show cause notice proposing to tax the said claim of deduction amounting to Rs. 1,48,24,633/- as capital gains. In the reply, dated 21.11.2012 and 23.11.2012, assessee submitted the KMBL has overriding title on the mortgaged asset (the said factory land), the bank invoked the SARFAESI Act and took possession of the said land. Eventually, the bank sold the said land and transferred the same to the buyers with any participation of the assessee and received sale proceeds directly to the account of the bank. Assessee has no role to play in all these events. In principle, the bank has become the owner of the land. Therefore, it is the case of the "diversion of income at source by overriding the title". Since, the assessee has lost the title as well as has never received the sale proceeds to his account, the sale proceeds are not taxable in the hands of the assessee. It is a case of diversion of income at source. Therefore, in the aforementioned computation, assessee reflected the same as an allowable deduction. Regarding Rs. 69,75,629/-, it is the case of the assessee that since the assessee claimed interest payable to the bank as deduction in past, to that extent the same is offered now as taxable portion. However, the Assessing Officer analyzed the provisions of section 48 of the Act and held that the claim is not sustainable in law as the gains arose on the sale of

the factory land of the assessee. AO also mentioned that the assessee received the sale consideration on sale of the said 6 plots of land. He also mentioned that what is allowable u/s 48(i) of the Act is only expenditure incurred wholly and exclusively in connection with such transfer, and not the expenditure of this type. Without much discussion in para 7.8 of the assessment order, AO rejected the assessee's contention that it is a case of "diversion of income at source by overriding the title". Contents of para 7.10 of the assessment order are extracted as under:

> *"7,10. Accordingly, the bank has recovered its dues, and the liability of the assessee was reduced by an amount of sale consideration received by the bank on behalf of the company. Therefore, the assessee has actually repaid its loan to the bank by selling the land and, therefore, cannot be considered as allowable expenditure within the meaning of section 48(1) of the Act."*

4.1. Accordingly, the amount of Rs. 1,48,24,633/- was added back to the total income of the assessee. Aggrieved with the said addition made by the AO, assessee carried the matter in appeal before the first appellate authority.

5. During the proceedings before the first appellate authority, assessee agitated against the said addition and made a written submission vide letter dated 26.4.2013, the contents of which are extracted in para 5.2 of the CIT (A)'s order. In the said submissions, assessee narrated the facts of the case and submitted that the assessee created charge on the asset in favour of the bank in connection with the loan of Rs. 306 lakhs. The bank invoked the SARFAESI Act and took possession of the land. Considering the powers conferred to the bank by the said SARFAESI Act vide the provisions of section 13(4), the bank sold the property and realised the proceeds directly without any involvement of the

assessee. Assessee relied on the judgment of the Calcutta High Court in the case of Gopee Nath Paul & Sons vs. Deputy CIT [2005] 278 ITR 240, which is relevant for the proposition that *"the expenditure incurred for perfection of title necessary for effecting sale / transfer is an allowable expenditure".* This is the case, where the liabilities of the bank were cleared by the sale proceeds of the assets. It was considered as an expenditure incurred wholly and exclusively in connection with the transfer. Assessee also relied on the view of the Andhra Pradesh High Court in such cases. Further, assessee relied on the judgment of the Apex Court in the case of R.M. Arunchalam Etc vs. CIT [1997] 227 ITR 222 (SC) to support its case. Thus, the assessee submitted that AO failed to the fact that there was a pre-existing overriding title in favour of the bank by virtue of joint equitable mortgage created on 5.2.2009 on immovable properties of the assessee. On considering the above written submissions of the assessee, CIT (A) did not go with the said submission. The arguments relating to "diversion of income by overriding title" was also not entertained. Relying on the judgment of the Hon'ble Supreme Court in the case of CIT vs. Attili N Rao [2001] 252 ITR 880 (SC), as well as the judgment of the Allahabad High Court in the case of CIT vs. Sharad Sharma (2008) 305 ITR 24 (All), CIT (A) opined that it a case of application of income and not diversion of income by overriding charges. Eventually, CIT (A) is of the opinion that the assessee is not entitled to deduction. CIT (A) also rejected the assessee's argument that it is a case of explaining in connection with the transfer of the asset / perfection of the title before the sale of transaction. He also discussed in para 5.5, the applicability of

the provisions of section 45(5)(b) and 45(5)(c) of the Act. CIT (A) also rejected adopting the cost of acquisition of the asset as on 1.4.1981 in view of the fact that the assessee became the owner of the land only after the date. Further, on the application of the provisions of section 47(xii) of the Act, the CIT (A) is of the opinion that the assessee-company is not managed by the worker's cooperative. Therefore, the same is outside the scope of the said provisions. Accordingly, CIT (A) dismissed the appeal of the assessee. Aggrieved with the said decision of the CIT (A), assessee is in appeal before the Tribunal.

6. During the proceedings before us, Ld Counsel for the assessee filed written submissions and the same are extracted as follows:

*"3.9. The principles of diversion of income by overriding title were explained by the Hon'ble Supreme Court in the case of **Sitaldas Tirathdas** (41 ITR 367) by referring to the judgment of Hon 'ble Privy Council in the case of **Raja Bejoy Singh Dudhuria vs. CIT** (1 ITR 135) and **P.C. Mullick** (6 ITR 206) with the following observations.*

"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assesse, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable ".

*3.10 The honourable **Calcutta High Court** held in the case of **Gopinath Paul and Sons vs. D.C.I.T. (278ITR 24O)***

5. Section 48(1), as it stood in 1992-93, while providing for computation of capital gains permitted in clause (i) deduction of the "expenditure incurred wholly and exclusively in connection with such transfer". The expression 'in connection with such transfer' is wider than the expression '[or the transfer'. Any amount the payment of which is absolutely necessary to effect the transfer will be an expenditure covered by clause (i) of section 48(1). In other words, if without removing any encumbrance, sale or transfer could not be effected, the amount paid for removing that encumbrance will fall under clause (i).

5.1 From the facts as disclosed above, it appears that the amount was received out of the sale of assets of both the firms under orders of this Court subject to meeting of the liability of the Allahabad Bank since confirmed only upon prior payment. Inasmuch as, unless this liability was met, the transferee could not derive any title. In other words, the sale consideration receivable by the assessee was less the liability of the Allahabad Bank. Thus, meeting this liability of one of the firms, when the entire assets were being sold, was an absolute necessity to effect the transfer. In other words, it was an encumbrance without removing which the sale or transfer could not be effected and the amount spent for removing this encumbrance would definitely attract clause (i) of section 48(1).

5.2 From the Assessment Order (page 37 of the paper book), it appears that earlier the assessee used to conduct its business under the name and style of Gobindo Sheet Metal Works & Foundry. CIT (Appeals) at pages 43-44 of the paper book have found that the short-term capital gain arising out of the sale of the assets pertaining to the erstwhile business of the

appellant in the name and style of Gobindo Sheet Metal Works & Foundry and on the sale of the factory and assets of the erstwhile business through public auction, the total consideration received was Rs.3,66,24,005. From the details of the expenses and liabilities claimed, it was seen that an amount of Rs,27,85,523 had been shown as payable to the Allahabad Bank. However, the CIT (Appeals) found that there was no pre-condition that the appellant could not sell its assets without settling the dues of the Allahabad Bank and even if it was, it would be a case of application of the income.

5.3 As discussed above, in this case the sale could not be effected without meeting the liability, as it appears from the different orders passed by this Court in the latter suit wherefrom it is apparent that the former suit was transferred to this Court and was ultimately settled between the parties through Lok Ada/at.

5.4 But from the facts as discussed above, we are of the view that the orders passed by this Court directing the sale of the assets of the two firms and its confirmation thereof are staring on the face of the inference drawn by the CIT (Appeals). Thus, we are of the view that the liability met by the assessee towards the dues of the Allahabad Bank was an expenditure incurred wholly and exclusively in connection with the transfer.

3.11 From the facts relating to the assessee's case explained in Para No. 3.1 to 3.5, it is quite manifest that once Kotak Mahindra Bank Ltd. invoked powers u/s.l3(4) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), the title over Plot No.P/1, P/2$_f$ P/3A, P/3B and P/4 was automatically divested from the assessee company and vested in Kotak Mahindra Bank Ltd. on 07.01.2010. Further, when the plots were sold by the bank in March, 2010, the sale deeds were executed between the buyer and the bank and the entire consideration received from buyer was appropriated towards the outstanding liability of the bank. The assessee was not at all involved in either the sale of plots or the execution of sale deeds. Therefore, the sale proceeds to the extent of amount appropriated towards loan never reached the assessee as its income and was diverted towards discharge of bank's obligation.

3.12 As regards reliance placed by the Cl. T.{A). while rejecting the assessee's claim upon the judgements of the honourable Supreme Court in the case of Cl. T. vs. Attili N. Rao (252 ITR 880) and the honourable Allahabad High Court in the case of CL T. vs. Sharad Sharma (305 ITR 24), it is submitted that these judgements are not applicable to the facts of the assessee's case.

3.13 In the case of CI.T. vs. Attili N. Rao, the assessee was carrying on abkari business. He mortgaged his immovable property to the Excise Department of Andhra Pradesh to secure payment of kist He could not pay the kist Therefore, the excise department sold the immovable property by way of public auction, deducted its dues towards kist and interest and paid the balance amount to the assessee. There was no court order for auction of the property and appropriation of proceeds towards kist and interest. It was simply a case of recovery of mortgage assets by its auction to recover government dues under the provisions of Andhra Pradesh State Excise Act. There was no divesting of title from the assessee and vesting thereof with the State Excise Department. On these facts, the honourable Supreme Court held that the capital gain was to be computed on the full price realized as reduced by the admitted deduction. The payment made to the Central Excise Department towards kist and interest was not a deductible expenditure.

3.14 In the case of Cl. T. vs. Sharad Sharma, M/s. Shanker Traders took loan from bank against mortgage of house property belonging to the partner, Shri Sharad Sharma. The bank enforced the recovery of loan against M/s. Shanker Traders. Under agreement with the bank, the house was auctioned by the assessee and after payment of bank loan of Rs.1,50,000/-, the remaining amount was received by the assessee. It was simply a case of sale of mortgage property and recovery of outstanding loan of the bank. There was no divesting of ownership of house from assessee and vesting thereof with the bank. On these facts, the honourable High Court held that it was not a case of diversion of income by overriding title but application of income towards repayment of bank loan. In 3 case of inheritance/acquisition along with the mortgage perfecting his title by getting mortgage discharged, the assessee would be entitled to get the deduction of the mortgage debt but where the charge is created by the assessee himself, it cannot be said that the amount of mortgage debt out of the sale proceeds be deductible while calculating the capital gains.

3.15 The ratio of the aforesaid judgements is not applicable because in the assessee's case, Kotak Mahindra Bank Ltd. took possession of 6 plots under SARFAESI Act, 2002. The land was divested from the assessee and vested with Kotak Mahindra Bank Ltd. After taking possession, the bank converted these plots into 7 plots. Further, when the plots were sold by the bank in March, 2010, the sale deeds were executed between the buyer and the bank and the entire

consideration received from buyer was appropriated towards the outstanding liability of the bank. The assessee was not at all involved in either the sale of plots or the execution of sale deeds.
3.16 In view of the above, we request your honour to allow the assessee's claim and exclude the principal amount of Rs.1,48,24,633/- appropriated by Kotak Mahindra Bank Ltd. towards its dues while computing Logn-term Capital Gains."

7. Further, Ld Counsel for the assessee also submitted that the SARFAESI Act, 2002 takes away all the rights of the possession including right to sale the secured property of the assessee. In this regard, Ld Counsel for the assessee brought our attention to the provisions of section 13 relating to "Enforcement of Security Interest" and submitted that vide clause (a) of sub-section 4 of section 13, *bank has right to transfer by way of lease, assignment or sale for realising the secured asset.* Further, bringing our attention to sub-section (6) of section 13, Ld Counsel for the assessee read out such transfer of secured asset by the bank shall have the effect as if the transfer was made by the owner of the secured asset.

8. On the other hand, Ld DR relied heavily on the order of the AO and the CIT (A). Elaborating the same, Shri S.K. Mahapatra, Ld DR for the Revenue submitted that if the case of the assessee is considered as diversion of income by overriding the title", the situation may become that the every loan defaulter of the financial institutions such as Banks shall not make any payment of taxes u/s 48 of the Act on the gains arose on transfer of the capital asset, given as security, which is eventually sold by the Banks. Further, he mentioned that it is a case of application of income as assessee's loans are eventually squared up with the bank. Further, replying to the Ld DR, Ld Counsel for the assessee submitted that it is a case where the agreements to transfer the secured assets were signed by the bank and the transferees never made TDS while making

payments to the bank. No liability on account of stamp duty was also incurred by the assessee. However, Ld DR has nothing to say on the fact that the assessee lost all the rights in the property on becoming a defaulter. The title is therefore not perfect. Referring to the AO's erroneous assumption of the fact given in para 7.8 of his order, Ld DR mentioned that the proceeds were not received by the assessee and they are received by the Bank. In principle the assessee lost the capital asset and now, in addition, the assessee needs to pay taxes too if the sale proceeds are subjected to tax.

Decision of the Tribunal:

9. We have heard both the parties on this issue and perused the orders of the Revenue Authorities, the paper book, written submissions filed before us. **Undisputed facts** in this case include (a) the secured asset in question is a factory land mortgaged to the bank; (b) Considering the undisputed default of the assessee in making the payments of installments, the assessee's account was declared as NPA by the bank; (c) the bank invoked the provisions of the SARFAESI Act, 2002 on the assets mortgaged to the bank; (d) Thus, there is no dispute on the fact that the said land in question is not free from encumbrance. The ownership title of the land is not perfect; (e) Under the SARFAESI Act, when the bank takes possession of the secured land, the bank gets the ‘right to transfer' by way of sale for the purpose of realizing the secured asset vide section 13(4)(a) of the Act. Thus, the assessee lost the right on the said property secured to the bank as the assessee is declared as 'defaulter' under the said Act. The Bank acted as a transferor in the said transfer transaction in matters of

executing the transfer deeds and registration deeds. The Bank got the superior rights on the property and assessee had no say in the matter in view of its undisputed default and the provisions of SARFAESI ACT. Further, it is also an undisputed fact that the transferee of the impugned property made the payment to the bank directly no amount was received by the assessee on account of the impugned sale transactions. Thus, we shall now under take to discuss various facets of the doctrines of (i) Over riding Title, (2) Application of Income; and (3) Diversion of Income (DoI) in the following paragraphs.

10. **Doctrine of Over-riding title:** this doctrine visualises the situation that, to start with, a property is actually owned by the assessee with proper ownership title. However, in the course of time when the same is secured/mortgaged with the creditor, the said title undergoes change by virtue of process of law or legal provisions and the creditor or the Bank gets the 'overriding title'. In the past, the Banks may knock the legal forums for getting such overriding title before the sale/auction. However, with the legislation of the SARFAESI ACT, 2002, such legal requirements are dispensed with and the creditor gets the over-riding title subjected to conditions discussed in the following paragraphs. Therefore, we now proceed to examine the said legislation as follows.

10.1 Provisions of section 13 of the SARFAESI ACT are relevant the same relating *INFORCEMENT OF SECURIT INTEREST read as follows,* -

i. *SEC J.3. Enforcement of security interest*
(2).....,
(3).....
(3A). .....
(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--
(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

(b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset: PROVIDED that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt:
PROVIDED FURTHER that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt.
(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;
(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.
(5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

10.2 *Interpretation of the above provisions:* The provisions of section 13 of the SARFAESI ACT, 2002 provides for enforcement of security interest. According to the said provisions, in case the "borrower (of loan) fails to discharge his liabilities in full' to the secured creditor/Bank, the same may take to following recourses to recover the dues, namely, **rt** ***take possession of the secured assets of the borrower*** *including the right to transfer by way of lease, assignment or sale for realising the secured asset; or (b)* ***take over the management of the business of the borrower*** *including the right to transfer by way of lease, assignment or sale for realising the secured asset" or (c)* ***appoint any person*** *(hereafter referred to as the* ***manager),*** *to manage the secured assets the possession of which has been taken over by the secured creditor (d)* ***require at any time by notice in writing, any person*** *who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower,* ***to pay the secured creditor,*** *so much of the money as is sufficient to pay the secured debt".* There are conditions specified section 13(4)(a) of the Act are relevant for the cases of takeover of the management of the business of the borrower'. Of course, the provisions of this clause (b) are irrelevant to the facts of the present case, where only the secured

assets of the borrower is taken possession of as per the provisions of the said clause (a). We shall elaborate the provisions of the said clause (a) as under;

10.3 The above provisions of section 13(4)(a) of the Act explains the various rights available to the bank when it takes over the possession of the secured asset of the borrower. To elaborate the said clause (a), the same is extracted as follows,-

> *"13(4) In case the **borrower fails to discharge his liability in full** within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--*
> *(a) take possession of the secured assets of the borrower including the **right to transfer by** way of lease, assignment or **sate for realising** the secured asset;....."*

10.4 The Bank is empowered by the said Act to take possession of the secured assets of the borrower. This right to take possession includes the Right to transfer'. This right to transfer includes various modes of transfer. The said Act empowers the Bank to **transfer the asset by way of sale of the secured asset.** However, the Bank is under statutory obligation to fulfil certain obligations and one such obligation relates to establishing the fact of *'borrower's fa/lure to discharge his liability in* ft///'as mentioned in subsection (4) of section 13 of the SARFAESI ACT, 2002. In other words, the bank assumes the right to take possession, right to transfer, right to sale for realising the secured asset on establishing the *"borrower's failure to discharge his liability'.* Of course, there are administrative and legal procedures to be followed by the Bank involving the principles of natural justice such as issuing the notices, declaring in books the said unrealised liabilities as NPAs and consequent write-off etc. Of course, the assessee-borrower has certain rights and can question the initiatives of the Bank to take possession of the secured asset.

10.5 However, in the instant case, the borrower gave in the said rights and has not questioned the bank's initiatives to sell the secured property in any legal

forums. In other words, on the facts of the borrower's failure to discharge the liability to the lender-bank, the assessee's title of ownership is subjected to the rights of the Bank, conferred by the said SARFAESI ACT. Thus, the provisions of the said Act provides to the lender-bank the 'over riding title' on the secured property. This is done by the process as per the provisions of law ie the SARFAESI ACT, 2002. These are the ingredients of the doctrine of overriding title.

10.6 *Prior to the legislation of the SARFAESI ACT, 2002:* It is not out of place to mention that in the **period prior to the said Act,** the lender banks are under obligation to get such over-riding title on such secured or mortgaged assets from the courts through the process of judgmental law. In other words, in cases of litigation, the Bank needs to obtain the orders from the Courts or DRT, as the case may be, before initiating the ‘act of transfer' of the secured assets of the borrower for realising the liabilities.

11. In the instant case, the bank intimated the borrower's failure to discharge its liabilities in full as the 'principles of justice' and they are in tune with the provisions of the SARFAESI ACT. Borrower has not objected to the same and the same is evident from the fact that it did not start any litigation in any court of law against the steps of the lender-Bank. Thus, in effect, the assessee subjected its rights on the ownership title of the said property to the Bank. The Bank took possession of the same and sub-divided the lands before the same are transferred to the buyers in the open market. It is also

relevant to mention that the assessee was not signatory to the sale deeds and it is the bank which transferred the property to the buyers. This fact cements the Bank's undisputed fact of overriding title over the property. Assessee has not played any role, whatsoever, in the sale transactions of the secured/ possessed land by the lender-Bank. **Therefore, we are of the opinion, this is undoubtedly a case of the overriding title.** Thus, having dealt with the doctrine of 'over-riding title' till now, we shall now take up the other limb ie doctrine of 'diversion of income' (DOI).

12. The provisions of the said clause (a) to section 13(4), extracted above, expressly mention that the bank has the right to take possession of the asset of the borrower, the assessee. This right to take possession includes right to transfer also. The said transfer can be affected by way of sale. These are the undisputed facts in the present case. When the right to take possession, right to transfer, right to sale are with the bank, nothing is left with the assessee, the borrower, except the weak ownership title on the said asset. Thus, the ownership title is overridden by the Bank's power conferred by SARFAESI Act. In that sense of the mater, we find the legal provisions are very clear that the bank has got overriding title on the asset. This SARFAESI Act secures / guarantees the rights of the transferee, who purchases the assets from the banks.

13. **Doctrine of Diversion of Income:** We have also gone through the various decisions cited by both the parties relating to the **diversion of income** (DOI) *versus* **application of income (Aol).** In matters relating to claim of deduction for property are not deductible as the case of DOI by ORT. It is the case there is no **process of law** involved and the Government never got an absolute overriding title. There is dispute over the sale of land, and assessee never objected to the said sale in any court of law. In this case, AP Government acted on the concessions of the assessee and it never got any overriding title on the land by way of any judgment from any Court/Tribunal. Para 13 of the said High Court's judgment is relevant.

19. Therefore, the legal proposition of law is that when the sale proceeds of mortgaged property are paid to the creditor of the assessee, the same are not deductible in computing the capital gains on the said property. Therefore, the payments made by the buyers of the property to the creditors directly does not make in any difference so long as there is never a overriding title over the mortgaged property. The underlying rationale of the same, in our opinion, is that, in all the above cases, the creditor/ Bank/Government never got the overriding title on the said property either by way of process of law or by an act of law such as the SARFAESI ACT, which provides for unfettered powers over the property to the creditor/Banks. Mere making payment by the buyer directly to the creditors without routing through the bank accounts of the land owner, does not grant any right for making claim of deduction. No claim of deduction is allowed

unless the creditor gets the overriding title and payments are directly paid to the creditors without routing through the owner's accounts. Otherwise, it will be a case of 'application of income' only and not deductible. Therefore, the Hon'ble courts have rightly held against the assessees in the said cases. As such, there are not judgmental law involving the sale of secured property, which are mortgaged under the provisions of the SARFAESI ACT. In our opinion, the only objection of the DRs for Revenue is that it may become a tax planning device for some tax payers, (ie to become a defaulter of taxes, allow the properties to be sold by the Banks / creditors and avoid paying capital gains tax on the sale proceeds), is not sustainable in law. It is commonsensical to think that no assessee wilfully wants to lose their properties for tax reasons.

20. Therefore, the provisions of section 13 of the said SARFAESI ACT, 2002 makes all the difference for such transaction of sale of the mortgaged properties these days. Diversion of income by overriding title has two clear limbs required for the assessees to fulfil when they successfully want to claim deduction/exemption of capital gains. These two limbs are interlinked and both the limbs are required to be fulfilled before any taxpayer claiming deduction/exemption.

21. It is relevant to mention here that procedurally, most of the sale transactions of the mortgaged properties by the Banks prior to the year 2002, are executed with the active involvement of the assessee, who is often a signatory to the said sale transactions of the said properties and therefore, the creditors/Banks *per $e,* do not have the power either to sign on the transfer deeds and to register

them in the names of the transferees. Thus, the creditors/Banks are never the transferors.

22. Therefore, considering the above settle legal propositions by virtue of the judgmental laws and also in view of the binding statutory provisions of section 13 of the SARFAESI ACT, 2002, and on the facts of this case (ie Bank got the overriding title and the payments are directly received by the bank from the buyer of the secured properties with they were first credited to the accounts of the assessee), we are of the opinion in principle, the doctrine of 'diversion of income by overriding title' applies to the facts of the present case. Therefore, the claim of deduction is sustainable in law. Accordingly, the **grounds** raised by the assessee are **allowed.**

23. In the result, the **appeal of the assessee is allowed.**

Order pronounced in the open court on September, 2015.

xxxx sd/-

(AMIT SHUKLA) **(D. KARUNAKARA RAO)**

JUDICIAL MEMBER ACCOUNTANT MEMBER

Mumbai; .9.2015

PER AMIT SHUKLA, JM:

I have gone through the order proposed by my learned Brother in this appeal and have also discussed the issue with him. However, I am unable to persuade myself to subscribe to the view proposed by my learned Brother and also unable to agree with the conclusion arrived at on the issue involved. I, therefore, consider it appropriate to express my view and conclusion on the issue by way of passing a separate order.

2. So far as the facts of the case and arguments put forth by the parties, as discussed in the draft order, there is not much dispute. However, to put succinctly, the relevant facts *qua* the

issue involved are that, the assessee company had a taken a corporate term loan of Rs. 3.06 crores from Kotak Mahindra Bank Ltd. during the relevant financial year 2008-09 for its business purpose, which was repayable in 36 monthly installments. The said loan was secured by mortgaging a part of assessee's factory land. The interest paid on such loan was otherwise allowed to the assessee or was allowable u/s 36(l)(iii) r.w.s. 43B. Since, assessee due to cash losses and liquidity constraints could not pay the installments, therefore, the Kotak Mahindra Bank Ltd. classified the assessee's account as Non-performing Asset (NPA) and initiated the recovery proceedings u/s 13(2) of the Securitization And Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2000, (SARFAESI Act) on the assessee company and personal guarantors. The Bank took possession of the mortgaged part of the factory land on 07.01.2010, which was divided into 7 plots, out of which 6 plots were sold in March, 2010 for a total sale consideration of Rs. 2,18,00,262/- and was appropriated by the Bank in the following manner :-

Towards interest dues	:-	Rs. 69,75,629/-
Towards principal amount	:-	Rs. 1, 48,24, 633/-
		Rs. 2,18,00,262/-

The assessee had duly shown the sale proceeds from the mortgaged asset in its books of account and also offered the income as 'Long-term capital gain' as per the computation of income, incorporated at page 3 of the Draft order.

3. However, the main bone of contention was the claim of amount adjusted by the Bank against the principal amount of loan of Rs. 1,48,24,633/- (out of the sale proceeds) as deduction u/s 48(i) as cost by the assessee in the computation of LTCG, being *'expenditure incurred wholly and exclusively in connection with such transfer'*. The assessee's claim was based on the principle that, act of the Bank taking possession of the land under SARFAESI Act, constitutes "diversion of income by overriding title". This claim had been denied by

the AO on the ground that it cannot be reckoned as expenditure u/s 48(i) to be allowed as cost of acquisition as it was an application of income. In the first appellate proceedings, Ld. CIT(A) too has rejected the assessee's contention for the claim for deduction mainly relying upon the decision of Supreme Court in the case of CIT vs. Attili N. Rao [2001] 252 ITR 880; and Allahabad High Court in CIT vs Sharad Sharma [2008] 305 ITR 24 (All.) and held that there is no diversion of income by overriding title .

4. The contention made by the Ld. Counsel and Id. DR has been elaborately dealt with in the draft order of the Ld. Brother, which are not being reiterated. The core argument of Ld. Counsel had been that, by virtue of statutory provisions of section 13 of SARFAESI Act, there is a clear cut overriding title on the mortgaged property in favour of the bank and the income realized by the bank and appropriated from the sale of such property directly, amounts to diversion of income and, therefore, the said principal amount cannot be held to be taxable in the hands of the assessee and or is allowable as deduction. He also submitted that, in wake of the SARFAESI Act, the earlier judicial decisions will no longer be applicable. At the time of hearing, following decisions were referred and relied upon, some of them will be discussed herein later in this order:-

ST. No.	Cases relied upon	Citation
1	Sitaladas Tirathdas	41ITR 367 (SC)
2	CIT vs. Attili N Rao	252 ITR 880 (SC)
3	Motilal Chahadamilal Jain vs CIT	190 ITR 1 (SC)
4	CIT vs Mathubhai C Patel	238 ITR 403 (SC)
5	CIT vs Roshanbabu Mohd. Hussein Merc	275 ITR 231 (Bom)
6	CIT vs Sharad Sharma	305 ITR 24 (All)

7	Raja Bejoy Singh Dudhania	1 ITR 135 (PC)
8	Gopinath Paul and Sons vs DCIT	278 ITR 240 (Cal)
9	Addl. CIT vs Glad Investment vt Ltd.	22 ITD 227 (DEL)

5. Now on these facts, and background the main issue involved here in this appeal are :-

Firstly, *whether the principal amount of loan of Rs. 1,48,24,6733/- can be allowed as deduction u/s 48(i) while computing the LTCG from sale consideration of mortgaged asset appropriated by Kotak Mahindra Bank, after taking possession of the said secured asset under the SARFAESI Act 2002, on the ground that there was "diversion of source/ income by overriding title;"*

Secondly, *whether the entire sums recovered from sale proceeds of the mortgaged assets and appropriated by the Bank towards 'Security interest' under section 13 of the SARFAESI Act will not fall within the charging provisions of Income Tax Act in the hands of the assessee on the principle of "Diversion of income by overriding title";*

Lastly, *whether by virtue of SARFAESI Act, the judicial pronouncements and the decisions available on the issue prior to the commencement of the said act will not be applicable, in as much as the provisions of the said Act provides for taking over the possession of the land to secure its security interest and hence overriding title gets vested with the Bank and consequently income gets diverted.*

6. First of all, on the first issue, undisputedly the assessee had taken a business term loan after creating a voluntarily incurred mortgage debt in favour of the Bank under a legally binding covenant under which the assessee was obliged to discharge the mortgage debt. It is a *trite* law that once the assessee himself has created the mortgage, he would not be entitle

to any deduction under section 48, either as a cost of acquisition or cost of improvement or any kind of expenditure incurred wholly and exclusively in connection with such transfer of capital asset. This proposition of law has been well settled by the Hon'ble Apex Court in two cases; **R M Arunachalam vs CIT (1997) 227 ITR 222; and VSMR Jagdish Chandran vs CIT (1997) 227 ITR 240.** A clear distinction has been drawn by the Apex Court that, where the previous owner had created a mortgage on the property in question and the assessee had inherited the said property along with the mortgage, in that event the assessee would be entitled to the deduction of the amount spent in getting mortgage discharged as cost of acquisition u/s 48. However, where the assessee himself has created the mortgage, then the same consequence will not follow and he would not be entitled for deduction. The relevant observation of the Hon'ble Court in R M Arunachalam (supra) laying down this proposition reads as under :-

In taking the view that in a case where the property has been mortgaged by the previous owner during his lifetime and the assessee, after inheriting the same, has discharged the mortgage debt, the amount paid by him for the purpose of clearing off the mortgage is not deductible for the purpose of computation of capital gains, the Kerala High Court has failed to note that in a mortgage there is transfer of an interest in the property by the mortgagor in favour of the mortgagee and where the previous owner has mortgaged the property during his lifetime, which is subsisting at the time of his death, then after his death his heir only inherits the mortgagor's interest in the property. By discharging the mortgage debt his heir who has inherited the property acquires the interest of the mortgagee in the property. As a result of such payment made for the purpose of clearing off the mortgage the interest of the mortgagee in the property has been acquired by the heir. The said payment has, therefore, to be regarded as 'cost of acquisition' under section 48 read with section 55(2) of the Act. ***The position*** **is,** ***however,***

different where the mortgage is created by the owner after he has acquired the property. The clearing off of the mortgage is created by the owner after he has acquired the property. The clearing off of the mortgage debt by him prior to transfer of the property would not entitle him to claim deduction under section 48 of the Act because in such a case he did not acquire any interest in property subsequent to his acquiring the same. *In CIT u. Daksha Ramanlal [1992] 197 ITR 123, the Gujarat High Court has rightly held that the payment made by a person for the purpose of clearing off the mortgage created by the previous owner is to be treated as cost of acquisition of the interest of the mortgage in the property and is deductible under section 48 of the Act". (P. 239) (emphasis added)*

Thus, the income applied in liquidation of a voluntarily incurred mortgaged debt is definitely exigible to tax, although the application may be under a legally binding covenant entered into by the recipient of the income or under a charge created by the debtor on his property. Hence, in my opinion, the assessee will not get the deduction of the principal amount of loan u/s 48, as the mortgage debt was created by the assessee itself, to which assessee was obliged to discharge. Any discharge of debt is nothing but application of income.

7, Now the moot question is, whether there is a *'diversion of income by overriding title'* and hence the entire sale proceeds appropriated by the Bank towards its security interest is exigible or chargeable to tax in the hands of the assessee or not.

8. This principle of "diversion of income by overriding title" has been applied and tested from earlier times under the Indian Income Tax Law and the concept has been well established that, where an obligatory charge is imposed by the testator; or by law upon some property; or charge is otherwise involuntarily created; then the sum so charged must be excluded from the income of the person in enjoyment of the property. In other

words, where income is not applied but 'diverted by an 'overriding title' from the assessee who would have otherwise have received it, it cannot be considered as the income of the assessee at all. Where the obligation effectively slices away part of the corpus of the right of the assessee to receive the entire income, it would be a case of 'diversion of income'. But the biggest rider in applying this principle and most determinative factor in deciding such situations as stressed by the Hon'ble Supreme Court in several cases from time to time is the nature and effect of the *assessee's obligation* in regard to the amount in question, Hon'ble Apex Court in the case of **CIT vs. Sitaldas Tirathdas, [1961] 41 ITR 367,** laid down the following test with regard to 'diversion of income by overriding title' in the following manner :-

> *"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income.* ***Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee.*** *Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow, ft is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable", (emphasis added)*

9. Thus, the true tests in deciding the "diversion of income by overriding title" lies in the nature of the 'obligation' which is the most decisive factor. If the assessee all throughout had an obligation to discharge his liability out of his income, then under all circumstances it would remain his obligation and the liability to discharge would be an application of income. There cannot be a two different limb of a same obligation; in the first place, there would be an obligation of the assessee to discharge his liability out of his own income and second, the obligation will get shifted because the title has been

passed to another person to discharge the liability of the assessee or on his behalf which still exists before the income reaches to the assessee. Under both the situations it is an obligation of the assessee and any discharge of obligation is nothing but application of income and assessee would not be entitled either to claim deduction or claim the amount as exempt. This principle was again reiterated by the Hon'ble Supreme Court in the case of ***CIT vs. Sunil J Kinariwala [2O03] 259 ITR 1O,*** wherein the Hon'ble Apex Court reiterated that the nature and effect of the assessee's obligation in regard to the amount in question is very crucial and determinative factor, whether there is diversion of income or not. Hence, in all such cases, the nature of obligation is to be examined.

10. If we apply the above principle of law, then here in this case, there cannot be denying fact that all throughout the obligation was upon the assessee to discharge its debt liability and to clear the charge on the mortgaged property. This can be gauged by following facts; the business loan was taken by the assessee for its own business purpose and liability to repay the loan/debt was on the assessee; interest paid/payable was claimed/allowable as deduction of expenses incurred for the business purpose in computation of total income; assessee was under the legally binding covenant to repay the loan along with the interest; property was mortgaged to the Bank to secure the debt/loan by the assessee; liability to free the charge on mortgage land was upon the assessee; Had the loan and interest been waived off by the bank, then assessee would have shown this as its income u/s 41(1); further, if the assessee would have paid back the entire loan, then the mortgaged property would have got vested back to assessee. Thus, the obligation was always upon the assessee and it would not be shifted to the

bank merely because the bank took possession of the land to enforce and realise its secured interest.

11. At the time of hearing catena of judicial decisions were cited from the side of both the parties in this regard (as cited above) and some of them were also filed before us in a separate compilation. Other than the case laws discussed above, the most relevant decisions on the issue involved and cited before us are being discussed here under :-

(i) CIT vs Attili N. Rao [2001] 252 ITR 880 (SC) :-

Here in this case question of law referred to before the Hon*ble Apex Court were as under :-

> *"Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was correct in holding that the amount realised by the sale of the assessee's interest in the property was only Rs. 4,33,960 i.e., Rs. 5,62,980 minus Rs. 1,29,020 ?*
> *Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was correct in holding that the amount realised under the charge or mortgage by the Government by public auction does not partake of the character of 'full value of consideration' envisaged under section 48 of the Income-tax Act ?*
> *Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was Justified in holding that the amount payable by the assessee in discharge of the mortgage debt to the Government on the sale of property was an expenditure incurred towards the cost of acquisition of the capital asset and deductible under section 48 of the Income-tax Act" ?*

The relevant facts of the case were as under :-

> *"The assessment year with which we are concerned is the assessment year 1982-83. The* assesses *carried on abkari business. In the course of the financial year 1970-71 he mortgaged to the Excise Department of the State of Andhra Pradesh immovable property belonging to him at Waltair, He did so to provide security for the amounts of "kits" which were due by him to the State. The State, in the assessment year with which we are concerned, sold the immovable property by public auction, without the intervention of the court, to realise its dues. A sum of Rs. 5,62,980 was realised at the auction. Thereabout, the State deducted the amount of Rs. 1,29,020 due to it towards "kits" and interest and paid over the balance to the assessee".*

On these facts their Lordships answered the question in the following manner :-

"8, We are of the view that the Tribunal and the High Court were in error. What was sold by the State at the auction was the immovable property that belonged to the assessee. The price that was realised therefore belonged to the assessee. From out of that price, the State deducted its dues towards "/cists" *and interest due from the assessee and paid over the balance to him. The capital gain that the assessee made was on the immovable property that belonged to him. Therefore, it is on the full price realised (less admitted deductions) that the capital gain and the tax thereon has to be computed".*

From the above proposition, it is amply clear that no such deduction of the dues realized by a creditor from the sale of immovable property of the assessee is allowable from the computation of capital gain in such cases and circumstances.

(ii) Decision of Bombay High Court in CIT vs Roshanbabu Mohammed Hussein Merchant, [2005] 275 ITR 231 (Bom)

In this case, the question of law admitted by the Hon'ble Jurisdictional High Court read as under :-

"Whether the repayment of the mortgage debt created by the assessee, is an expenditure incurred in connection with the transfer of mortgaged asset allowable under section 48(i) of the Income Tax Act".”

Facts of the case were as under :-

During the relevant year, the assessee, after obtaining permission from the bank, sold a part of the aforesaid land for a consideration of Rs. 3,92,000 and deposited the entire amount of Rs. 3,92,000 with the State Bank of Saurashtra towards discharge of the debt. The assessee claimed that the long term capital gain arising on sale of the above land was exempt from capital gains tax. The assessing officer completed the assessment under section 143(3) of the Income Tax Act by rejecting the contention of the assessee and taxed the same. On appeal, the CJT(A) upheld the contention of the assessee. On further appeal filed by the revenue, the Tribunal upheld the order ofCIT(A) on the ground that firstly, the sale proceeds were diverted by an overriding title in favour of the bank and the sale proceeds did not reach the assessee and secondly, the amount paid by the assessee to discharge the debt was an expenditure incurred by the assessee for removing the encumbrance which was

absolutely essential to effectively transfer the plot and, therefore, the same was deductible under section 48 of the Income Tax Act. Challenging the said order, the present appeal is filed by the revenue. In Tax Appeal No. 603 of 2000, the Tribunal took contrary view and held that the amount paid to discharge the debt was neither diverted by overriding title nor such expenditure can be regarded as an expenditure incurred in connection with transfer.

The Hon'ble High Court after discussing the proposition of law reiterated by Hon'ble Apex Court in the case of R.M. Arunchalam *(supra);* VSMR Jagdishchandran vs CIT *[supra]* and CIT vs Attli N. Rao, held as under :-

" 14. From the aforesaid decisions of the Apex Court, it is clear that there is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to the mortgage created by the previous owner, the assessee acquires absolute interest in that property only after the interest created in the property in favour of the mortgagee is transferred to the assessee that is after the discharge of mortgage debt. In such a case, the expenditure incurred by the assessee to discharge the mortgage debt created by the previous owner to acquire absolute interest in the property is treated as 'cost of acquisition' and is deductible from the full value of consideration received by the assessee on transfer of that property. However, where the assessee acquires a property which is unencumbered, then, the assessee gets absolute interest in that property on acquisition. When the assessee transfers that property, the assessee is liable for capital gains tax on the full value (less admitted deductions) realised, even if an encumbrance is created by the assessee himself on that property and the assessee is under an obligation to remove that encumbrance for effectively transferring the property. In other words, the expenditure incurred by the assessee to remove the encumbrance created by the assessee himself on the property which was acquired by the assessee without any encumbrance is not allowable deduction under section 48 of the Income Tax Act.

15. It is true that in none of the aforesaid cases, the Apex Court has specifically held that repayment of the mortgage debt created by the assessee himself is not an

expenditure incurred for effectively transferring the property. However, it is implicitly held by the Apex Court that the expenditure incurred to remove the encumbrance created by the assessee himself on a property on which the assessee had absolute interest is not an expenditure incurred for effectively transferring the property as contemplated under section 48 of the Income Tax Act. It is not in dispute that in both the appeals which are before us, the property on which the encumbrance was created by the assessee was acquired by the assessee free from encumbrances. Therefore, in the light of the decisions of the Apex Court referred to hereinabove, it must be held that the assessee is not entitled to the deduction of the expenditure incurred to remove the encumbrance created by the assessee himself.

16. The contention that the assessee has not received a pie front the transfer and the entire sale proceeds realised on transfer of the mortgaged asset has been appropriated towards discharge of mortgage is also without any merit. As held by the Apex* Court, *when the property belonging to the assessee is sold in discharge of the mortgage created by the assessee himself, then, irrespective of the amount actually received by the assessee, the capital gain has to be computed on the full price realised (less admissible deduction) on transfer of the asset. *To illustrate, suppose the assessee mortgages its capital asset and obtains loan of Rs. 1 lakh from a bank. Thereafter, if the assessee transfers the said capital asset with the consent of the bank for Rs. 1 lakh and pays the entire amount of Rs. 1 lakh to the bank to discharge the mortgage created by the assessee, then it is not open to the assessee to contend that the capital gains tax is not leviable on transfer of the property because the assessee has not received a pie on transfer of that capital asset, (emphasis added)"*

17. As regards the decisions of this court in the case of Shakuntala Kantilal (supra) followed in the case of Abrar Alvi (supra) and the decisions of the Kerala High Court in the case of Smt. Thressiamma Abraham (supra) which are strongly relied upon by the counsel for the assessee, we are of the opinion that the said decisions are no longer good law in the light of the subsequent decisions of the Apex Court referred to hereinabove.

18. For all the aforesaid reasons, we answer question set out at para 2 in the negative, i.e., in favour of the revenue and against the assessee.

From the law as discussed and decided by the Hon'ble Jurisdictional High court it is absolutely clear that, firstly, when the assessee himself has created a mortgaged charge, then no deduction is allowable for discharging the charge or encumbrance created by the assessee on mortgaged asset; and secondly, when the property is sold for discharge of such a mortgaged debt, then whether the amount has been actually realized by the assessee or not is immaterial and the whole of the amount of sale realised is to taxed as capital gain in the hands of the assessee. This is evident from the highlighted portion of the judgment and clinches the issue before hand.

(Hi) CIT vs Sharad Sharma, [2008] 305 ITR 24 (Allahabad) :-

The question of law referred to the Hon'ble High Court for opinion was as under :-

"Whether on the facts and circumstances of the case, the Tribunal was justified in holding that there was an overriding charge against the sale proceeds of property and the assessee was not liable for capital gains in respect ofKs. 1,50,000paid to bank in discharge of loan taken by M/s Shanker Traders?"

The Hon'ble Court again after reiterating the similar decisions of Hon'ble Supreme Court as discussed herein above, decided the question in favour of the revenue as under : -

"The question with regard to diversion of income on account of overriding title was not decided by the Apex Court in the case of RM. Arunachalam (supra) on the ground that the said question had not been raised either before 'he Tribunal or the High Court, However, in the present case we find that this question had been raised and the Tribunal had taken a view that the Bank had an over-riding title over the property sold. The reasoning given by the Tribunal with regard to over-riding charge over the sale income is not correct for the reason as the assesses *had himself created the mortgage by taking a loan from the Bank and the said property had been secured for repayment of loan. It is not a case where the assesses had inherited the property or had acquired the property along with charge but in fact had himself created the charge over the property. In a case of inheritance/acquisition along with the mortgage, perfecting his title by getting mortgage discharged, the* assesses *would be entitled to get the deduction of the mortgage debt but where the charge is created by the assessee himself, it cannot be said that the amount of mortgage debt out of the sale proceeds be deductible while calculating the capital gains. The present one is a case of application of income by the assessee.*

Further the Apex Court dealing with the issue of diversion of income by overriding title in the case of Commissioner of Income-Tax v. Sunil J. Kinariwala reported in 2003 *(259)* ***ITR 10*** *held as follows;*

It may be pointed out that under the scheme of the Act, it is the total income of an assessee, computed under the provisions of the Act, that is assessable to income -tax So much of the income which an assessee is not entitled to receive by virtue of an overriding title created in favour of a third party would get diverted at source and the same cannot be added in computing the total income of the assessee. The principle is simple enough but more often than not, as in the instant case, the question arises as to what is the criteria to determine, when does the income attributable to an assessee get diverted by overriding title'? The ***determinative factor, in our view, is the nature and effect of the assessee's obligation in regard to the amount in question.*** *When a third person becomes entitled to receive the amount under an obligation of an assessee even before he could lay a claim to receive it as his income, there would be a diversion of income by overriding title;* ***but when after receipt of the income by the assessee, the same is passed on to a third person in discharge of the obligation of the asses see, it will be a case of application of income by the assessee and not of diversion of income by overriding title.***

In view of the discussion made above we find that in the present case the assessee was not entitled to the deduction as claimed on account of discharge of mortgage debt of Rs. 95,000/- to the Bank. In fact the entire amount of sale consideration had been received by the assessee and thereafter part of it applied for discharge of the mortgage debt. It was thus a case of application of income received, (emphasis added)."

12. Thus, from the proposition of law and ratios as culled out from the above decisions, it is absolutely clear that if the borrower assessee has created a mortgaged debt by itself and if for discharge of its debt liability, the mortgaged property has been taken over or taken into possession by the secured creditor/ lender to realize the loan / debt amount directly, then neither the deduction of loan amount is allowed u/s 48 nor it is a case of 'diversion of income by overriding title'. The amount appropriated by the Bank after disposing of the mortgaged property of the assessee is thus, purely an application of income.

13. A very different proposition has been canvassed by the Ld. Counsel before us, superseding the law propounded and settled by the Hon'ble Apex Court and High Courts as stated above that, now by virtue of commencement of SARFAESI Act 2002, all such decisions and law laid down by the Hon'ble Courts on this subject will not be applicable,

as in wake of the provisions of the said Act, assessee is completely precluded from the title of the land, as now the Bank / financial institutions for realizing its secured interest or debt has got all the powers and right to acquire the title on the mortgaged assets, which amounts to 'diversion of income by overriding title'. The distinction between the position prior to commencement of the SARFAESI Act and after the commencement, made by the Ld. Counsel can be summarized in brief as under :-

(i) Prior to the Act, no such method of recovery of overdue or NPA was prescribed, whereas now the Act prescribes three rights/ mode of recovery of NPA viz., securitization; asset reconstruction and enforcement of security without the intervention of the Court;

(ii) Prior to the Act, lender could recover its debt from borrower either by filing a monetary suit for recovery or summary suit u/s 37 of the CPC or foreclosure of mortgage. Now the bank/ secured creditor is vested with various kind of rights for either taking over the possession of the securities/secured asset of the borrower or can transfer by way of lease/assignment of sale. It also has right to take over the management of the business of the borrower or can appoint a Manager to manage the asset possession of which has been taken;

(iii) Earlier all the options of recovery required intervention of the Courts inasmuch as Civil Suit had to be filed for obtaining the decree in favour of the lender and the Court can adjudicate the amount due and pass the final award whereas, now no intervention of the Court is required and rights have been vested to the bank/secured creditors itself.

(iv) The Court earlier use to appoint Receiver to take possession of the secure assets, sell it and appropriate the proceeds towards payment of lender's dues and now under the Act after taking over the possession of the secured assets, the secured creditor can transfer the secure assets by way of lease, assignment or sale in its own right in the capacity of a transferor and not on behalf of the borrower. Secure creditor issues sale certificate to the transferor and the borrower is not required to execute the document, relating to transfer.

(v) Lastly, earlier the Civil suit for recovery could be filed by the lender if the borrowers have defaulted any payments of dues, whereas now section 13 of the Act has given a huge powers to the lenders and if notice has been issued, the borrower cannot sale, lease or transfer the asset.

14. However, such a distinction as made by the Id. Counsel above are purely superficial and will not make any difference to the legal proposition as discussed in the foregoing paragraphs. Much emphasis has been laid on Section 13 of the SARFAESI Act by the Ld. Counsel before us, in support of his contention that now in view of this section all the earlier law propounded will not be applicable. In my humble opinion, such a proposition and argument of the Ld. Counsel cannot be appreciated at all, firstly, the SARFAESI Act merely prescribes a speedy mode and rights for recovery of the debts / NPA by the Banks and it is not a mode or instrument to acquire the property *albeit* Bank takes over only the "security interest" on the asset to recover the outstanding Joan liability of the borrower. The Bank assumes the role of an agent or steps into the shoes of the borrower while disposing off the assets, which earlier was very cumbersome and time consuming through the process of Civil Courts under section 37 of Civil Procedure Code; Secondly, even the civil courts restrict the rights of the owner over the mortgaged asset or appoint court receiver to take over the possession of the secured assets and sell or lease the property to realize the debts of the lender or award decree in favour of the lender over the mortgaged asset to realize/ recover the debts; lastly, there is no takeover of obligation of the assessee by the Bank, because the loan is taken against mortgage of property, which means there is an obligation on the borrower assessee to repay the said Joan along with all the interest and other costs. The title of such security interest, that is, mortgaged asset flows from the borrower to the lender or consequent buyer with the sole intent of discharging the obligation of the borrower which comprise of outstanding loan amount along with accrued interest thereon.

15. Now let us examine the relevant provision of SARFAESI Act.

The preamble of Act envisages: -

"An Act to regulate securitisation and reconstruction of financial assets and enforcement of security interest and for matters connected therewith or incidental thereto.

Thus, this Act has been enacted by the Parliament to regulate the securitization and reconstruction of financial assets and to enforce the "security interest" and not for acquisition of the property or the title thereof. Before analyzing section 13, first of all certain definition illustrated in various clauses of Section 2 of the Act which are self explanatory are very relevant to understand the law as envisaged in Section 13, which are reproduced as under:-

(f) "Borrower" *means any person who has been granted financial assistance by any bank or financial institution or who has given any guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank or financial institution and includes a person who becomes borrower of a securitisation company or reconstruction company consequent upon acquisition by it of any rights or interest of any bank or financial institution in relation to such financial assistance;*

(j) ***"default"*** *means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of*

such borrower is classified as non-performing asset in the books of account of the secured creditor;

(I) ***"financial asset"*** *means any loan or advance granted or any debentures or bonds subscribed or any guarantees given or letters of credit established or any other credit facility extended by any bank or financial institution; (I) "financial asset" means debt or receivables and includes- (i) a claim to any debt or receivables or part thereof, whether secured or unsecured; or (ii) any debt or receivables secured by, mortgage of, or charge on, immovable property; or (Hi) a mortgage, charge, hypothecation or pledge of movable property; or (iv) any right or interest in the security, whether full or part underlying such debt or receivables; or (v) any beneficial interest in property, whether movable or immovable, or in such debt, receivables, whether such interest is existing, future, accruing, conditional or contingent; or (vi) any financial assistance;*

(m) "financial institution" means—

(i) a public financial institution within the meaning of section 4A of the Companies Act, 1956 (1 of 1956);

(ii) any institution specified by the Central Government under sub-clause (ii) of clause (h) of section 2 of the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (51 of 1993);

(Hi) the International Finance Corporation established under the International Finance Corporation (Status, Immunities and Privileges) Act, 1958 (42 of 1958);

(iv) any other institution or non-banking financial company as defined in clause (f) of section 45-1 of the Reserve Bank of India Act, 1934 (2 of 1934), which the Central Government may, by notification, specify as financial institution for the purposes of this Act;

(o) "non-performing asset" *means an asset or account of a borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset,— (a) in case such bank or financial institution is administered or regulated by any authority or body established, constituted or appointed by any law for the time being in force, in accordance with the directions or guidelines relating to assets classifications issued by such authority or body; (b) in any other case, in accordance with the directions or guidelines relating to assets classifications issued by the Reserve Bank;*

(zb) ***"Security agreement",*** *means an agreement, instrument or any other document or arrangement under which security interest is created in favour of the secured creditor including the creation of mortgage by deposit of title deeds with the secured creditor;*

(zc) ***"Secured assets"*** *means the property on which security interest is created;*

(zd) ***"Secured creditor"*** *means any bank or financial institution or any consortium or group of banks or financial institutions and includes—*

(i) debenture trustee appointed by any bank or financial institution; or

(ii) securitisation company or reconstruction company, whether acting as such or managing a trust set up by such securitisation company or reconstruction company for the securitisation or reconstruction, as the case may be; or

(Hi) any other trustee holding securities on behalf of a bank or financial institution, in whose favour security interest is created for due repayment by any borrower of any financial assistance;

(ze) ***"Secured debt"*** *means a debt which is secured by any security interest:*

(zf) ***"Security interest"*** *means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment other than those specified in section 31;*

Now in light of these definitions let us examine Section 13 which envisages **the enforcement of security interest.** The section 13

reads as under :-

(1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced,

|j without the intervention of court or tribunal, by such creditor in

[1] accordance with the provisions of this Act.

(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any installment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under subsection (4).

(3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower. (3A) If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate within one week of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower: PROVIDED that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely:--

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

(b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset: PROVIDED that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt: PROVIDED FURTHER that where the management of whole of the business or part of the business is severable, the secured creditor shall take over the management of such business of the borrower which is relatable to the security for the debt.

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor; (d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any

money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

(5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

(6) Any transfer of secured asset after taking possession thereof or takeover of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset,

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

(8) If the dues of the secured creditor together with all costs, charges and expenses incurred by him are tendered to the secured creditor at any time before the date fixed for sale or transfer, the secured asset shall not be sold or transferred by the secured creditor, and no further step shall be taken by him for transfer or sale of that secured asset.

(9) In the case of financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than three-fourth in value of the ***amoux**** *outstanding as on a record date and such action shall be* ***binding on***

all the secured creditors: PROVIDED that in the case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of section 529A of the Companies Act, 1956 (I of 1956): PROVIDED FURTHER that in the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub-section (1) of section 529 of the Companies Act, 1956 (1 of 1956), may retain the sale proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A of that Act: PROVIDED ALSO that the liquidator referred to in the second proviso shall intimate the secured creditors the workmen's dues in accordance with the provisions of section 529A of the Companies Act, 1956 (1 of 1956) and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimated dues with the liquidator: PROVIDED ALSO that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator: PROVIDED ALSO that the secured creditor shall furnish an liquidator to pay the balance of the workmen's dues, if any. Explanation : For the purposes of this subsection,- (a) "record date" means the date agreed upon by the secured creditors representing not less than three-fourth in value of the amount outstanding on such date; (b) "amount outstanding"shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(11) Without prejudice to the rights conferred on the secured creditor under or by this section, the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of subsection (4) in relation to the secured assets under this Act.

(12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.
(13) No borrower shall, after receipt of notice referred to in subsection (2), transfer by way of sale, lease or otherwise (other than in / the ordinary course of his business) any of his secured assetsreferred to in the notice, without prior written consent of the ***secured*** *creditor.*

16 From the conjoint reading of above provisions relevant key points for the purpose of our adjudication are as under ;-

(i) Now for the enforcement of security interest, no intervention of court or Tribunal is required by the secured creditors as Banks have been given sufficient powers to enforce its security interest.

(ii) If the borrower who is liable or obliged under a 'Security Agreement' to make the payment to the secured creditor, makes any default in repayment of secured debt and his account has been classified as NPA, then Secured Creditor may issue notice under sub-section (2) to the borrower to discharge his full liabilities, in a certain time bound manner as mentioned in the notice. The borrower can raise objections against the notice which the secured creditor has to consider and dispose off in writing setting out the reasons.

(iii) In case the borrower fails to discharge his liability in full within the period and in terms of notice, then, the secured creditor may take recourse to various measures as illustrated in the various clauses to sub-section 4 of section 13, to recover his secured debt only. The secured creditor has to take recourse u/s 14(1) of the Chief Metropolitan Magistrate or District Magistrate to take over the possession of the property. Thus, the crucial focus of sub-section (4) is that powers and measures is "to recover the secured debt" only and not over and above. In other words the title in some of the cases is passed for securing the debt and realizing the same. Shift in title is not shift on obligations of the borrower albeit obligation of the borrower is being discharged by the lender.

(iv) The measures as illustrated in various clauses of the subsection (4) are purely mechanism to secure the debts like, taking possession of the secured asset (mortgaged asset) including the right to transfer; take over the management of the business of the borrower, appoint any person to manage the secured assets; to give time to person who has acquired the secured assets from the borrower for recovery of money; Thus, all these modes and measures are purely for realization of secured debts, which otherwise borrower was obliged to pay. In other words, all these powers and measures are to facilitate the recovery of debt due from the borrower which earlier was cumbersome and long drawn process through civil courts.

(v) Sub-section 7, provides that all the costs, charges and expenses, etc shall be recoverable by the borrower or adjusted first from the money realization. If there is complete passing of the title, then there is no question of recovery of costs. This itself goes to show that secured creditor is realizing its secured debt and nothing beyond.

(vi) Sub-section 8 lays down a very important point that, if the dues of the secured creditor along with the costs are tendered to the secured creditors, then no step shall be

17. Thus, the powers had been vested to Banks/ Secured Creditors to recover only the secured debts from the borrower, that is, the title or right on mortgaged asset (secured asset) assumed by the Bank is solely for securing and realizing its debts, which

otherwise was the obligation of the buyer. The bank only act as legally authorised agents to recover their money, which the borrower has failed to do so. From the scope of section 13 and powers and mode of recovery as enumerated in sub-section (4) read with other provisions, one thing is amply evident that, powers and right has been given to the Bank to recover its secured debt in various forms. The title over the secured asset is passed to the Bank only and only to extent of secured debt and not beyond it. In this context, Ld. Counsel's argument can be negated by following illustration:-
'A' (as a borrower) has borrowed a sum of Rs. 1 crore from Bank 'B' (Lender) after mortgaging a property or asset worth Rs. 2 crores. 'A' could only pay back Rs. 50 lakhs on principal amount and interest accrued thereof of Rs. 25 lakhs. Thereafter 'A' commits default in repayment of balance principal amount of Rs. 50 lakhs and some interest accrued thereon, say Rs. 10 lakhs. 'B' initiates proceedings under SARFAESI Act and issues notice u/s 13(2) of Act. 'A' is unable to comply with terms of the notice within 60 days. 'B' makes a requisition in terms of section 14 for acquiring the property and sells it to the outsiders for Rs. 2 crores (on actual value) and from the sale proceeds recovers a sum of Rs. 50 lakhs plus interest of Rs. 10 lakhs, i.e. the amount of secured debt due. Then, the moot point is, whether 'B' is entitled to appropriate all the money of Rs. 2 crores; or the secured interest /debt due of Rs.60 lakhs; or the balance sum of Rs. 1.40 crores is to be paid back to the assessee as this was not part of secured interest or debt due. No where the SARFAESI Act, provides that the 'B' is entitled to appropriate all, albeit only to the extent of balance secured debt of Rs. 60 lakhs.

If the contention of the Ld. Counsel is accepted, then the logical proposition would be that, to the extent of Rs. 60 lakhs there was a *'diversion of Income by overriding title'* and for the balance money of Rs. 1.40 crores, there was no such diversion and the title belonged to the assessee. This would, in my humble opinion would not be correct proposition, because, the title on the and passes to the bank only to fulfill the obligation

of the assessee and enable the **Bank to recover** its own due money/debt. There would be **no deviation of** the aforesaid principles, even in the case where **the amount** realized by sale of mortgaged asset has been **appropriated** whole as the debt due is more or same as in the **present** case. It cannot be principally held or accepted that, whenever on the sale of mortgaged asset the debt amount realized is the same or less then there would be an overriding title of the mortgage asset to the bank and therefore, the whole of the amount realized should not be considered in the hands of the borrower and in cases the amount realized is more on sale of mortgaged asset, the excess of the amount or income will belong to the assessee. Here in this case, the Ld. Counsel had tried to contend before us that all the amount has been appropriated by the bank after taking over the possession of the mortgaged property and, therefore, such an income which has not come to the assessee and appropriated directly at source by the bank, amounts to 'diversion of income by overriding title'. Such a contention of the Counsel has to be out rightly rejected, because if for instance, had the bank realized excess amount from sale of mortgaged asset, then whether the excess amount too would have been appropriated by the Bank or whether the assessee would have given up its claim of excess amount in favour of the bank. The answer will be negative. Under the SARFAESI Act also the bank can only enforce its secure debts and not beyond that. Therefore, the contention raised by the Ld. Counsel has no legs to stand.

18. As per the accounting entry, in the books of account of the borrower assessee, the loan amount from the liability side stands reduced and the asset stands disposed off for the discharge of liability shown in the balance sheet and accordingly, the relevant entries are made in the books of account. This precisely the assessee has also done in its books of account, which is a correct and fair manner. Therefore, the sales of asset reflected in the books were rightly shown under the head "capital gain" and income was computed under

"'Lone Term Caprtal Gain". Had there been a case of "diversion of the Income by source or by overriding title", then the whole of the amount on sale of assets would not have entered into the charging provisions of the Income Tax Act, at all, that is, would not have been even entered the computation of total income. But here the assessee had duly disclosed the sale consideration of the mortgaged asset not only in the books of account but also shown it as its income as LTCG in the computation of income, *albeit* claimed a wrong deduction of principal amount as cost of acquisition. The assessee now cannot plead otherwise. Even if we go by the proposition that entries in the books of account are not relevant for deciding the taxability of income, then also the fundamental aspect that permeates in this case is that, the liability/debt was entered in the books of account and duly reflected in the audited balance sheet and all throughout the obligation to discharge its self created liability/debt was upon the assessee which remained its obligation till the end. Hence, such a discharge of liability/debt even under the action taken by lender under the SARFAES1 Act was nothing but application of income.

19. To conclude, under the SARFAESI Act the Bank merely gets a statutory enforceable power/right to sell and dispose off the security interest, the obligation of payment of which was on the borrower and the borrower has not done or played his part of covenant to discharge his obligation on the outstanding loan. In all such cases, the income on sale of secured asset by the secured creditor for its secured interest accrues or belongs to the borrower assessee and here the income has been applied by the lending bank holding the first charge on such income for specific discharge of obligation of the assessee as per the legal covenant agreed in a contract between the lender and the borrower. There can be no diversion of income simply because now the contract between the parties is enforced through the SARFAESI Act. The Act merely gives more power to the lender banks to

enforce the contract between the parties and safeguard the security interest of the Bank, which was earlier done through mechanism of long drawn process under CPC through CiviJ Courts.

20. Hence, in my humble opinion there is no material difference in the position of law with the enactment of SARFAES1 Act, so as to come to a different conclusion that law applicable prior to the commencement of the Act will no longer will be applicable. Therefore, the legal proposition as upheld by the Hon*bJe Supreme Court and High Court will still hold the ground in such cases. Accordingly, the claim of deduction of the principal amount of Rs. 1,48,24,633/- made by the assessee on the principle of 'diversion by overriding title' cannot be upheld and same is denied to the assessee, because it is neither a case of diversion of income nor a case for claim of deduction while computing the capital gain, albeit, it's purely a case of an application of income as it was the assessee's obligation to pay its debt. Thus, the ground raised by the assessee is dismissed.

In the result, the appeal of the assessee is dismissed.

Sd/-

(AMIT SHUKLA)
JUDICIAL MEMBER

Mumbai, Date : 23rd October, 2015

REFERENCE UNDER SECTION 255(4) OF INCOME TAX ACT

2. In the backdrop of the divergent views taken by Hon'ble Accountant Member and Hon'ble Judicial Member, who constituted the Bench, a reference

was made to the Hon'ble President, vide reference dated 27-08-2015 to nominate a Third Member to answer the following questions:-

> *"(i) Whether, on the facts and circumstances of the case, the assessee was justified in claiming the deduction of Rs.1,48,24,633/- out of full value of consideration arising from the transfer of mortgaged capital asset by the Kotak Mahindra Bank, which took over the possession of the said asset under the provisions of the SARFAESI Act, 2002.*
>
> *(ii) Whether, on the facts and circumstances of the case, the entire sale consideration, which is received by the Kotak Mahindra Bank from the transfer of mortgaged assets under the provisions of section 13 of the SARFAESI Act, will not be chargeable to Income tax in the hands of the assessee on the principle of "diversion of income by overriding title".*

3. The Hon'ble President was pleased to nominate Hon'ble Accountant Member as a Third Member to decide the above questions, vide his order dated 12-05-2019. The Hon'ble Third Member vide his order dated 10-05-2019 has decided the issues in the following manner:-

PER G.S.PANNU, VICE PRESIDENT:

"The following points of difference have been referred to me by the Hon'ble President under Section 255(4) of the Income-tax Act, 1961 (in short 'the Act') :

"(i) Whether, on the facts and circumstances of the case, the assessee was justified in claiming the deduction of Rs.1,48,24,633/- out of full value of consideration arising

from the transfer of mortgaged capital asset by the Kotak Mahindra Bank, which took over the possession of the said asset under the provisions of the SARFAESI Act, 2002.

(ii) Whether, on the facts and circumstances of the case, the entire sale consideration, which is received by the Kotak Mahindra Bank from the transfer of mortgaged assets under the provisions of section 13 of the SARFAESI Act, will not be chargeable to Income tax in the hands of the assessee on the principle of "diversion of income by overriding title".

2. Briefly put, the relevant facts are that the assessee is a company incorporated under the Companies Act, 1956 and, is *inter-alia,* engaged in the business of manufacture of cotton / polyester sewing and industrial threads and also engaged in the processing of cotton yarn. It filed its return of income declaring a loss of `64,93,927/-. In the return of income so filed, the assessee claimed deduction of `1,48,24,633/- from its income computed under the head Capital Gains. The facts in this regard are that the assessee took a corporate loan of `306 lakhs from M/s. Kotak Mahindra Bank Ltd. ('KMBL') during the financial year 2008-09 relevant to Assessment Year 2009-10 for its business. The said loan was repayable in 36 monthly instalments. From August 2009 onwards assessee defaulted in repayment of loan, and KMBL classified assessee's account as a Non-Performing Asset ('NPA') on 21.11.2009. In this regard, a notice was served on 30.11.2009 as per the provisions of Section 13(2) of the Securitisation and Reconstruction of Financial Assets of Security Interest Act, 2002 (in short 'SARFAESI Act') on the assessee company and its personal guarantors, viz. Mr. H. S. Bapna and Mrs. Urmila Bapna. The total outstanding liability to KMBL at that point of time was `3,40,61,488/-. On 07.01.2010, KMBL took over possession of the factory land of the assessee admeasuring 6,883.517 sq. mtrs. which was sub-divided into 7 plots and 6 of these sub-plots were sold by KMBL in March, 2010.

KMBL directly received the consideration amounting to `2,18,00,262/- and adjusted the said realisation against the outstanding loan of the assessee, i.e. a sum of `1,48,24,633/- was adjusted against the principal component of the loan and `69,75,629/- was adjusted against the interest component of the loan. While computing the Capital Gain under the Act, assessee treated the entire amount of Rs.2,18,00,262/- received by the bank on sale of plots as sale consideration; however, the amount of `1,48,24,633/- which was apportioned against the principal component of the loan was claimed as deduction under Section 48 of the Act alongwith the indexed cost of acquisition and improvements (`3,43,583/- and other incidental expenses of `6000/- relating to sales). The Assessing Officer disallowed the above claim of the assessee and made an addition of `1,48,24,633/- while computing the income under the head 'Capital Gains'. On further appeal by the assessee, the CIT(A) upheld the order of the Assessing Officer. Aggrieved by the same, assessee preferred further appeal before the Tribunal.

3. When the matter came up before the Division Bench, the appellant contended that the consideration received by KMBL on sale of plots, to the extent it was adjusted by KMBL towards principal component of the loan, never accrued to the assessee and was in the nature of '*diversion of income by overriding title*' and, therefore, the same should be allowed as deduction while computing the income under the head Capital Gains. The learned Accountant Member concurred with the submissions advanced on behalf of the assessee on this issue and ordered deletion of addition made on this account. In deleting the addition, the learned Accountant Member observed that the property was mortgaged with KMBL and on default by the assessee in repayment of loan, the

property automatically vested with KMBL as per Section 13 of the SARFAESI. Further, KMBL got overriding title and the payments were directly received by KMBL on account of transfer of secured assets. Thus, the doctrine of *'diversion of income by overriding title'* applied to the facts of the present case. On the other hand, the learned Judicial Member passed an order sustaining the addition made by the Assessing Officer on the ground that the charge on the property was created by the assessee himself and thus, was in the nature of a voluntary charge. The doctrine of *'diversion of income by overriding title'* is not applicable in the case of voluntary charge, but is applicable only in the case of automatic / compulsory charge. It was also noticed by the learned Judicial Member that if the argument of the assessee is accepted, this *modus operandi* will be used as a tax evasion method and every assessee will suo-moto create a charge on the property and will default in making payment of loans, and eventually avoid tax on Capital Gain resulting from transfer of asset whose proceeds are used to repay the loan liability. In view of this difference of opinion between the learned Judicial Member and learned Accountant Member, the matter has been referred to me for my opinion.

4. The questions to be answered by me in this order, as framed by the two learned Members of the Division Bench, and reproduced above, is whether assessee was justified in making deduction of `1,48,24,633/- from the full value of consideration of the property mortgaged with KMBL, which took over possession of the said property as per provisions of SARFAESI Act; and, whether the entire sale consideration received by KMBL on sale of asset will not be chargeable to tax in the hands of the assessee on the principle of *'diversion of income by overriding title'.*

5. At the outset, I make it clear that as regards the facts which are relevant to decide the dispute, there is no difference between the learned Members constituting the Division Bench, and therefore the same are not being repeated by me for the sake of brevity.

6. Before me, the learned representative attempted to support the order passed by the learned Accountant Member. At the outset, it was argued that even the learned Judicial Member has accepted the fact that because of the default in payment of loan by the assessee to KMBL, the mortgaged property vested with the bank. Once that is so, the consideration received on transfer of said property never accrued to the assessee as the asset itself did not belong to the assessee. It was further contended that the property was sold by KMBL in its own right and not as the agent of the assessee. There was no principal-agent relationship between KMBL and the assessee. My attention was drawn to clause nos. 9, 11 and 12 of the notice issued by KMBL under Section 13(2) of the SARFAESI Act dated 30.11.2009, possession notice by KMBL dated 07.01.2010 and the sale certificate by KMBL. In the possession notice dated 07.01.2010, it was pointed out that the assessee had expressed its inability to repay the loan and KMBL has in clear terms stated that they have taken over the possession of the mortgaged property and assessee was asked not to deal with the said property. Further, it was pointed out that as per sale certificate, the property was sold by the authorised officer on behalf of KMBL and not on behalf of the assessee. According to him, this clearly shows that at the time of sale of asset, the same did not belong to the assessee but it was the property of the KMBL, and KMBL sold the same on principal to principal basis and not as the agent of the assessee. It was also pointed out that the learned Judicial Member on one hand accepts the fact that the sale is by KMBL and on the other hand states it is on

behalf of the assessee. My attention was drawn to the provisions of Section 13(4) of the SARFAESI Act to state that on default by the borrower in repayment of loan within the stipulated time, the property vests with the secured creditor and the creditor obtains the right to sell the property in his own right.

7. Per contra, the learned DR contended that the computation of Capital Gains is to be made as per the scheme of the Act and not as per the SARFAESI Act. The provisions of SARFAESI Act cannot override the provisions of the Act. He further contented that the real owner of the property remains the assessee even at the time of sale of the property by the secured creditor. He further argued that there is no change in position of law after the introduction of SARFAESI Act. It was further argued that if KMBL is treated as the real owner, KMBL should have paid the capital gains tax, which is not the case. It was further argued that the object of SARFAESI Act is to facilitate the recovery and not to mitigate Capital Gains tax. My attention was also drawn to the provisions of Section 13(6) of the SARFAESI Act which states that on transfer of asset by the secured creditor to the transferee, the transferee will get all right, title and interest in the said property as if the transfer is made by the borrower. It was thus argued that the property at the time of sale belonged to the assessee and thus, the sale of property by KMBL was on behalf of the assessee and, therefore, the amount recovered by KMBL shall not be allowed as deduction while computing Capital Gain in the hands of the assessee.

8. The learned DR further argued that the contention of the assessee that assessee lost ownership of the property at the time of vesting of property in favour of KMBL is incorrect as at the time of second transaction of property sale by KMBL, the loan account of the assessee got settled, which was not so at the

time of vesting of the property in favour of KMBL and, therefore, the sale of property by KMBL was on account of the assessee. The amount retained by KMBL towards loan liability was merely an application of income by the assessee. In this regard, the learned DR relied on the decision of the Chennai Bench of the Tribunal in the case of *Geetha Subrabamiam vs. ITO on ITA Nos. 427 & 428/MDS/2017 dated 27.04.2017*. It was further argued that merely by taking over possession of the assets of borrower under SARFAESI Act, the secured creditor does not acquire the ownership of the assets or becomes the owner of the assets. In this regard, he placed reliance on the decision of the Delhi Bench of the Tribunal in the case of *Rajasthan Petrosynthetics Ltd in ITA no. 1397/Del/2013 dated 22.08.2014*. It was further argued that if KMBL would have realised any amount in excess of the amount of loan liability recoverable by KMBL, the excess would have been returned by KMBL to the assessee. Thus, it cannot be said that the ownership of the assets vested with KMBL only and asset was sold by KMBL on principal to principal basis and not as agent of the assessee.

9. I have carefully considered the rival submissions, perused the respective orders passed by the learned Judicial Member and learned Accountant Member and the material placed on record. The two aspects which I find are relevant on the facts of the present case are that doctrine of *'diversion of income by overriding title'* and implication of SARFAESI Act on the doctrine of *'diversion of income by overriding title'*. Since the facts are not in dispute and are already dealt with exhaustively in the respective orders passed by learned Accountant Member and learned Judicial Member, the same are not discussed again for the sake of brevity. Firstly, I shall deal with the doctrine of *'diversion of income by overriding title'* in cases wherein the mortgage has been created by the assessee himself. The Hon'ble Supreme Court in the case of *R M Arunachalam vs CIT*

[1997] 227 ITR 222 has discussed the above doctrine. The relevant para of the said judgment is reproduced hereunder:

> *"In taking the view that in a case where the property has been mortgaged by the previous owner during his lifetime and the assessee, after inheriting the same, has discharged the mortgage debt, the amount paid by him for the purpose of clearing off the mortgage is not deductible for the purpose of computation of capital gains, the Kerala High Court has failed to note that in a mortgage there is transfer of an interest in the property by the mortgagor in favour of mortgagee and where the previous owner has mortgaged the property during his lifetime, which is subsisting at the time of his death, then after his death his heir only inherits the mortgagor's interest in the property. By discharging the mortgage debt his heir who has inherited the property acquires the interest of the mortgagee in the property. As a result of such payment made for the purpose of clearing off the mortgage the interest of the mortgagee in the property has been acquired by the heir. The said payment has, therefore, to be regarded as 'cost of acquisition' under section 48, read with section 55(2). <u>The position is, however, different where the mortgage is created by the owner after he has acquired the property. The clearing off the mortgage debt by him prior to transfer of the property would not entitle him to claim deduction under section 48 because in such a case he did not acquire any interest in the property subsequent to his acquiring the same.</u> In Daksha Ramanlal's case (supra) the Gujarat High Court has rightly held that the payment made by a person for the purpose of clearing off the mortgage created by the previous owner is to be treated as cost of acquisition of the interest of the mortgagee in the property and is deductible under section 48."*
>
> (underlined for emphasis by me)

10. Further, in the case of *CIT vs. Attilli N. Rao [2001] 252 ITR 880 (SC)* the question before the Hon'ble Supreme Court was as under:

> *"1. Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was correct in holding that the amount realised by the sale of the assessee's interest in the property was only Rs. 4,33,960 i.e., Rs. 5,62,980 minus Rs. 1,29,020 ?*

2. Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was correct in holding that the amount realised under the charge or mortgage by the Government by public auction does not partake of the character of 'full value of consideration' envisaged under section 48 of the Income-tax Act ?

3. Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was justified in holding that the amount payable by the assessee in discharge of the mortgage debt to the Government on the sale of property was an expenditure incurred towards the cost of acquisition of the capital asset and deductible under section 48 of the Income-tax Act?

4. Whether on the facts and in the circumstances of the case and in law, the Appellate Tribunal was correct in holding that the assessee was not vested with full interest in the property sold and capital gains be computed only with reference to the price realised towards his interest with property ?"

(underlined for emphasis by me)

While answering the above questions, the Hon'ble Supreme Court held as under:-

*"8. We are of the view that the Tribunal and the High Court were in error. What was sold by the State at the auction was the immovable property that belonged to the assessee. The price that was realised therefore belonged to the assessee**.** From out of that price, the State deducted its dues towards "kits" and interest due from the assessee and paid over the balance to him. The capital gain that the assessee made was on the immovable property that belonged to him. Therefore, it is on the full price realised (less admitted deductions) that the capital gain and the tax thereon has to be computed."*

(underlined for emphasis by me)

11. Further, the Hon'ble Supreme Court in the case of *CIT vs. Sitaldas Tirathdas [1961] 41 ITR 367* has laid down following test with regard to *'diversion*

of income by overriding title'. The relevant para of the said judgment is reproduced hereunder:-

> *"In our opinion, the true test is whether the amount sought to be deducted, in truth, never reached the assessee as his income. Obligations, no doubt, there are in every case, but it is the nature of the obligation which is the decisive fact. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be said to be a part of the income of the assessee. Where by the obligation income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation after such income reaches the assessee, the same consequence, in law, does not follow. It is the first kind of payment which can truly be excused and not the second. The second payment is merely an obligation to pay another a portion of one's own income, which has been received and is since applied. The first is a case in which the income never reaches the assessee, who even if he were to collect it, does so, not as part of his income, but for and on behalf of the person to whom it is payable."*
>
> (underlined for emphasis by me)

12. It is evident from the aforesaid rulings of the Hon'ble Supreme Court, which have been relied by the learned Judicial Member, that when the charge on the property has been created by the assessee himself, he cannot claim deduction of the principal amount of the loan either as expenditure under Section 48 of the Act or as *'diversion of income by overriding title'*. To this extent, I concur with the view of the learned Judicial Member. In the case of *Attilli N. Rao (supra),* the Hon'ble Supreme Court, while arriving at the conclusion, observed that at the time when the property was sold, the property belonged to the assessee and, therefore, the sale consideration of the said property also belonged to the assessee and denied the deduction claimed by the assessee from the full value of consideration received on sale of property. This aspect

needs to be analysed in the facts of the present case to decide whether the ratio laid down in the case of *Attilli N. Rao (supra)* still holds good.

13. In the case of *Sitaldas Tirathdas (supra),* the Hon'ble Supreme Court has laid down the test that it is the nature of obligation which is the decisive test. Ostensibly, there is a difference between the nature of an amount which an assessee is obliged to apply out of his income and the amount which does not reach the assessee's hands so as not to form part of the total income of the assessee.

14. The learned representative for the assessee has also drawn my attention to the provisions of Section 13 of the SARFAESI Act, which read as under:-

> *"Enforcement of security interest.*
> *13. (1) Notwithstanding anything contained in section 69 or section 69A of the Transfer of Property Act, 1882 (4 of 1882), any security interest created in favour of any secured creditor may be enforced, without the intervention of the court or tribunal, by such creditor in accordance with the provisions of this Act.*
> *(2) Where any borrower, who is under a liability to a secured creditor under a security agreement, makes any default in repayment of secured debt or any instalment thereof, and his account in respect of such debt is classified by the secured creditor as non-performing asset, then, the secured creditor may require the borrower by notice in writing to discharge in full his liabilities to the secured creditor within sixty days from the date of notice failing which the secured creditor shall be entitled to exercise all or any of the rights under sub-section (4) :*
> *[Provided that—*
>
> *(i) the requirement of classification of secured debt as non-performing asset under this sub-section shall not apply to a borrower who has raised funds through issue of debt securities; and*

(ii) in the event of default, the debenture trustee shall be entitled to enforce security interest in the same manner as provided under this section with such modifications as may be necessary and in accordance with the terms and conditions of security documents executed in favour of the debenture trustee.]

(3) The notice referred to in sub-section (2) shall give details of the amount payable by the borrower and the secured assets intended to be enforced by the secured creditor in the event of non-payment of secured debts by the borrower.

[(3A) If, on receipt of the notice under sub-section (2), the borrower makes any representation or raises any objection, the secured creditor shall consider such representation or objection and if the secured creditor comes to the conclusion that such representation or objection is not acceptable or tenable, he shall communicate [within fifteen days] of receipt of such representation or objection the reasons for non-acceptance of the representation or objection to the borrower:

Provided that the reasons so communicated or the likely action of the secured creditor at the stage of communication of reasons shall not confer any right upon the borrower to prefer an application to the Debts Recovery Tribunal under section 17 or the Court of District Judge under section 17A.]

(4) In case the borrower fails to discharge his liability in full within the period specified in sub-section (2), the secured creditor may take recourse to one or more of the following measures to recover his secured debt, namely :—

(a) take possession of the secured assets of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset;

[(b) take over the management of the business of the borrower including the right to transfer by way of lease, assignment or sale for realising the secured asset :

Provided that the right to transfer by way of lease, assignment or sale shall be exercised only where the substantial part of the business of the borrower is held as security for the debt :

Provided further that where the management of whole of the business or part of the business is severable, the secured creditor

shall take over the management of such business of the borrower which is relatable to the security for the debt;]

(c) appoint any person (hereafter referred to as the manager), to manage the secured assets the possession of which has been taken over by the secured creditor;

(d) require at any time by notice in writing, any person who has acquired any of the secured assets from the borrower and from whom any money is due or may become due to the borrower, to pay the secured creditor, so much of the money as is sufficient to pay the secured debt.

(5) Any payment made by any person referred to in clause (d) of sub-section (4) to the secured creditor shall give such person a valid discharge as if he has made payment to the borrower.

[(5A) Where the sale of an immovable property, for which a reserve price has been specified, has been postponed for want of a bid of an amount not less than such reserve price, it shall be lawful for any officer of the secured creditor, if so authorised by the secured creditor in this behalf, to bid for the immovable property on behalf of the secured creditor at any subsequent sale.

(5B) Where the secured creditor, referred to in sub-section (5A), is declared to be the purchaser of the immovable property at any subsequent sale, the amount of the purchase price shall be adjusted towards the amount of the claim of the secured creditor for which the auction of enforcement of security interest is taken by the secured creditor, under sub-section (4) of section 13.

(5C) The provisions of section 9 of the Banking Regulation Act, 1949 (10 of 1949) shall, as far as may be, apply to the immovable property acquired by secured creditor under sub-section (5A).]

(6) Any transfer of secured asset after taking possession thereof or take over of management under sub-section (4), by the secured creditor or by the manager on behalf of the secured creditor shall vest in the transferee all rights in, or in relation to, the secured asset transferred as if the transfer had been made by the owner of such secured asset.

(7) Where any action has been taken against a borrower under the provisions of sub-section (4), all costs, charges and expenses which, in the opinion of the secured creditor, have been properly incurred by him or any expenses incidental thereto, shall be recoverable from the borrower and the money which is received by the secured creditor shall, in the absence of any contract

to the contrary, be held by him in trust, to be applied, firstly, in payment of such costs, charges and expenses and secondly, in discharge of the dues of the secured creditor and the residue of the money so received shall be paid to the person entitled thereto in accordance with his rights and interests.

[(8) Where the amount of dues of the secured creditor together with all costs, charges and expenses incurred by him is tendered to the secured creditor at any time before the date of publication of notice for public auction or inviting quotations or tender from public or private treaty for transfer by way of lease, assignment or sale of the secured assets,—

(i) the secured assets shall not be transferred by way of lease assignment or sale by the secured creditor; and

(ii) in case, any step has been taken by the secured creditor for transfer by way of lease or assignment or sale of the assets before tendering of such amount under this sub-section, no further step shall be taken by such secured creditor for transfer by way of lease or assignment or sale of such secured assets.]

(9) [Subject to the provisions of the Insolvency and Bankruptcy Code, 2016, in the case of] financing of a financial asset by more than one secured creditors or joint financing of a financial asset by secured creditors, no secured creditor shall be entitled to exercise any or all of the rights conferred on him under or pursuant to sub-section (4) unless exercise of such right is agreed upon by the secured creditors representing not less than [sixty per cent] in value of the amount outstanding as on a record date and such action shall be binding on all the secured creditors :

Provided that in the case of a company in liquidation, the amount realised from the sale of secured assets shall be distributed in accordance with the provisions of section 529A of the Companies Act, 1956 (1 of 1956) :

Provided further that in the case of a company being wound up on or after the commencement of this Act, the secured creditor of such company, who opts to realise his security instead of relinquishing his security and proving his debt under proviso to sub-section (1) of section 529 of the Companies Act, 1956 (1 of 1956), may retain the sale proceeds of his secured assets after depositing the workmen's dues with the liquidator in accordance with the provisions of section 529A of that Act :

Provided also that the liquidator referred to in the second proviso shall intimate the secured creditor the workmen's dues in accordance with the

provisions of section 529A of the Companies Act, 1956 (1 of 1956) and in case such workmen's dues cannot be ascertained, the liquidator shall intimate the estimated amount of workmen's dues under that section to the secured creditor and in such case the secured creditor may retain the sale proceeds of the secured assets after depositing the amount of such estimated dues with the liquidator :

Provided also that in case the secured creditor deposits the estimated amount of workmen's dues, such creditor shall be liable to pay the balance of the workmen's dues or entitled to receive the excess amount, if any, deposited by the secured creditor with the liquidator :

Provided also that the secured creditor shall furnish an undertaking to the liquidator to pay the balance of the workmen's dues, if any.

Explanation.—For the purposes of this sub-section,—

(a) "record date" means the date agreed upon by the secured creditors representing not less than [sixty per cent] in value of the amount outstanding on such date;

(b) "amount outstanding" shall include principal, interest and any other dues payable by the borrower to the secured creditor in respect of secured asset as per the books of account of the secured creditor.

(10) Where dues of the secured creditor are not fully satisfied with the sale proceeds of the secured assets, the secured creditor may file an application in the form and manner as may be prescribed to the Debts Recovery Tribunal having jurisdiction or a competent court, as the case may be, for recovery of the balance amount from the borrower.

(11) Without prejudice to the rights conferred on the secured creditor under or by this section, the secured creditor shall be entitled to proceed against the guarantors or sell the pledged assets without first taking any of the measures specified in clauses (a) to (d) of sub-section (4) in relation to the secured assets under this Act.

(12) The rights of a secured creditor under this Act may be exercised by one or more of his officers authorised in this behalf in such manner as may be prescribed.

(13) No borrower shall, after receipt of notice referred to in sub-section (2), transfer by way of sale, lease or otherwise (other than in the ordinary course

of his business) any of his secured assets referred to in the notice, without prior written consent of the secured creditor."

Sub-section (2) of Section 13 of the SARFAESI Act provides that if the borrower defaults in repayment of loan or any instalment thereof and his account is classified as a Non-Performing Asset, then the secured creditor shall issue a notice requiring him to make the payment within sixty days, failing which the secured creditor shall exercise his rights conferred under Sub-section (4) of the SARFAESI Act. Sub-section (4) of SARFAESI Act provides that if the borrower fails to make payment within the time specified in the notice issued under Sub-section (2), the secured creditor shall have right to exercise various options which, *inter-alia*, includes right to take possession of the secured asset and the right to transfer by way of lease, assignment or sale for realising the secured asset. Thus, Sub-section (4) of Section 13 of SARFAESI Act provides the secured creditor with the right to transfer the secured asset in order to realise the secured debt.

15. Further, on perusal of Sub-section (13) of Section 13 of SARFAESI Act, I find that once the borrower receives notice under Sub-section (2) of the SARFAESI Act, his right to part with the property is restricted; and, the borrower cannot transfer the secured asset by way of sale, lease or otherwise without prior written consent of the secured creditor.

16. Thus, in sum and substance, I find that once the borrower defaults in repayment of loan or instalment and the secured creditor issues the notice specified in Sub-section (2) of Section 13 of the SARFAESI Act, the right of the borrower with respect to the secured asset gets restricted, and he is not allowed

to part with the secured asset without the prior approval of the secured creditor. Further, on non-repayment of loan or instalment amount within the period specified in the notice issued under Sub-section (2) of Section 13 of the SARFAESI Act, all the rights in the secured asset get vested with the secured creditor and the borrower has no right in the said asset. The borrower is not free to decide even the way in which the secured asset shall be parted with. It is the sole discretion of the secured creditor as to how the secured asset shall be dealt with. This right in favour of the secured creditor is created by virtue of SARFAESI Act; and, this has been interpreted by the learned representative for the assessee to say that the mortgaged property vested with KMBL and, therefore, the property was sold by KMBL in its own right. In my considered opinion, the fall-out of non-compliance envisaged in Sub-section (2) of Section 13 of the SARFAESI Act provides the secured creditor all or any of the rights enumerated in Sub-section (4) thereof. Clause (a) of Sub-section (4) of Section 13 of the SARFAESI Act is being sought to be understood by the assessee to mean taking possession of the secured asset by KMBL as an owner *per se.* So however, in my considered opinion, the reading of clause (a) of Sub-section (4) of Section 13 of the SARFAESI Act does not justify the aforesaid interpretation. Sub-section (4) of Section 13 of the SARFAESI Act says "*In case the borrower fails to discharge his liability ..... the secured creditor may take recourse ..... to recover his secured debt .....".* Furthermore, clause (a) of Sub-section (4) of Section 13 of the SARFAESI Act, *inter-alia*, says "*take possession of the secured assets ..... including the right to transfer ..... for realising the secured asset*". Quite clearly, vesting of the secured asset with the secured creditor is prescribed by SARFAESI Act to enable the secured creditor "*to recover his secured debt"* including, *inter-alia*, empowering the secured creditor to take possession and transfer by way of lease, assignment or sale the secured asset

"*for realising the secured asset*". Therefore, in my considered opinion, the stand of the assessee (on the strength of SARFAESI Act) that the mortgaged property vested with KMBL and to say that the consideration received by KMBL on transfer of said property never accrued to the assessee as the asset did not belong to the assessee is untenable given the mandate of the SARFAESI Act.

17. I find that in the present case the assessee defaulted in repayment of loan to KMBL and KMBL classified the account of the assessee as Non-Performing Asset which is the precondition before issuing notice under Sub-section (2) of Section 13 of the SARFAESI Act. The assessee was thus issued notice under Sub-section (2) of Section 13 of the SARFAESI Act dated 30.11.2009. The assessee failed to make payment to the secured creditor within the period specified in the notice issued under Sub-section (2) of Section 13 of the SARFAESI Act. Thus, by virtue of Sub-section (4) of Section 13 of the SARFAESI Act, KMBL was vested with the option to sell the secured asset, which is represented by plots, in the present case. KMBL invoked the SARFAESI Act and accordingly took possession of the plots, sold them and recovered the amount of loan liability outstanding from the assessee.

18. The situation can also be seen *de hors* the SARFAESI Act. The assessee in the present case availed mortgage loan from KMBL and, one of the condition was that if the assessee defaults in repayment of loan and interest, the mortgaged property will be sold by KMBL to recover the outstanding loan and interest amount from the assessee. The assessee and KMBL, both were aware of this fact at the time of advancing of loan by KMBL to the assessee; and, the assessee voluntarily chose to enter into such an arrangement wherein property owned by it was mortgaged to the bank as security; admittedly, assessee agreed to the

condition of disposal of the property by KMBL in case of default in repayment of loan by it. This arrangement, even without force of any law, was clear and unambiguous. Thus, it was only a voluntary action on the part of the assessee to enter into such an obligation and assessee was not compelled by law or any other obligation beyond it's control to enter into such an arrangement. Once that is so, any action taken by KMBL to enforce it's right to recover the amount which, in the present case, is right to sell the property to recover amount cannot be said to be transaction beyond the control of the assessee. Thus, the amount recovered by KMBL can by no stretch of imagination be treated as *'diversion of income by overriding title'*. The principle of *'diversion of income by overriding title'* applies when the transaction is beyond the control of the assessee due to which assessee has to make commitment to either divert it's income or part with income earned by it in a particular manner. The principle of *'diversion of income by overriding title'* has been laid down by the courts to overcome the situation wherein an assessee does not have a free hand on the amount earned by it or is in fact not received by an assessee due to circumstances beyond it's control. Such principle would not be attracted in cases wherein assessee by his own past action creates a future obligation for himself to utilize the amount in a particular manner. Thus, the claim of the assessee cannot be accepted in the facts of the present case.

19. Section 13 of the SARFAESI Act cannot come to the rescue of the assessee. I find that at the time of entering into mortgage agreement assessee was well aware of the consequences of non-payment of loan amount which, *inter-alia*, included procedure of recovery of amount and sale of mortgage asset by the secured creditor. It is not something new or some unforeseen event which assessee was not aware of. Having complete knowledge of the consequences of

default in repayment of loan, assessee still chose to enter into such an arrangement. So it is an action of the assessee, which has created the instant obligation on itself. Insofar as the argument of the learned representative that the instant obligation was not voluntary and was mandated by the SARFAESI Act, in my view, the same is quite misplaced inasmuch as it is only the voluntary act of the assessee of entering into mortgage loan arrangement with KMBL and the subsequent default in repayment which has triggered Sub-section (13) of Section 13 of the SARFAESI Act placing restriction on the assessee to transfer the mortgaged/secured asset by way of sale, lease or otherwise without the prior consent of KMBL. Alternatively, I find that SARFAESI Act merely provides a recovery mechanism and nothing else. The SARFAESI Act cannot be interpreted to mean that it has created right of *'diversion of income by overriding title'*. While interpreting the law, due regard must be given to the intent and purpose of the law. The purpose of SARFAESI Act, and which clearly emerges from the phraseology of Section 13 of SARFAESI Act, is to effectuate and expedite the recovery of secured interest of the secured creditor and certainly not, so far as the present case is concerned, to reduce or to impair the provisions of the Act in determination of income-tax liability of the assessee.

20. In my considered opinion, so far as the instant dispute is concerned, the legal position prevailing prior to SARFAESI Act is also germane even after the enactment of SARFAESI Act. The law laid down by the Hon'ble Courts with respect to *'diversion of income by overriding title'* and deduction to be claimed under Section 48 of the Act while computing the income from Capital Gains, which are discussed by the ld. Judicial Member and also relied upon by the ld. DR, are still good law, and is fully applicable in the instant case.

21. In view of the above reasoning, I hold that in the present case there was no diversion of sale proceeds by overriding title, but on the contrary, there is only a mere application of the sale proceeds realised on sale of plots towards the discharge of outstanding loan liability of the assessee. I also hold that assessee cannot claim any part of such application as deduction for the purpose of computing Capital Gain in terms of Section 48 of the Act.

22. I thus agree with the view taken by the learned Judicial Member that the consideration from sale of property to the extent of principal component of loan adjusted by the bank cannot be treated as *'diversion of income by overriding title'* and was thus not deductible from the total consideration accrued to the assessee from sale of property.

23. In view of the foregoing discussion, the questions put forth before me are answered in negative, and against the assessee. The decision arrived at by learned Judicial Member is the correct view, and I concur with the view adopted by the learned Judicial Member on this issue.

24. The Registry of the Tribunal is directed to list the appeal before the Division Bench for passing the final order in accordance with the majority view.

Sd/-
(G.S. PANNU)
VICE PRESIDENT

Mumbai, Dated 10th May, 2019"

Per Pawan Singh, J.M

4. In accordance with the majority view, we hold that the grounds of appeal raised by the assessee are dismissed.

3. In the result, appeal filed by the assessee is dismissed.

Order pronounced in the open court on 05-09-2019.

Sd/-	**Sd/-**
(Rajesh Kumar)	(Pawan Singh)
ACCOUNTANT MEMBER	JUDICIALMEMBER

Mumbai, Dt : 5th September, 2019
Pk/-
Copy to :

1. Appellant
2. Respondent
3. CIT(A)
4. CIT
5. DR

By order

Asstt. Registrar, ITAT, Mumbai