
(2013) 04 GUJ CK 0071
In the Gujarat High Court
Case No : Tax Appeal No. 332 of 2013

Commissioner of Income Tax-II	Vs	APPELLANT
Special Prints Ltd.		RESPONDENT

Date of Decision : 15-04-2013

Acts Referred:

Citation : (2013) 262 CTR 119 : (2013) 356 ITR 404 : (2013) 215 TAXMAN 628

Hon'ble Judges : S.G. Gokani, J; Akil Abdul Hamid Kureshi, J

Bench : Division Bench

Advocate : Sudhir M. Mehta, for the Appellant; J.P. Shah and Manish J. Shah, for the Respondent

Judgement

Akil Kureshi, J.—Revenue is in appeal against the judgment of the Income Tax Appellate Tribunal, Ahmedabad [""Tribunal"" for short] dated

26th October, 2010, raising following questions for our consideration:-

(A) ""Whether on the facts and in the circumstances of the case and in law, the Hon'ble Tribunal was justified in deleting the addition of Rs.

6,43,81,967/- by not taking into consideration the tax exploitative scheme adopted by the assessee to defraud the revenue ?

(B) ""Whether on the facts and in the circumstances of the case and in law, the Hon'ble ITAT was justified in not appreciating the fact that there

was no commercial purpose of the transaction of Cumulative Convertible Preference Shares other than avoidance by setting off the short term

capital gain into long term capital loss?

These questions arise in the following factual background.

1.1 Respondent-assessee is a limited company. During the previous year relevant to A.Y. 2001-02, the assessee had sold its plant and machinery

to a group company viz., M/s. Garden Silk Mills Limited for a consideration of Rs. 8.95 crores [rounded off] against the written down value of Rs.

2.58 crore [rounded off] and had thus earned short term capital gain of Rs. 6.37 crore [rounded off]. During the same period, the assessee

company had also entered into another transaction with another group company viz., SPS Silks Limited, to whom the assessee had sold

12,00,000 1% Cumulative Convertible Preference shares of M/s. Garden Finmark Limited at Rs. 6.25 per share. These shares were allotted to

the assessee by M/s. Garden Finmark Limited on 21st March, 1997 at the rate of Rs. 45/- per share; which included Rs. 10/- as Face value and

Rs. 35/- as Premium. In the process of this transaction of sale of CCPS, the assessee-company had incurred long term capital loss of Rs. 6.34

crore [rounded off]. This loss, the assessee had set off against capital gain of Rs. 6.37 crore earned on account of sale of plant and machinery.

1.2 During the assessment, the Assessing Officer inquired into this capital loss. Assessee pointed out the reason for sale of the shares as also the

basis of the valuation. It was pointed out that the price was adopted as per the valuation report of the valuer-M/s. CC Chokshi & Company, who

had recommended the price band of Rs. 6 to Rs. 6.50 per share.

1.3 The Assessing Officer, however, found that the assessee had entered into a colourable device for tax avoidance. Relying on and referring to

the decision in case of McDowell and Co. Ltd. Vs. Commercial Tax Officer, , he disallowed the entire loss of Rs. 6.43 crore towards sale of

CCPS.

1.4 Assessee carried the matter in appeal. CIT(A), by his detailed judgment, reversed the decision of the Assessing Officer and held that the

transactions would fall within the legitimate tax planning and would not amount to colourable device for tax avoidance. He found that the assessee

had relied on the report of the valuer, who had adopted correct parameters. The assessee had sufficient justification for sale of these shares.

1.5 The decision of CIT(A) was carried in appeal by the Revenue. The Tribunal, by the impugned judgment, dismissed Revenue's appeal. The

Tribunal held that the valuation report was on the basis of consideration of relevant factors and did not suffer from any infirmity. Against such

judgment of the Tribunal, Revenue has preferred the present Tax Appeal.

1.6 Learned advocate Shri Sudhir Mehta appearing for the Revenue vehemently contended that the Assessing Officer had pointed out several

defects in the valuation of shares adopted by the assessee. He submitted that the assessee had acquired such shares less than five years back at a

high cost of Rs. 45/- per share and such shares were sold at a heavy loss during the period when the assessee had earned substantial capital gain.

There was no justification for sale of shares and the only motive was to avoid tax for which such a colourable device was adopted.

2. On the other hand, learned advocate Shri Shah for the respondent, appearing on Caveat, supported the decisions of CIT(A) and the Tribunal.

He submitted that the Assessing Officer had rejected the valuation report without any basis. He had neither examined the valuer nor called for

independent valuation of the shares. Only on the basis of suspicion, he had disallowed the entire loss incurred by the assessee in the process of

selling the shares.

3. Having thus heard learned counsel for the parties and having perused the documents on record, we find that the CIT as well as the Tribunal both

had concurrently come to the conclusion that the shares were sold on the basis of the valuation report, which did not suffer from any infirmity. We

notice that the Assessing Officer had doubted the valuation report, however, did not chose to obtain any independent valuation. Additionally, the

entire transaction was seen as colourable device for tax avoidance on the following grounds:-

(1) Assessee did not produce minutes register and therefore, according to him, it was not possible to ascertain the correct sequence of events of

the transactions in question;

(2) The assessee had sold only 12,00,000 shares out of total holding of 15.36 lakh shares. The sale proceeds of which was sufficient to set off

short term capital gain;

(3) According to him, the assessee did not suffer from any liquidity crisis since from the balance sheet of the assessee-company, it could be seen

that the assessee had cash and bank balance of Rs. 2.22 crore.

3.1 On the basis of such factors, the Assessing Officer came to the following conclusion:-

Findings:

(1) It is pertinent to note that the Garden Finmark Limited had itself valued its preference shares at Rs. 35/- premium to its price of Rs. 10/- in the year 1996-97. The company has consistent track record of making profit in every year thereafter. Therefore, it is hard to believe that Rs. 45 1-

word of share is valued at Rs. 6.25 1-in a span of 5 years in spite of the company making substantial and consistent profit.

(2) The assessee after knowing at what rate shares could be sold did not brought to the notice of the public about its intention to sale these shares.

The assessee did not call for the highest bid for the shares. Had the intention of the assessee was bona fide, the assessee would have had given

public notice and invited offers from the public. The assessee did not do this. Instead, the assessee completed the deal in camera with SPS.

If there was nothing to conceal on the part of the assessee, then as a prudent businessman, the assessee should have had call for offer from the

public at large in order to get maximum.

(3) This is not a case of simply sale of 1% Cumulative Convertible Preference Share of Garden Finmark Limited but this is a case of sale of those

shares putting the purchasers into controlling power on Garden Finmark Limited as these 12,00,000/- shares are going to be converted into equity

shares before 20.03.2007 which is fast approaching.

The plan of the Garden Group is so deliberate, that it did not allow outsider to come into controlling power of Garden Finmark Limited which

again is holding huge number of equity shares of Garden Silk Mills Limited and thereby in a controlling capacity.

It is clear in this case that the assessee has carried out transaction which has no commercial (business) purpose apart from the avoidance of liability

of tax as held in the case of Dawson. This inserted step is to be disregarded and the Court is to look at the end-result of the taxing it in accordance

with the "provisions of taxing statutes. In the result, I assessment satisfied that to sell the 1% Cumulative Convertible Preference share of SPS Silk

Limited is colourable device of the assessee to defeat the interest of the revenue and such device deserves to be rejected. Accordingly, the claim of

long term capital loss of Rs. 6,36,92,624/- is disallowed.

4. CIT(A), however, dealt with each individual objection of the Assessing Officer and found that-(i) the valuation report was based on proper

considerations and the valuer had advised the company to sell the shares in the range of Rs. 6 to Rs. 6.50 per share; (ii) the assertion that the

assessee was not suffering from liquidity crisis was not correct. He accepted the assessee's explanation that though the assessee had a balance of

Rs. 2.22 crore; out of it, a sum of Rs. 1.34 crore comprised of fixed deposit in the form Excise Duty margin, lying with the Bank of Baroda and a

sum of Rs. 69 lakh had to be kept aside as per the order of the High Court; and a sum of Rs. 80 lakh represented non-refundable deposits. It was

also found that the entire transaction was entered into after obtaining appropriate report from the valuer. In other words, merely because certain

minor details viz., minutes of meetings were not produced, would not be fatal.

4.1 In his judgment, the appellate Commissioner had paid sufficient attention on the valuation method adopted by the valuer. He noticed that such

valuation was arrived at after taking into account the profit earnings as well as net asset value.

4.2 It was this decision of the CIT (A) which the Tribunal confirmed by the impugned judgment. The Tribunal also examined the method of

valuation adopted by the valuer for fixing the range of Rs. 6 to Rs. 6.50 per share. In this regard, the Tribunal noted as under:-

It has been observed that they have adopted two types of methods to arrive at such a conclusion, namely;

(i) Net Assets value methods (Book value & Intrinsic value):

They have computed the value of the equity share of GFL, on a diluted basis, based on the book value of its assets and liabilities as at 31st March,

2000. On this basis the value per equity share of Rs. 10/- worked out to Rs. 46.27 per share. After adjusting the net assets value as on 31st May,

2000 on account of the diminution in the value of investments in the equity shares of Garden Silk Mills Limited [based on the weighted average

market price of the share for the last six months ended 31.5.2000] the value per share of Rs. 10/- fully paid up based on the intrinsic worth of net

assets works to Rs. 7.79.

It has been further mentioned that if one were to give a 75% weightage to the value based on intrinsic worth of net assets and a 25% weightage to

the value based on book value of net assets, the value per equity share of GFL based on net assets would work out to Rs. 17.41.

(ii) Profit earnings method

Under this method, value of shares of a company is arrived at by capitalizing its future maintainable profits by an appropriate Price Earning Ratio.

In the present circumstances, as the past profits of the company as tabulated have shown a declining trend they have considered it reasonable to

apply weights of 1, 2 and 3 to the profits for the years 1997-98, 1998-99 and 1999-2000 respectively to arrive at the future maintainable profits.

Considering all the relevant facts in respect of the business, past track record of revenues and profits, nature of business and industry, quality of the

assets and so on, in our opinion, it would be appropriate and reasonable to apply a capitalization rate of 20% corresponding to a PE ratio of 5, in

the present case. Applying the PE ratio of 5 to the weighted average profits for the three years ended 31.3.2000, the value per share of Rs. 10/-

fully paid up works out to Rs. 5.92.

4.29 In consonance with the ruling of the Hon"ble Supreme Court in the case of Hindustan Lever Employees" Union Vs. Hindustan Lever Limited

and others, , in the present case, the valuer had considered it appropriate to apply a weightage of 75% to the value as per the profit earning

capacity method and 25% to the value based on net assets method, resulting in the value of the equity shares of GFL, working out to Rs. 8.79/-

per share. The valuer had further reasoned that although the CCPS carry an option to convert them into equity shares, their holders do not enjoy

the same rights as holders of equity shares of the Company. Hence the value of the equity share of GFL would have to be appropriately

discounted to arrive at the value of CCPS.

4.30 In conformity with the ruling of the Hon"ble Supreme Court in the case of A.R. Krishnamurthy and Another Vs. Commissioner of Income

Tax, Madras, , the valuer had concluded in its valuation report as under:

On consideration of the above factors and issues, in our opinion, SPL can sell the 15236650 1% Cumulative Convertible Preference Shares of

Rs. 10/- each fully paid up of Garden Finmark Limited, at a price in the range of Rs. 6/- (Rupees Six only) to Rs. 6.50 (Rupees Six and paise

Fifty] per share.

4.31 After due consideration of the facts and legal aspects of the issues involved and as per our above observation discussions we do not have any

hesitation to confirm the order of the learned CIT (A). It is ordered accordingly.

5. We are of the opinion that the appellate Commissioner as well as the Tribunal having examined all aspects of the matter and in particular the

valuation report and having come to the conclusion that such report did not suffer from any legal infirmities, no interference is called for.

6. If one peruses the order of the Assessing Officer as a whole, primarily, he was concerned about the assessee having sold sizeable number of

shares inviting considerable loss during the same period, when the assessee had sold certain assets and earned capital gain. Surely, merely because

the assessee claimed set off of capital loss against the capital gain incurred during the same period by itself cannot be branded as a colourable

device or method for tax avoidance. If both the transactions are genuine and also traded at proper valuation, merely because the period co-existed

or permitted the assessee to set off its capital loss against some capital gain, by itself would not give rise to the presumption that the transaction was

in the nature of colourable device. Even if the assessee consciously entered into the transaction with an object of earning set off, may be a case of

tax planning but as long as such tax planning is achieved through legitimate means, the revenue surely cannot object to the same.

6.1 The fact that the assessee sold only 12 lakh shares out of more than 15 lakh shares of a certain scrip held by it again by itself can hardly be a

factor to brand the assessee of colourable device. It may be one of the factors to set the Assessing Officer thinking, without there being anything

additional in the form of the valuation itself being artificial, the Revenue cannot object to the assessee selling part of its shareholding.

7. In the present case therefore, what essentially boils down to is whether the shares were sold at a correct price or at the price which was

artificially arrived at to inflate the loss. In this respect, we have already noticed that the CIT[A] as well as the Tribunal both had gone to the factual

findings pertaining to the methodology adopted by the valuer in valuing the shares. We have also noticed that the Assessing Officer; except for

doubting such valuation, on the basis of circumstances, did not have anything concrete at hand to hold that the price of Rs. 6.25 per share was not

the correct price. In the circumstances, we do not find that the Tribunal had committed any error.

8. Before closing, we may notice that in case of Porrits and Spencer (Asia) Ltd. Vs. The Commissioner of Income Tax, , the Punjab & Haryana

High Court had somewhat similar situation to tackle with. Referring to and relying on the decision of the Apex Court in case of Union of India and

Another Vs. Azadi Bachao Andolan and Another, and the decision of this Court in case of Banyan and Berry Vs. Commissioner of Income Tax, ,

it was observed that once the transaction is genuine merely because it has been entered into with a motive to avoid tax, it would not become

colourable device, earning any disqualification. It was observed as under:

18. The aforesaid discussion would show that once the transaction is genuine merely because it has been entered into with a motive to avoid tax, it

would not become a colourable device and consequently earn any disqualification. Hon"ble the Supreme Court in the concluding paras of its

judgment in Azadi Bachao Andolan (supra) has rejected the submission that an act, which is otherwise valid in law, cannot be treated as non est

merely on the basis of some underlying motive supposedly resulting in some economic detriment or prejudice to the national interest as per the

perception of the Revenue. The aforesaid view looks to be the correct view. It has ready support from the Division Bench judgment of this Court

rendered in the case of Satya Nand Munjal (Supra) and the Division Bench judgment of Orissa High Court in the case of Industrial Development

Corporation of Orissa Limited (supra) and various other judgments of Delhi and Madras High Courts (supra).

In the result, no question of law arises. Tax Appeal is, therefore, dismissed.