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**(1990) 02 CAL CK 0050**

**In the Calcutta High Court**

**Case No : Income-tax Reference No. 258 of 1986**

Karala Valley Tea Co. Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

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**Date of Decision : 02-02-1990**

**Acts Referred:**

Income Tax Act, 1961 — Section 79

**Citation :** (1995) 1 ILR (Cal) 299 : (1990) 186 ITR 1

**Hon'ble Judges :** Bhagabati Prasad Banerjee, J;Ajit Kumar Sengupta, J

**Bench :** Division Bench

**Advocate :** N.K. Poddar, for the Appellant;A.C. Maitra, for the Respondent

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**Judgement**

Bhagabati Prasad Banerjee, J.—The following questions of law have been referred by the Income Tax Appellate Tribunal, "D" Bench, Calcutta, u/s 256(1) of the Income Tax Act, 1961, for the opinion of this court :

"(a) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the losses of the earlier years cannot be set off against the profits assessable for the assessment year 1978-79 in the case of the assessee because of the provisions of Section 79 of the Income Tax Act though there was no change in the shareholding during the previous year within the meaning of that section ?

(b) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that set off of past losses can be denied to the assessee u/s 79 of the Income Tax Act because of the change in its shareholding even where such change was effected with a view to avoiding or reducing any liability to tax ?

(c) Whether, on the facts and in the circumstances of the case, there was any material before the Tribunal to hold that the change in the shareholding of the assessee-company was effected with a view to avoiding or reducing any liability to tax within the meaning of Section 79 of the Income Tax Act, 1961 ?

(d) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in rejecting the assessee's claim for set off of the loss for the year 1976 against the profits of the year 1977 though there was no change in the shareholding within the meaning of Section 79 of the Income Tax Act after January 10, 1976 ?"

2. The facts relating to this case, shortly, are as follows : The assessment year in question is 1978-79 for which the relevant year of account is the year ending on December 31.

3. The assessee is a resident-company. It owns a tea garden and is engaged in the business of cultivation, manufacture and sale of tea. The assessee-company keeps accounts on mercantile basis. In the course of the assessment proceedings for the assessment year 1978-79, the Income Tax Officer noticed that there had been a change in the shareholding structure of the assessee-company. This change occurred on January 10, 1976, when more than 51 per cent, of the shares of the assessee-company, which were previously held by the Guha Roy Group stood transferred to the Mehra Group. The assessee-company had suffered substantial business losses when the company was held by the said Guha Roy Group. While making the assessment for the assessment year 1978-79, the Income Tax Officer intended to invoke the provisions of Section 79 of the Income Tax Act, 1961, and to deprive the assessee-company of the benefit of setting off in the current year, the business losses carried forward from the earlier years.

4. It was explained before the Income Tax Officer, on behalf of the assessee-company, that the change in the shareholding became necessary owing to continued losses suffered by it on account of depression in the tea market and lack of financial resources. It was, further explained by the assessee-company that the change in the shareholding took place not on the first day of the previous year under reference but on January 10, 1976. i.e., in the earlier year. The Income Tax Officer held that the assessee had tried to avoid or reduce its liability to tax because the new incoming shareholders owed very small amounts to the assessee-company as compared to its total liability to the bank and others. The Income Tax Officer also held that it was never clarified as to how the shares of the assessee-company changed hands through a private treaty bypassing the other claimants, such as banks. The Income Tax Officer was of the view that there was an obvious attempt on the part of the assessee-company to avoid or reduce the tax liability and ultimately held that the business losses of the assessee-company carried forward from the earlier years cannot be set off against its business income as assessed in the assessment year 1978-79 in question.

5. The assessee preferred an appeal to the Commissioner of Income Tax (Appeals) against the order of the Income Tax Officer.

6. The Commissioner of Income Tax (Appeals) held and observed that an

assessee cannot be deprived of the benefit of carry forward of business loss merely on the ground that there has been a change in more than 51% of its voting power, unless such change in the shareholding takes place with a view to avoid or reduce the tax liability. He also pointed out that conditions (a) and (b) of Section 79 are both cumulative in effect and unless both the conditions are affirmatively satisfied against the assessee-company, the benefit of carrying forward business loss cannot be deprived to an assessee. The Commissioner of Income Tax (Appeals) further held that, in the instant case, there was no doubt that the first condition of Section 79 was satisfied, inasmuch as there had been a change in the shareholding structure of the assessee-company in the sense that shares carrying more than 51% of the voting power which were previously held by the Guha Roy Group are now held by the Mehra Group. But the Commissioner of Income Tax (Appeals) held that the change in the shareholding had taken place in this case not with a view to reduce the tax liability but as a bona fide business transaction. The Commissioner of Income Tax (Appeals), accordingly, directed the Income Tax Officer to allow the assessee-company the benefit of setting off its brought forward losses in respect of the earlier years against its business income for the assessment year 1978-79, inasmuch as, in his view, Section 79 had no application in this case.

7. The Revenue filed an appeal against the said order to the Income Tax Appellate Tribunal. In reply, it was submitted by Mr. Poddar, on behalf of the assessee, that the assessee-company has placed all materials before the tax authorities below and the Commissioner of Income Tax (Appeals) had himself referred to such materials and had recorded a clear finding that the change in the shareholding of the assessee-company was effected due to severe financial crisis faced by it and such change was nothing but a bona fide business transaction. On the other hand, both the Income Tax Officer as well as the Tribunal merely relied on conjectures and did not appreciate the commercial of Income Tax (Appeals) (sic.). It was well-known in business circles that such changes in the controlling interest of a company always took place through private treaties and generally the bank did not take over a company for running it as a going concern. The person taking over need not necessarily be a creditor of the concern under take over. If this aspect was appreciated by the Income Tax Officer as well as by the Tribunal, it was clear, Mr. Poddar contended, that they would have been satisfied that the change in the shareholding in this case was not effected with a view to avoiding or reducing any liability to tax. The entire approach of the Tribunal, according to Mr. Poddar, was wrong as found later by the Supreme Court in Commissioner of Income Tax, Bombay Vs. Italindia Cotton Co. (P) Ltd., which fully supported the case of the assessee-company.

8. In the course of hearing before this court, Sri N. K. Poddar, advocate, appearing on behalf of the assessee-company, referred to the provisions of Section 79 of the Income Tax Act, 1961, as it stood all along at the relevant time. Section 79 reads as under :

"Carry forward and set-off of losses in the case of certain companies.-- Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless--

(a) on the last day of the previous year the shares of the company carrying not less than fifty-one per cent. of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent. of the voting power on the last day of the year or years in which the loss was incurred ; or

(b) the Income Tax Officer is satisfied that the change in the shareholding was not effected with a view to avoiding or reducing any liability to tax."

9. Mr. Poddar, learned counsel for the assessee, referred to the decision of the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Italindia Cotton Co. (P) Ltd.*, . In this case the Supreme Court held that the two conditions specified in Clauses (a) and (b) of Section 79 of the Income Tax Act, 1961, which applied to a company which is not a company in which the public are substantially interested, are intended to operate as alternative to one another. If the terms of either Clause (a) or Clause (b) are satisfied, the disqualification suffered by the company, by reason of a change in the shareholding in the relevant previous year, is removed and the company is entitled to the benefit of the provisions relating to carry forward and set-off of losses. The benefit is available notwithstanding the change in the shareholding in the previous year if the change was not effected with a view to avoiding or reducing any liability to tax. The Supreme Court also observed that there may be a change in the shareholding and it may result in change of control of the company, yet, every such change need not fall within the prohibition against the carry forward and set-off. The acquisition of control over a company provides a source of both direct and indirect financial benefit as well as power over its policies and activities. The change may, therefore, be effected for business and commercial reasons. On the other side, there can be a case where the change may be effected with a view to avoiding or reducing some liability to tax. Only in the latter case, the benefit of carrying forward business loss may be denied to a company. The Supreme Court in this case held that to avoid falling within the scope of Section 79, it was sufficient for the assessee to show that the case attracts either Clause (a) or Clause (b) and not both. If the assessee succeeds in doing so, he will be entitled to the benefit of the provisions of the Income Tax Act entitling him to claim a carry forward and set-off of losses suffered by the company in an earlier year.

10. Relying on the principles laid down by the Supreme Court in the said case, it was, inter alia, contended by Mr. Poddar, on behalf of the assessee-company, that the Tribunal in this case was clearly wrong in observing that the benefit of carrying forward losses can be denied to an assessee-company only if it was

found that there has been a change of more than 51% in the shareholding structure as laid down in Clause (a) of Section 79 of the said Act. This view of the Tribunal, Mr. Poddar, contended was clearly contrary to the principles laid down by the Supreme Court in *Commissioner of Income Tax, Bombay Vs. Italindia Cotton Co. (P) Ltd.*, for, unless such change is shown to have been effected with a view to avoid or reduce any liability to tax, the benefit of carry forward cannot be denied.

11. As regards the second condition mentioned in Clause (b) of Section 79, Mr. Poddar reiterated what has been found in this case by the Commissioner of Income Tax (Appeals). It was clearly recorded by the Commissioner of Income Tax (Appeals) that the change in the shareholding in the case of the assessee-company was effected as a bona fide business transaction. Admittedly, the assessee-company was suffering substantial losses year after year on account of a slump in the tea market and also on account of lack of proper management as Mr. B. C. Guha Roy, who was then managing the company, was seriously ill and he ultimately died in August, 1976. The assessee-company was also passing through a great financial crisis, as it could not repay the overdraft taken from the bank. The bank also had initiated civil and criminal suits against the company and its erstwhile directors which were pending in different courts. The bank also refused to extend overdraft facility to the assessee-company on the hypothecation of crops. In this situation, one of the creditors of the company, viz., the Mehra Group, came forward and purchased the controlling interest from the Guha Roy Group. Mr. Poddar, therefore, submitted that it was clearly a case of a bona fide commercial transaction and there was no intention to reduce or avoid any tax liability. It was further submitted that the Tribunal, in holding that the change in shareholding was effected in this case from the Guha Roy Group to Mehra Group, with a view to avoiding or reducing liability to tax, did not refer to any fact or material whatsoever on record. The Tribunal only referred to the inference drawn by the Income Tax Officer. Even the Income Tax Officer had no material before him, which could lead him to conclude that the change in the shareholding was effected with a view to avoiding or reducing any liability to tax. The Income Tax Officer only wondered as to how it was possible for a company to change hands through a private treaty bypassing the bank. Mr. Poddar submitted that the Income Tax Officer was not aware and did not appreciate the day-to-day realities of the business and the commercial world. The bank could not have been a claimant for the take-over of a business as a going concern. The business of the bank is to finance commercial activities. It is no part of the business of the bank to purchase and/or manage business concerns. As such, there was no question of any bypassing of the bank in this case. Further, take over need not be by a person who is already an existing creditor. Even a rank outsider could take over a concern which may have been financed by the bank. Merely because the bank was a major creditor of the assessee-company, it could not have taken over its management in its own hands. Mr. Poddar, therefore, submitted that this aspect was not properly appreciated either by the Income Tax

Officer or by the Appellate Tribunal. Apart from this, no other fact or material whatsoever was pointed out either by the Income Tax Officer or by the Tribunal to show as to how they were satisfied that the change in the shareholding in this case was effected with a view to avoiding or reducing any liability to tax. The assessee-company had placed all facts before the tax authorities and the Commissioner of Income Tax (Appeals) had appreciated all such facts and had recorded a clear finding to the effect that the change in the shareholding in this case was a bona fide business transaction. Mr. Poddar contended that the Tribunal had no material before it to reverse this finding of the Commissioner of Income Tax (Appeals).

12. Sri A. C. Maitra, learned counsel for the Revenue, submitted that the assessee-company in this case has not discharged the onus which lay on it to show that the change in the shareholding was not effected with a view to avoiding or reducing any liability to tax.

13. The Supreme Court in the case of Commissioner of Income Tax, Bombay Vs. Italindia Cotton Co. (P) Ltd., , held, at page 164, that "the object sought to be served by enacting Section 79 appears to be to discourage persons claiming a reduction of their tax liability on the profits earned in companies which had sustained losses in earlier years. It was not unusual for a group of persons to acquire a company which had suffered losses in the earlier years, in the expectation that the company would earn substantial profits after such acquisition, and they would benefit by a reduction of the tax liability on those profits on a set-off of losses carried forward from earlier years before the acquisition. The acquisition of a company in such a case would be effected by a change in its shareholding and the control over the company could be ensured by securing the beneficial ownership of shares carrying 51 per cent. or more of the voting power. If the change in the shareholding did not result in holding voting power of 51 per cent. or it was established that the shares of the company carrying not less than 51 per cent. of the voting power were beneficially held by the same persons, both on the last day of the previous year as well as the last day of the year or years in which the loss was incurred, it could be presumed that there was no change in the control over the company and the disqualification imposed on the company because of the change in its shareholding would stand removed.

14. But there may be a change in the shareholding and it may result in a change of control of the company. Yet, every such change of shareholding need not fall within the prohibition. There can be a case where persons already owning a shareholding carrying less than 51 per cent. of the voting power in the company may enlarge their shareholding during the previous year in order that control over the company may pass to them. Attempts to acquire control over a company by controlling a majority of the shareholding are not unknown. The acquisition of control over a company provides a source of both direct and indirect financial benefit as well as power over its policies and activities. On the

other side, there can be a case where the change is effected with a view to avoiding or reducing some liability to tax. The change is effected not for business or commercial reasons but in order that tax liability may be avoided or reduced. In that event, the change in the shareholding will tend to bring about the result which Section 79 was designed to prevent. In our opinion, to avoid falling within the scope of Section 79, it is sufficient for the assessee to show that the case attracts either Clause (a) or Clause (b). If the assessee succeeds in doing so, he will be entitled to the benefit of the provisions of the Income Tax Act, entitling him to claim a carry forward and set-off of losses suffered by the company in an earlier year or years against the income of the previous year. We are fortified in our conclusion by the view expressed by the Gujarat High Court in *Commissioner of Income Tax, Gujarat-III Vs. Shri Subhlaxmi Mills Ltd.*, , and by the Madras High Court in *Commissioner of Income Tax Vs. Saravanbhava Mills Pvt. Ltd.*, ."

15. In view of the observation made by the Supreme Court in this case, the Tribunal, in our view, was wrong in holding that the benefit of carrying forward losses can be denied to an assessee-company only if it was found that there has been change of more than 51% shareholding structure as laid down in Clause (a) of Section 79 of the said Act. Mere change in the shareholding is not the decisive factor. It may be mentioned that the change in the shareholding occurred on January 10, 1976, relevant to the assessment year 1977-78 and not 1978-79 which was the assessment year in question. There are also sufficient materials on record indicating the reasons for sustaining losses from year to year which could not be ignored. In our view, both the Income Tax Officer and the Tribunal were wholly wrong in holding that the change of shareholding of Guha Roy Group to Mehra Group was effected with a view to avoiding or reducing the tax liability. In view of the fact that, in view of the financial difficulties, the company was transferred to Mehra Group which was the creditor of the company for about Rs. 25 lakhs. When the creditor company came forward and purchased the controlling interest from the Guha Roy Group, it cannot be said to be a case of not a bona fide commercial transaction. In the facts and circumstances of the case, it is clear that there is no intention to reduce or avoid tax liability. In view of the above, questions Nos. 2 and 3 are answered in the negative and in favour of the assessee and, in the facts and circumstances of the case, there is no need to answer questions Nos. 1 and 4. There will be no order as to costs.

Ajit K. Sengupta, J.

16. I agree.