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IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGNAL CIVIL JURISDICTION

INCOME TAX APPEAL NO. 2001 OF 2009

The Commissioner of Income Tax,
Mumbai ..Appellant

versus

M/s. Polychem Ltd. ..Respondent.
ig .....

Mr.Suresh Kumar for appellant.

Mr.J.D.Mistri, Senior Advocate with Ms.Aasifa Khan for respondent.

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CORAM : DR.D.Y.CHANDRACHUD &

M.S. SANKLECHA, JJ.

8 February 2012. ORAL JUDGMENT (PER DR.D.Y.CHANDRACHUD,J.) : This appeal by the Revenue under Section 260A of the Income Tax Act, 1961 arises from an order of the ITAT dated 22 May 2007 in relation to the Assessment Year 1994-1995. The appeal gives rise to the following substantial question of law: Whether in the facts and circumstances of the case and in law, the Tribunal is right in holding that the capital gains are not applicable in view of the fact that the IMFL business has been transferred as going concern and therefore a slump sale? The appeal is admitted on this question. With the consent of the counsel appearing on behalf of the Revenue and the assessee the appeal is taken up for hearing and final disposal. 2. The assessee is a company which at the material time was inter alia engaged in the business of manufacture and sale of liquor. An agreement was entered into by the assessee on 24 March 1994 with International Distillers (India) Pvt. Ltd. by which the assessee agreed to sell to the purchaser the undertaking / business together with its assets and liabilities as a running business / going concern on as is where is basis. The Undertaking / business which formed the subject matter of sale was the business of manufacturing, blending, bottling, distribution, storage and sale of Indian Made Foreign Liquor. The Assessing Officer noted that the assessee having transferred its IMFL division as a going concern / running business, it was stated in the Notes forming part of the computation of income that the written down value of the assets transferred was shown as a deduction for the purpose of computing depreciation from the block of assets. The assessee stated that the excess of the cost of IMFL business amounting to Rs.6.90 corers was not taxable and was not deducted from the respective block of assets. The assessee was called upon to justify this claim in response to which the assessee stated that it had transferred its IMFL business as a going concern for a total consideration of Rs.10.38 Crores. According to the assessee the profit arising on the transfer of the undertaking was not chargeable to tax. The Assessing Officer in the course of his computation deducted from the total sale price of Rs.10.38 Crores the written down value of the fixed assets and the value of the stores, raw materials and finished goods which was worked out at Rs.3.48 crores. The difference of Rs.6.90 Crores was held to be chargeable under the head of capital gains. The Assessing Officer proceeded on the basis that what was transferred by the assessee was the entire business as a slump sale but came to the conclusion that the profit arising on such transfer of business as a going concern would be chargeable to tax under the head of capital gains. 3. The order of the Assessing Officer was challenged in appeal by the assessee. The Commissioner (Appeals) by his order dated 5 July 2002 affirmed the order passed by the Assessing Officer and upheld the addition in the amount of Rs.6.90 crores. The Commissioner (Appeals) came to the conclusion that the agreement between the assessee and the purchaser made it clear that a lump sum consideration was in fact arrived at on the basis of the assets of the assessee. This was sought to be fortified by a communica-

tion addressed to the Assessing Officer by the purchaser, furnishing a valuation of the land, building and fixed assets and a communication addressed by the assessee stating that the book value of the assets transferred to the purchaser was Rs.3.48 crores. The Commissioner held that the net worth of the unit was ascertained by evaluating each asset and liability and the sale price being determined on the basis of each asset and liability it could not be asserted that the assets were not acquired at any cost. In appeal before the Tribunal the case of the assessee was that what was transferred to the purchaser was the entire business and undertaking of the IMFL unit on the basis of a slump sale. On this basis, reliance was sought to be placed on a judgment of a Division Bench of this Court in Premier Automobiles Ltd. v. Income Tax Officer1. The Tribunal accepted the submission of the assessee that in the present case the entire business of the undertaking was transferred as a going concern together with all fixed assets and intangibles for a lump sum consideration without a separate valuation of the assets sold. The Tribunal held that this was, therefore, not a sale of itemized assets. The Tribunal came to the conclusion that it was not possible to ascertain the cost of the capital asset viz. the IMFL undertaking / business or the cost of the improvements thereto and it was hence not possible to compute any chargeable capital gain on the sale of the undertaking as a going concern. In holding thus, Tribunal relied upon its own decision in the case of Coromandel Fertilizers Ltd. Vs. DCIT.2 4. Counsel appearing on behalf of the Revenue has submitted that (i) in the decision of the Division Bench in Premier Automobiles (Supra) this Court having come to the conclusion that there was a transfer of an undertaking as a going concern on the basis of a slump sale nonetheless remanded the proceedings back to 1(2003) 264 ITR 193 2 90 ITD 344 the Assessing Officer for determination of the capital gains that would be attracted in accordance with the provisions of Sections 45 to 50. Consequently it was submitted that in the present case also an order of remand was warranted to the Assessing Officer to make a determination of the capital gains, if any, that had arisen as a result of a sale of the undertaking; (ii) The Assessing Officer had in the present case noted in paragraph 4.1 of his order that from a copy of the agreement which was filed, the profit on the sale of the business had been worked out at Rs.6.90 Crores being the difference between the sale price of Rs.10.38 Crores and the written down value of the fixed assets and the value of the stores, raw materials and finished goods of Rs.3.48 Crores; (iii) Moreover, as noted by the Commissioner (Appeals), the purchaser as well as the assessee had furnished a valuation of the fixed assets which was the subject matter of transfer and the Commissioner consequently held that it was not the case of the assessee that any of the assets transferred did not have a cost or that it was self generated. In this view of the matter, it was urged before the Court that an order of remand would be necessitated to the Assessing Officer to compute the liability on account of capital gains resulting from the transfer of the undertaking. 5. On the other hand, it was urged on behalf of the assessee by counsel that (i) The Assessing Officer, Commissioner (Appeals) as well as the Tribunal have all proceeded on the basis that the capital asset that was transferred was the undertaking of the IMFL unit as a going concern without there being an itemized transfer of the assets of the undertaking; (ii) The agreement for the transfer of the undertaking dated 24 March 1994 would make it abundantly clear that what was transferred included, besides the land, building and fixed assets, the benefit of all pending contracts, all licenses, permissions and approvals received from the Central and the State Governments, distribution network, intangible assets including rights in intellectual property and workforce employed in the undertaking; (iii) In such a situation it is evident that prior to the insertion of Section 50B into the provisions of the Income Tax Act, 1961 in a case such as the present the computation provisions for computing capital gains would break down since no cost can be attributed to the intangibles which formed subject matter of the transfer. In this regard, reliance has been placed on the decision of the Supreme Court in the case of PNB Finance Ltd. Vs. CIT.3 3[2008] 307 ITR 75] 6. In the present case, while we deal with the submissions which have been urged on behalf of the Revenue and the assessee it would, at the outset, be necessary to advert to the salient provisions of the agreement dated 24 March 1994 in pursuance of which the IMFL undertaking came to be transferred by the assessee. The agreement makes it clear both in its recitals and in clause 1.1 of the contract that the assessee was transferring to the purchaser the undertaking / business as a running business / going concern together with its assets and liabilities. The undertaking / business which was sought to be transferred was the business of manufacturing, blending, bottling, distribution, storing and sale of Indian Made Foreign Liquor. The undertaking / business consisted besides immovable property and movable property (including plant and machinery); current assets including raw materials, stock in trade and book debts; the benefits of all pending contracts, engagements and orders; all licenses and other permissions and approvals required from the State and Central Government) to carry on liquor business; the distribution network, marketing strategies, plans, advertising information and customer list; and the use of intangible assets referable to the undertaking / business including trade marks. Schedule IV to the agreements sets out the pending contracts, Schedule V the licenses which the assessee held and Schedule VI the trade marks which the assessee was transferring to the buyer. The Agreement does not contain an itemized valuation in respect of the land, building and fixed assets transferred. Under the agreement the assessee transferred to the purchaser the entire undertaking / business at and for a consideration of Rs.10.60 Crores. Under Clause 5.2 the consideration as determined was subject to a due diligence audit of the assets and liabilities as reflected in the Closing Accounts and was subject to adjustment to be made in the following manner:- (1) if any machinery was missing it was to be replaced by the vendor; and (2) if there was any variance in the current assets or liabilities it was liable to be adjusted from the price. Possession of the undertaking was to be handed over by the assessee to the purchaser on the Closing Date. Under Clause 6 the assessee transferred its employees involved in the undertaking / business as part of the undertaking / business as a going concern to the purchaser. 7. Reading the agreement as it stands, it is evident that the subject matter of contract between the assessee and the purchaser was the transfer of the business of the undertaking of the IMFL unit as a going concern. The total consideration of Rs.10.6 crores that is determined under the agreement was for the transfer of the business and undertaking as a whole comprising of but not limited to the land, building and fixed assets. Among the assets that were transferred included the benefit of the existing contracts, licenses which the assessee held entitling it to manufacture and sell Indian Made Foreign Liquor, intangibles including the right to utilize trade marks and the labor force which was being transferred to the purchaser. The transaction involved a slump sale. There was no itemized valuation of the fixed assets and other assets which formed part of the undertaking. What was sold comprised of the undertaking and the business as a whole. 8. The Judgment of the Division Bench of this Court in Premier Automobiles Ltd. Vs. Income Tax Officer (Supra) contains an elucidation of the distinction between a slump sale agreement and an agreement for the transfer itemwise of the fixed assets of an undertaking. In the case of a slump sale the sale is for a lump sum price and there is a transfer of the entire business for a fixed price. The sale consideration is, in other words, not attributable to the individual assets of the assessee. Both in the case of a slump sale as well as in the case of itemized assets a transfer of land, building, plant and machinery may and probably would be involved. However, where there is a slump sale, the transfer of land, building, plant and machinery forms part of the transfer of the entire business. On the other hand where there is an itemized sale the transfer of land, building, plant and machinery takes place in specie. This distinction which was noted in the judgment of Premier Automobiles must equally apply to the facts of the present case. There was, as we have noted earlier, neither a transfer of assets in specie nor was a valuation placed in the agreement on the individual assets of the undertaking that formed the subject matter of the transfer. 9. The Assessing Officer proceeded on the basis, and in our view erroneously, that from the copy of the agreement which was filed, the profit on the sale of the business had been worked out by taking the sale price of Rs.10.38 crores and after deducting from it the written down value of the fixed assets, stores, raw materials and finished goods of Rs.3.48 crores, there was a profit of Rs.6.90 crores. The agreement dated 24 March 1994 does not contain any such computation. There was, therefore, fundamentally an error on the part of the Assessing Officer when he proceeded to hold that there was a profit of Rs.6.90 crores being the difference between the sale price and the deductions which he erroneously regarded as having emerged from the agreement itself. From the order passed by the Commissioner (Appeals), it emerges that the purchaser had in response to a query of the Commissioner indicated by its letter dated 24 August 1998 the valuation made by a valuer in a report of September 1994 of the lands, buildings, plant and machinery. The Commissioner also noted that the assessee had by its letter dated 18 August 1998 furnished a figure of Rs.3.48 crores as being the value of the stores, raw materials, fixed assets and finished products. As the order of the Commissioner (Appeals) itself recognizes in para 3.10, Rs. 3.48 crores represented the book value of the assets transferred to the purchaser by the assessee. The book value of the assets transferred to the purchaser by the assessee had to be reflected of necessity in the books of the assessee. Rs.3.48 crores was the written down value on the date of the transfer.

The point which both the Assessing Officer and the Commissioner (Appeals) missed however, was the fact that when a transfer takes place as in the present case of the whole business and undertaking of the assessee and the transfer involves not only fixed assets such as land, building and machinery but other component elements such as the benefit of existing contracts, licenses and approvals and intangibles including intellectual property and transfer of the work force of the undertaking or business, it would be impossible in a case such as the present to attribute or allocate the sale consideration as between the fixed assets on the one hand and the intangibles on the other. 10. It must be emphasized that in the present case the Court is dealing with the position as it existed prior to the insertion of the provisions of Section 50B by the Finance Act of 1999. As a result of the provisions of Section 50B which have been inserted with effect from 1 April 2000 any profits or gains arising on a slump sale effected in the previous year are to be chargeable to income tax as capital gains arising from the transfer of long term capital assets and are to be deemed to be the income of the previous year in which the transfer took place. Under the Proviso capital gains are to be treated as arising from a transfer of short term capital assets in the case of an undertaking owned and held by an assessee for not more than thirty-six months. Sub-section (2) of Section 50B provides that in such case the net worth of the undertaking or the division shall be deemed to be the cost of acquisition and the cost of improvements for the purposes of Sections 48 and 49. Under sub-section (3) every assessee in the case of a slump sale has to furnish along with the return of income, a report of an accountant indicating the computation of the net worth of the undertaking or division. Explanation 1 defines the expression "net worth" as the aggregate value of the total assets of the undertaking or division as reduced by the value of liabilities as appearing in the books of account. For the purpose of this appeal Section 50B has no application. 11. In such a situation it would be necessary to advert to the decision of the Supreme Court in PNB Finance Ltd. Vs. Commissioner Income Tax (Supra). In that case Punjab National Bank was nationalized under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. Upon nationalization a compensation of Rs.10.20 crores was paid, computed on capitalization of the previous five years' profits. The issue which arose before the Supreme Court was whether the transfer of a banking undertaking gave rise to taxable capital gains under Section 45. In that case the Assessing Officer had held that since the assessee had submitted its own computation of the fair market value of the undertaking the only issue required to be considered was the correctness of the figure of capital loss submitted by the assessee. The Assessing Officer computed the capital gains and on an appeal by the assessee the A.A.C. held that it was not possible to allocate the full value of the consideration received between the various assets of the undertaking. Consequently it would not be possible to determine the cost of acquisition and of improvement under Section 48. The Tribunal in appeal took the view that since the assessee had exercised its option for substitution of the fair market value as on 1/1/1954 it was not open to the assessee to contend that the cost of acquisition was not computable. The Tribunal consequently affirmed the view of the Assessing Officer. In appeal the Delhi High Court sustained the judgment of the Tribunal relying upon the decision of the Supreme Court in CIT Vs. Artex Manufacturing Company.4 The Supreme Court in appeal held that the decision in Artex dealt with the provisions of Section 41(2) and was, therefore, not applicable to the case at hand which dealt with the issue of capital gains. The Supreme Court enunciated that as regards the applicability of Section 4[1997] 227 ITR 260 (SC) 45 three tests are required to be applied. First, both the charging Section and computation provisions are inextricably linked. Second, the test of allocation / attribution must be applied, the object being to determine whether the slump price was capable of being attributable to individual assets. Third, there is a conceptual difference between the undertaking and its components. In that context the Supreme Court held as follows: "...there is a conceptual difference between an undertaking and its components. Plant, machinery and dead stock are individual items of an Undertaking. Business Undertaking can consist of not only tangible items but also intangible items like, goodwill, man power, tenancy rights and value of banking licence. However, the cost of such items (intangibles) is not determinable. In the case of CIT v. B.C. Srinivasa Setty reported in [1981] 128 ITR 294, this Court held that Section 45 charges the profits or gains arising from the transfer of a capital asset to income-tax. In other words, it charges surplus which arises on the transfer of a capital asset in terms of appreciation of capital value of that asset. In the said judgment, this Court held that the"asset" must be one which falls within the contemplation of Section 45. It is further held that, the charging section and the computation provisions together constitute an integrated Code and when in a case the computation provisions cannot apply, such a case would not fall within Section 45. In the present case, the Banking Undertaking, inter alia, included intangible assets like, goodwill, tenancy rights, man power and value of banking licence. On facts, we find that item-wise earmarking was not possible. On facts, we find that the compensation (sale consideration) of Rs. 10.20 cr. was not allocable item- wise as was the case in Artex Manufacturing Co. (supra)." 12. Bearing in mind the facts of the present case, we are of the view that law that has been enunciated by the Supreme Court in PNB Finance (Supra) would govern this appeal. In the present case undoubtedly there has been no itemized sale of the assets of the undertaking. The subject matter of the transfer is the business undertaking of the IMFL Unit as a whole. In a situation such as the present, itemized earmarking would not be possible. That is because the business of the undertaking consists not only of tangible items but other intangibles such as rights in intellectual property, licenses and manpower. The Cost of such intangibles is not determinable. In PNB Finance (Supra) the Supreme Court followed the dictum in its earlier decision in CIT Vs. B.C. Srinivasa Setty5 that the charging section and the computation provisions constitute an integrated code and when in a case the computation provisions cannot apply, such a case would not fall within Section 45. The facts of the present case are squarely within the principle which has been laid down by the Supreme Court in PNB Finance. 13. The submission which has been urged on behalf of the Revenue is that though the Division Bench of this Court in Premier Automobiles accepted the submission of the assessee that what was involved in that case was a slump sale, the Court nonetheless remanded the proceedings back to the Assessing Officer in order to 5 1981 128 ITR 294 determine the capital gains that had arisen with reference to provisions of Sections 45 to 50. Hence, the same course should be followed. This submission, on a close reading of the decision in Premier Automobiles, is lacking in substance. It must be noted that in Premier Automobiles, the Assessing Officer, Commissioner (Appeals) and the Tribunal, in a majority judgment, had come to the conclusion that the sale was of itemized assets. The questions of law that were framed for decision of the Division Bench were (i) whether the Tribunal was justified in holding that the transaction of sale was not a slump sale; (ii) whether the Tribunal was justified in holding that the lump sum consideration was apportionable to different assets; and (iii) whether the apportionment of the consideration by the transferee for its accounting purposes should be taken by the Assessing Officer for working out the depreciation allowable to the assessee. The Division Bench answered the first two questions in the negative, in favour of the assessee and against the Revenue. The third question was answered by holding that the sale was a slump sale. The Division Bench, however, having held that the transaction was a slump sale, the question of computation did not arise before the Court in that appeal. It was in that view of the matter that the Assessing Officer was directed to determine on remand whether any capital gains tax liability would arise and if so to determine the quantum thereof. The order of remand in Premier Automobiles was consequently as a result of the fact that the principal issue which fell for determination before the Division Bench was whether the Tribunal was justified in coming to the conclusion that there was an itemized sale and not a slump sale of the undertaking. In the present case the facts would clearly show that the Assessing Officer proceeded on the basis that what was involved was a transfer of the whole undertaking and business of the assessee as a going concern. This position was not in dispute before the Commissioner (Appeals) who affirmed the view of the Assessing Officer in the appeal by the assessee. Again before the Tribunal there was an appeal by the assessee and not by the Revenue. The fact that what was involved was a transfer of the entire business as a going concern was, therefore, not in dispute before either of the authorities or the Tribunal. The Tribunal has corrected the view which was taken by the Assessing Officer and by the Commissioner (Appeals) by holding that it was not possible to attribute the consideration which was paid, towards the individual assets which form a component part of the transfer of the business. The Tribunal has held that this would not be possible in view of the facts which have already been discussed earlier. Having affirmed the view which has been taken by the Tribunal, we find no merit in the contention of the Revenue that a further order of remand would be warranted. 14. For these reasons, we answer the question of law which has been framed in the affirmative. The appeal shall accordingly stand disposed of. There shall be no order as to costs. (Dr. D.Y. Chandrachud, J.) (M.S. Sanklecha, J.)