

(1992) 01 DEL CK 0003

In the Delhi High Court

Case No : Civil Writ Appeal No. 1644 of 1986

Indian Explosives Ltd.

APPELLANT

Vs

Union of India and Others

RESPONDENT

Date of Decision : 07-01-1992

Acts Referred:

Income Tax Act, 1961 — Section 72A

Citation : (1992) 195 ITR 232

Hon'ble Judges : S. Duggal, J;B.N. Kirpal, J

Bench : Division Bench

Advocate : Debi Pal, A.K. Verma, Priya Hingorani, Tarun Banga, Rajindra, D.C. Taneja and R.N. Verma, for the Appellant;

Judgement

B.N. Kirpal, J.

(1) The challenge in this writ petition under Article 226 of the Constitution is to the order 7th April, 1986 passed by the Specified Authority, Government of India, Ministry of Industries, Department of Industrial Development, u/s 72-A of the Income Tax Act, 1961 (in short the Act), whereby it did not recommend to the Central Government to make declaration under that section.

(2) This writ petition will dispose of Civil Writ No. 1644 of 1986 and Civil Writ No.485 of 1989.

(3) Briefly stated, the facts are that a company known as M/s. Alkali & Chemicals Corporation of India Ltd. (hereinafter referred to as "ACCI") was carrying on business or manufacture and sale of polythene, rubber Chemicals, paints etc. The said Acci was incurring losses especially in the financial years 1980-8). and 1981-82. Both the companies, namely, the petitioner and Acci decided to amalgamate. Accordingly, on 30th September, 1982 the petitioner and Acci passed resolutions in their respective Board meetings approving the scheme of amalgamation subject to the obtaining of necessary permission from various authorities. The scheme of amalgamation, inter alia, postulated that the transfer

of Acci will be with effect from 1st October, 1982. This scheme was conditional upon certain approvals being obtained from different authorities, namely, M.R.T.P. and Fera and it was further provided that the scheme shall be deemed to be effective on the date on which the last of such approvals was obtained. The scheme also postulated issuance of shares of the petitioner company to the erstwhile shareholders of ACCI.

(4) On 27th December, 1982 an application for approval of amalgamation was filed u/s 23(2) of the M.R.T.P. Act. This approval was received with the Central Government passing an order on 18th January, 1984. As both the companies, namely, the petitioner as well as Acci were registered in the State of West Bengal, appropriate applications u/s 391 of the Act were filed in the High Court at Calcutta. The Calcutta High Court vide its order dated 9th February, 1984 accorded its approval and thereafter the scheme of amalgamation became binding on all the shareholders of both the companies. Approval to the issuance and allotment of equity and preference shares was also accorded by the meeting of the shareholders and, thereafter by the Controller of Capital Issue. In addition thereto, M/s. Imperial Chemical Industries, a company incorporated in England, also held shares in Acci and approval was also obtained from the Reserve Bank of India for Imperial Chemical Industries to acquire shares of the petitioner company in lieu of its shares of ACCI.

(5) According to section 72-A of the Act if a declaration is made by the Central Government, then the accumulated lost and the unabsorbed depreciation of the amalgamating company is deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company. For seeking such a declaration, the petitioner applied on 25th May, 1984 before the Secretary, Ministry of Industries, Department of Industrial Development, Government of India. The application which is made has to be considered and, according to the provisions of section 72A, recommendation has to be made by the Specified Authority, which is constituted by the Central Government by notification published in the Official Gazette. It is only after the recommendation is made and the same is accepted by the Central Government that the benefit "of section 72A of the Act can be availed of by the amalgamated company.

(6) SUB-SECTION (1) of Section 72A of the Act, with which we are concerned, reads as under:

"72A.(1) Where there has been an amalgamation of a company owning an industrial undertaking or a ship with another company and the Central Government, on the recommendation of the specified authority, is satisfied that the following conditions are fulfilled ,namely:- (a) the amalgamating company was not, immediately before such amlgatmon, financially viable by reason of its liabilities, losses and other relevant factors; (b) the amalgamation was in the public interest ; and (c) such other conditions as the Central Government may, by notification in the Official Gazette, specify, to ensure that the benefit under this section is restricted to amalgamation which would facilitate the rehabilitation

or revival of the business of the amalgamating company, Then the Central Government may make a declaration to that effect, and, thereupon, notwithstanding anything confined in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and the other other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly."

(7) It is common ground that no condition has been notified by the Central Government under sub-clause (c) of sub-section (1) of Section 72A of the Act. In order to get the benefit of this provision the petitioner company had, Therefore, to satisfy that Acci was not, immediately preceding amalgamation financially viable and, secondly, the amalgamation was in the public interest. With this end in view, lot of correspondence was exchanged between the parties and hearings took place to which we will presently refer.

(8) Before we do so, it will be appropriate to consider the decision of the Supreme Court relating to the interpretation of section 72A for the reason that it is the ratio of this decision which was kept in mind by the parties while corresponding with each other. In the case of Commissioner of Income Tax, Bombay and others v. Mahindra and Mahindra Ltd. and others, 144 Itr 225 (hereinafter referred to as M & M), M & M had applied to the Specified Authority u/s 72A of the Act for making a recommendation to the Central Government to accord sanction under the said provision M & M had amalgamated with M/s. International Tractor Company of India Limited, which had, in the immediate three preceding years of the amalgamation, had profit in one year but loss in two years. The Specified Authority gave six reasons for not making the recommendation u/s 72A. The Central Government adopted the reasons given by the Specified Authority and refused to issue the declaration which was sought u/s 72A of the Act. On a petition being filed under Article 226 of the Constitution, a Division Bench of this Court allowed the same and directed the Specified Authority and the Central Government to consider the case de novo in the light of the observations made by the Court. An appeal was filed by the Commissioner of Income Tax. While dismissing the appeal, the Supreme Court adverted to the speech of the Finance Minister and also Notes on Clauses of the Finance Bill of 1977 whereby section 72A was inserted in the Income Tax Act. After referring to the same the Court observed :

" THAT the financial non-viability of an undertaking had been equated with the sickness of such undertaking and obviously in the context of its revival by a sound undertaking the sickness must be of a temporary character and not any basic or permanent sickness. An undertaking which is basically or potentially non- viable will ordinarily be incapable of revival and would face a closure; in other words, the financial non-viability spoken of by the section must refer to

sickness brought about by temporary adverse financial circumstances that disables "the unit to stand and work on its own. This is also made clear by the provision contained in cl,(a) of sub-s.(I) which states that the financial non-viability of the amalgamating company has to be judged by reference to "its liabilities, losses and other relevant factors."

(9) After referring to a study conducted by the National Council of Applied Economic Research on financial viability, it was observed by the Supreme Court as follows: "NCAER has further observed that where all the three parameters - profitability, liquidity and solvency - show positive figures the unit's financial viability will be sound; where one of the three parameters shows negative figure the unit could be regarded as "tending towards sickness", when two of the three parameters show negative figures, it would be case of "incipient sickness" and when all the three parameters show negative figures the unit is "sick". This being the true concept of financial non-viability as understood, by men of business and commerce and by financial institutions it is by reference to these several tests or criteria adopted by them that the question has to be decided whether a particular undertaking is financially non-viable at a given point of time." After receipt of the application, some additional information was sought for by the Specified Authority on 20th June 1984. Vide letter dated 9th July, 1984. This information was supplied. Vide letter dated 8th October, 1984 the specified Authority wrote to the petitioner that the amalgamating company did not appear to be a non-viable company prior to amalgamation. The Specified Authority wanted some further information in respect of three years prior to the effective date to amalgamation i.e. 1st October, 1982. This information was supplied by the company vide its letter dated 23rd November, 1984. While supplying this information, it was pointed out that the company's balance sheet had been drawn up according to the provisions of the Companies Act and depreciation had been charged on the straight-line method. According to the petitioner, in order to see the financial viability of the Acci, it was necessary that the depreciation should be calculated according to the provisions of the Indian Companies Act. The contention of the petitioner was that Cci was a non-viable unit and reasons for this were continued in the aforesaid letter of 23rd November, 1984. This was supplemented by a further letter of 4th December, 1984 when comparative figures in respect to the company as per the balance sheet and also as per the Income Tax Act were given.

(10) On 10th May, 1985, the Specified Authority once again required the petitioner to furnish certain additional information. In this letter, reference was made to the aforesaid judgment of the Supreme Court in the case of M & M (supra) and it was noted that the National Council of Applied Economic Research had on a study set out three parameters for judging non-viability of a company. Information in this regard was sought by the Specified Authority because, according to it, Acci was not a non-viable unit. By its letter dated 5th June, 1985, the petitioner sought to establish that by applying the criteria laid down by the National Council of Applied Economic Research, Acci was a non-viable unit.

Reference was made to the judgment of the Supreme Court in the case of M & M (supra) and it was urged that Acci was a sick unit. After the receipt of the letter of 5th June, 1985, no communication appears to have been received by the petitioner except the impugned order dated 7th April, 1986. The petitioner was informed that the Specified Authority regretted its inability to recommend to the Central Government the scheme of amalgamation of Acci with the petitioner for the purpose of section 72A of the Act. It was stated in the said letter as follows:

"....." THE Specified Authority is not satisfied that the conditions as referred to in sub-section (1) of Section 72A of the Income Tax Act, 1961 are fulfilled in view of the following: The requirement that the amalgamating company viz. M/s. Alkali & Chemicals Corporation of India Limited was not immediately before amalgamation, financially viable by reason of its liabilities, losses and other relevant factors is not fulfilled. It was noted that the solvency of the amalgamating company was on the positive side, to the extent of Rs.3.65 crores as per books of accounts on the date of amalgamation approved by the High Court i.e. 1st October, 1982."

(11) The present writ petition has been filed challenging the aforesaid letter of 7th April, 1986. We are informed that the Central Government has not so far passed any formal order pursuant to the aforesaid decision of the Specified Authority. As we read section 72A of the Act, it is quite evident that under sub-clauses (a) and (b) of section 72A, two conditions have to be fulfilled, namely, that the amalgamating company is not financially viable and secondly, the amalgamation has to be in the public interest. Under sub-section (1) of section 72A an application has to be filed if an amalgamation has already taken place. It is for this reason that the sub-clause of section 72A(1) refers to the financial viability of the amalgamating company with regard to the point of time which is immediately before the amalgamation. When an application u/s 72A(1) of the Act is filed, it is obvious that the same will be considered by the Specified Authority and the Central Government only after amalgamation has been given effect to. What sub-clause (a) of section 72A enjoins is that the effects of the amalgamation are to be ignored and the financial viability of the amalgamating company alone has to be considered as on the date immediately prior to the amalgamation. The said sub-clause further indicates that the amalgamating company should not be financially viable by reason of "its liabilities, losses and other relevant factors." It is evident, Therefore, that apart from the liabilities and losses, there can be other relevant factors also, which can lead one to the conclusion that the amalgamating company was not financially viable. It is not possible for any Court to enumerate in any great detail, if at all, the relevant factors which will show the non-viability of a company. Apart from the liabilities and losses, it is possible and this is recognised by the provision, that there may be various other factors which, when taken into consideration, can indicate about the financial viability of the amalgamating company.

(12) One of the important factors which has to be taken into consideration are

the cash losses. Even though on the date immediately preceding the amalgamation, the value of the assets may be more than the liabilities, but it may happen that because of recurring cash losses, the Specified Authority may come to the conclusion that the company is not financially viable. It was sought to be contended before us by Dr. Pal that even by applying the straightline method of calculating depreciation, and even if the book figures are accepted, the only conclusion which can be possibly arrived at, in the present case, is that Acci has not financially viable. He has submitted that in the year ending 1980, the networth of Aci as per the straightline method of calculating depreciation was Rs.1238 lacs. This figure due to losses came down to Rs.740 lacs in the year ending 1980-81 and as on 30th September, 1982, this figure has further come down to Rs.364 lacs. According to the learned counsel, the financial condition of the company was such that the substrate of the company was going down and the company which was solvent was repeatedly progressing towards insolvency. It was submitted by the learned counsel that the impugned order does not indicate that the Specified Authority had considered the aforesaid and other circumstances. Another factor in this connection which has been highlighted by the learned counsel is that in the year 1980 the profit of Acci was Rs.153 lacs which was soon converted to loss of Rs.533 lacs in the year 1981 and to a further loss of Rs.376 lacs in the year ending 1981-82. According to the petitioner, as per the ratio of the decision of the Supreme Court in *M & M*, the only conclusion possible in the present case was that Acci was financially not viable. He also contended that the respondents were not right in ignoring the written down value of the assets and in applying the straight-line method for the purpose of calculating the depreciation. The learned counsel submitted that, as we are concerned with the provisions of the Indian Income Tax Act which should be calculated. He further argued that under the tax laws it is always the provisions of Indian Income Tax Act which are applied for determining the written down value. The learned counsel has relied upon the provisions of the Income Tax Act and the rules framed there under in an effort to show that for determining the networth, the balance sheet figures are not final and they can be adjusted by determining the written down value as per the Income Tax Act.

(13) It is not necessary for us, at this stage, to give any finding as to whether the solvency of the company has to be determined by having regard to the depreciation as per the Income Tax Act or by taking the book value which has been arrived at by adopting straight-line method. "The reason is that the Specified Authority is a statutory body constituted under Explanation to section 72A of the Act. This authority discharges statutory functions, namely, that of making recommendations to the Central Government whether to making declaration u/s 72A or not. The recommendations so made have been subject of judicial review. This is evident from the decision of this Court in *Mahindra and Mahindra Ltd. and others Vs. Union of India and others*, , which was upheld by the Supreme Court in *Commissioner of Income Tax, Bombay and Others Vs. Mahindra and Mahindra Limited and Others*, . This Court as well as the Supreme

Court set aside the decision of the Specified Authority and issued directions to the Specified and the Central Government to decide the application de novo. This being so, it is incumbent, in our opinion, for the Specified Authority to pass a speaking order. The Specified Authority must indicate the reasons why it does or does not recommend a declaration to be made u/s 72A. It is clear that the Specified Authority is only a recommendatory body and the final decision has to be of the Central Government. If the Specified Authority recommends the grant of declaration u/s 72A, it is open to the Central Government after applying its mind, not to accept the recommendation. The Central Government obviously cannot apply its mind unless it knows the reasons, which weighed with the Specified Authority in making such a recommendation. Similarly, after the Specified Authority comes to the conclusion that the amalgamating company was financially viable or that the amalgamation was not in the public interest, then it would be incumbent upon the Specified Authority to give reasons for its conclusion.

(24) Some reasons were given by the Specified Authority in the case of Mahindra and Mahindra Ltd. which were examined by this Court and the Supreme Court. In the present case, however, the only reason given by the Specified Authority for not making the recommendation in favor of the petitioner is that according to the Specified Authority, Acci was solvent to the extent of Rs.3.65 crores as per the books of account on the date of amalgamation. As we have indicated, this is not the only criteria which is to be adopted. Solvency, no doubt, is relevant factor but when the solvency is repeatedly eroding, the Authority can legitimately come to the conclusion that company is no longer financially viable. Dr. Pal has drawn our attention to the fact that even by calculating the depreciation on straight-line method, the company continued to make cash losses and the solvency of Acci came to a minus figure from the year 1984 onwards. In the year ending 1982-83, the figure had come down from Rs.3.65 crores to only Rs.533 lacs and in the subsequent year this has become a minus figure of Rs.195 lacs in 1984 and Rs-395 lacs in 1985. This clearly establishes, according to the learned counsel, that as on 1st October, 1982 Acci was not financially viable. The impugned order in essence is a non-speaking order. It does not deal at length with the various contentions which had been raised by the petitioner, nor has it dealt with this aspect, namely, as to whether by seeing the result of immediately three preceding years, is the contention of the petitioner justified, namely, that Acci is financially non-viable. As noted by the Supreme Court in *M & M* (supra), an undertaking which is basically or potentially non-viable will ordinarily be incapable of revival and would face a closure. Therefore, it will be important to see as to what would be the position of the company, namely, Acci if it is not amalgamated. If but for amalgamation there would be closure of Acci, then the only conclusion which would be possible is that the Acci was financially not viable. In judging this, the frequency and the extent of cash losses is most important. The impugned order has not made any reference to the losses which Acci started incurring from the financial year ending 1981-82 onwards.

(25) While examining the application u/s 72A, the purpose and intent of insertion of the section has to be kept in view. Section 72A was enacted with view to provide an incentive to robust companies to take over and amalgamate with them companies which would otherwise become a burden on the economy. It is no doubt true that when a declaration u/s 72A is granted, the amalgamated company does receive benefits, in as much as it is able to take advantage of the unabsorbed depreciation and accumulated losses. But this is precisely the incentive which is given to the healthy companies and, we feel, that the legislative intent of giving such incentive should not ordinarily be set at naught. The Specified Authority and the Central Government should take an overall view of the matter and come to a pragmatic and practical conclusion as to whether the conditions specified in section 72A are satisfied or not. We may here note that where the provisions of Section 72A are not misused, there is further safeguard which are provided in section 272A of the Act. Once a declaration u/s 72A has been accorded, then before getting the benefit under the provision, the amalgamated company has to fulfill the conditions specified in sub-section (2) of section 72A. One of the important conditions stipulated in sub-section (2) of section 72A is obtaining of a certificate from the Specified Authority to the effect that adequate steps had been taken by the amalgamated company for the rehabilitation or revival of business of the amalgamating company. In other words, the benefit of section 72A will not be obtained if the sole idea of amalgamation was not the revival of the amalgamating company but was only to take benefit of the carry forward losses and unabsorbed depreciation. The revival of a sick unit or positive efforts in this 72A behalf are the pre-conditions to the benefits u/s being availed of. We, Therefore, feel that an application u/s 72A should be considered most sympathetically from a businessman's point of view. If a company has become commercially insolvent or is likely to become commercially insolvent, then every effort should be made to prevent such a situation from arising and if an amalgamation takes place and conditions under sub-section (1) of section are satisfied, then there is no reason as to why a declaration 72A should not be accorded.

(26) As already observed, the impugned order is for all practical purposes a non-speaking order. We, Therefore, issue a writ of mandamus quashing the decision of the Specified Authority contained in the impugned order dated 7th April, 1986 and we direct the said Authority to reconsider the matter in the light of the observations made in this judgment and give a fresh recommendation by a speaking order within four months from today and the Central Government shall pass an order in consequence thereof within one month of the recommendation of the Specified Authority. Pending the ultimate decision by the Central Government, the stay of further proceedings in relation to the assessment year 1984-85 to 1987-88 granted by our interim orders will continue.

(27) There will be no order as to costs.