IN THE HIGH COURT OF CALCUTTA

ITA No.27 of 2003

EVEREADY INDUSTRIES INDIA LTD

Vs

COMMISSIONER OF INCOME-TAX, KOLKATA- II & ANR

Bhaskar Bhattacharya and Sambuddha Chakrabarti, JJ

Dated: March 4, 2011

Appellant Rep by: Dr Debi Prasad Paul, Mr J P Khaitan
Respondent Rep by: Mrs Smita Das Dey

Per: Bhaskar Bhattacharya:

This appeal under Section 260A of the Income-tax Act, 1961 is at the instance of an assessee and is directed against an order dated 27th June, 2002 passed by the Income-tax Appellate Tribunal, "E" Bench, Kolkata, in *I.T.A. No. 2600(Cal) of 1997* relating to the Assessment Year 1990-91 thereby partly allowing the appeal filed by the appellant and affirming the order of the Commissioner of Income-tax (Appeals) upholding the disallowance of loss on account of purchase and resale of UTI units. The Tribunal, however, made it clear that the allowance of loss should be restricted to the extent of dividend brought to tax by the Assessing Officer and consequently, to that extent, the appeal was allowed.

Being dissatisfied, the assessee has come up with the present appeal:

At the time of admission of this appeal, a Division Bench of this Court formulated the following questions of law:

"This appeal will be heard on the substantial question of law as to whether the Learned Tribunal was justified in upholding the findings of the Assessing Officer and whether the findings of the learned Tribunal were contrary to the materials on record and/or were based on no material and were therefore perverse. The appeal will also be heard on the further question as to whether the findings of the learned Tribunal that the unit transactions which took place in the present case were solely for reducing the assessee's tax liability and that the ratio of the McDowell's case apply to the present case are based on a misconstruction of the said decision."

The facts leading to the filing of this appeal may be summed up thus:

a) The assessee had purchased 35 lakh units of UTI from Peerless General Finance & Investment Co. Ltd. ("Peerless") on 29th May, 1989 at the rate of Rs.14.75 per unit for a total consideration of Rs.5,16,25,000/-. Those very units were sold back to Peerless on 31st July, 1989 at the rate of 13 per unit for the aggregate consideration of Rs.4,55,00,000/-.

b) While the units were purchased cum-dividend, as the booking closing date was 30th June, 1989 and the shares were purchased on 29th May, 1989, those units having been sold after the book closure, i.e. on 31st July, 1989, were sold ex-dividend. The assessee also received dividend at the rate of 18% on those units, which worked out to be Rs.63 lakh. Thus, in connection with the aforesaid transaction, the assessee incurred a loss of Rs.63,84,000/- which is the subject matter of dispute.

c) It may also be mentioned that the assessee paid interest amounting to Rs.13,13,890/- for loan obtained during the time it had purchased those units and paid brokerage of Rs.1,40,000/- for purchasing the units and also incurred stamp duty of Rs.2,59,000/- on this purchase.

d) Another peculiar factor of the transaction was that at the time of purchase of the aforesaid units at the rate of Rs.14.75 per unit on 29th May, 1989, the assessee also entered into an irrevocable commitment to sell back those units to Peerless at the rate of Rs.13 per unit on 31st July, 1989. Thus, at the very beginning, the assessee entered into a commitment to sell the units at a lower price.

e) While, in the original assessment proceedings, the Assessing Officer did not take any objection to the loss so incurred by the assessee, the CIT, in exercise of his revisional power under Section 263 of the Act restored the matter to the file of the Assessing Officer for de novo examination of the matter.

f) In passing such order, the CIT observed as follows:

"From the above discussion, it appears that the assessee entered into an agreement by buying a loss in advance. This aspect of the case has not been enquired into by not making enquiry with the Peerless General Finance & Investment Co. Ltd. and the bank. Therefore, the AO made an assessment which was both erroneous and prejudicial to the interest of revenue.

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"In view of the above legal position discussed in the preceding paragraphs based on decided cases of several High Courts, I have no hesitation in coming to the conclusion as I have done. The AO will make a fresh assessment and in doing so shall offer reasonable opportunity of being heard to the assessee. He would also make enquiries as are necessary to come to a finding in this case."

g) After the matter was restored to the file of the Assessing Officer, he came to the conclusion that the explanation furnished by the assessee regarding the loss incurred was vague and without substance. It was further observed that the fact remained that the assessee agreed to sell the units at a loss and thus, the loss was known right from the time when the purchases were made and therefore, the loss was a pre-determined loss. The Assessing Officer also was not satisfied about the assessee's explanation that it incurred the loss in expectation of high dividend from UTI. The Assessing Officer, thus, disallowed, inter alia, the loss incurred by the assessee in purchase and sale of the units amounting to Rs.63,84,000/-.

h) On an appeal being preferred, the assessee submitted before the CIT(A) that the loss on purchase and sale of share was a real loss and it was neither vague nor without substance, as alleged by the Assessing Officer. The assessee further contended that Unit Trust of India, being a Government of India Enterprise, there cannot be any kind of connivance between the UTI and the assessee and that the allegation of pre-determined loss in the sale of units was not correct because the dividend received by the assessee was not taken into account by the Assessing Officer.

i) CIT(A), however, was not impressed by the aforesaid contention of the assessee and came to the conclusion that the loss on sale of units was pre-determined. The CIT(A) took note of the correspondence run between the assessee and Peerless from which it was clear that even before the purchase transaction could materialize, the assessee had undertaken to sell units back to Peerless those units at a lower price. The CIT (A), in essence, held that the transaction was a sham and collusive transaction.

j) Being dissatisfied, the assessee preferred an appeal before the Tribunal below and as indicated earlier, the Tribunal below allowed the appeal only to this extent by agreeing with the learned counsel for the assessee that when the loss on account of sale of units was being disallowed, it was not open to the Assessing Officer to tax income from dividend from the transaction which had been treated as a sham transaction and a colourable device. The Tribunal, thus, only decided to direct the Assessing Officer to exclude the dividend earned on these units from the income of the assessee and thus, the loss on account of purchase and resale of units would allow only to the extent of net dividend income, i.e. after allowing deduction under Section 80M brought to tax.

Being dissatisfied, the assessee has come up with the present appeal.

Dr. Paul, the learned senior counsel appearing on behalf of the appellant, by placing strong reliance upon the decision of the Supreme Court in the case of Commissioner of Income-tax vs. *Walfort Share And Stock Brokers P. Ltd. reported in (2010) 326 ITR (SC)*, has contended that the Tribunal below erred in law in treating the transaction as a colourable device. Dr. Paul, in this connection, relies upon the following observations of the Supreme Court in the said decision as quoted below:

"The next point which arises for determination is whether the "loss" pertaining to exempted income was deductible against the chargeable income. In other words, whether the loss in the sale of units could be disallowed on the ground that the impugned transaction was a transaction of dividend stripping. The Assessing Officer in the present case has disallowed the loss of Rs.1,82,12,862 on the sale of 40 per cent tax-free units of the mutual fund. The Assessing Officer held that the assessee had purposely and in a planned manner entered into a pre-meditated transaction of buying and selling units yielding exempted income with the full knowledge about the guaranteed fall in the market value of the units and the payment of tax-free dividend, hence, disallowance of the loss.

"In the lead case, we are concerned with the assessment years prior to insertion of section 94(7) vide the Finance Act, 2001 with effect from April 1, 2002. We are of the view that the Assessing Officer had erred in disallowing the loss. In the case of Vijaya Bank v. Addl. CIT [1991] 187 ITR 541, it was held by this court that where

the assessee buys securities at a price determined with reference to their actual value as well as interest accrued thereon till the date of purchase the entire price paid would be in the nature of capital outlay and no part of it can be set off as expenditure against income accruing on those securities. "The real objection of the Department appears to be that the assessee is getting tax-free dividend; that at the same time it is claiming loss on the sale of the units; that the assessee had purposely and in a planned manner entered into a pre-meditated transaction of buying and selling units yielding exempted dividends with full knowledge about the fall in the NAV after the record date and the payment of taxfree dividend and, therefore, the loss on sale was not genuine. We find no merit in the above argument of the Department. At the outset, we may state that we have two sets of cases before us. The lead matter covers assessment years before insertion of section 94(7) vide the Finance Act, 2001 with effect from April 1, 2002. With regard to such cases we may state that on the facts it is established that there was a "sale". The sale price was received by the assessee. That, the assessee did receive dividend. The fact that the dividend received was tax free is the position recognized under section 10(33) of the Act. The assessee had made use of the said provision of the Act. That such use cannot be called "abuse of law". Even assuming that the transaction was pre-planned there is nothing to impeach the genuineness of the transaction. With regard to the ruling in McDowell and Co. Ltd. v. CTO [1985] 154 ITR 148(SC), it may be stated that in the latter decision of this court in Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 it has been held that a citizen is free to carry on its business within the four corners of the law. That, mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon even by the judgment of this court in McDowell and Co. Ltd.'s case (supra). Hence, in the cases arising before April 1, 2002, losses pertaining to exempted income cannot be disallowed. However, after April 1, 2002, such losses to the extent of dividend received by the assessee could be ignored by the Assessing Officer in view of section 94(7). The object of section 94(7) is to curb the short-term losses. Applying section 94(7) in a case for the assessment year(s) falling after April 1, 2002, the loss to be ignored would be only to the extent of the dividend received and not the entire loss. In other words, losses over and above the amount of the dividend received would still be allowed from which it follows that Parliament has not treated the dividend stripping transaction as sham or bogus. It has not treated the entire loss as fictitious or only a fiscal loss. After April 1, 2002, losses over and above the dividend received will not be ignored under section 94(7). If the argument of the Department is to be accepted, it would mean that before April 1, 2002 the entire loss would be disallowed as not genuine but, after April 1, 2002, a part of it would be allowable under section 94(7) which cannot be the object of section 94(7) which is inserted to curb tax avoidance by certain types of transactions in securities. There is one more way of answering this point. Sections 14A and 94(7) were simultaneously inserted by the same Finance Act, 2001. As stated above, section 14A was inserted with effect from April 1, 1962 whereas section 94(7) was inserted with effect from April 1, 2002. The reason is obvious. Parliament realized that several public sector undertakings and public sector enterprises had invested huge amounts over last couple of years in the impugned dividend stripping transactions so also declaration of dividends by mutual fund are being vetted and regulated by SEBI for last couple of years. If section 94(7) would have been brought into effect from April 1, 1962, as in the case of section 14A, it would have resulted in reversal of large number of transactions. This could be one reason why Parliament intended to give effect to section 94(7) only with effect from April 1, 2002. It is important to clarify that this last reasoning has nothing to do with the interpretations given by us to sections 14A and 94(7). However, it is the duty of the court to examine the circumstances and reasons why section 14A

inserted by the Finance Act, 2001 stood inserted with effect from April 1, 1962 while section 94(7) inserted by the same Finance Act as brought into force with effect from April 1, 2002."

In view of the aforesaid decision, Dr. Paul prays for setting aside the order passed by the Tribunal below.

Mrs. Das Dey, the learned advocate appearing on behalf of the Respondent-Revenue has, however, opposed the aforesaid contention advanced by Dr. Paul and has virtually relied upon the observations made in the order impugned.

After hearing the learned counsel for the parties and after going through the aforesaid decision of the Supreme Court, we find that it is now clear that the fact that the dividend received by the assessee was tax free is the position recognized under Section 10(33) of the Income-Tax Act. It appears that the assessee has utilized the said provision of the statute and as such, the same cannot be called as an abuse of the process of law. As pointed out by the Supreme Court, even if we assume for the sake of argument, that the transaction was a pre-planned one, there was nothing to impeach the genuineness of the transaction. As regards the observation of *O. Chinnappa Reddy, J. in the case of McDowell & Co. Ltd. Vs. CTO reported in (1995) ITR 148 (SC),* it was pointed out by the Supreme Court in the later decision of the Supreme Court in the case of *Union of India Vs. Azadi Bachao Andolan (2003) 263 ITR 706,* that a citizen is free to carry on his business within the four corners of the law and that mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon. Thus, in a case arising before April 1, 2002, the losses pertaining to exempted income cannot be disallowed.

We, therefore, set aside the order passed by the authorities below and hold that in the case before us, the assessee is entitled to claim loss on the aforesaid transaction by answering the two questions framed by the Division Bench in favour of the assessee against the Revenue. We direct the Assessing Officer to treat the loss arising out of the aforesaid transaction and also to grant benefit of exemption as pointed out by the Supreme Court.

The appeal is, thus, allowed.

In the facts and circumstances, there will be, however, no order as to costs.