

PETITIONER:
COMMISSIONER OF INCOME TAX, BOMBAY

Vs.

RESPONDENT:
ITALINDIA COTTON CO. (P) LTD.

DATE OF JUDGMENT 05/09/1988

BENCH:
PATHAK, R.S. (CJ)
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PATHAK, R.S. (CJ)
MUKHARJI, SABYASACHI (J)

CITATION:
1988 AIR 2057 1988 SCR Supl. (2) 814
1988 SCC (4) 221 JT 1988 (3) 566
1988 SCALE (2) 654

ACT:

Income Tax Act, 1961--5. 77--Carry forward and set-off of loss incurred in any earlier year against income of the relevant previous year--Conditions provided in cls. (a) and (b) of s. 79 operate in the alternative, not cumulatively.

HEADNOTE:

The respondent-assessee which had suffered a loss during the assessment year 1960-61, and whose share-holding had undergone a change subsequently, claimed a set-off against the same in its assessment for the year 1963-64, but the Income-tax Officer turned it down on the ground that s. 79 of the Income-tax Act, 1961 dis-entitled the assessee from claiming such a set off since 51% of the voting power held by persons on the last day of the year in which the loss was suffered was no longer held by them on March 31, 1963. On appeal, the Appellate Assistant Commissioner held that before the right to set off a loss could be denied to an assessee, not only should there be a change in the persons holding a voting power of not less than 51% but further the change should have been effected with a view to avoiding or reducing the liability to tax. On appeal by the Revenue, the Appellate Tribunal observed that the denial of the set off of a loss incurred in an earlier year was subject to two exceptions: (i) that the beneficial holding representing not less than 51% of the voting power should not change hands between the last day of the year in which the loss was incurred and the last day of the relevant previous year, and (ii) that any change in the share-holding should not have been effected with a view to avoiding or reducing any liability to tax; that these two exceptions applied independently, and if either came into play, the prohibition contained in s. 79 against the setting off of a loss could not be invoked by the Revenue. However, at the instance of the assessee, the Tribunal referred the following question to the High Court for its opinion:

"Whether both the conditions mentioned in clause (a) and clause (b) of s. 79 must apply for disentitling the loss of a prior year being allowed as set off in accordance with the substantive provisions of s. 79 of the Income-tax Act, 1961?"

PG NO 814

PG NO 815

The If High Court answered the question in favour of the assessee, holding that even if a change in the voting power of not less than 51% between the two relevant dates has taken place, for the Revenue to succeed, such change should be effected with a view to avoiding or reducing any liability to tax.

Dismissing the appeal,

HELD: In our opinion, to avoid falling within the scope of s. 79 it is sufficient for the assessee to show that the case attracts either cl.(a) or cl.(b). If the assessee succeeds in doing so, he will be entitled to the benefit of the provisions of the Income Tax Act entitling him to claim a carry forward and set off losses suffered by the company in an earlier year or years against the income of the previous year. [820C-D]

Section 79 is an exception to the scheme enacted in Chapter VI for the carry forward and setting off of a loss incurred in any earlier year against the income of the relevant previous year. The provision was enacted in the Income-tax Act, 1961 for the first time in order to deny that benefit to companies not being companies in which the public are substantially interested. On its plain terms s. 79 provides that in the case of such companies, if a change in share-holding has taken place in a previous year, no loss incurred in any year prior to the previous year shall be carried forward or set off against the income of the previous year unless (a) both on the last day of the previous year and on the last day of the year or years in which the loss was incurred the shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons (b) the Income-tax Officer is satisfied that the change in the share holding was not effected with a view to avoiding or reducing any liability to tax. The question before us is whether the two conditions operate cumulatively or in the alternative. In other words, should both conditions exist together to nullify the prohibition against carry forward and set off of the loss? Upon careful consideration we are of opinion that the conditions are intended to operate as alternative to one another. If the terms of either cl. (a) or cl. (b) are satisfied, the disqualification suffered by a company, by reason of a change in share-holding in the previous year, is removed, and the company is entitled to the benefit of the provisions in Chapter VI relating to the carry forward and set off of losses. The benefit is available notwithstanding the change in share-holding in the previous year, if shares representing not less than 51% of the voting power remain beneficially held by the same persons on the relevant dates. Similarly, the benefit is available notwithstanding the

PG NO 816

change in shareholding in the previous year if the change was not effected with a view to avoiding or reducing any liability to tax. [818F-H, 819A-D]

Commissioner of Income-tax, Gujarat-III v. Shri Subhalaxmi Mills Ltd., [1983] 143 I.T.R. 863 and Commissioner of Income-tax v. Saravanabhava Mills Pvt. Ltd., [1983]143I.T.R.856, approved.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1520 (NT) of 1986.

From the Judgment and Order dated 10.8.1977 of the Bombay High Court in I.T.R. No. 34 of 1968.

V.S. Desai and Ms. A. Subhashini for the Appellant.

Harish Salve, Mrs. A.K. Verma and Joel Peres for the Respondents.

The Judgment of the Court was delivered by

PATHAK, CJ: This appeal by special leave is directed against the judgment of the Bombay High Court construing the provisions of s. 79 of the Income-tax Act, 1961 in favour of the assessee.

Three private limited companies, the Italindia Cotton Co. (P) Ltd., who is the assessee before us, the India Corporation (P) Ltd and the International Cotton (P) Ltd. were controlled by three groups of share holders, who may be described as the Chunilal Group, the Babubhai Group and the Purushottam Group. There was a change in the share holding of the three companies during the accounting year ending 31 March, 1963. The Chunilal Group acquired controlling interest in India Corporation (P) Ltd., the Babubhai group acquired controlling interest in the assessee company and the Purushottam Group acquired controlling interest in International Cotton (P) Ltd.

The assessee suffered a loss in the accounting year ending 31 March 1960, relevant to the assessment year 1960-61, in the amount of Rs.12,172. This was available for a set off in a subsequent year. But having regard to the change in the share holding of the assessee during the accounting year ending 31 March, 1963 relevant to the assessment year 1964-64, the question arose whether the assessee was entitled to of carrying forward that loss for the purpose of computing

PG NO 817

its assessable profits for that assessment year. The Income-tax Officer held that s. 79 of the Income-tax Act, 1961 disentitled the assessee from claiming such a set off. He said that 51% of the voting power held by persons on the last day of the year in which the loss was suffered was no longer held by them on 31 March, 1963. On appeal by the assessee, the Appellate Assistant Commissioner of Income-tax took a different view. He held that before the right to set off a loss could be denied to an assessee, not only should there be a change in the persons holding a voting power of not less than 51% but further the change should have been effected with a view to avoiding or reducing the liability to tax. The Revenue appealed to the Income Tax Appellate Tribunal. Upon an analysis of s. 79 the Tribunal observed that the denial of the set off of a loss incurred in an earlier year was subject to two exceptions, the first being that the beneficial holding representing not less than 51% of the voting power should not change hands between the last day of the year in which the loss was incurred and the last day of the relevant previous year, and the second exception was that any change in the share-holding contemplated by the parent provision should not have been effected with a view to avoiding or reducing any liability to tax. According to the Tribunal the two exceptions applied independently, and if either came into play the prohibition contained in s. 79 against the setting off of a loss could not be invoked by the Revenue. It appears to have been admitted before the Tribunal that the assessee was not entitled to the benefit of the first exception, and in the view which it took it rendered no definite finding on whether the assessee fell within the terms of the second exception.

At the instance of the assessee the Tribunal referred the following question to the Bombay High Court for its opinion:

"Whether both the conditions mentioned in clause (a) and clause (b) of s. 79 must apply for disentitling the loss of a prior year being allowed as set off in accordance with the substantive provisions of s. 79 of the Income-tax Act, 1961?"

The High Court answered the question in favour of the assessee, holding that even if a change in the voting power of not less than 51% between the two relevant dates has taken place, for the Revenue to succeed such change should be effected with a view to avoiding or reducing any liability to tax. It observed that as the Tribunal had not considered the question whether the change in the voting power had taken place with a view to avoiding or reducing any liability to tax that question should now be decided by

PG NO 818

the Tribunal before the claim for a set off could be finally disposed of. And now this appeal.

Chapter VI of the Income-tax Act, 1961 contains a number of provisions entitling the assessee to the carry forward and set off of a loss suffered by him. Section 70 provides for the set off of a loss from one source against income from another source under the same head of income. Section 71 provides for the set off of a loss from one head against income from another head. Section 72 entitles an assessee to carry forward and set off a business loss which could not be set off wholly during the year in which it arose. Then follow provisions relating to the setting off of losses in certain particular cases. Section 79, with which we are concerned, provides:

"Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless--

(a) on the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred; or
(b) the Income-tax Officer is satisfied that the change in the share-holding was not effected with a view to avoiding or reducing any liability to tax."

Section 79 is an exception to the scheme enacted in Chapter VI for the carry forward and setting off of a loss incurred in any earlier year against the income of the relevant previous year. The provision was enacted in the Income-tax Act 1961 for the first time in order to deny that benefit to companies not being companies in which the public are substantially interested. On its plain terms s. 79 provides that in the case of such companies, if a change in shareholding has taken place in a previous year, no loss incurred in any year prior to the previous year shall be carried forward or set off against the income of the previous year unless (a) both on the last day of the previous year and on the last day of the year or years in

PG NO 819

which the loss was incurred the shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons (b) the Income-tax Officer is satisfied that the change in the share in holding was not affected with a view to avoiding or reducing any liability to tax. The question before us is whether the two

conditions operate cumulatively or in the alternative. In other words, should both conditions exist together to nullify the prohibition against carry forward and set off of the loss? Upon careful consideration we are of opinion that the conditions are intended to operate as alternative to one another. If the terms of either cl.(a) or cl.(b) are satisfied, the disqualification suffered by a company, by reason of a change in share-holding in the previous year, is removed, and the company is entitled to the benefit of the provisions in Chapter VI relating to the carry forward and set off of losses. The benefit is available notwithstanding the change in share- holding in the previous year, if shares representing not less than 51% of the voting power remain beneficially held by the same persons on the relevant dates. Similarly, the benefit is available notwithstanding the change in shareholding in the previous year if the change was not effected with a view to avoiding or reducing any liability to tax.

The object sought to be served by enacting section 79 appears to be to discourage persons claiming a reduction of their tax liability on the profits earned in companies which had sustained losses in earlier years. It was not unusual for a group of persons to acquire a company, which had suffered losses in earlier years, in the expectation that the company would earn substantial profits after such acquisition, and they would benefit by a reduction of the tax liability on those profits on a set off of losses carried forward from earlier years before the acquisition. The acquisition of a company in such a case would be effected by a change in its share holding and the control over the company could be ensured by securing the beneficial ownership of shares carrying 51 per cent or more of the voting power. If the change in share holding did not result in holding voting power of 51 per cent or it was established that the shares of the company carrying not less than 51 percent of the voting power were beneficially held by the same persons, both on the last day of the previous year as well as the last day of the year or years in which the loss was incurred, it could be presumed that there was no change in the control over the company, and the disqualification imposed on the company because of the change in its share holding would stand removed.

But there may be a change in the share-holding, and it may result in a change of control of the company. Yet every

PG NO 820

such change of shareholding need not fall within the prohibition. There can be a case where persons already owning a shareholding carrying less than 51 percent of the voting power in the company may enlarge their share-holding during the previous year in order that control over the company may pass to them. Attempts to acquire control over a company by controlling a majority of the share-holding are not unknown. The acquisition of control over a company provides a source of both direct and indirect financial benefit as well as power over its policies and activities. On the other side, there can be a case where the change is affected with a view to avoiding or reducing some liability to tax. The change is effected not for business or commercial reasons but in order that tax liability may be avoided or reduced. In that event, the change in the share-holding will tend to bring about the result which s. 79 was designed to prevent. In our opinion, to avoid falling within the scope of s. 79 it is sufficient for the assessee to show that the case attracts either cl. (a) of cl. (b). If the assessee succeeds in doing so, he will be entitled to the benefit of the provisions of the

Income Tax Act entitling him to claim a carry forward and set off losses suffered by the company in an earlier year or years against the income of the previous year. We are fortified in our conclusion by the view expressed by the Gujarat High Court in Commissioner of Income-tax, Gujarat-III v. Shri Subhalaxmi Mills Ltd., [1983] 143 I.T.R. 863 and by the Madras High Court in Commissioner of Income-tax v. Saravanabhava Mills Pvt Ltd., [1983] I.T.R.856.

In our judgment, the High Court is right in the view taken by it and the appeal must be dismissed.

The appeal is dismissed with costs.

H.L.C.

Appeal dismissed

JUDIS