(1977) 08 BOM CK 0047

Bombay High Court

Case No: Income-tax Reference No. 9 of 1968

Ginners and Pressers P. Ltd.		APPELLANT
	Vs	
Commissioner of Income Tax, Bombay City-I		RESPONDENT

Date of Decision: Aug. 8, 1977

Acts Referred:

- Income Tax Act, 1922 - Section 10(5)

Citation: (1978) 113 ITR 616

Hon'ble Judges: V.D. Tulzapurkar, J; R.M. Kantawala, J

Bench: Division Bench

Advocate: D.H. Dwarkadas, for the Appellant; R.J. Joshi, for the Respondent

Judgement

Tulzapurkar, J.

Two question have been referred to us for our determination by the Tribunal in this reference u/s 66(1) of the Indian Income Tax Act, 1922, and these questions run as follows :

"(1) Whether, on the facts and in the circumstances of the case, the proviso to section 10(5)(a) of the Indian Income Tax Act, 1922, was attracted ?

(2) If proviso to section 10(5)(a) was attracted, whether the basis of fixing the written down value adopted by the department and upheld by the Tribunal and the written down values fixed on that basis for all the assessment years were in accordance with the requirements of law ?"

2. The questions related to assessment years 1953-54 to 1958-59. M/s. Ginners & Pressers Pvt. Ltd., is a private limited company which was incorporated on February 9, 1950. Admittedly, it was a 100% subsidiary of another private limited company

named M/s. Kilachand Devchand & Co. Ltd., hereinafter referred to as "the parent company". The object of formation of the assessee-company was to take over some oil and ginning mills, factories and lands belonging to and used in its business by the parent company. These assets were taken over by the assessee-company at a cost of Rs. 13,50,000. Their written down value for the transferor (parent company) was only Rs. 2,21,142 while their original purchase cost to the parent company was Rs. 5,52,475. Admittedly, the assessee-company did not pay cash to the parent company for those assets acquired by it but made payment by issuing fully paid up shares of that value. It appears that while making the original assessment for 1953-54 to 1956-57, the Income Tax Officer allowed depreciation to the assessee-company on those assets on their book value of Rs. 13,50,000. Later on, these assessments were reopened u/s 34. After reopening the assessment, the Income Tax Officer for the assessment years 1953-54 to 1958-59 considered the question of fixing the written down value (actual cost) of those assets under the proviso to section 10(5)(a) of the Act. It was contended on behalf of the assessee-company that the transfer of assets of the parent company to the assessee-company had been done with a view to put an end to the harassment caused to the parent company by various Government departments, which called for various break-ups, balance-sheets, etc., that the transfer was effected out of commercial expediency, inasmuch as it was thought advisable to have a separate organisation for the factories where the work was different from the business carried on by the parent company and that the transfer was not effected for the main purpose of obtaining reduction in tax liability by claiming depreciation with reference to the enhanced cost but reduction of tax liability was merely incidental to the transfer. For these reasons it was contended that the proviso to section 10(5)(a) was not attracted. Alternatively, it was contended that even if the said proviso was attracted, then in spite of the transaction being one between the holding company and its 100% subsidiary company, the basis for fixing the written down value (actual cost) of the assets must be their fair market value on the date of transfer as it was not illegal for one company to transfer its assets to another allied company against shares to be issued at their market value of those assets. The Income Tax Officer rejected both the contentions and took the view that the assessees explanation for the transfer effected (viz., that the same was to avoid harassment and out of commercial expediency) was not acceptable, for, if the said explanation was true, the transfer of the assets would have taken place at their book value itself. The Income Tax Officer further observed that the price fixed for the assets in connection with the transfer was obviously so fixed with an eye to obtain reduction of liability to Income Tax by claiming depreciation with reference to the enhanced cost. He, therefore, came to the conclusion that the proviso to section 10(5)(a) was attracted. On the alternative submission, with the previous approval of the Inspecting Assistant Commissioner, he fixed the written down value (actual cost) of those assets at the written down value plus the balancing charge arising u/s 10(2)(vii) of the Act as the cost of these assets to the vendor and on that basis he allowed

depreciation for the assessment year 1953-54 and calculated the written down value for the subsequent years.

3. The assessee-company appealed to the Appellate Assistant Commissioner against the fixing of written down value (actual cost) of the above assets for all the assessment years and the self-same contentions were urged in appeal. The Appellate Assistant Commissioner observed that, since the shares in both the assessee-company and the parent company were held by the same persons or their nominees, the transfer was not an ordinary commercial transaction in the strict sense of the term and since all the requirements of the proviso to section 10(5)(a) were present, he upheld the Income Tax Officer''s order as well as the basis on which the written down value (actual cost) was determined by him. The matter was carried further to the Tribunal by the assessee-company by way of second appeal. It was contended on behalf of the assessee-company that, prior to actual transfer of those assets by the parent company to the assessee-company, those assets had been got valued by the valuers and it was on the basis of such valuation report that the assets had been transferred by the parent company to the assessee-company for Rs. 13,50,000 and since the sale of those assets being at their fair market value, the proviso to section 10(5)(a) was not attracted. The alternative contention was also pressed before the Tribunal. The Tribunal rejected the valuer''s report because the material on the basis of which the value had been fixed by the valuers for the assets in question had been withheld by the witness who was examined on behalf of the valuers before the Income Tax Officer and the non-production of such material, the Tribunal observed, led to an adverse inference being drawn against the assessee-company to the effect that if that information was placed before the Tribunal it would have gone against the assessee-company. After rejecting the valuer''s report, therefore, the Tribunal upheld the Income Tax Officer''s written down value (actual cost) as fixed by the department. At the instance of the assessee-company the two questions set out at the commencement of the judgment have been referred to us for our determination.

4. Mr. Dwarkadas, appearing for the assessee, has raised two contentions before us. In the first place, he has contended that, before the proviso to section 10(5)(a) could be attracted and applied to the facts of the case, it was incumbent upon the Income Tax authorities as well as the Tribunal to determine the market value of those assets in question on the date of the transfer and unless the market values determined on the date of the transfer was found to be less than the consideration for which the transfer had been effected, viz., Rs. 13,50,000, no inference was possible that the main purpose of transfer of such assets directly or indirectly to the assessee-company was for obtaining reduction of liability to Income Tax by claiming depreciation with reference to the enhanced cost. He pointed out that the facts that the transfer was between the holding-company and its 100% subsidiary company and the consideration for the transfer had been paid not in cash but in the shape of fully paid up shares were the circumstances which could create suspicion but could

not lead to a necessary inference that the main purpose of the transfer was to obtain reduction of liability to Income Tax by claiming depreciation with reference to the enhanced cost. He urged that it was only by relying upon these facts and circumstances that the taxing authorities as well as the Tribunal have drawn the inference for attracting the applicability of the proviso to section 10(5)(a) of the Act. He also contended that the Tribunal erred in rejecting the valuer''s report and the material that was placed before it to arrive at the correct market value of the transferred assets. Secondly, he contended that even if it is assumed that the proviso to section 10(5)(a) was attracted to the facts of the case, simply because the valuer''s report produced by the assessee-company was rejected, was no ground for the taxing authorities or the Tribunal to come to the conclusion that the actual cost (written down value) to the assessee-company of the assets transferred would be the written down value of those assets in the parent company''s records on the date of transfer plus the balancing charge arising u/s 10(2)(vii) of the Act. He urged that actually the taxing authorities and the Tribunal ought to have determined the market value of the assets transferred on the date of transfer and then proceeded to decide what depreciation should be allowed to the assessee-company.

5. After giving our anxious consideration to the aforesaid submissions which were made by Mr. Dwarkadas and after considering the same in the context of the relevant proviso to section 10(5)(a) as also the facts and circumstances obtaining case, we are unable to accept any of these submissions for the reasons which we shall presently indicate.

6. In order to consider the question as to whether the proviso to section 10(5)(a) would be attracted or not, it would be desirable to set out the relevant provisions of that proviso. Section 10(5)(a) and the proviso thereto ran as follows : Section 10(5).

In sub-section (2)..... and

"written down value" means -

(a) in the case of assets acquired in the previous year, the actual cost to the assessee :

Provided that where, before the date of acquisition by the assessee, the assets were at any time used by any other person for the purposes of his business and the Income Tax Officer is satisfied that the main purpose of the transfer of such assets, directly or indirectly to the assessee, was the reduction of a liability to Income Tax (by claiming depreciation with reference to an enhanced cost), the actual cost to the assessee shall be such an amount as the Income Tax Officer may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case....."

7. There is no doubt that before the aforesaid proviso is applied to any particular case two conditions are required to be satisfied. First, the assets prior to the date of

acquisition by the assessee must have been used by another person for the purpose of his business and, secondly, the Income Tax Officer must be satisfied that the main purpose of the transfer of such assets, directly or indirectly, to the assessee was the reduction of a liability to Income Tax by claiming depreciation with reference to an enhanced cost, and if these two conditions are satisfied, then, the Income Tax Officer has power to determine the actual cost of transferred assets to the assessee at such amount as he may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case. It is no doubt true that the taxing authorities as well as the Tribunal have come to the conclusion that to the instant case this proviso to section 10(5)(a) was clearly attracted and thereby they have come to the conclusion that both the conditions, and particularly the second one, were satisfied in the instant case. Mr. Dwarkadas urged that it was true that the transfer to question was between the parent company and the assessee-company-100% subsidiary company of the former-that it was also true that the transfer of assets had been effected for consideration of Rs. 13,50,000 and it was further true that this price was paid not in cash but in the shape of fully paid up shares. But he urged that even if these facts were accepted, these would not lead to an inference that purpose of transfer was the reduction of a liability to Income Tax by claiming depreciation with reference to an enhanced cost. He did not dispute that the first condition was satisfied, for, obviously these assets had been used by the parent company for their business before they were transferred to the assessee-company. He urged that the inference that the second condition was satisfied could only be drawn if the taxing authorities as well as the Tribunal had arrived at the market value of the assets as on the date of their transfer and if such market value was less than the consideration for which the transfer had been effected. It cannot be disputed that the aforesaid three facts, about which there is no dispute between the parties, are not the facts on the basis of which this requisite inference required for the purpose of applying the proviso to section 10(5)(a) could be drawn, but these three facts have also to be borne in mind along with the aspect as to whether the market value of the assets transferred on the date of transfer would be considerably low or equal to consideration for which the transfer was effected. There is no doubt that, in the absence of fair market value of the assets transferred being known on the date of transfer, the requisite inference under the proviso to section 10(5)(a) of the Act cannot be drawn. But it is not as if the taxing authorities as well as the Tribunal have not dealt with this aspect of the matter at all while deciding the question of applicability of the proviso to section 10(5)(a) to the facts of the present case. On the aspect of the market value of the transferred assets on the date of transfer, since the transaction was between the two companies, one of which was the holding company and the other 100% subsidiary company, the facts pertaining to the real market value of the assets transferred as on the date of transfer would be within the exclusive knowledge of either of the two companies and above the relationship between the two companies was of the type mentioned above, it would be within the exclusive knowledge of the

assessee-company also. Placed in that situation the taxing authorities as well as the Tribunal could and did call upon the assessee-company to place the material for the purpose of knowing what was the market value of the assets transferred as on the date of transfer and all that the assessee-company did was to produce the valuer''s report-a report giving valuation of the transferred assets at about the time when the transfer was to be effected. However, admittedly, the valuers did not indicate any reasons or grounds for fixing a particular valuation of a particular item which they (valuers) did to their report. In the absence of such material in the form of reasons or grounds for fixing such valuation of several items of the assets in their valuation report, such material could have been produced by the witness (valuer) at the time of such examination, especially when he was summoned by the taxing authorities. But in his evidence the valuer, who was examined, disowned knowledge whether the notes on the basis of which he had fixed the valuation were available or not, and what is more, he stated that even if the notes were available with him he would not have produced the same for perusal or scrutiny before the taxing authorities or the Tribunal. When such was the answer given by the valuer, it was difficult to place any reliance upon the valuation report. In our view, the taxing authorities as well as the Tribunal were perfectly justified in rejecting the valuation report, for, in the absence of reasoning or grounds for the opinion given by the valuer, the expert evidence would not be of any value. Apart from that, the Tribunal, in our view, was also further justified in drawing an adverse inference against the assessee-company to the effect that, had such material been produced, the same would have gone against the assessee-company, which, in other words, means that the correct market value of the assets transferred might have been lower than the consideration for which the transaction was effected and if such adverse inference has been correctly drawn by the Tribunal, it is obvious that the proviso to section 10(5)(a) would be clearly attracted. What would be the normal market value of the assets as on the date of transfer is a different matter, but for the purpose of attracting the proviso to section 10(5)(a) all that is required to be proved is that the market value of the assets transferred as on the date of their transfer was lower than the consideration for which the transfer had taken place and if the circumstances led to that adverse inference then the proviso to section 10(5)(a) of the Act could be clearly attracted. In our view, therefore, the taxing authorities as well as the Tribunal were right in coming to the conclusion that this is a case to which the proviso to section 10(5)(a) was attracted and, accordingly, the first question referred to us will have to be answered against the assessee-company.

8. Turning to the second question, it was urged by Mr. Dwarkadas that under the proviso to section 10(5)(a) it was incumbent upon the Income Tax Officer as well as the Appellate Assistant Commissioner and the Tribunal to determine the actual cost to the assessee and such actual cost could be the fair market value of the assets transferred and there was no material on record on the basis of which such actual cost could be determined by the taxing authorities or by the Tribunal and, therefore,

at least for the purpose of determining the actual cost the matter will have to be sent back to the Tribunal. In this behalf strong reliance was placed by him upon the last part of the proviso, which runs thus :

"The actual cost to the assessee shall be such an amount as the Income Tax Officer may, with the previous approval of the Inspecting Assistant Commissioner, determine having regard to all the circumstances of the case."

9. He urged that this part of the proviso casts an obligation upon the Income Tax Officer to determine the actual cost which could only be the market value of the transferred assets on the date of transfer. It is not possible to accept this submission of Mr. Dwarkadas as laying down absolutely correct proposition having regard to the wording of the last portion on which he himself has relied. The last portion of the proviso nowhere speaks of market value being determined by the Income Tax Officer, but it speaks of actual cost being determined by the Income Tax Officer and such actual cost has to be determined by the Income Tax Officer with the previous approval of the Inspecting Assistant Commissioner, having regard to all the circumstances of the case. Now, admittedly, in the instant case, the assessee-company did not lead any evidence or produce any material before the taxing authorities as well as the Tribunal to arrive at the correct determination of the actual cost of the assets transferred and, placed in that situation, it does appear that the Income Tax Officer proceeded to fix or determine the actual cost (written down value) of the assets transferred by adopting the written down value of those assets transferred in the books of the transferor of the assessee-company as on the date of transfer and added to that figure the balancing charge arising u/s 10(2)(vii) of the Act. It cannot be disputed that this method, if adopted, would clearly give the actual cost of the assets transferred to the transferor-company as on the date of transfer and we do not see any reason why if the same value is taken to be the actual cost to the transfer-company, as on the date of transfer, the determination would be irrational or unreasonable. If the Income Tax Officer adopted this method of determining the actual cost of the transferred assets with the approval of the Inspecting Assistant Commissioner it will be difficult to say that the method adopted was unreasonable or irrational. In the light of the facts and circumstances which obtained in the case, the Tribunal has also taken the view that the manner in which the actual cost had been determined by the Income Tax Officer could not be regarded as unreasonable or erroneous and we do not see any reason to interfere with that view of the Tribunal, and the second question, therefore, will have to be answered accordingly.

Having regard to the above discussion, our answers to the two questions are as follows :

Question No. 1 : In the affirmative, against the assessee.

Question No. 2 : The basis adopted by the department in fixing the actual cost of the transferred assets to the assessee-company would be in accordance with the requirements of law.

10. The assessee will pay the costs of the reference to the revenue.