Pnb Finance Ltd vs Commissioner Of Income Tax-I, New Delhi on 6 November, 2008

Author: S.H. Kapadia

Bench: B. Sudershan Reddy, S.H. Kapadia

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION
CIVIL APPEAL NO. 3721 OF 2002

PNB Finance Ltd. ... Appellant
versus
Commissioner of Income Tax-I, New Delhi ... Respondent

JUDGMENT

S.H. KAPADIA, J.

This civil appeal is directed against the judgment of Delhi High Court in Income tax Reference under Section 256(1) of the Income Tax Act, 1961 ("1961 Act") for the assessment year 1970-71.

2. The issue which arises for determination in this civil appeal is whether transfer of Banking Undertaking on the facts and circumstances of this case gave rise to taxable capital gains under Section 45 of the 1961 Act.

3. Punjab National Bank Ltd. was set up in 1895 in an area which now falls in Pakistan. It was nationalized as Punjab National Bank (PNB) by Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. On 19.7.1969 PNB Ltd. on nationalization vested in Punjab National Bank. PNB Finance Ltd. is the appellant herein. On nationalization it received compensation of Rs. 10.20 cr. This compensation was calculated on the basis of capitalization of last 5 years profits. The said compensation was received during the accounting year ending 31.12.1969 corresponding to the assessment year 1970-71.

4. During the assessment year 1970-71, appellant had to compute capital gains under Section 48 by deducting from the sale consideration the cost of acquisition as increased by the cost of improvement and expenses incurred in connection with the transfer. Under the law then prevailing, assessee could index the cost of acquisition by applying cost inflation index which became indexed cost of acquisition.

5. Incidentally, it may be noted that by an amendment to Section 50B inserted by the Finance Act, 1999 w.e.f. 1.4.2000, cost of acquisition is now notionally fixed in case of "slump" sale. Under the said arrangement, assessee is required to draw up his Balance Sheet as on the date of transfer for its undertaking and net worth of that date is now required to be taken into account. Under the said amendment, net worth consists of written down value (WDV) of depreciable assets and the book value of the current assets minus liabilities taken over. Therefore, after 1.4.2000 cost of acquisition is notionally fixed in case of slump sale. However, no such formula existed during assessment year 1970-71. At that time, assessee had to deduct either cost of acquisition or fair market value as on 1.1.1954 from the sale price (compensation) of Rs. 10.20 cr. [see Section 55(2)(i)]. This option was conferred on the assessee solely for its benefit. However, Section 55(2) only triggered if there existed the figures of "cost of acquisition" and "fair market value" as on 1.1.1954 so that the choice could be exercised. At that time, it was open to the assessee to contend that he would exercise the option only after both the figures of original cost and fair market value of the asset as on 1.1.1954 was available. In short, it is only after 1.4.2000 that computation machinery came to be inserted in Section 48 which deals with mode of computation.

6. Any surplus on transfer of capital asset is chargeable to tax under Section 45 in the previous year in which the transfer took place (i.e. in this case on 18.7.1969). This is the mandate of Section 45. The full value of consideration received by the assessee in this case was Rs. 10.20 cr.

7. A Return was filed in this case by the assessee showing an income of Rs. 2,03,364. In the covering letter with which the Return of Income was filed by the assessee it was noticed by the AO that the assessee had opted for having the value ascertained of the banking undertaking as on 1.1.1954. The letter was dated 30.9.1970. In para 5 of that letter, the assessee stated as follows:

> "Assuming, while denying, that the provisions of Section 45 are applicable, the Company exercises its option for substitution of the fair market value of such Undertaking as on 1st January, 1954 in accordance with Section 49 & 50 of the Income Tax Act, 1961."

8. It was argued by the assessee before the AO that the option under Section 55(2)(i) was to be exercised only if it was advantageous to the assessee. The assessee submitted that he had an option under Section 55(2)

(i) of having the value of the undertaking ascertained either on the basis of historical cost of acquisition of the capital asset (banking undertaking) or having its value ascertained as on 1.1.1954, whichever is higher but could not exercise it as the cost of acquisition in this case was not computable. In the alternative, appellant-assessee herein submitted fair market value of the undertaking as on 1.1.1954. By letter dated 30.9.1970, assessee claimed a capital loss. The AO held that since the assessee had submitted its own computation of the fair market value of the undertaking as on 1.1.1954 the only question he was required to consider was the correctness of the figure of capital loss submitted by the assessee vide its covering letter dated 30.9.1970. In this connection, it may be noted that compensation of Rs. 10.20 cr. was paid to the assessee from which assessee claimed deduction of Rs. 17,22,73,246 (market value of the undertaking as on 1.1.1954 fixed at Rs. 10,41,51,625 plus cost of improvement fixed at Rs. 6,81,21,621). This is how the assessee contended that it had in the above transaction suffered a capital loss of Rs. 7.02 cr. This calculation was not accepted by the AO who proceeded to hold on the basis of capitalization of last 5 years profits the capital gains of Rs. 1,65,34,709 (see page 42 of the Paper Book).

9. Aggrieved by the decision of the AO, the matter was carried in appeal by the assessee to the Appellate Assistant Commissioner who by his order dated 16.10.1974 came to the conclusion that, in this case, it was not possible to allocate the full value of the consideration received (compensation) amounting to Rs. 10.20 cr. between various assets of the undertaking and, consequently, it was not possible to determine the cost of acquisition and cost of improvement under the provisions of Section 48 of the 1961 Act and since computation was inextricably linked with the charging provisions under Section 45 of the said Act it was not possible to tax the surplus, if any, under Section 45 of the 1961 Act.

10. Aggrieved by the decision of the Commissioner, the Department went by way of Reference to the Tribunal which took the view that, in this case, since the assessee had exercised its option for substitution of fair market value of the undertaking as on 1.1.1954 it was not open to the assessee to contend that cost of acquisition was not computable and, therefore, the AO was right in arriving at the figure of capital gains fixed by him at Rs. 1,65,34,709.

11. At this stage, it may be noted that on the request of the assessee the Tribunal referred the matter to the High Court under Section 256(1) of the 1961 Act in which the impugned judgment had been given by Delhi High Court. In the impugned judgment, the High Court relied upon the decision of this Court in CIT v. Artex Manufacturing Co. reported in (1997) 227 ITR 260 to hold that "in the case of a slump transaction when the business is sold as a going concern, it is not impossible to determine the actual cost, namely, the cost of acquisition, even though, in a given case, it may be a self-generated asset."

12. The question which arises for determination in this civil appeal is whether judgment of this Court in Artex Manufacturing Co. (supra) is applicable to the present case. In that case, the assessee, a partnership firm, entered into an agreement with the company to sell its business as a going concern for a consideration of Rs. 11,50,400. From the information supplied by the assessee to the AO, it was evident that the sale consideration stood arrived at after taking into account the value of plant, machinery and dead stock as computed by the valuer. The Tribunal held that, the surplus arising on the sale was taxable under Section 41(2) of the Act and not as capital gains. The High Court reversed that finding of the Tribunal and held that the surplus was taxable as capital gains under Section 45 and not under Section 41(2). At the instance of the Revenue, this Court on an appeal held that on the facts and in the circumstances of the case Section 41(2) was applicable as the amount of Rs. 11,50,400, being the consideration, stood arrived at by taking into consideration the value of the plant, machinery and dead stock. It was further held that, the surplus resulting from transfer of plant, machinery and dead stock was either taxable as income under Section 41(2) or as capital gains under Section 45. It was held that since income was chargeable to tax under Section 41(2), the impugned decision of the High Court that such income was chargeable to tax as capital gains was erroneous.

13. In order to decide the applicability of the judgment of this Court in Artex Manufacturing Co. (supra) we need to examine the scope of Section 41(2). At the outset, it may be noted that, in this case, the Department has not relied upon Section 41(2). In fact, none of the authorities below, apart from the High Court, has relied upon Section 41(2). For the first time, relying upon Section 41(2), the High Court has dismissed the Reference initiated at the behest of the assessee.

14. Section 41(2) stands attracted only in the case of a sale of building, machinery, plant or furniture in the previous year. In other words, Section 41(2) applies to a sale of depreciable assets. Secondly, the amount received from such a sale must exceed the written down value of such building, machinery, plant or furniture. Section 41(2) states that certain gains from disposition of building, machinery, plant or furniture shall be deemed to be profits of the previous year. Section 41(2) refers to the concept of a "balancing charge" which arises only when depreciable asset is sold. Section 41(2) brings to tax the balancing charge (difference between written down value and historical cost of depreciable asset) on sale. The object underlying Section 41(2) is to recoup the depreciation allowed by way of deduction under the 1961 Act to the seller of depreciable asset. To attract Section 41(2) the subject matter should be depreciable asset and the consideration received should be capable of allocation between various assets.

15. Section 41(2) and Section 45 operate in different fields. In the case of CIT v. Mugneeram Bangur & Co. reported in (1965) 57 ITR 299 this Court held that where the entire business of the undertaking together with its assets including the depreciable assets and liabilities was sold for a composite price without any item-wise earmarking, Section 41(2) was not attracted. But, where the transfer of the entire business as a going concern is involved and the contract indicates item-wise consideration, Section 41(2) would stand attracted with regard to the amount of surplus to the extent of the difference between the written down value of the depreciable asset(s) so transferred and the actual cost thereof.

16. In the case of Artex Manufacturing Co. (supra) this Court found, that a valuer was appointed, that valuer submitted his valuation report in which itemized valuation was carried out and on that basis the consideration was fixed at Rs. 11,50,400.00. Therefore, the sale consideration had been arrived at after taking into account the value of plant, machinery and dead stock as computed by the valuer and, consequently, it was held that the surplus arising on the sale was taxable under Section 41(2) of the Act and not as capital gains. In the circumstances, the judgment of this Court in the case of Artex Manufacturing Co. (supra) was not applicable to the present case. Further, this Court in the case of CIT v. Electric Control Gear Manufacturing Co. (1997) 227 ITR 278 has held that whether the business of the assessee stood transferred as a going concern for slump sale price, in the absence of evidence on record as to how the slump price stood arrived at, Section 41(2) had no application. It is interesting to note that the judgment in the case of Electric Control Gear Manufacturing Co. (supra) is given by the same Bench which decided the case of Artex Manufacturing Co. In fact, both the judgments are reported one after other in 227 ITR at pp. 260 and 278 respectively. In the present case, as can be seen from the impugned judgment of the Delhi High Court, the judgment of this Court in Electric Control Gear Manufacturing Co. (supra) is missed out. That judgment has not been considered by the High Court. As stated above, this Court has clarified its judgment in Artex Manufacturing Co. (supra) in its judgment in the case of Electric Control Gear Manufacturing Co..

Therefore, Section 41(2) has no application to the facts of the present case.

17. As regards applicability of Section 45 is concerned, three tests are required to be applied. In this case, Section 45 applies. There is no dispute on that point. The first test is that the charging section and the computation provisions are inextricably linked. The charging section and the computation provisions together constituted an integrated Code. Therefore, where the computation provisions cannot apply, it is evident that such a case was not intended to fall within the charging section, which, in the present case, is Section 45. That section contemplates that any surplus accruing on transfer of capital assets is chargeable to tax in the previous year in which transfer took place. In this case, transfer took place on 18.7.1969. The second test which needs to be applied is the test of allocation/attribution. This test is spelt out in the judgment of this Court in Mugneeram Bangur & Co. (supra). This test applies to a slump transaction. The object behind this test is to find out whether the slump price was capable of being attributable to individual assets, which is also known as item-wise earmarking. The third test is that 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 consists 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).

18. For the aforestated reasons, we hold that on the facts and circumstances of this case, which concerns assessment year 1970-71, it was not possible to compute capital gains and, therefore, the said amount of Rs. 10.20 cr. was not taxable under Section 45 of the 1961 Act. Accordingly, the impugned judgment is set aside.

19. Before concluding, we may state that in this case, Section 55(2)(i) did not operationalize. Under Section 55(2), fair market value as on 1.1.1954 could have substituted the figure of cost of acquisition provided the figures of both "cost of acquisition" and "fair market value as on 1.1.1954" were ascertainable. The letter dated 30.9.1970 does not indicate the choice. Even the working done by the AO based on capitalization of last 5 years' profits would give the Enterprise Value of the Undertaking and not the cost of acquisition. Hence, Section 55(2) was not applicable.

20. Consequently, the civil appeal filed by the assessee stands allowed with no order as to costs.

................................J. (S.H. Kapadia) ....J. (B. Sudershan Reddy) New Delhi;

November 6, 2008.