

(1983) 10 KAR CK 0016

In the Karnataka High Court

Case No : Income-tax Reference Cases No's. 289 and 290 of 1978

Commissioner of Income Tax, Karnataka

APPELLANT

Vs

Master Raghuveer Trust

RESPONDENT

Date of Decision : 05-10-1983

Acts Referred:

Companies Act, 1956 — Section 394

Income Tax Act, 1961 — Section 2 (47), 256 (1), 47 (vii), 53

Citation : (1984) 40 CTR 163 : (1985) 151 ITR 368 : (1984) 16 TAXMAN 406

Hon'ble Judges : S.R. Rajashekhara Murthy, J; Mohammad Sharif, J

Bench : Division Bench

Advocate : K. Srinivasan and H. Raghavendra Rao, for the Appellant; G. Sarangan, for the Respondent

Judgement

Jagannatha Shetty, J.—The Income Tax Appellate Tribunal, Bangalore Bench, at the instance of the Revenue has referred the following two questions under s. 256(1) of the I.T. Act, 1961 (the "act") :

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that no transfer was involved within the meaning of section 2(47) on the amalgamation of Syndicate Bank Ltd. with the Industrial Credit & Development Syndicate in spite of the provisions of section 47(vii) so as to attract the capital gains tax ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that in the event of it being held that a transfer was involved in the transaction in question, proportionate exemption to the extent of Rs. 100 out of the total consideration Rs. 235 paid for every share of Rs. 100 held in Syndicate Bank Ltd., would be available to the assessee ?"

2. The facts in detail will be found in the statement of the case and may briefly be summarised as follows :

The assessee trust was a shareholder in the Syndicate Bank Ltd. ("SB Ltd"). After

the nationalization of banks in July, 1969, the SB Ltd. was amalgamated with the Industrial Credit & Development Syndicate ("ICDS") as per the scheme approved by this court under s. 394 of the Companies Act, 1956. Consequently, the assessee received equity shares, advance call deposit certificates, debentures and redeemable bonds in the ICDS of the total value of Rs. 235 for every unit of Rs. 100 of the face value of the shares held by the assessee in the SB Ltd. For the assessment year 1974-75, assessee claimed exemption of the capital gains realised from the said scheme of amalgamation on two grounds : (i) that there was no transfer involved as required under s. 2(47) of the Act; and (ii) even if there was a transfer, the sum realised therefrom was exempt under s. 47(vii) of the Act. The ITO rejected both the contentions. He determined the capital gains at Rs. 12,750 after allowing certain deductions.

3. Challenging the legality of the order of assessment, the assessee appealed to the AAC reiterating the contentions which were not accepted by the ITO. The AAC allowed the appeal observing that the transaction involved in the scheme of amalgamation did not attract the levy of capital gains since there was no transfer and even if it was a transfer, then s. 47(vii) regards such a transaction as not a transfer. As against the order of the AAC, the Department preferred an appeal before the Tribunal, and the assessee preferred cross-objections. In the cross-objections, it was contended that the AAC should have held that in the event of the transaction being held to be a transfer, then under s. 47(vii) that part of the capital gains arising from that portion of the consideration attributable to the shares in the ICDS would be exempt from taxation.

4. The Tribunal held that there was no transfer involved within the meaning of s. 2(47) of the Act when the amalgamating company transferred its shares consequent on the scheme of amalgamation approved by this court. The Tribunal also observed that s. 47(vii) has been enacted by way of clarification and no transfer is involved when a shareholder gets some shares or cash from the amalgamated company in lieu of his shares in the amalgamating company. As regards the contention raised in the cross-objection was concerned, the Tribunal observed :

"It does not appear to have to have been the intention of parliament to deny exemption even partially in cases where part of the consideration is paid in shares and part in cash or in any other form. From the very nature of things, the amount payable for the share in the amalgamating company would, in most cases, be an odd figure which would not wholly adjust with the value of the shares in the amalgamated company and that odd part of the same had to be paid in cash. It would, therefore, be reasonable to hold that to the extent consideration is paid in shares, in the event of it being held that, in a case of amalgamation, capital gains tax is attracted, the compensation would be exempt proportionately from assessment of capital gains tax."

5. With these conclusions, the Tribunal dismissed the appeal.

6. The question raised in these cases is of considerable importance. It relates to the scope and ambit of the charging provision in relation to capital gains tax in regard to the transactions involving the merger of two companies under a scheme of amalgamation approved by a High Court under s. 394 of the Companies Act, 1956. The word "amalgamation" generally has no precise meaning. In Halsbury's Laws of England, Fourth Edition, Vol. 7, at p. 1539, it is stated :

"Meaning of "reconstruction" and "amalgamation". - Neither "reconstruction" nor "amalgamation" has a precise legal meaning..... Amalgamation is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to a new company, or by the transfer of one or more undertakings to an existing company. Strictly "amalgamation does not, it seems, cover the mere acquisition by a company of the share capital of other companies which remain in existence and continue their undertakings, but the context in which the term is used may show that it is intended to include such an acquisition"."

7. Under s. 2(1A) of the Act, "amalgamation" has been defined to mean :

" "amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as result of the merger, as the amalgamated company in such a manner that -

(i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

(ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;

(iii) shareholders holding not less than nine-tenths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first-mentioned company."

8. It was stated in the counsel for the assessee that the amalgamation of the SB

Ltd. with the ICDS was in accordance with the above provisions of s. 2(1A) of the Act, and all the liabilities of the SB Ltd. and the shareholders holding not less than nine-tenths in value of the shares became the liabilities and shareholders in the ICDS.

9. Consequent on the amalgamation, the SB Ltd. has been struck off from the register as required under s. 394(1)(iv) of the Companies Act. The question to be considered herein is whether there was a transfer of a capital asset within the meaning of s. 2(47) of the Act and, if so, whether the assessee got shares, debentures and redeemable bonds from the ICDS as consideration for that transfer.

10. Section 2(47) :

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

11. Section 45 :

"Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in section 53, 54B, 54-D and 54-E be chargeable to Income Tax under the head "Capital gains"....."

12. Section 48 provides mode of computation of capital gains and it states that the income chargeable to tax as capital gains shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the amount stated thereunder. If there is no consideration received or accruing to the assessee as a result of the transfer, the method of computation prescribed under s. 48 is wholly inapplicable. This necessarily follows that a transaction in order to attract the charge of tax as capital gains must be for consideration and if there is no consideration, the transfer contemplated will not be exigible to capital gains tax.

13. When a partner retires from the firm and receive some amount in respect of his share in the partnership, there is no transfer of interest and there is no element of sale, exchange, relinquishment or extinguishment of his rights in his assets, inasmuch as he takes away the asset representing his interest in the partnership and no part of the amount received by him would be exigible to capital gains tax under s. 45 (see (1) Commissioner of Income Tax, Gujarat Vs. Mohanbhai Pamabhai, Commissioner of Income Tax Vs. Madan Lal Bhargava,

14. Similarly, when a shareholder receives assets in specie or cash representing his shares on distribution of the net assets of the company in liquidation as contemplated under s. 46, there is no transfer as envisaged under s. 2(47) of the Act, inasmuch as he receives that asset in satisfaction of the right which belonged to him by virtue of his holding shares and not by operation of any transaction which amounts to transfer (see the decisions of the Supreme Court : (i) Commissioner of Income Tax, Madras Vs. Madurai Mills Co. Ltd., The

Commissioner of Income Tax, Gujarat II, Ahmedabad Vs. Shri R.M. Amin, L.R. of The Late Shri. Chunnibhai J. Amin, Baroda, . In Madurai Mill's case, there was distribution of assets of three companies which went into liquidation and as a consequence thereof, the assessee company obtained certain cash or assets in the shape of shares in the other companies and also immovable properties. The ITO held that by reason of distribution of the assets of the companies under liquidation, there resulted capital gains within the meaning of s. 12B of the Indian I.T. Act, 1922. But the Madras High Court, on a reference, held that the transaction which reflected a distribution of assets on liquidation cannot be characterised as a transfer or sale to attract the capital gain tax. The decision of the Madras High Court has been reported in Madurai Mills Company Ltd. Vs. Commissioner of Income Tax, . That view has been affirmed by the Supreme Court in Commissioner of Income Tax, Madras Vs. Madurai Mills Co. Ltd., . R. M. Amin's case was also concerned with the distribution of assets of a private limited company in Uganda on liquidation. The assessee therein had held 192 shares. He got the certain cash amount by way of distribution of the net assets of the said company. The question arose whether the amount received by the assessee was a consideration for extinguishment of the rights of the assessee and whether it could be considered as a transfer within the meaning of s. 2(47) of the Act. The Gujarat High Court held that what the assessee received was not a consideration [See Commissioner of Income Tax, Gujarat II Vs. R.M. Amin. (Legal representative of the Late Chunibai Amin), . It was observed at page 203 :

"... When a shareholder receives moneys representing his share on distribution of the net assets of the company in liquidation, he receives such moneys in satisfaction of the right which belongs to him by virtue of his holding the share and not by way of consideration for the extinguishment of his right or rights in share. The share merely represents like right to receive moneys on distribution of the net assets of the company in liquidation and that right is satisfied and, by satisfaction, extinguished when such moneys are received by the shareholder. Such moneys received by the shareholder do not represent any consideration received by him as a result of the extinguishment of his rights in the share. It is not the extinguishment of his rights in the share for which consideration is received by him : it is rather because moneys representing his share in the distribution are received by him that his rights in the share are extinguished."

15. In the appeal against the judgment of the Gujarat High Court, the Supreme Court in The Commissioner of Income Tax, Gujarat II, Ahmedabad Vs. Shri R.M. Amin, L.R. of The Late Shri. Chunnibhai J. Amin, Baroda, .

The argument of Mr. Desai, learned counsel for the appellant, is that when the assessee received the sum of Sh. 4,68,489 in lieu of the 192 shares held by him in the Uganda company, he received that amount as a result of transfer. The word "transfer", in relation to a capital asset, according to the learned counsel, includes extinguishment of any rights therein. The words "extinguishment of any rights therein", it is submitted, would cover the case of the assessee when he

received the amount mentioned above on account of the shares held by him in the Uganda Company. The above contention has been controverted by Mr. Sen who has urged that there was no transfer contemplated by law as to attract the levy of tax on capital gains. After giving the matter our earnest consideration, we are of the opinion that the contention of Mr. Sen is well founded."

16. The court further observed at 373 :

""When a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment or transfer."

The above observations, though made in the context of section 12B of the Act of 1922 which related to capital gains in respect of profits or gains arising from sale, exchange, relinquishment or transfer of capital assets, in our opinion, would also cover the case of extinguishment of any rights in capital assets."

17. From these two decisions of the Supreme Court, it will be clear that when a shareholder receives money or other assets representing his share in distribution of the net assets of the company in liquidation, he receives that money or other asset in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to sale, exchange, relinquishment of the asset or extinguishment of any rights in the capital assets.

18. What then would be the position, if under a scheme of amalgamation approved by the High Court under s. 394 of the Companies Act, a shareholder receives some shares or some shares coupled with some debentures and bonds from the amalgamated company equivalent to the agreed value of his shares in the amalgamating company ? Mr. Srinivasan, counsel for the Revenue, urged that the transaction involved in the scheme of amalgamation is clearly a transfer since the right of the assessee in the assets of the SB Ltd. has been extinguished and in consideration thereof he received some shares and debentures from the ICDS. Mr. Sarangan, counsel for the assessee, strenuously urged that the shares allotted by the ICDS by reason of the arrangement entered into between SB Ltd. and the ICDS cannot be regarded as consideration for the extinguishment of his rights in the assets of the SB Ltd. According to the counsel, under the scheme of amalgamation of the SB Ltd. stood dissolved and thereafter its shares had no value and the receipt of shares from the ICDS did not constitute a consideration since there was no transfer of shares by the assessee to the ICDS. The allotment of shares and debentures by the ICDS was a necessary consequence of the arrangement agreed upon between the two companies under the scheme of amalgamation.

19. The contention of Mr. Sarangan finds support from the decision of the Bombay High Court in Commissioner of Income Tax, Bombay City II Vs. Rasiklal

Maneklal (H.U. F.), Bombay, In that case also, under a scheme approved by the High Court, there was a transfer of one company with all property rights to another company. The scheme also provided for an increased in the share capital in the amalgamated company and those newly created shares were to run *pari passu* with the existing shares of the amalgamating company in all respects. The amalgamated company was directed to allot one share for every two shares in the amalgamating company. The assessee therein, accordingly, received 45 shares. On the question, whether the receiving of new shares in lieu of the old shares amounted to exchange or relinquishment of rights in the capital asset, the Bombay High Court observed that there was no provision in the scheme of amalgamation directing the assessee to transfer his shares to the amalgamated company or any one else. It was further observed that under the scheme of amalgamation, the old company stood dissolved and, thereafter, the shares of the old company had no value, and the receipt of shares by the assessee in the amalgamated company did not constitute either exchange or relinquishment of the old shares.

20. Mr. Srinivasan, however, relied upon the decision of the Calcutta High Court in *Central India Industries Ltd. Vs. Commissioner of Income Tax*, . Therein under two schemes of amalgamation approved by the High Court of Punjab and Rajasthan, the shareholders of the two amalgamating companies receives shares in the third company in the prescribed proportions. The assessee claimed that on such amalgamation he has sustained capital loss. The Calcutta High Court while largely depending upon the terms in the scheme of amalgamation observed (at p. 218) :

"The shares allotted as provided in the foregoing clause will be issued and delivered to the registered shareholders or to their nominees in exchange for ordinary shares of Merchandise and Stores Ltd. and R. G. D. Ltd. in the proportion above mentioned."

21. The High Court, accordingly, held that it was at least a case of transfer of shares by the assessee, if not an exchange. The decision of the Gujarat High Court in *Commissioner of Income Tax Vs. Vania Silk Mills (P.) Ltd.*, is also of no assistance to the contention urged by Mr. Srinivasan. In that case, the assessee had insured his machinery which was destroyed by fire accident. The assessee received some insurance claim. The question arose whether the excess amount received by the assessee was liable to capital gains tax. The High Court answered that question in the affirmative.

22. The decision of the Calcutta High Court in *Shaw Wallace and Co. Ltd. Vs. Commissioner of Income Tax*, , on which both the counsel relied in support of their respective contentions, had the following facts. The assesses company in that case was holding 100 per cent. shares of three subsidiary companies. Under the scheme of arrangement arrived at by and between the assesses company and its subsidiary company approved by the Calcutta High Court and the Madras High Court, the subsidiary companies were amalgamated with the assesses

company. The rights of the assessee company in the shares of the subsidiary companies stood extinguished. The assessee company claimed that the extinguishment in the shares of the subsidiary companies should be considered as a transfer within the meaning of s. 45 read with s. 2(47) of the I.T. Act. It was also contended that the assessee company suffered a capital loss since the shares of the subsidiary companies were rendered without value. The Revenue, on the other hand, depended upon s. 47(v) of the Act which provides that a transfer of a capital asset by its subsidiary company to the holding company is not to be regarded as a transfer. On these contentions, the Calcutta High Court observed (pp. 408-409) :

"It appears to us that the controversy in the present references is solved by the sections involved... It seems to us that, in the instant case, the net effect of the scheme of amalgamation is a transfer of the entire capital assets of the subsidiary companies to the holding company which also holds the entire share capital of the subsidiary companies. Such a transfer or transaction would fall within s. 47(v) of the Act and again be excluded from the operation of s. 45.

Lastly, if we look behind the facade and lift the corporate veil, it appears that the assessee in effect had all the rights of an owner over all the assets of the subsidiary companies inasmuch as the assessee held 100% shares of the subsidiaries. In that view, it does not appear to us that there could be any element of gain or loss when the assessee rearranged its capital base and instead of keeping the capital in the name or in the control of its subsidiaries brought back the same under its direct control."

23. In substance, the conclusion was that the transfer of a capital asset by a subsidiary company to a holding company is no transfer, firstly, on the ground that it falls under s. 47(v) and, secondly, on the ground that it is a rearrangement of capital base.

24. To sum up :

(i) Capital gains arise on the transfer of a capital asset. "Capital asset" includes all kinds of property, movable or immovable, tangible or intangible, fixed or circulating, except those referred under s. 2(14) of the Act. Section 45(1) of the Act provides that any profits or gains from the transfer of a capital asset effected in a previous year shall, save as otherwise provided in ss. 53, 54, 54B, 54D and 54E, be chargeable to Income Tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

(ii) Section 2(47) defines "transfer" in relation to a capital asset to include the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law. The definition is wide and any transaction, whereby the ownership of an assessee in a capital asset ceases, is also to be treated as a "transfer".

(iii) For chargeability to tax under s. 45, there must be a transfer, and the profit

or loss whereon is assessable under the head "Capital gains". Where there is a transfer without there being any profit arising on the transfer, there is no profit liable to capital gains tax.

(iv) The Act, under ss. 46 and 47, specifies certain transactions which do not constitute "transfer", or although there may be transfers, those are to be ignored for the purpose of "capital gains".

(v) Section 48 provides the mode of computation of capital gains which itself indicates that if there is no consideration received or accruing to the assessee as a result of the transfer, then the "transfer" will not be exigible to capital gains tax, and

(vi) The extinguishment of a right in a capital asset must necessarily be compensated by consideration paid by one party to the other which means that there must at least be two parties to the transaction.

25. Let us assume, as Mr. Srinivasan urged, that in the process of amalgamation of companies, there would be transfer of assets of the amalgamating company to amalgamated company inasmuch as, there would be extinguishment of rights in the shares held by the assessee in the amalgamating company. But, where is the consideration for such extinguishment and who has paid it to the assessee ? In the first place, the assessee was not an eo nomine party to the amalgamation or to any transaction by which its assets were transferred to the ICDS. Secondly, by the process of amalgamation, the shares held by the assessee in the SB Ltd. had become useless or valueless and the SB Ltd. was struck off from the register under s. 394(1)(iv) of the Companies Act. And thirdly, the assessee, as a member of the amalgamating company, the SB Ltd., was entitled to some shares, bonds, etc., from the ICDS. This is neither in satisfaction of its rights nor as a consideration for the transfer.

26. This allotment of shares, etc., to the assessee cannot, therefore, be considered as a transfer for consideration within the meaning of s. 2(47) of the Act.

27. In *Secretary, Board of Revenue v. Madura Mills Co. Ltd.* AIR 1937 Mad 259, a Full Bench of the Madras High Court, after considering the effect of allotment of shares by a company, observed (p. 260) :

We find it difficult to follow this distinction. As we have already observed, it is no doubt true that in the hands of a shareholder, a share is property, and when a shareholder exchanges his shares with another, it may be possible to regard the transaction as amounting to a transfer whether by way of exchange or conveyance : *Coats v. Inland Revenue Commissioners* [1897] 2 QB 423. But when the company is for the first time issuing shares, it seems to us that there is no question of property already possessed by the company being thereby transferred to the allottee. Whatever may be the exact nature of right which the allottee acquires between the date of allotment and the date of entry of his name

in the register, it is difficult to regard the issue of the shares to him by allotment as amounting to a "transfer of property" by the company to him."

28. In *V. G. M. Holdings Ltd., In re* [1942] 12 Comp Cas 254 : 1 All ER 224, Lord Greene M. R. observed :

"Counsel for the appellant endeavoured heroically to establish the proposition that a share before issue was an existing article of property, that it was an existing bundle of rights which a shareholder could properly be said to be purchasing when he acquired it by subscription in the usual way. I am quite unable to accept that view. A share is a chose-in-action. A chose-in-action implies the existence of some person entitled to the rights, which are rights in action as distinct from the rights in possession, and, until the share is issued, no such person exists. Putting it in a nutshell, the difference between the issue of share to the subscriber and the purchase of share from an existing shareholder is the difference between the creation and the transfer of a chose-in-action. The two legal transactions of the creation of a chose-in-action and the purchase of a chose-in-action are quite different in conception and in result."

29. Considering the facts and circumstances of the case, in the light of the authorities to which we have called attention, it is, in our judgment, not possible to hold that the allotment of shares by the ICDS to the shareholders of SB Ltd. was by way of transfer for consideration for the transfer effected under the amalgamation.

30. In view of the conclusion that we have reached, it may not be necessary to consider the second question referred by the Tribunal, but since the question has been debated before us, we may briefly deal with the contentions. The second question turns on the scope of s. 47(vii). It reads :

Section 47 : Nothing contained in section 45 shall apply to the following transfers : -

(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if -

(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company; and

(b) the amalgamated company is an Indian company;"

31. The Tribunal has held that if the assessee had received consideration from the ICDS partly by shares and partly by bonds or debentures then to the extent of consideration paid in shares, it would be exempt proportionately from the assessment of capital gains tax. This conclusion is perhaps on the ground that s. 47(vii) is attracted to such a transaction. We may straightaway state that if s. 47(vii) is applicable to the case on hand, then there is no question of pro rata exemption to the extent of Rs. 100 out of the total estimated consideration of Rs. 235. If, on the other hand, s. 47(vii) is not attracted, then the mode of

computation is governed by s. 48 and by no other method.

32. We should not, however, be understood to have expressed any opinion on the applicability of s. 47(vii) when the consideration for transfer of shares is paid partly by shares and partly by cash, bonds or debentures.

33. The first question is very inarticulately worded and is confusing. The real question that arises out of the order of the Tribunal is :

"Whether the amalgamation of the Syndicate Bank Ltd. with the Industrial Credit & Development Syndicate resulted in a transfer of capital asset of the assessee under s. 2(47) of the Act so as to be chargeable to Income Tax under the head "Capital gains" ?"

34. The question is, therefore, reframed as above and answered in the negative and in favour of the assessee.

35. In view of our answer to the first question, question No. 2 does not survive and it is, therefore, not answered.

36. The parties will pay and bear their own costs.