I.C.I. (India) Private Ltd. vs The Commissioner Of Income Tax, West ... on 20 January, 1972

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Bench: A.N. Grover, M.H. Beg

JUDGMENT

A.N. Grover, J.

1. This is an appeal by special leave from an order of the Calcutta High Court directing the Income-tax Appellate Tribunal, 'B' Branch, Calcutta, to draw a statement of case relating to four questions of law which, it was stated, arose out of the order of the Tribunal in the matter of assessment of the appellant which was the assessee in respect of the assessment year 1962-63. The Appellate Tribunal had rejected the application of the Commissioner of Income-tax requiring it to refer those questions to the High Court. The High Court, on being moved, issued a rule nisi and then made it absolute after full arguments without giving any reasons, whatsoever.

2. The assessee is a 100% subsidiary of Imperial Chemical Industries Ltd., incorporated in the United Kingdom (hereinafter referred to as I.C.I. for convenience). I.C.I. advanced large amounts by way of loans to the assessee from time to time. This, it was claimed, was done for subscribing to shares in three Indian Companies called Indian Explosives Ltd., Alkalai and Chemical Corporation of India and Atic Industries Private Ltd., (herein after called as I.E.L., A.C.C.I and ATIC respectively). Subsequently the assessee transferred the shares in the aforesaid companies at par to I.C.I. in satisfaction of the loans advanced by that company. The Income-tax Officer applied Section 52 of the Income-tax Act, 1961 (hereinafter called the 'Act') and assessed the assessee to capital gains. The Appellate Assistant Commissioner took the contrary view and held that on the facts which had been established, the assessee was not liable to capital gains under the aforesaid section. The Tribunal upheld the decision of the Appellate Assistant Commissioner by a detailed and well reasoned order.

3. Broadly, the case of the assessee was that I.C.I. wanted to make investments in India in sterling currency. The assessee was already in existence but the other three companies which have been mentioned, were incorporated later. I.C.I. devised a scheme by which it could make the investment as desired by it and by which it could also take advantage of the tax relief which could be availed of by the new enterprises under Section 15(C) and 56(A) of the Income-tax Act, 1922. The scheme in

short was that I.C.I. would arrange to let the assessee hold shares in the three companies by investing the money which was to be given by I.C.I. to the assessee. The modus operandi was that I.C.I. would give that money by way of loans to the assessee who agreed that the shares in the three companies would be transferred to I.C.I. in satisfaction of the loans at par or issue price as and when desired by I.C.I. All this was done after negotiations with the concerned Department of the Government of India at the highest level and with the approval of the Reserve Bank of India. The entire scheme was conceived and was put into operation prior to 30th November 1956 when the Finance Bill was introduced re-imposing capital gains tax which had remained abolished for certain years. There was a provision for charging interest by the I.C.I. from the assessee at a rate not exceeding 1/2% above the Indian Bank rate which came to 51/2% per annum but the interest was not to exceed in any case the dividends received by the assessee from those shares. It was claimed on behalf of the assessee that this arrangement was advantageous both to I.C.I. and the assessee. I.C.I. having taken the risk (of depreciation in shares or otherwise) attached to the new business pioneering adventures, ensured that capital appreciation of the shares, if any, also went to itself. The assessee did not suffer any disadvantage because it bad to pay no interest if no dividend was received and it could keep and get the benefit of any dividend in excess of 51/2%. As a result of I.C.I. investments being held through the assessee instead of directly, I.C.I. achieved an advantage of saving tax in U.K. amounting to & pound; 68,000 in the relevant years.

4. In 1959 the structure of Indian taxation regarding the grossing up of dividends was radically changed and by the Finance Act 1959, the system of grossing up of dividends (under Section 16(2) and 18(5) of 1922 Act) was abolished and intercorporate dividends became liable to income tax at each stage. Thus, the dividends passing from the three companies through the assessee to I.C.I. became liable to tax stages. This affected the net return of I.C.I. on its investments in the three companies substantially. In these circumstances, it was decided by I.C.I. that the investments in the three companies should be held by it directly. For that reason it called upon the assessee in February 1961 to transfer to it the aforesaid shares in the three companies at the issue price in satisfaction of the sterling loans in accordance with the previous agreements. The approval of the Reserve Bank to these transfers was received in February 1961 and the transfers were made in March/April 1961. According to the assessee there was no question of the transfer of shares having been affected with the object of avoidance or reduction of the liability of the assessee to capital gains which alone could attract the applicability of Section 52 of the Act.

5. Section 52 is in the following terms:

> Consideration for transfer in cases of understate ment : Where the person who acquires a capital asset from an assessee is directly or indirectly connected with the assessee and the Income-tax Officer has reason to believe that the transfer was effected with the object of avoidance or reduction of the liability of the assessee under Section 45, the full value of the consideration for the transfer shall, with the previous approval of the Inspecting Asstt. Commissioner, be taken to be the fair market value of the capital asset on the date of the transfer.

6. The necessary ingredients of the section are:

(i) there should be a direct or indirect connection between the person who acquires a capital asset and the assessee; (ii) the Income tax Officer should have reason to believe that the transfer was effected with the object of avoidance or reduction of the liability of the assessee to capital gains; (iii) if the first two conditions are satisfied then the full value of consideration for the transfer can be taken to be the fair market value of the capital asset on the date of the transfer.

7. As regards the first requirement, that was admittedly satisfied in the present case. The second requirement could be satisfied only if there was any cogent material on which the Income tax Officer could have reason to believe that the transfers were effected with the object of avoidance and reduction of liability to capital gains. It is abundantly clear that the intention with which a particular transfer is made and the object which is to be achieved by such transfer is essentially a question of fact the conclusion relating to which is to be arrived at on a consideration of the relevant material. In other words, before the Income tax Officer can have any reason to believe that a transfer was effected with the object mentioned in the section facts must exist showing that the object was to avoid or reduce the liability to capital gains.

8. The Tribunal examined fully the correspondence and the other material with regard to each of the three Indian companies in which the investment had been made of the money advanced by I.C.I. to the assessee. We may briefly notice the discussion relating to each company. It was in or about 1949 that I.C.I. was asked by the Government of India to consider the manufacture of commercial Lasting High Explosives in India. Negotiations advanced more towards October 1953 when the representatives of I.C.I, met the officials of the Government of India. The Tribunal referred to the minutes of the meeting held on October 1, 1953 as also on the 6th October 1953. In the final draft of the Declaration of Intention dated November 5, 1953, it was mentioned that the Government had agreed that if I.C.I. made a loan to the assessee the latter would hold the shares in I.E.L. and that the loan "may be repaid by a transfer of the shares to I.C.I. at any time". On 21st December 1954, the assessee applied to the Reserve Bank of India for formal sanction for borrowing Rs. 160 lakhs from I.C.I. for the purchase of shares in I.E.L. in terms of the agreement dated November 5, 1953. It was stated in the letter that I.C.I. would charge no interest until such time as the shares began to yield dividends. The loans were advanced from 30th September 1954 to 30th June 1957 by the I.C.I. to the assessee of the equivalent of Rs. 160 lakhs in Sterling. The other correspondence relating to the aforesaid amount was also noticed by the Tribunal. In 1958 there was a Rights Issue by I.E.L. I.C.I. agreed to give a loan of Rs. 80 lakhs to the assessee to cover the Sterling requirement of I.E.L. The assessee was to take up shares of that amount. The terms of the loan were that I.C.I. had the right to acquire at any time the shares held by the assessee In I.E.L. at par in satisfaction of the loan and the rate of interest payable on the loan was to be 1% above the Indian Bank rate. This was followed by other correspondence and a resolution which was record ed on 30.9.1958 containing terms of the second loan of Rs. 80,00,000/-. It is not necessary to refer to the other correspondence looked into by the Tribunal with regard to that loan. On 15.2.1961 the assessee was called upon by I.C.I, to transfer the investments in satisfaction of the loans. After the sanction was obtained from the Reserve Bank of India, the shares were transferred at par. The Tribunal referred to the undisputed facts relating to the circumstances in which the scheme for advancing the loan to the assessee for investment in I.E.L. came to be mooted and was ultimately approved by the Government. This is

what the Tribunal said :

> The above background would show that the idea was not to make the assessee the real beneficial owner of the shares. The fact that the shares should be held only for a time beneficially by the assessee is clear from the "Declaration of Intention" dated 5.11.1953

9. Before the Tribunal the counsel for the Department had accepted the position that if there was an arrangement or agreement before the reintroduction of capital gains tax he would have no case. According to him, until the transfers were actually made of the shares, there was no agreement on which the parties could have gone to court in order to obtain the share transfers at par in favour of I.C.I. The Tribunal proceeded first to examine whether there was any kind of understanding between the assessee and I.C.I. regarding the transfer of shares at par. After recapitulating the correspondence and the relevant facts, the Tribunal came to the following conclusion:

> Taking this along with the minutes of the meeting with the officials of the Government of India, in October 1953, it is clear that the whole idea of I.C.I. throughout was to make some funds available to the assessee so that the shares could be acquired in its name and that the shares could be transferred to I.C.I. as and when it demanded.
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> It was, however, stated by the Tribunal that taking into account the correspondence and the documents referred to earlier it was satisfied with the assessee's case that the transfer of shares to London at issue price or at par was throughout the basis of the advances of loans to the assessee. It is necessary to reproduce paragraph 31 of the order of the Tribunal:
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> In October 1953, there was no mention of any capital gains tax being revived. At that time the assessee could not have had any idea of avoiding or reducing any liability to capital gains tax. The learned Counsel for the department laid some emphasis on the fact that there was no enforceable arrangement. The question as to whether there was an enforceable arrangement or not is not really material. What we have to find out is whether the object in putting through these transactions of taking over the shares at par or at issue price was one of avoidance or reduction of liability to capital gains tax. That object does not get established by the mere absence of an enforceable arrangement. Having regard to the assessee being the subsidiary of I.C.I., there is nothing surprising about the arrangement not being so formal or not being put through after complying with all the necessary legal formalities. The absence of formal agreement is thus understandable in this context and cannot by itself suggest anything in favour of the department. Businessmen are not always motivated by legalistic considerations. Even taking that the arrangement was only binding morally and not legally, still so long as the assessee wanted to fulfil a moral obligation and had not the capital gains tax in mind, it cannot be said that the transaction was entered into with the object of avoidance or reduction of liability to capital gains tax.

The Tribunal proceeded to say:

> We have to find out the object of the transaction. It is removed in point of time from the result. In such a case one cannot try to infer the object from the results. We really have to put ourselves at a point of time when the transaction was conceived...Taking the materials before us, we consider that there is nothing to suggest that the parties had the capital gains tax in their mind in 1953 and later when they put through the aforesaid transactions. We have, therefore, to hold that the factual requisites of Section 52 have not been established here.

10. In dealing with the second Company, namely, A.C.C.I. it was pointed out by the Tribunal that the scheme for manufacturing Polythene was placed before the Government of India by a letter of the assessee dated 13.12.1955 addressed to Mr. H.V.R. Iengar, Secretary, Minister of Commerce and Industry, in which it was specifically stated that to enable the assessee to subscribe for the new shares I.C.I. would lend the subscription monies to the assessee on the understanding that at a later date I.C.I. could acquire at the issue price these new shares in satisfaction of its loan. The Tribunal dealt with all the relevant facts relating to the loan advanced to A.C.C.I. including those stated in the affidavits of P.T. Manzies dated 17.8.1966 and U.R. Newbery dated 10.1.1967 and considered that the transaction relating to this Company was not in any way different from those relating to the I.E.L. ATIC, the third Company was incorporated primarily for the manufacture of certain Dye-stuffs. On 29.12.1955 I.C.I. agreed to advance Rs. 25 lakhs as loan to the assessee. The shares acquired under the loan could be transferred to I.C.I. on request by the latter at the issue price. I.C.I. waived its right to interest on the loan until the commencement of the period in respect of which ATIC paid the dividend. There was a further loan of Rs. 35,00,000 on the same terms. These shares were also subsequently required to be transferred to I.C.I. in February 1961. The Appellate Assistant Commissioner had referred to the affidavits which had been filed on behalf of the assessee and had mentioned that the Department had not cross-examined the deponents. Before the Tribunal the counsel for the Department stated that he accepted the affidavits as correct in so far as facts were concerned but he only disputed the inferences therefrom. The Tribunal in this connection observed:

> In our opinion, once the facts mentioned therein are taken as correct, the inference that the transaction was not for the purpose of avoiding or reducing liability to capital gains tax has to follow.

11. Finally the Tribunal, as stated before, confirmed the decision of the Appellate Assistant Commissioner that the material on record did not justify the conclusion of the Income tax Officer that the object of the transfer of the shares of all the three Companies by the assessee to I.C.I. was the avoidance of liability to capital gains which would attract the applicability of Section 52 of the Act.

12. The Commissioner of Income tax asked for a reference on six questions The Tribunal again examined the further contentions of the Department in its order dated 28.7.1969 by which it declined to make the reference on the ground that no question of law arose out of the order of the Appellate Tribunal. Only four questions appear to have been pressed for being referred. As regards

question No. 1 (which was No. 3 before the Tribunal) it was pointed out that it proceeded on the basis that there was some dispute about the construction of the correspondence or documents. The Tribunal observed that there was no such dispute and it had not been suggested that a particular expression in any letter or document had been wrongly construed. Regarding question No. 2 (which was No. 4 before the Tribunal), the Departmental representative was asked to particularise the documents or evidence omitted from consideration. He referred to certain documents and evidence which according to him had not been considered by the Tribunal. The Tribunal made it clear that all the relevant materials which had been referred to had been considered by it. These materials were distributed over four bulky volumes of typed records and, therefore, each document could not have been mentioned in the order. Nothing relevant was actually over-looked. At any rate the documents on which particular reliance was placed on behalf of the Department were considered and the Tribunal observed that the grievance of omission of materials from consideration related to irrelevant matters. As regards 'the other two questions, the Tribunal observed that the charge of perversity was only a desperate attempt at extracting a question of law where none existed and that the object or intention of an assessee was always a question of fact. It was a factual inference to be drawn from other facts. It was pointed out that on the construction of Section 52, the parties had not joined any issue.

13. We may now mention the four questions which the High Court directed to be referred:

> 1. whether on the facts and in the circumstances of the case and on a proper construction of the documents referred to and/or considered by it the Tribunal was right in arriving at the finding that the transfer of the shares to Imperial Chemical Industries Ltd., London at the issue price or par was throughout the basis of the advance of loans to the assessee?
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> 2. Whether, in arriving at the said finding the Tribunal misdirected itself in law in basing the said finding on evidence covering some matters only and ignoring evidence on other essential matters?
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> 3. Whether, on the facts and in the circumstances of the case and particularly in view of the finding that there was no enforceable agreement making it obligatory upon the assessee to transfer the shares to Imperial Chemical Industries Ltd., London, at par or issue price the conclusion of the Tribunal that the transfer of the shares by the assessee to the latter company at par was not effected with the object of avoidance or reduction of the liability of the assesses to capital gains tax was unreason able or perverse?
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> 4. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that Section 52 of the Income tax Act, 1961, was not applicable to the facts of the case?

On the analysis of Section 52 of the Act made by us at a previous stage and the clear, cogent and precise findings and conclusions of the Appellate Tribunal, we are wholly unable to comprehend,

how any question of law of the nature sought to be referred arose or arises from the order of the Appellate Tribunal. It is unfortunate that in a case of this nature and magnitude, the High Court did hot choose to record a speaking order to enable us to appreciate the reasons which prevailed with it for directing the four questions to be referred. The jurisdiction in the matter of reference can be exercised (i) when the point for determination is a pure question of law such as construction of a statute or document of title; (ii) when the point for determination is a mixed question of law and fact. While the finding of the Tribunal on the facts is final its decision as to the legal effect of those findings is a question of law, (iii) a finding on a question of fact is open to attack as erroneous in law when there is no evidence to support it or if it is perverse. Where, however, the finding is one of fact, the fact that it is an inference from other basic facts will not alter its character as one of fact (See Sree Meenakashi Mills Ltd. v. Commissioner of Income tax, Madras 31 I.T.R. 28. In that case it was held that there was no question of construction of any statutory provision or document of title. The issues which arose for determination, whether the sales entered in books of the appellant in the names of the intermediaries were genuine, and if not, to whom the goods were sold and for what price, were all questions of fact. Their determination did not involve the application of any legal principles to facts established by the evidence. The findings of the Tribunal were amply supported by evidence and were eminently reasonable. It, therefore, followed that there was no question which could be referred to the Court under Section 66(1) of the Income tax Act 1922. The same principles will apply when a reference is sought under Section 256 of the Act. We are altogether unable to see how findings of the Appellate Tribunal that the transfer of shares in the present case was not made with the intention or object of avoidance or reduction of liability to capital gains were not questions of fact and did not depend on inference of facts from the evidence or the material before the Tribunal. It can well be said that the determination of the question whether the object of the assessee was to avoid or reduce its liability to capital gains by making the transfers in question did not involve tie application of any legal principles to the facts established by the evidence. The findings of the Tribunal were amply supported by evidence and were eminently reasonable. It is true that the amount involved is very large but that cannot justify a reference as under Section 256 of the Act neither the Appellate Tribunal could make a reference nor could the High Court direct the reference to be made to it by the Tribunal on pure questions of fact.

14. The learned Counsel for the Commissioner has sought to invite our attention to certain parts of the order of the Tribunal and, in particular, to the statement extracted by us at an earlier stage about the question whether the assessee had held the shares beneficially and the point which was debated before the Tribunal whether there was any binding; legal agreement between 'the assessee and I.C.I. for transfer of the shares at par. We are unable to see how these matters were relevant for the purpose of determining the intention or object under-lying the transfer of the shares to I.C.I. by the assessee. Once the Tribunal came to the conclusion which was purely one of fact that before there was any proposal to reimpose capital gains tax which came to be embodied in the Finance Bill towards the end of November 1956, the scheme had been fully evolved between the assessee and I.C.I. of making the loans by the latter to the former for being invested in the three companies and that the shares would be transferred at par by the assessee to I.C.I. whenever desired, the applicability of Section 52 could not be attracted as the same depended on certain facts which must exist or must be found and which had not been so found by the Tribunal.

15. In the result the appeal is allowed and the order of the High Court is hereby set aside. The assessee shall be entitled to its costs in this Court.