
(1978) 07 CAL CK 0059

In the Calcutta High Court

Case No : Income-tax Reference No. 106 of 1977

Shaw Wallace and Co. Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 25-07-1978

Acts Referred:

Income Tax Act, 1961 — Section 2(47), 45, 47

Citation : (1979) 119 ITR 399

Hon'ble Judges : Dipak Kumar Sen, J;C.K. Banerji, J

Bench : Division Bench

Advocate : Debi Pal and R.K. Murarka, for the Appellant;Ajit Sengupta, for the Respondent

Judgement

Sen, J.—The facts and the proceedings leading up to this reference are, inter alia, as follows. Shaw Wallace & Co. Ltd., the assessee, was at the material time the holding company in respect of the following subsidiary companies holding 100% of the shares of the later : (a) Atlas Fertilisers Ltd.; (b) Bengal Distilleries Co. Ltd., and (c) Indo-Agri. Ltd. Under schemes of arrangement arrived at by and between the assessee on the one hand and each of the said subsidiary companies on the other which were duly sanctioned respectively by this court in respect of Atlas Fertilizers Ltd. and Bengal Distilleries Co. Ltd. and by the Madras High Court in respect of Indo-Agri. Ltd., the said subsidiary companies were amalgamated with the assessee on the following terms and conditions :

(a) All the property, rights and powers of the subsidiary companies would be transferred to the assessee as from the 1st January, 1966, and vest in the assessee u/s 394(2) of the Companies Act, 1956,

(b) All liabilities and debts of the subsidiary companies would as from the said date be transferred to and become the liabilities and debts of the assessee.

(a) The assessee being the beneficial owner of the entire issued share capital there would be no issue of shares to the assessee.

(d) The subsidiary companies would within 21 days after the date of the order to be passed by the court cause a certified copy of the court's order to be delivered to the Registrar of Companies, West Bengal, for registration and on such certified copy being so delivered the subsidiary companies would be dissolved without winding up.

2. In the assessment year 1967-68, the previous year having ended on the 31st December, 1966, the assessee claimed a capital loss of Rs. 19,43,551 alleging that such loss had occurred on amalgamation of the said subsidiary companies with the assessee. The ITO held that the said claim was inadmissible u/s 47(vi) of the I.T. Act, 1961.

3. Being aggrieved, the assessee preferred an appeal to the AAC. The AAC held that no details of the said loss had been produced either before the ITO or in the appeal and that the claim was not substantiated. Accordingly, he confirmed the order of the ITO and disallowed the assessee's claim. He also held that the claim, in any event, was not admissible u/s 47 of the Act.

4. The assessee preferred a further appeal to the Tribunal. The assessee's contention before the Tribunal was that it was not correct that evidence substantiating the loss had not been produced in the assessment proceedings or before the AAC. It was contended further that in the instant case Section 47(vi) of the Act was not applicable inasmuch as the capital loss had occurred on the extinguishment of the rights of the assessee in the shares of the subsidiary companies as a result of the amalgamation. The extinguishment of such rights was for a consideration, being the net assets transferred to the assessee from the amalgamating companies. It was, therefore, contended that there was a transfer in the artificial and extended sense within the meaning of Section 2(47) of the Act and there was a consequent capital loss within the meaning of Section 45 of the Act inasmuch as the net assets of the amalgamating companies transferred to the assessee were much less in value than the value of their shares held by the assessee.

5. It was contended on behalf of the revenue on the other hand that there was no question of any capital gain or loss inasmuch as there was no transfer involved in the amalgamation and even if it be held that there was a transfer, the same came within the purview of Section 47.

6. The Tribunal, after consideration of the respective submissions and of the authorities cited, held that as a result of the scheme of amalgamation. the rights and liabilities of the amalgamating companies vested in the amalgamated company and there was extinction of the rights of the assessee in the share capital of the amalgamating companies. This transaction was similar to a transaction where a shareholder received his share of capital of his company on a final distribution of the net assets in liquidation thereof and there was no transfer of capital assets which would result in capital gain or loss. The appeal of the assessee was dismissed.

7. On the application of the assessee u/s 256(1) of the I.T. Act, 1961, the Tribunal has drawn up a statement of case and has referred for the opinion of this court the following question as a question of law arising from its order:

" Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the loss representing the difference between the cost of the shares held by the assessee in Atlas Fertilisers Ltd., Bengal Distilleries Co. Ltd. and Indo-Agri. Ltd. and the net assets taken over by the assessee from the respective companies as a result of the scheme of amalgamation cannot be allowed as a capital loss within the meaning of Section 45 read with Section 2(47) of the Income Tax Act, 1961 ? "

8. To appreciate the controversy, in the instant case, it is necessary to keep in view the relevant provisions of the statute. Section 2(47) of the I.T. Act, 1961, reads as follows :

" (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."

9. Section 45 of the Act reads as follows :

" 45. Capital gains.--(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53, 54, 54B, 54C and 54D, 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."

10. The relevant portion of Section 47 is as follows :

" 47. Transactions not regarded as transfer.--Nothing contained in Section 45 shall apply to the following transfers :--.....

(v) any transfer of a capital asset by a subsidiary company to the holding company, if-

(a) the whole of the share capital of the subsidiary company is held by the holding company; and

(b) the holding company is an Indian company ;

(vi) any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company ;

(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;....."

11. At the hearing. Dr. Debi Pal, learned counsel for the assessee, contended, that in the instant case the assets, rights and liabilities of the amalgamating companies were first transferred to and vested in the assessee. It is only thereafter that the amalgamating companies stood dissolved as provided for in the scheme. As a result of such dissolution the rights of the assessee in the shares of the amalgamating companies stood extinguished. This extinguishment of the rights of the assessee in the shares of the amalgamating companies, according to Dr. Pal, was a transfer within the meaning of Section 45 read with Section 2(47) of the Act and as a result of this transfer the assessee undoubtedly suffered a capital loss. The computation of such loss was the value of the net assets vesting in the assessee from the amalgamating companies minus the cost of acquisition of the shares.

12. Dr. Pal contended further that Section 47(vi) was not attracted in the facts and circumstances because the transfer on the basis of which the loss was being claimed was not the transfer of a capital asset by the amalgamating companies to the amalgamated company but the deemed transfer resulting from extinguishment of the rights of the amalgamated company in the shares of the amalgamating companies.

13. Dr. Pal finally contended that the facts in the present case were distinguishable from the liquidation of a company where a shareholder continued to exercise his rights as a shareholder till dissolution and participated in the distribution of the surplus assets of the company, if any, as a shareholder.

14. Mr. Ajit Sengupta, learned counsel for the revenue, contended on the other hand that where there was amalgamation there could not be any profit or gain to the shareholder unless there was an exchange of shares as a result of amalgamation. Mr. Sengupta contended further that if it be held that the transfer in the instant case was the extinguishment of the rights of the assessee in the shares of the amalgamating companies then as no consideration passed in such a transfer there would be no question of capital gain or loss.

15. In support of the respective contentions of the parties the following decisions were cited from the Bar which are considered hereinafter in their chronological order:

(a) *Bacha F. Guzdar Vs. Commissioner of Income Tax, Bombay*, . This decision was cited by Dr. Pal for the following observations of the Supreme Court defining the rights of a shareholder vis-a-vis the company (at p. 6 of ITR):

" There is nothing in the Indian law to warrant the assumption that a shareholder who buys shares buys any interest in the property of the company which is a juristic person entirely distinct from the shareholders. The true position of a shareholder is that on buying shares an investor becomes entitled to participate in the profits of the company in which he holds the shares if and when the

company declares, subject to the articles of association, that the profits or any portion thereof should be distributed by way of dividends among the shareholders. He has undoubtedly a further right to participate in the assets of the company which would be left over after winding up but not in the assets as a whole."

(b) Commissioner of Income Tax, Gujarat II Vs. R.M. Amin. (Legal representative of the Late Chunibai Amin), . The facts in this case were that as a result of the liquidation of a private limited company incorporated in Uganda the assessee who held 192 shares in the said company received a certain sum of money. It was found that the sum received by the shareholder exceeded the value of the said shares as on the 1st January, 1954. The revenue sought to treat the excess as capital gain chargeable to tax u/s 45 of the Act on the ground that it was profit or gain arising from relinquishment of a capital asset or the extinguishment of rights in the shares within the meaning of Section 2(47) of the Act. The Tribunal, however, held that the excess did not accrue to the assessee from relinquishment of any capital asset or extinguishment of any right therein and, therefore, there was no capital gains chargeable to tax. On a reference, the Gujarat High Court considered Section 2(47) and held that the words " any rights " in that section must be held to include all rights and, therefore, where a capital asset was incorporeal property consisting of nothing but a bundle of rights and all such rights were extinguished, the expression " extinguishment of any rights therein" in the said section was satisfied. The word " therein " meant nothing more than the rights " in the capital asset ". The High Court also held that the transfer contemplated by Section 45 read with Section 2(47) was a transfer as a result of which consideration was received by the assessee or accrued to the assessee. Only where an element of consideration was involved in the extinguishment of rights in the capital asset; it would be a transfer exigible to capital gains tax. The High Court observed as follows (at p. 203 of 81 ITR):

" Substituting the words " extinguishment of any rights in the capital asset" for the "words "transfer of the capital asset", the transaction, in order to attract the charge of tax as capital gains, must, therefore, be such that consideration is received by the assessee or accrues to the assessee as a result of the extinguishment of the rights in the capital asset. There must be an element of consideration for the extinguishment of the rights in the capital asset. Then only would it be a transfer exigible to capital gains tax. Now, as we have already pointed out above, 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 the share. The share merely represents the 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. We are, therefore, of the view that when a shareholder receives his share on final distribution of the net assets of the company in liquidation, there is no transfer of capital asset by him which would attract the charge of capital gains tax u/s 45." (c) Commissioner of Income Tax, Bombay City II Vs. Rasiklal Maneklal (H.U. F.), Bombay, . The facts in this case were, inter alia, that the assessee, a HUF, at the material time held 90 shares of the face value of Rs. 100 each in a company known as Shorrock Spinning and Manufacturing Co. Ltd. During the assessment year in question the said Shorrock Spinning and Manufacturing Co. Ltd. was amalgamated with another company known as New Shorrock Spinning and Manufacturing Co. Ltd. Under the scheme, the undertaking and all the property, rights and powers of the first Shorrock company were transferred to and vested with effect from 1st January, 1960, in the New Shorrock company and, similarly, liabilities and duties of the first Shorrock company were transferred with effect from the same date to the new Shorrock company. The scheme provided for an increase in the share capital of the new Shorrock company and permitted a further issue of 14,625 ordinary shares of the face value of Rs. 125 each. These new shares were to rank pari passu with the existing shares of the new Shorrock company and, under the scheme, the new Shorrock company was directed to allot to the shareholders of the Shorrock company at the rate of one share in the new Shorrock company for every two shares of the Shorrock company. The assessee, accordingly, received 45 shares of the new Shorrock company. This exchange of shares resulted in a profit to the assessee and the revenue sought to tax the same as capital gains. The Tribunal, however, held that as a result of such amalgamation there was neither a sale nor a transfer by way of an exchange, and also held that there could be no relinquishment implying existence of some property to be relinquished. In that case, the assessee's shares in the old company ceased to exist, and, therefore, there could be no relinquishment and, accordingly, the assessee was not liable to be taxed for capital gains. On a reference, the Bombay High Court held that the assessee had not given up, surrendered or abandoned or even relinquished his interest in the shares. By reason of the order of the court the assets and liabilities of the amalgamating company were transferred to the new Shorrock company and, thereafter, the amalgamating company was directed to be dissolved and it ceased to exist. Therefore, there was no question of the assessee relinquishing his interest in the shares of that company, and consequently, the allotment of shares of the new Shorrock company to the assessee, though caused by the assessee's holding shares in the amalgamating company, was neither a transaction of exchange nor relinquishment and, therefore, the gain, if any, resulting therefrom was not liable to be taxed as capital gains.

(d) Central India Industries Ltd. Vs. Commissioner of Income Tax, . The facts in,

this case were, inter alia, that the assessee held certain shares in two companies which were amalgamated with a third company under a scheme of amalgamation approved by the High Court. As a result of the amalgamation the shareholders in the said two amalgamating companies received shares in the third company in a prescribed proportion to their shares held in the amalgamating companies. The assessee claimed that on such amalgamation it had sustained a capital loss. The shares of the amalgamating companies were not quoted on the stock exchange and if their value was computed by the break-up method, then the said shares on the date of the amalgamation were worth much more than the market value of the equivalent shares of the third company as allowed under the scheme.

On a reference, this court held that on the facts there was transfer of the shares" of the assessee in favour of the third company which resulted in a capital loss to the assessee u/s 12B of the Indian I.T. Act, 1922.

(e) The Commissioner of Income Tax, Gujarat II, Ahmedabad Vs. Shri R.M. Amin, L.R. of The Late Shri. Chunnibhai J. Amin, Baroda, . Here the Supreme Court affirmed the decision of the Gujarat High Court in Commissioner of Income Tax, Gujarat II Vs. R.M. Amin. (Legal representative of the Late Chunibai Amin), . The Supreme Court reiterated its observations made in Commissioner of Income Tax, Madras Vs. Madurai Mills Co. Ltd., as follows (at p. 373 of 106 ITR) :

" 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 Supreme Court further observed as follows:

" 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."

(f) Commissioner of Income Tax Vs. Vania Silk Mills (P.) Ltd., . The facts in this case were that the assessee, a company, had purchased machinery and hired it out to a mill at an annual rent. During the relevant assessment year, the machinery at the mill was damaged by fire beyond repairs. The mills had insured the machinery and on a settlement of the insurance claim, received an amount, a part of which was paid by the mills to the assessee. The cost price of the machinery was Rs. 2,81,741. The written down value thereof in the books of the assessee was Rs. 2,62,781 and the assessee received a sum of Rs. 6,32,533 from the mill out of the insurance claims. The question arose as to what extent, if at all, the assessee was liable to be taxed for capital gains. On a reference, the Gujarat High Court held that the expression " extinguishment" as appearing in Section 2(47), in its ordinary meaning, included destruction or demolition and that there was nothing in the subject or context of the section to cut down the

wide operation of its meaning. The High Court further held that u/s 45 real profits arising from such transactions would be brought to tax inasmuch as capital gain was the difference between the net consideration for the demolition or destruction and the original cost of acquisition and cost of improvement in the asset. Dr. Pal relied on the following observations of the High Court at p. 312 of the report:

" It follows from the foregoing discussion that the Legislature, in order to effectuate its intention, has deliberately chosen the language of widest amplitude by using the expression "the extinguishment of any rights therein " in Section 2(47). It covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the bundle of rights --qualitative or quantitative--which the assessee has in capital asset, whether such asset is corporeal or incorporeal."

16. It appears to us that the controversy in the present reference is solved by the sections involved. It is clear from Section 45 that a capital gain, in the negative sense a capital loss, can only occur from the transfer of a capital asset. A transfer always involves more than one party. There cannot be a transfer from a person to himself. In this view, the expression " or the extinguishment of any rights therein " in Section 2(47) must mean the extinguishment of rights as a result of some operation involving more than one person. Both the Gujarat High Court and the Supreme Court observed that a consideration must be involved in a transfer before there can be any capital gain or capital loss.

17. In the instant case, under the scheme, there has been, firstly, a transfer of the capital assets of the amalgamating companies to the amalgamated company. This part of the scheme, in our opinion, is clearly covered by Section 47(vi) of the Act and there cannot be any capital gain or loss arising from such a transfer because the section excludes this type of transfer from the ambit of Section 45. The scheme further provides for the subsequent dissolution of the amalgamating companies. This part of the scheme involves an operation where we fail to find any element of transfer. The dissolution takes place by operation of the scheme sanctioned by law and as a result of this dissolution the rights of the assessee, if any, remaining in the shares of the amalgamating companies come to an end. If we keep these two parts of the scheme in watertight compartments as has been suggested by Dr. Pal then the extinguishment of the rights of the assessee in the shares in the instant case does not involve either a transfer involving another person or any consideration passing as a result thereof. There can, therefore, be no question of capital gain or loss though there may be an extinguishment of rights.

18. On the other hand, if we do not keep the two parts of the scheme separately, then the extinguishment of the rights in the said shares is inextricably linked with the transfer of the capital assets of the amalgamating companies to the amalgamated company. u/s 47(vi) such a transaction has to be excluded from the operation of Section 45, and there cannot be any capital gain or loss.

19. Looking at the matter from another angle, 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 Section 47(v) of the Act and again be excluded from the operation of Section 45.

20. 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.

21. For the reasons above, the revenue succeeds in this reference. The question is answered in the affirmative. There will be no order as to costs.

Banerji, J.

22. I would like to add a few words on the scope and effect of amalgamation of companies. u/s 394 of the Companies Act, 1956, when a scheme of amalgamation is sanctioned by the court, the following provisions are made for carrying out the scheme :

(i) the transfer to the transferee-company of the whole or any part of the undertaking, property or liabilities, of the transferor-company;

(ii) the allotment or appropriation by the transferee-company of the shares, debentures, policies" or other like interests in the company which, under the compromise or arrangement, are to be allotted or appropriated by that company to or for any person;

(iii) the continuation by the transferee-company of any legal proceedings pending by or against the transferor-company ;

(iv) the dissolution, without winding up, of the transferor-company;

(v) the provision to be made for any person who, within such time and in such manner as the court directs, dissents from the compromise or arrangement.

(vi) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out.

23. The scheme also makes provisions for acquisition by the transferee-company of the shares of shareholders who dissent to the scheme or do not assent to transfer their shares in the transferor-company to the transferee-company and elaborate provisions in that behalf are contained in Section 395 of the Companies Act, 1956. In the instant case, under the schemes of amalgamation as

sanctioned by the court, the whole of the undertakings, properties and assets of the transferor-companies were transferred to and vested in the assessee as the transferee-company and the transferor-companies were ultimately dissolved. The schemes of amalgamation as sanctioned in the instant case specifically provided that the assessee being the beneficial owner of the entire issued share capital of the transferor-companies there would be no issue of shares to the assessee.

24. The legal effect of the said amalgamations was that not only the transfer or companies were joined with the assessee but they were also absorbed into and blended with the assessee.

25. The assessee as a shareholder of the transferor-companies had certain very limited rights flowing from the shares which primarily were :

(1) Participation in the dividend of the transferor-companies when declared.

(2) Right to take part in the management of the transferor-companies by voting in the meetings of the transferor-companies and on certain specified circumstances and on fulfilment of certain specified conditions could call an extraordinary general meeting by requisition.

(3) Participation in the capital of the transferor-companies on liquidation.

26. Keeping in view the above legal position let us now consider whether it could be said in the instant case that any of the above rights of the assessee as a shareholder of the transferor-companies were extinguished by the said schemes of amalgamation.

27. The entire profits that might be earned by or through the undertakings, assets, rights and powers of the transferor-companies would become the profits of the assessee and thus there was no extinguishment of the right of the assessee to participate in the dividends of the transferor-companies but enlargement of such right of participation.

28. In managing its own affairs the assessee would also be solely managing the entire affairs of the transferor-companies, and, therefore, there was no extinguishment of the right of the assessee as a shareholder to take part in the management of the transferor-companies but again enlargement of such right.

29. The entire capital and assets of the transferor-companies having vested in the assessee, as a result of the said amalgamations, the assessee became the sole owner of the capital of the transferor-companies. There was, therefore, no extinguishment of the right of the assessee in participating in the capital on the liquidation of the transferor-companies.

30. The assessee was a party to the said schemes of amalgamation and consented and agreed to the same whereunder, as noted earlier, no shares were to be issued to the assessee in lieu or exchange of the shares held by it in the transferor-companies. The shares held by the assessee in the transferor-companies represented the capital invested by the assessee in the said

companies and by the said amalgamations the assessee became the sole owner of the entire capital of the transferor-companies. By virtue of the said amalgamations the assessee as the transferee-company became the sole repository of all the rights which flowed from or were imbedded in the shares held by the assessee in the transferor-companies.

31. For all the above reasons, there was no extinguishment of any right of the assessee as holder of the shares in the transferor-companies.

32. On all other aspects of this case, I fully agree with the reasonings and conclusions of my learned brother and I agree that the question referred should be answered in the affirmative and in favour of the revenue.