

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 26.06.2012

CORAM:

THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN
and
THE HONOURABLE MR.JUSTICE K.RAVICHANDRABAABU

Tax Case (Appeal) Nos.1311 and 1312 of 2005

M/s.EID Parry (India) Limited
'Dare House'
#234, NSC Bose Road
Chennai-600 001. .. Appellant in both T.Cs

versus

The Dy. Commissioner of Income Tax
Special Range-I
Chennai-600 034. .. Respondent in both TCs

PRAYER: Tax Case Appeal Nos.1311 and 1312 of 2005 is filed under Section 260A of the Income Tax Act against the order of the Income Tax Appellate Tribunal, 'A' Bench, Chennai dated 29.03.2005 made in I.T.A.Nos.209 and 210(Mds)/1999.

For appellant : Mr.M.P.Senthil Kumar
For respondent : Mr.T.R.Senthil Kumar
Standing Counsel for Income Tax

JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

The assessee is on appeal as against the order of the Income Tax Appellate Tribunal in respect of the assessment year 1994-95 and 1995-96. The following are the substantial questions of law raised in the Tax Case Appeal filed by the assessee T.C.(A) No.1311 of 2005:

- (i) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the investment allowance cannot be carried forward? and
- (ii) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that as per the Explanation 2 to Clause (c) of Section 43(6), the unabsorbed depreciation of FGCL - Amalgamating Company cannot be added to the written down value?

2. The following substantial questions of law are raised in T.C.(A) No.1312 of 2005:

- (i) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that as per the Explanation 2 to Clause (c) of Section 43(6), the unabsorbed depreciation of FGCL - Amalgamating Company cannot be added to the written down value?
- (ii) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in upholding disallowance of deduction under Section 35D in respect of issuance of euro shares? And
- (iii) Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding, on the alternative claim of treating the expenditure under Section 37, that the euro issue expenses should be disallowed as capital expenditure?

3. The Tribunal passed a common order in the assessee's appeal and in the Revenue's appeal. The present appeal in T.C.(A) No.1311 of 2005 is in respect of the orders passed in the assessee's appeal, regarding the written down value to be arrived at the hands of the amalgamated company, the assessee herein. It is seen from the facts herein that M/s.Falcon Gulf Ceramics Limited was amalgamated with the assessee company with effect from 1.4.1993. In arriving at the written down value of the assets at the hands of the amalgamated company, namely, the assessee herein, the Assessing Authority noted that the assessee had made the written down value based on the decision of the Bombay High Court reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)). The assessee contended that as per Section 43(6) Explanation 2(b), the written down value of the assets at the hands of the amalgamated company would be the written down value of the assets at the hands of the amalgamating company. In other words, the written down value at the hands of the amalgamated company would be the written down value as arrived at by the actual cost of the assets as reduced by the depreciation actually allowed to the amalgamating company. Placing emphasis on the provisions of Section 43(6) Explanation 2(b), the assessee submitted that as held in the decision of the Bombay High Court referred to above, Explanation 3 to Section 43(6) has no relevance in the matter of arriving at the written down value of the assets and the assessee had properly computed the value of the assets taken over from the amalgamating company by adding the unabsorbed depreciation to the written down value of the assets. The assessee contended that Section 72A has no relevance to the case.

4. The Assessing Authority, however, rejected the plea, by holding that the decision of the Bombay High Court was rendered prior to the amendment to Explanation 2 to Section 43(6) under the Taxation Law Amendment Act, 1986, which was effective from 1.4.1988. The Assessing Officer pointed out that the new Explanation 2 clearly stated that the written down value of the stock of assets of the amalgamating company would be the actual cost of the asset minus the amount of depreciation actually allowed in relation to the preceding previous year before the date of amalgamation. Considering the difference in the provision of law, there was no scope of any adjustment to be made in the written down value as appearing in the books of accounts of the amalgamating company. In the circumstances, the Assessing Authority pointed out that the carry forward and set off of accumulated loss and unabsorbed depreciation of the amalgamating company on the amalgamated company would be available to the amalgamated company only on satisfying the conditions enumerated under Section 72A. The Assessing Officer pointed out that the assessee had made a back-door entry to claim unabsorbed depreciation of the amalgamating company through Explanation 2A and Explanation 3, which was not permissible. Apart from this issue, the Tribunal also considered the claim of carry forward of the investment allowance under Section 32A. The Assessing Authority pointed out that in the absence of any of the stipulations provided for under the sub section not being satisfied by the amalgamating company, the assessee was not entitled to have the benefit under Section 32A(6). The Assessing Authority pointed out that the assessee failed to produce any evidence that the amalgamating company was allowed investment allowance at Rs.1,31,99,650/-. There being no such evidence, the relief sought for under Section 32A(6) was rejected.

5. As far as the assessment order relating to the assessment year 1995-96 in T.C.(A) No.1312 of 2005 is concerned, apart from the issue of Section 43(6), the assessment also considered the deduction under Section 35D. A perusal of the order of assessment shows that a sum of Rs.47,67,581/- represented expenses on global deposit receipt of 47,67,581 ordinary shares. The Directors' Report, which is discussed in the assessment order, reveals that the initial results of the neem based pesticides produced from the assessee's plant was encouraging and necessary registration in India had been obtained for marketing the product. In the meantime, the assessee had plans for setting up of a plant on commercial basis. The note further pointed out that the company had gone in for issue of global shares, principally for financing new projects and expansion of existing facilities of the company, which were described as the company capital expenditure - new project.

6. Pointing out that the projects would require approval from Government bodies, the assessee issued global deposit receipts. Pending clearance for the new projects, the company had invested in certain investments. Thus the brochure clearly pointed out to the plan of the company in raising the capital. The Assessing Authority viewed that the money realised from Euro issue was mainly utilised in increasing its investments; consequently, the expenses relating to the raising of the shares was not entitled for deduction under Section 35D.

7. The assessee went on appeal in respect of both assessment years before the Commissioner of Income Tax (Appeals). In considering the issue on the written down value, the

Commissioner of Income Tax (Appeals) viewed that the decision of the Bombay High Court relied on by the assessee related to the pre-amendment provisions; consequently, the order of the Officer could not be faulted with.

8. As regards the investment allowance, which the assessee wanted to carry forward, the Commissioner rejected the contention of the assessee. So too the issue on amortization of expenses relating to the issue of Euro shares. On appeal before the Tribunal, the assessee once again failed. Hence the present appeal before this Court.

9. Learned counsel appearing for the assessee placed reliance on the decision of the Bombay High Court reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)), the decision reported in [2010] 324 ITR 29 (Mad) (Commissioner of Income-tax v. Silical Metallurgic Ltd.), after the amendment, which relates to the assessment year 1992-93 as well as the decision reported in [2009] 310 ITR 392 (SC) (Commissioner of Income-tax Vs Doom Dooma India Ltd.) and submitted that irrespective of the amendment to sub section (2), the decision of the Bombay High Court reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)) would still have relevance for the purpose of considering whether Explanation 3 would have to be read into Explanation 2 for the purpose of arriving at the written down value at the hands of the assessee, the amalgamated company. Pointing out to the provisions under Section 72A that the carried forward depreciation is deemed to be the depreciation of the previous year at the hands of the amalgamated company, subject of course, to other conditions to be satisfied therein, learned counsel submitted that for the purpose of arriving at the written down value at the hands of the amalgamated company - the assessee herein, the written down value shall be one which would be arrived at, at the hands of the transferor company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. Thus the actual cost of the above block of assets of the transferee company shall be the written down value of the block of assets at the hands of the transferor company as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. Explanation 3 is relevant only in respect of the carried forward depreciation as granted under Section 32(2) and what is contemplated under Explanation 3 is the carried forward depreciation which is deemed to have been actually allowed and has nothing to do with Explanation 2. In the context of the provisions thus read and in the background of the decision of the Bombay High Court, he submitted that the Tribunal committed a serious error in accepting the view of the Revenue.

10. As far as the carry forward of the investment allowance is concerned, even though the assessee raised an issue, yet, he could not place any material to show that the amalgamating company did, in fact, make any claim of having deposited any amount, as contemplated under Section 32A(6).

11. As far as the issue of Euro share is concerned, learned counsel pointed out to the note which explained the purpose of raising the Euro shares. Considering the fact that the Euro

shares were for increasing the base of the capital of the company for expansion as well as for new projects, the expenditure has to be necessarily considered in the context of the purpose for which it was done.

12. Per contra, learned Standing Counsel supported the order of the Tribunal and in turn, the order of the Assessing Officer.

13. Heard learned counsel appearing on either side and perused the material placed on record.

14. Section 43 of the Income Tax Act provides the definition of certain terms relevant to the profits and gains of business or profession. Section 43(1) provides for definition of "actual cost". Section 43(6) gives the definition of "written down value". As far as the assets which are transferred under the scheme of amalgamation or merger is concerned, Explanation 2 of sub section (6) is relevant. Explanation 2 substituted the original Explanation 2 and 2A by the Taxation laws (Amendment and Miscellaneous Provisions) Act, 1986 with effect from 1.4.1988. Explanation 2A was later on inserted by Finance Act, 2000 with effect from 1.4.2000. In the case before us, we are concerned about Explanation 2 only and Explanation 2A, dealing with demerger, has no relevance to the facts of the case. Explanation 2 and 3 read as under:

" Explanation 2.--Where in any previous year, any block of assets is transferred,--

(a) by a holding company to its subsidiary company or by a subsidiary company to its holding company and the conditions of clause (iv) or, as the case may be, of clause (v) of section 47 are satisfied; or

(b) by the amalgamating company to the amalgamated company in a scheme of amalgamation, and the amalgamated company is an Indian company, then, notwithstanding anything contained in clause (1), the actual cost of the block of assets in the case of the transferee company or the amalgamated company, as the case may be, shall be the written down value of the block of assets as in the case of the transferor- company or the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.

Explanation 3.--Any allowance in respect of any depreciation carried forward under sub-section (2) of section 32 shall be deemed to be depreciation "actually allowed". "

15. A reading of Explanation 2 shows that in the case of an amalgamation, the cost of the block of assets at the hands of the amalgamated company would be the written down value of the block of assets of the amalgamating company for the immediately preceding previous year, after the amount of depreciation actually allowed in relation to the said preceding previous year.

16. Before going into the said explanation in depth, we need to consider the decision reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)) which considered a question similar to the one on hand. The Bombay High Court reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)) deals with the issue relating to assessment years 1975-76 and 1979-80. The

question raised therein in that case was with reference to the written down value of the assets on the amalgamation of companies. The Bombay High Court considered the scope of Explanation 2A, as it stood then, prior to the substitution, under the Taxation Laws (Amendment and Miscellaneous Provisions) Act, 1986, with effect from 1.4.1988 and Explanation 3, which remain unchanged and hence, relevant for the present year under consideration.

17. Before going into the decision of the Bombay High Court, it is necessary that we extract Explanation 2A and Explanation 3 relevant to the assessment years considered in the Bombay judgment reported in [1991] 187 ITR 1 (Commissioner of Income-tax Vs Hindustan Petroleum Corporation Ltd. (Bom)):

" Explanation 2A. -Where, in a scheme of amalgamation, any capital asset is transferred by the amalgamating company to the amalgamated company, and the amalgamated company is an Indian company, the written down value of the transferred capital asset to the amalgamated company shall be taken to be the same as it would have been if the amalgamated company had continued to hold the capital asset for the purposes of its business.

Explanation 3. -Any allowance in respect of any depreciation carried forward under sub-section (2) of section 32 shall be deemed to be depreciation 'actually allowed'."

18. The facts were that L company was amalgamated with the assessee company in July, 1974. At the hands of the amalgamating company, at the end of the previous year relevant to the assessment year 1974-75, depreciation allowance of Rs.21,42,815/- remained unabsorbed. In the assessment for 1975-76, the assessee amalgamated company claimed depreciation on the written down value of the assets. The Income Tax Officer determined the written down value by reducing from the actual cost, not only the depreciation actually allowed, but also the depreciation carried forward, and allowed depreciation on that basis. On the question as to whether the Officer was correct in working out the written down value by taking into account the unabsorbed depreciation also, the Bombay High Court held that as the amalgamated company was no longer in existence, the unabsorbed depreciation allowance of Rs.21,42,825/- could not be carried forward under Section 32(2); as such, it was not allowable as a depreciation of the current year under Section 32(2) in the hands of the assessee.

19. Thus Explanation 3 was not attracted to the present case. The Bombay High Court pointed out that going by Explanation 2A, the written down value of the assets at the hands of the amalgamated company would be the actual cost of the assets to the amalgamating company, less depreciation actually allowed to the company. The unabsorbed depreciation, which was not to be set off for carry forward, could not be taken into account.

20. In coming to the conclusion, the Bombay High Court pointed out that the legal position about the unabsorbed depreciation is that, under normal circumstances, it is not carried forward as such, but is added to the depreciation for the following previous year and deemed to be a part of that allowance. This would be possible only if the assessee continued to carry on the business in the following years. Thus, when the company is not in existence, the unabsorbed depreciation could not, under Section 32(2), be treated and/or allowed as depreciation of the current year.

21. The Bombay High Court further pointed out that the main purpose of Explanation 3 was to avoid an anomaly, which would have otherwise resulted, but for Explanation 3. After narrating the anomalies that Explanation 3 seeks to cure, the High Court further pointed out that the fiction created in Explanation 3 operates in a particular situation, i.e., a case in which any allowance in respect of any depreciation is carried forward under Section 32(2). In the context of the fact that the amalgamating company is no longer in existence, the situation necessary for the application of the fiction did not arise. Thus the High Court pointed out that the case therein had to be approached independent of Explanation 3, which had no relevance to the case. As per Section 43(6)(b), the written down value is the actual cost of the asset to the assessee, less depreciation actually allowed. The expression "actually allowed" means not including notional allowance, vide [1966] 60 ITR 165 (SC) (CIT Vs. Dharampur Leather Co. Ltd.). Read with Explanation 3, it would mean the actual cost reduced both by depreciation allowed and depreciation notionally allowed i.e., carried forward under Section 32(2). Referring to Explanation 2A, the Bombay High Court held that the written down value of the assets taken over by the amalgamated company during the previous year, would be the written down value of the amalgamating company, if it had continued to hold the assets for its business. Thus Explanation 2A created a fiction that the amalgamating company could be deemed to hold the assets and for the limited purpose of arriving at the cost of the assets at the hands of the amalgamated company, the written down value at the hands of the amalgamating company is adopted. Beyond this fiction, Explanation 2A did not travel further to consider the unabsorbed depreciation, a position which is considered only under Explanation 3.

22. Referring to Section 72A, the Bombay High Court pointed out that in cases falling under Section 72A, Explanation 3 would undoubtedly apply as a pre-condition, that the unabsorbed depreciation in the hands of the amalgamating company could be carried forward under Section 32(2) in the hands of the amalgamated company. Thus, the Bombay High Court held "it would be in order if Explanation 3 is applied to a case covered by Explanation 2A only if the pre-condition for its application is found to exist and not otherwise. Even otherwise, applying the provisions of Explanation 3 to a case like the one before us in which allowance in respect of a depreciation is not actually carried forward, is likely to cause injustice. Thus, Explanation 3 was not attracted to the case and the written down value of the assets would be the actual cost of the assets to the amalgamating company, less depreciation actually allowed to the company and the unabsorbed depreciation, which is not to be set off or carried forward should not be taken into account. "

23. As far as the present case is concerned, it is no doubt true that Explanation 2 is not similarly worded as Explanation 2A, which was considered by the Bombay High Court. The provisions contained in Explanation 2, applicable to the present case, in fact, brings out the intention better and is crisp in its language, as is evident from a reading of Explanation 2. As per Explanation 2, the actual cost of the block of assets at the hands of the amalgamated company is "the written down value of the block of assets" as in the case of the transferor company or the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said immediately preceding previous year. The use of the phrase "for the immediately preceding previous year"

with reference to the written down value at the hands of the transferor company and the amount of depreciation actually allowed assumes significance in understanding what should be the cost of the block of assets at the hands of the amalgamated company.

24. Section 2(34) defines "previous year" to mean a "previous year" as defined in Section 3. Section 3 defines "previous year" as a financial year immediately preceding the assessment year. "Assessment year" is defined under Section 2(9) to mean the period of 12 months commencing on the 1st day of April every year. Thus, with "previous year" definition on hand to mean the financial year starting from 1st April to 31st March of a particular year, the phrase used in the Section, as referable to the written down value of the block of assets in the hands of the transferor amalgamating company, is the written down value of the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year. Thus the emphasis herein is the value available in the immediately preceding previous year and the depreciation actually allowed in relation to the said preceding previous year.

25. The case on hand relates to the assessment years 1994-95 and 1995-96. Taking assessment year 1994-95, the previous year for this assessment would be 1993-94 i.e., from 1.4.1993 to 31.3.1994. The term "preceding" the previous year means, "earlier than the previous year or going before the previous year." Thus, as far as assessment year 1994-95 is concerned, with the previous year 1993-94, the immediate preceding previous year would be 1992-93. Thus the written down value arrived at during 1992-93 after actually allowing the depreciation in 1992-93 would be the written down value at the hands of the transferor company. In other words, the written down value as on 1.4.1993 would be the actual cost of the block of assets at the hands of the amalgamated company. It means, the Written Down Value as on 01.04.1993 would include the unabsorbed depreciation at the end of 31.03.1994. Thus, in considering what is the depreciation actually allowed, the reasoning of the Bombay High Court thus assumes significance, that the written down value at the hands of the amalgamating company has to be taken as one arrived at on the depreciation actually allowed and the written down value would be as in the immediate preceding previous year. Short of repetition, we would say, in respect of the assessment year 1994-95, the previous year being 1993-94, the written down value as on 1.4.1993, which would be the written down value as of 1992-93, wherein, the depreciation is actually allowed, shall be taken to be the actual cost of the block of assets of the amalgamated company.

26. As far as assessment year 1995-96 is concerned, the previous year being 1994-95, the immediately preceding previous year would be 1993-94. Hence, the written down value arrived at after actually allowing the depreciation in 1993-94 shall be the opening written down value on 1.4.1994 and this shall be the actual cost of the assets at the hands of the amalgamated company. Thus, going by the above-said provisions and applying the Bombay High Court decision, with which we agree, we have no hesitation in accepting the plea of the assessee, and answer the question that Explanation 3 has no relevance in working out the written down value of the block of assets at the hands of the amalgamated company that the working has to be as per Explanation 2 to Clauses 3 of Section 43(6). In the circumstances, we accept the contention of the assessee and allow the Tax Case.

27. In the background of the said discussion, which was also applied by this Court in the decision reported in [2010] 324 ITR 29 (Commissioner of Income-tax v. Silical Metallurgic Ltd.), we agree with the assessee's contention that the written down value of the assets at the hands of the amalgamated company will be the written down value at the hands of the amalgamating company for the immediate preceding previous year arrived at after reducing the depreciation actually allowed in the said preceding previous year and Explanation 3 will have no relevance for the purpose of finding out the written down value of the amalgamating company, which, in turn, is that of the amalgamated company. In thus arriving at the value, the question of a further reduction by invoking Explanation 3 does not arise. In the light of the above discussion, one has to see the scope of Section 72A.

28. Section 72A is a specific provision to deal with cases of carry forward and set off of accumulated loss and unabsorbed depreciation allowance in cases of amalgamation or demerger. As per sub section (1), the accumulated loss and unabsorbed depreciation of the amalgamating company is deemed to be the loss or the allowance of depreciation to the amalgamated company for the previous year in which the amalgamation is effected. Unabsorbed depreciation is defined in the Explanation to mean share or allowance of an amalgamating company which remains to be allowed and it would have been allowed to the amalgamating company under the provisions of the Act as if the amalgamation had not been effected. The benefit available under Section 72A was also considered by the Bombay High Court. Going by the reasoning, we have no hesitation in agreeing with the same.

29. As far as the issue relating to the investment allowance is concerned, on the facts found by the Tribunal that the transferor company had not created any reserves in compliance of the provisions of Section 32A(6), we have no hesitation in confirming the order of the Tribunal. Thus as far as T.C.(A) No.1311 of 2005 is concerned, while the first question stands answered against the assessee, the second question on Section 43(6) is answered in favour of the assessee. Thus T.C.No.1311 of 2005 stands partly allowed.

30. As far as T.C.(A) No.1312 of 2005 is concerned, we answer the first question under Section 43(6) Explanation 2 in favour of the assessee.

31. As far as amortisation of the expenses relating to the issuance of shares under Section 35D is concerned, the assessment order contained an extract of brochure on euro issue. It is stated therein that the proceeds of offering of Rs.47,67,581/- global depository receipts representing 47,67,581 ordinary shares at the issue price of 8.39 USD per global depository receipt, would be used by the company "principally for financing the new projects and expansion of existing facilities of the company which are described under the company-Capital Expenditure and New Projects." The note pointed out that the new projects and expansion would require various consents and authorisations from Governmental bodies, but awaiting clearance, the proceeds were directed to be kept in certain investment. The investment was thus made awaiting authorisation from various Governmental bodies. This was cited by the Assessing Officer to hold that the claim for deduction was not sustainable. The

Government does not dispute the fact that a sum of Rs.46,24,780/- was an expenditure incurred in connection with the additional issue of share and this was directly relatable to the expansion of the capital base of the company. When the purpose and raising of the capital euro issue is not in dispute, nor are there materials to counter the claim of the assessee that the expenditure was in connection with raising the capital for the new projects as well as for expansion, we have no hesitation in accepting the claim of the assessee for deduction of the expenditure in connection with the Euro issue. Consequently, we answer the question in favour of the assessee.

32. In the light of the answer given to the second question, the third question arising in T.C.No.1312 of 2005 as to the alternative claim for deduction under Section 37 does not arise. Consequently, T.C.(A) No.1312 of 2005 stands allowed.

In the result, T.C.(A) No.1311 of 2005 stands partly allowed and T.C.(A) No.1312 of 2005 stands allowed. No costs.

Index: Yes / No

(C.V.,J.) (K.R.C.B.,J.)

Internet: Yes / No

26.06.2012

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To

1. The Income Tax Appellate Tribunal, 'A' Bench, Chennai.
2. The Commissioner of Income Tax (Appeals) - V, Chennai.
3. The Deputy Commissioner of Income Tax, Special Range-I, Chennai.

CHITRA VENKATARAMAN,J.

and

K.RAVICHANDRABAABU,J.

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Tax Case (Appeal) Nos.1311 and
1312 of 2005

Dated: 26.06.2012