A M/S. MCDOWELL & COMPANY LTD.

v.

COMMISSIONER OF INCOME-TAX, KARNATAKA CENTRAL, BANGALORE

B (Civil Appeal No. 3893 of 2006)

MARCH 09, 2017

[A. K. SIKRI AND ASHOK BHUSHAN, JJ.]

Income Tax Act, 1961 – s. 72A – Provisions relating to carry
C *forward and set off of accumulated loss and unabsorbed depreciation allowance in certain cases of amalgamation – Benefit of provisions of s. 72A – Grant of – Waiver of interest by financial institutions, if to be treated as income of assessee company, which took over sick company through scheme of amalgamation – Tribunal granted benefit of provisions of s. 72A and also held that waiver of*
D *interest by financial institutions would not be treated as income of assessee u/s. 41(1) – Said order set aside by the High Court – On appeal, held: Assessee took over the sick company-HPL and HPL ceased to have any identity – Since the benefit of interest accrued after the company had ceased to exist and was in fact, availed of*
E *by assessee, the assessee company was allowed to set off the amalgamated losses of the company amalgamated with it – When assessee is allowed the benefit of the accumulated loses, while computing those loses, the income which accrued to it had to be adjusted and only thereafter net losses could have been allowed to be set off by the assessee company – It cannot be said that the*
F *assessee would be entitled to take advantage of the accumulated loses but while calculating these accumulated loses at the hands of amalgamated company, the income accrued u/s. 41(1) at the hands of HPL would not be accounted for – Order passed by the High Court upheld.*

G **Dismissing the appeal, the Court**

HELD: 1.1 The High Court took note of the fact that the assessee had taken over the sick company-HPL through the scheme of amalgamation and that the HPL ceased to have any identity as it did not remain a 'person' either in fact or in law after

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amalgamation. However, rights are determined in terms of the scheme of amalgamation and since the benefit of interest had accrued after the company had ceased to exist, it was, in fact, availed of by the assessee company. The assessee company was allowed to set off the amalgamated losses of the company amalgamated with HPL. This was the benefit which accrued to the assessee under section 72A of the Income Tax Act. When the assessee is allowed the benefit of the accumulated loses, while computing those loses, the income which accrued to it had to be adjusted and only thereafter net losses could have been allowed to be set off by the assessee company. Calculations to this effect are given by the Assessing Officer in his assessment order and there is no dispute about the same. [Para 10] [862-E-H]

1.2 The assessee was given the benefit of accumulated loses of the amalgamated company. The effect thereof is that though these loses were suffered by the amalgamated company they were deemed to be treated as loses of the assessee company by virtue of Section 72A. It cannot be said that the assessee would be entitled to take advantage of the accumulated loses but while calculating these accumulated loses at the hands of amalgamated company, i.e., HPL, the income accrued under section 41(1) at the hands of HPL would not be accounted for. That had to be necessarily adjusted in order to see what are the actual accumulated loses, the benefit whereof is to be extended to the assessee. Thus, the High Court's analysis of Section 41(1) along with Section 72A, is concurred with. [Para 10] [863-B-D]

Saraswati Industrial Syndicate v. CIT **(1990) Supp. SCC 675 : [1990] Suppl. SCR 332 – distinguished.**

Case Law Reference

[1990] Suppl. SCR 332	**distinguished**	**Para 10**

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 3893 of 2006.

From the Judgment and Order dated 05.04.2005 of the High Court of Karnataka at Bangalore in I.T.R.C. No. 12 of 2002.

Jaideep Gupta, Sr. Adv., Kunal Chatterji, Ms. Maitrayee Banerjee, Advs. for the Appellant.

A Y. P. Adhyaru, Sr. Adv., Rupesh Kumar, S. A. Haseeb, Mrs. Anil Katiyar, Advs. for the Respondent.

The Judgment of the Court was delivered by

A. K. SIKRI, J. 1. This appeal is preferred against judgment dated 05.04.2005 of the High Court of Karnataka whereby the appeal B of Commissioner of Income Tax (Revenue) was allowed setting aside the order to the Income Tax Appellate Tribunal(ITAT) which had granted the benefit of provisions of Section 72A of the Income Tax Act, 1961 (hereinafter referred to as 'Act') to the appellant-assessee and, at the same time, held that waiver of interest by financial institutions would not C be treated as income of the appellant-assessee under Section 41(1) of the Act.

2. Brief summary of the facts which have led to the present appeal may be taken note of at this stage.

3. There was a company known as M/s. Hindustan Polymers D Limited (HPL) which had become a sick industrial company. Proceedings in respect of the said company were pending before the Board for Industrial and Financial Reconstruction (BIFR) under Sick Industrial Companies Act (SICA). At that stage, petitions under Section 391 and 392 of the Companies Act, 1956, were filed in the High Court of Bombay E and Madras for amalgamation of HPL with the assessee-appellant herein i.e., M/s. McDowell and Company Limited. Both the High Courts approved the scheme of amalgamation as a result of which, w.e.f. 01.04.1977, HPL stood amalgamated with the assessee/appellant-company.

F 4. As mentioned above, HPL, which was an industrial undertaking, had become a sick company and it owed a lot of money to banks and financial institutions. In its books of accounts, the interest which had accrued on the loans given by such financial companies were shown as the money payable on account of interest to the said banking companies and was reflected as expenditure on that count. As the interest payable G was treated as expenditure, benefit thereof was taken in the assessment orders made. The assessee had approached the Central Government, before moving the High Court, with the scheme of amalgamation for getting benefits of Section 72A of the Act. This section makes provisions relating to carry forward and set off accumulated loss and unabsorbed depreciation allowance in certain cases of amalgamation or demerger H

etc. Under certain circumstances and on fulfillment of conditions laid down therein, the company which takes over the sick company is allowed to set off losses of the amalgamated company as its own loses. The Central Government had made a declaration to this effect under Section 72A of the Act granting the benefit of the said provision to the assessee.

5. Under the scheme of amalgamation that was approved by the High Court, after following the procedure in terms of Sections 391 and 392 of the Companies Act, which includes the consent of the secured creditors as well, the banks which had advanced loans to HPL agreed to waive off the interest which had accrued prior to 01.04.1977. As already stated above, this interest was claimed as expenditure by HPL in its returns. On the waiver of this interest, it became income in terms of Section 41(1) of the Act. In the return filed by the assessee for the Assessment Year 1983-1984, the assessee claimed set off of the accumulated loses which it had taken over from HPL by virtue of the provisions contained in section 72A of the Act. This was allowed. However, later on, it came to the notice of the Assessing Officer that while allowing the aforesaid benefit to the assessee, the income which had accrued under section 41(1) of the Act had not been set off against the accumulated loses. It so happened that on certain grounds, the assessment was reopened by the Assessing Officer and while undertaking the exercise of reassessment, the Assessing Officer also noticed that the aforesaid fact, viz., the income which had accrued within section 41(1) of the Act as mentioned above, was not set off while giving benefit of accumulated losses under Section 72(A) of the Act to the assessee. The Assessing Officer, therefore, treated the aforesaid income at the hands of the assessee herein and adjusted the same from the accumulated loses. The assessment order was drawn accordingly. This reassessment was challenged by the assessee by filing appeal before the Commissioner of Income Tax (Appeals), which was dismissed. However, in further appeal before the ITAT, the assessee succeeded inasmuch as the ITAT held that the aforesaid income under Section 41(1) of the Act was not at the hands of the assessee herein but it may be treated as income of the HPL and since HPL was a different assessee and a different entity, the assessee herein was not liable to pay any taxes on the said income. Feeling aggrieved thereby, the Revenue sought reference under Section 256 of the Act and ultimately, the reference was made on the following questions of law:

A "Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in upholding that the over due interest waived by the financial institutions amounting to Rs.25.02 lakhs is not assessable in the hands of the assessee?"

6. This question of law has been decided in favour of Revenue by B the impugned judgment.

7. It is argued by Mr. Jaideep Gupta, learned senior counsel appearing for the assessee-appellant, that the High Court has not appreciated the provisions of the Act, viz., Section 72A or Section 41(1) in their proper perspective and has also committed error in not properly C understanding the ratio of the judgment of this Court in '*Saraswati Industrial Syndicate* v. *CIT*' [(1990) Supp. SCC 675] thereby committing serious error in answering the said question. It was argued that the benefit of section 72A of the Act was given as the assessee fulfilled all the conditions stipulated therein and the Central Government while giving declaration was satisfied that the eligibility conditions for D taking advantage of carry forward and set off of accumulated loses of the HPL were fulfilled. He, thus, submitted that insofar as the benefit of carry forward of accumulated loses of HPL and seeking set off thereof is concerned, it was the statutory right of the appellant-assessee which became available to it by virtue of the declaration given by the Central E Government under the aforesaid provisions.

8. On the other hand, submitted the learned counsel, that insofar as Section 41(1) is concerned, language thereof makes it abundantly clear that the income has to be treated at the hands of "first mentioned person" which is HPL in the instant case. This HPL was a distinct F entity in law and was also a different assessee. Therefore, any such income earned by the HPL could not have been treated as income of the assessee herein. Mr. Gupta submitted that this is, in fact, the ratio of the judgment of this Court in '*Saraswati Industrial Syndicate*' (supra) wherein section 41(1) of the Act is interpreted in the following manner:

G "Section 41(1) has been enacted for charging tax on profits made by an assessee, but it applies to the assessee to whom the trading liability may have been allowed in the previous year. If the assessee to whom the trading liability may have been allowed as a business expenditure in the previous year ceases to be in existence or if the assessee is changed on account of the death of the earlier

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assessees the income received in the year subsequent to the previous year or the accounting year cannot be treated as income received by the assessee. In order to attract the provisions of Section 41(1) for enforcing the tax liability, the identity of the assessee in the previous year and the subsequent year must be the same. If there is any change in the identity of the assessee there would be no tax liability under the provisions of Section 41. In *CIT v. Hukumchand Mohanlal* this Court held that the Act did not contain any provision making a successor in a business or the legal representatives of an assessee to whom the allowance may have been already granted liable to tax under Section 41(1) in respect of the amount remitted on receipt by the successor or by the legal representative. In that case the wife of the assessee on the death of her husband succeeded to the business carried on by him. Another firm which had recovered certain amounts towards the sales tax from the assessee's husband succeeded in an appeal against its sales tax assessment and thereupon the firm refunded that amount to the assessee which was received during the relevant acounting period. The question arose whether the amount so received by the assessee could be assessed in her hands as a deemed profit under Section 41(1) of the Act. This Court held that Section 41 did not apply because the assessee sought to be taxed was not the assessee as contemplated by Section 41(1) as the husband of the assessee had died, therefore the revenue could not take advantage of the provisions of Section 41(1) of the Act.

9. He also drew attention of this Court to the discussion contained in paragraph 6 of the said judgment in support of his submission that since HPL was a different assessee, this income could not be held to be the income of the amalgamated company, i.e., the assessee herein, for the purposes of Section 41(1) of the Act which aspect is explained by this Court in the following manner:

"In the instant case the Tribunal rightly held that the appellant company was a separate entity and a different assessee, therefore, the allowance made to Indian Sugar Company, which was a different assessee, could not be held to be the income of the amalgamated company for purposes of Section 41(1) of the Act. The High Court was in error in holding that even after amalgamation

A of two companies, the transferor company did not become non-existent instead it continued its entity in a blended form with the appellant company. The High Court's view that on amalgamation there is no complete destruction of corporate personality of the transferor company instead there is a blending of the corporate personality of one with another corporate body and it continues as such with the other is not sustainable in law. The true effect and character of the amalgamation largely depends on the terms of the scheme of merger. But there cannot be any doubt that when two companies amalgamate and merge into one the transferor company loses its entity as it ceases to have its business. However, their respective rights or liabilities are determined under the scheme of amalgamation but the corporate entity of the transferor company ceases to exist with effect from the date the amalgamation is made effective."

10. The aforesaid arguments appear to be attractive in the first blush, but a little deeper scrutiny thereof in the light of the situation prevailing in the instant case would reflect that these arguments need to be rejected. In fact, same arguments were advanced before the High Court as well which did not find merit therein. The High Court took note of the fact that the assessee had taken over the sick company-HPL through the scheme of amalgamation sanctioned in 1982 w.e.f. 01.04.1977 and that the HPL ceased to have any identity as it did not remain a 'person' either in fact or in law after amalgamation. However, rights are determined in terms of the scheme of amalgamation and since the benefit of interest had accrued after the company had ceased to exist, it was, in fact, availed of by the assessee company. What is more important is that the assessee company was allowed to set off the amalgamated losses of the company amalgamated with it, i.e., HPL. This was the benefit which accrued to the assessee under the provisions of section 72A of the Act. When the assessee is allowed the benefit of the accumulated loses, while computing those loses, the income which accrued to it had to be adjusted and only thereafter net losses could have been allowed to be set off by the assessee company. Calculations to this effect are given by the Assessing Officer in his assessment order and there is no dispute about the same. Judgment of this Court in *Saraswathi Industrial Syndicate Ltd.* (supra) deals with the provisions of Section 41(1) of the Act *per se*. Section 72A of the Act was not the

subject matter of the said decision. Therefore, the principle laid down in the said case may not be applicable in the instant case inasmuch as the position would be totally different in those cases where the income has accrued to an amalgamated company under Section 41(1) of the Act and, obviously, that cannot be treated as income at the hands of the company which has taken over the amalgamated company. However, in the instant case, the assessee was given the benefit of accumulated loses of the amalgamated company. The effect thereof is that though these loses were suffered by the amalgamated company they were deemed to be treated as loses of the assessee company by virtue of Section 72A of the Act. In a case like this, it cannot be said that the assessee would be entitled to take advantage of the accumulated loses but while calculating these accumulated loses at the hands of amalgamated company, i.e., HPL, the income accrued under section 41(1) of the Act at the hands of HPL would not be accounted for. That had to be necessarily adjusted in order to see what are the actual accumulated loses, the benefit whereof is to be extended to the assessee. We, thus, agree with the High Court in its analysis of Section 41(1) along with Section 72A of the Act, which is to the following effect:

> "10. Though the ITO proposed to treat the waiver of interest portion as revenue receipt in the hands of assessee's company under Section 41(1) of the Act, the same is to be read with Section 72A of the Act. The Finance Minister in his Budget speech while introducing Section 72A of the Act stated that the sickness among industrial undertaking was regarded as a matter of grave national concern inasmuch as closure of any sizable manufacturing unit industry entailed social costs in terms of production loss and unemployment as also waste of valuable capital assets, and experience had shown that taking over of such sick units by Governments was not always a satisfactory or economical solution; it was felt that a more effective method would be to facilitate amalgamation of sick industrial units with sound ones by providing incentives and removing impediments in the way of such amalgamation which would not merely relieve the Government of un-economical burden of taking over and running sick units but save the Government from social costs in terms of loss of production and unemployment. With such objection in view, in order to facilitate the merger of sick industrial units with sound

A ones and as and by way of offering an incentive in that behalf section 72A was introduced, whereunder, by a deeming fiction, the accumulated loss or unabsorbed depreciation of the amalgamating company is treated to be a loss or, as the case may be. The Revenue before the first appellate authority emphasized the application of section 72A of the Act, to the facts of the case. The first appellate authority and also the Tribunal failed to consider the scope and object of section 72A of the Act. Thus, the Tribunal committed an error in treating the waiver of interest as not income of the assessee."

C 11. We, thus, find that this appeal is without any merit and is, accordingly, dismissed.

Nidhi Jain Appeal dismissed.