IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH.

I.T.R. No.111 of 1995
Date of decision: 12.7.2010

The Commissioner of Income Tax (Central), Ludhiana.

-----Applicant.

Vs.

M/s Oswal Spinniing & Weaving Mills Ltd., Ludhiana

-----Respondent

CORAM:- HON'BLE MR. JUSTICE ADARSH KUMAR GOEL
HON'BLE MR. JUSTICE AJAY KUMAR MITTAL

Present:- Mr. K.K. Mehta, Sr. Standing Counsel
for the revenue.

Mr. S.K. Mukhi, Advocate
Mr. Rajiv Sharma and Ms. Jyoti, Advocates
for the assessee.

ADARSH KUMAR GOEL, J.

1. The Income Tax Appellate Tribunal, Chandigarh has referred following question of law for opinion of this Court, arising out of its orders dated 22.9.1992 in I.T.A. No.1227/Chandi/1987 for the assessment year 1983-84:-

> "Whether on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that transfer of assets at W.D.V. level valued at Rs.3,01,700/- in exchange of shares valued at Rs.15,74,874/- did not constitute "transfer" within the

> meaning of section 2(47) and also was right in law in deleting the addition of Rs.12,73,174/- made by the Assessing Officer by invoking proviso to section 41(2) of the Income Tax Act, 1961?"

2. The assessee is a limited company and engaged in manufacture of yarn and vanaspati ghee and sale thereof. For the year in question, the assessee filed return declaring loss of Rs.25,50,380/- which was subsequently revised on 31.3.1986 declaring loss of Rs.23,41,950/-. During the course of assessment proceedings, the Assessing Officer found that certain assets pertaining to textile unit of the assessee were transferred to the shareholders at written down value of Rs.3,01,700/- in exchange of 3017 shares held by the shareholders which were surrendered by the company. The value of 3017 shares @ Rs.522/- per share was 15,74,874/-. This transaction was shown by one of the shareholders to fall under the capital gains tax. However, the Assessing Officer sought explanation from the assessee as to why the transaction be not charged under capital gain tax in its case as well, whereupon it was pointed out that as the assets were transferred by the company to its shareholders and, therefore, no liability to capital gain tax would arise. The Assessing Officer invoked Section 41(2) of the Income Tax Act, 1961 (for short, "the Act") in respect of transferred assets in lieu of excess value of the shares over the written down value of the assets and made an addition of Rs.12,73,174/-. On appeal, it

was contended by the assessee that the reduction of share capital of the company did not amount to sale or transfer and valuation of the shares was against the principles laid down by the Hon'ble Supreme Court in ***C.W.T.*** ***v.*** ***Mahadeo Jalan and others*** [1972] 86 ITR 621 and thus, no profit may be involved if value of shares was taken to be equal to the value of assets transferred. The CIT(A) set aside the said addition by holding that no transfer of assets was involved and it was only reduction of the share capital. Reliance was placed on judgment of the Hon'ble Supreme Court in ***CIT*** ***v.*** ***R.M. Amin*** [1977] 106 ITR 368 to hold that reduction in subscribed capital of the company did not amount to sale or transfer. In that process, no profit was made to attract Section 41(2) of the Act. However, no finding on the issue regarding valuation of shares was recorded, as it was held to be not taxable. The Tribunal upheld the view of CIT(A).

3. We have heard learned counsel for the parties and perused the record.

4. Learned counsel for the revenue submitted that from the facts it is clear that the assessee had availed the benefit of depreciation under Section 32 in respect of land, building and machinery which was transferred for consideration higher than the written down value and therefore, the assessee had made profit which was covered under Section 41(2) of the Act. Reliance has been placed on judgment of the Hon'ble Supreme Court in ***Kartikeya V. Sarabhai*** ***vs. CIT*** [1997] 228 ITR 163,

distinguishing earlier judgment in _**R.M. Amin**_'s case (*supra)*, holding that payment of lesser value for shares of more value involves profit. Reliance has also been placed on judgment of the Allahabad High Court in _**Chandra Katha Industries**_ ***v.*** _**CIT**_ [1982] 138 ITR 168, to canvass that the expression "sold" in Section 41 (2) of the Act includes an exchange and therefore, the excess over the written down value of the asset would be taxed under the said provision.

5. Learned counsel for the assessee on the other hand supported the view taken by the CIT(A) and the Tribunal, to the effect that transfer of assets at written down value for higher value of shares should be treated to be reduction in the value of the share capital, which could not be equated to transfer and since no transfer was involved therein, so as to attract Section 41 (2) of the Act.

6. The findings of CIT(A) recorded in para 3.9 which had been affirmed by the Tribunal while adjudicating the issue are to the following effect:-

> "3.9 As regards the observation of the ITO in his order, the ITO mentioned in his order that the word 'transferred back to the company has been mentioned and the basis of that word transferred be held that there is a transfer. Hence the transfer is involved in these transactions. As the transfer of the asset to the company i.e. there is a transfer of the shares of the company and back to the company. It means to the extent of 3017 shares the corresponding assets have

been distributed to the outgoing share holders and the capital stand reduced to that extent. Had it been the transfer to third party then the appellant itself, the interpretation of the ITO about the word 'transfer' was justified. In the instant case, the word transfer cannot be used and section 41(2) cannot be applied in the case because there is no transfer of the assets rather it was reduction of the share capital."

7. The points that arise for consideration in this reference can be categorized into two sub headings:-

(a) Whether in the facts and circumstances of the case, the transfer of assets at written down value in exchange of shares would constitute 'transfer' within the meaning of Section 2(47) of the Act?

(b) If answer to the first question is in the affirmative, whether the allotment/exchange of shares for higher consideration than the written down value of the assets would attract provisions of Section 41(2) of the Act?

8. Adverting to the first question, it would be advantageous to refer to Section 2(47) of the Act, which defines 'transfer' at the relevant time. The same reads as under:-

"2(*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. According to the aforesaid provision, this Clause introduces an artificial extended meaning to the expression 'transfer'. The said term includes transaction of 'sale' and 'exchange', which even in ordinary parlance, would be transfers, but it also takes within its ambit 'relinquishment' or 'extinguishment of rights', which may otherwise be not included in the said term.

10. The Hon'ble Supreme Court in ***Kartikeya*** (*supra)* while considering the scope of 'transfer' within the meaning of Section 2(47) of the Act, where the company had sought to reduce the share capital by reducing the face value of the preference shares, had held the same to be 'transfer' under Section 2(47) of the Act. The Hon'ble Supreme Court distinguishing earlier judgment in ***R.M. Amim***'s (*supra)* observed:-

> "8. The company under s.100(1)(c) of the Companies Act has a right to reduce the share capital and one of the modes, which can be adopted, is to reduce the face value of the preference shares. This is precisely what has been done in the instant case. Instead of there being a 100 per cent extinction of the right which was there in the Anarkali's case (supra), here the right as a preference shareholder of the appellant stands reduced from Rs.500/-to Rs.50/-per share. A sum of Rs.450/-per share has been paid by

the company to the appellant on account of the extinguishment of his right to the aforesaid extent.

9. Yet another right which is apparently effected as a consequence of this reduction is with regard to the voting right. According to s.87(2)(a) of the Companies Act, a holder of a preference share has a right to vote only on resolution placed before the company which directly affect the rights attached to his preference shares. In the case of cumulative preference share, if dividend remains unpaid for not less than two years preceding the date of commencement of the meeting, then even a preference shareholder, by virtue of s.87 (2)(b) of the Companies Act, gets a right to vote on every resolution placed before the company at any meeting like a member holding equity shares. What is important for our purposes is the provisions of s.87(2) (c) which, inter alia, provides.

“Where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-section, his voting right on a poll, as the holder of such share, shall, subject to the provisions of s.89 and sub-s.(2) of s.92, be in the same proportion as the capital paid up in respect of the preference share bears to the total paid-up equity capital of the company”.

Therefore, with the reduction in the face of the share from Rs. 500/- per share to Rs. 50/- per share, the value of the vote of the appellant in the event of there being a poll would stand considerably reduced. Such reduction of the right in the capital asset would clearly amount to a transfer within the meaning of that expression in Section 2(47) of the Act.

> 10. The decision in R.M. Amin's case (supra) can be of no help to the appellant. In that case, the company had gone into voluntary liquidation and the assessee had received a sum in cash of the amount which he had paid for the share. It was held that when share holder receives money representing his share on the distribution of the net assets of a company in liquidation, he receives that money in satisfaction of the right which belongs to him by virtue of his holding the share and not by any operation of any transaction which amounted to sale, exchange, relinquishment, transfer of a capital asset or extinguishment of any right in capital assets. The payment received by the contributories on the liquidation of the company would not amount to a transfer and it is for this reason that R.M. Amin's case (supra) was distinguished by this Court in Anarkali's case."

In view of above, the answer to the first question that assets given at written down value in exchange of shares would amount to 'transfer' within the meaning of Section 2(47) of the Act.

11. Adverting to the second limb, it would be profitable to reproduce Section 41(2) of the Act as it stood at the relevant time. The same reads as under:-

> "41. xx xx xx xx xx
>
> (2) Where any building, machinery, plant or furniture, which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or

destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceeds the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business or profession of the previous year in which the moneys payable for the building, machinery, plant or furniture became due:

Provided that where the building sold, discarded, demolished or destroyed is a building to which *Explanation 5* to section 43 applies, and the moneys payable in respect of such building, together with the amount of scrap value, if any, exceed the actual cost as determined under that *Explanation*, so much of the excess as does not exceed the difference between the actual cost so determined and the written down value shall be chargeable to income-tax as income of the business or profession of such previous year:

Provided further that where an asset representing expenditure of a capital nature on scientific research within the meaning of clause (*iv*) of sub-section(2B) of section 35, read with clause (*4*) of section 43 owned by the assessee which was or has been used for the purposes of business after it ceased to be used for the purpose of scientific research related to the business is sold, discarded, demolished or destroyed, the provisions of this sub-section shall apply as if for the words “actual cost”, at the first place where they occur, the words, “actual cost and increased by twenty-five per cent thereof” had been substituted.

Explanation.—Where the moneys payable in respect of the building, machinery, plant or furniture referred to in this sub-section become due in a previous year in which the business or profession for the purpose of which the building, machinery, plant or furniture was being used is no longer in existence, the provisions of this sub-section shall apply as if the business or profession is in existence in that previous year."

12. The aforesaid provision applies wherever the sale proceeds of the capital asset of an assessee exceeds the written down value. The amount that is chargeable to tax under this Section is so much of the excess as does not exceed the difference between the actual cost and the written down value. This is taxed as income arising from business or profession of the assessee in the previous year in which the asset is sold. The said charge is termed as balancing charge. This represents the depreciation allowance which is allowed in the previous years from the profits earned by the assessee in those years and where subsequently the capital asset has been sold for excess value, then the difference between original cost and the written down value is treated as income under Section 41(2) of the Act by way of balancing charge.

13. The Allahabad High Court in ***Chandra Katha Industries***'s case (*supra)* while considering the scope of Section 41(2) of the Act has observed as under:-

"The principle underlying this provision is that where a building, machinery, plant or furniture owned by the assessee is sold, discarded, demolished or destroyed, the depreciation allowance and the balancing allowance under s.32(1) would recoup to the assessee the entire capital loss on the asset. If the assessee is able to recover more than the written down value out of the "moneys payable" in respect of the asset together with the amount of scrap value, if any, a balancing charge is levied by this sub-section on the excess recovered to the extent of the total of depreciation allowances granted in, the past. In other words, the Revenue takes back what it had given by way of depreciation allowance in the earlier years. Thus, to attract this provision, there must be sale, discarding, demolition or destruction; such sale, discarding, demolition or destruction should be of a building, machinery, plant or furniture. Such asset should be owned by the assessee and the moneys payable in respect of such asset together with the amount of scrap value, if any, should exceed the total of the depreciation granted on such asset in the past. If it is so, the excess to the extent of the total of depreciation allowances granted in the past is deemed to be income liable to tax. For our purposes what is required to be seen is the scope of expressions "sold" "moneys payable" and the "asset sold". The word "sold" which occurs in this sub-section includes a transfer by way of exchange or a compulsory acquisition under any law for, the time being in force and the expression "money payable" includes the sale price or insurance, salvage or compensation moneys as provided in cl. (iii) of sub-s.

> (1) of s.32 r/w the Explanation. In our opinion, an analysis of these provisions furnish a clear answer to the two contentions urged on behalf of the assessee. Here, there was a sale of all the assets and liabilities of the assessee including land, building, plant and machinery. In respect of land, building, plant and machinery, which constitutes immovable property, the sale was effected by a sale deed executed on August 1, 1970, i.e., within the previous year under consideration. The agreement to sell which was executed on July, 31, 1970 i.e. which fell within the preceding accounting year, would not create any right in favour of the vendee in respect of immovable property. In respect of immovable property of the value exceeding Rs.100 unless the transaction is evidenced by a written instrument duly registered, the transfer does not become complete in the eye of law. Sec. 53A of the Transfer of Property Act would not be attracted because it has not been found by the Tribunal that the possession over the immovable property was transferred as a result of the agreement to sell. At any rate, such transaction would become complete in the eye of law only when a proper sale deed is executed and registered."

14. In view of judgment of the Hon'ble Supreme Court in ***Kartikeya***'s case (*supra)* and judgment of the Allahabad High Court in ***Chandra Katha Industries'*** case (*supra),* we are of the view that transfer of assets at written down value for shares of higher value amounts to transfer and attract tax under Section 41

(2) of the Act. View taken by the Tribunal, thus, cannot be upheld.

15. The question referred is answered accordingly.

(ADARSH KUMAR GOEL)
JUDGE

July 12, 2010
ashwani

(AJAY KUMAR MITTAL)
JUDGE