

## **PRIVY COUNCIL**

Indian Iron and Steel Co., Ltd.

Vs.

Commissioner of Income-Tax, Bengal

P.C.A.No.7 of 1942

(Lords Atkin, Russell of Killowen and Porter JJ.)

25.03.1943

### **JUDGMENT**

#### **LORD PORTER J.**

1. The appellant is a company incorporated and registered under the Companies Act in the year 1918. It carried on the business of an ironfounder and steel maker at Hirapur in the Province of Bengal. By an agreement dated 8th September 1936, made between the appellant and a company named the Bengal Iron Company, Ltd., the former agreed to acquire and take over the whole of the property and assets of the latter as existing on the date of transfer. This second company was incorporated and registered in England and had carried on at Kulti in the same Province a business similar to that of the appellant. On 2nd December 1936, in pursuance of this agreement, and after it had been sanctioned by the High Court in England, the Bengal company transferred to the appellant the whole of its undertaking and assets, and from 3rd December (1) the appellant carried on the business previously carried on by that company as part of and in combination with its own existing business, and (2) the Bengal company ceased to carry on business and went into voluntary liquidation. In addition to the provisions already set out, the agreement of 8th September contained (inter alia) a further clause assigning, "so far as capable of being assigned, any claim which the Bengal company may have in respect of unabsorbed depreciation allowances." These allowances are those specified in Section 10, Income-tax Act, 1922, a section which, so far as is material, contains the following provisions :

10-(1) The tax shall be payable by an assessee under the head "Business" in respect of the profits or gains of any business carried on by him.

(2) Such profits or gains shall be computed after making the following

allowances, namely :

(i) any rent paid for the premises in which such business is carried on, provided that, when any substantial part of the premises is used as a dwelling house by the assessee, the allowance under this clause shall be such sum as the Income-tax Officer may determine having regard to the proportional part so used ;

(ii) in respect of repairs, where the assessee is the tenant only of the premises, and has undertaken to bear the costs of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed ;

(vi) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed :

Provided that :

(a) the prescribed particulars have been duly furnished; (b) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or, if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years; and (c) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Income-tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant, or furniture, as the case may be;

(vii) in respect of any machinery or plant which, in consequences of its having become obsolete, has been sold or discarded, the difference between the original cost to the assessee of the machinery or plant as reduced by the aggregate of the allowances made in respect of depreciation under clause (vi), or any Act repealed hereby, or the Income-tax Act, 1886, and the amount for which the machinery or plant is actually sold, or its scrap value;

(vii-a) in respect of animals which have been used for the purposes of the business otherwise than as stock in trade and have died or become permanently useless for such purposes, the difference between the original cost to the

assessee of the animals and the amount, if any, realised in respect of the carcasses or animals.

2. In a case where a company continues to carry on its own business the principle for computation of these allowances is reasonably well settled, but where one company absorbs another at the end or in the course of a current fiscal year difficulties have from time to time arisen as to the correct allowances to be made. The statutory provision dealing with the liability to tax of a company whose business is transferred at these times is contained in Section 26(9) of the same Act and is as follows :

26. - (2) Where, at the time of making an assessment under section 23, it is found that the person carrying on any business, profession or vocation has been succeeded in such capacity by another person, the assessment shall be made on such person succeeding, as if he had been carrying on the business, profession or vocation throughout the previous year, and as if he had received the whole of the profits for that year.

3. The question for their Lordships' determination is to ascertain the true construction to be placed upon the two sections quoted when read together and to determine the principle upon which depreciation is to be computed and allowed in the case of such a change. After the amalgamation of the two companies an assessment was made upon the appellant company for the year 1937-38, based upon the figures of the previous year, 1st April 1936 to 31st March 1937, the year in which the transfer took place. Against this assessment, the Indian company appealed and the Assistant Commissioner of Income-tax made an altered assessment which has been summarized in a case afterwards stated by the Commissioner on 19th December 1940. Before the summarized conclusions arrived at by the Assistant Commissioner are set out, it is desirable to state the relevant facts and the contentions put forward on behalf of each of the parties.

4. Up to the time of the amalgamation, neither company had been very successful, with the result that each had acquired under Section 10 (2) (vi) a large unabsorbed depreciation allowance. By the end of the fiscal year 1935-36, this allowance in the case of the Bengal Company had reached the figure of Rs. 85,45,150 and in the case of the Indian Company amounted to Rs. 62,00,775. Admittedly as at that date each of those two separate companies could have claimed to set off against any future profit made by it the depreciation allowance to which it was then entitled. The question now in dispute arises as to the amount of benefit to which the combined companies, if they may be so described, are entitled at the end of the next fiscal year and how much of

that amount can be carried on to future years. The appellant maintained that it must be assessed under Section 26(2) in respect of the business of the Bengal Company as if it had been carrying on that business as a separate activity for the whole year and had received the whole of the profits for that year.

5. The profits, it is alleged, of the Bengal Company's business had to be ascertained up to the end of 2nd December 1936; to those profits must be added the proper proportion of the profits of the combined businesses attributable to the Bengal Company's portion of it, calculated in accordance with the method adopted in *Bell v. National Provincial Bank of England*. From the total yearly profits of that business, ascertained in that way, the appellant was entitled to have the advantage of deducting the previously ascertained unabsorbed depreciation allowance of Rs. 85,69,148, and also further depreciation allowances for the current year, calculated over the whole of the period upon the original cost to the Bengal Company of the assets upon which depreciation was allowable. Similarly, it was said, with reference to the Indian Company the profits must be ascertained by the same method of computation, and were subject to the deduction of the original unabsorbed depreciation allowance allotted to that company of Rs. 62,00,775, together with the appropriate depreciation for the current year calculated upon the same principles as those adopted in the case of the other company. The profits and allowances having been ascertained in this way, the appellants contended that the lesser sum, i. e., profits, should be deducted from the greater, i. e., the unabsorbed depreciation allowance, and the resultant figure carried forward to the next year, the appellant being thus entitled to the future benefit of both sets of unabsorbed depreciation allowance as a deduction from its future profits.

6. The respondent, on the other hand, asserted that the correct method to adopt was to find the profits of the Bengal Company for the 8 months from 1st April to 2nd December 1936, and to deduct the resultant figure from the unabsorbed depreciation allowance standing to the credit of that company on 1st April 1936, together with the further proper depreciation to be allowed to that company for the same 8 months, calculated on the original cost of those assets to that company. This calculation admittedly would result in a minus figure, but, said the income-tax officials, no further benefit of this unabsorbed depreciation was to be given to anyone. So far as the Indian Company was concerned, it was to enjoy the advantage of (1) depreciation allowance for the whole year in respect of its original buildings, etc., calculated on the cost of those assets to it;

(2) depreciation allowance for the period 3rd December 1936 to 31st March

1937, on the assets acquired from the Bengal Company, calculated not on the costs to that company, but on the price at which the Indian Company acquired them from that company; and (3) its own unabsorbed allowance carried forward from the beginning of the fiscal year. From these three sums added together was to be deducted the profits of the business- meaning thereby the profits of the Indian Company (if any) for the whole year, together with those of the acquired business for the period 3rd December 1936 to 31st March 1937. The resultant sum would still be a minus quantity and would remain as an unabsorbed depreciation allowance to the credit of the Indian Company, but the benefit of the unabsorbed balance of the other company could not be used to diminish future income-tax returns of the Indian Company.

7. The contentions of each party as applicable to the present case can be set out with substantial accuracy by quoting from the figures in the stated case. The company in their return claimed the following sums as admissible by way of depreciation :

(a) Depreciation of the two companies for the year 1936-37 ... ..	23,49,815-0-0
(b) Unabsorbed depreciation of the Indian Company ... ..	62,00,776-0-0
(c) Unabsorbed depreciation of the Bengal Company ... ..	85,69,148-0-0
Total ... ..	1,71,19,738-0-0

8. The Appellate Assistant Commissioner's conclusions were as follows :-

(i) BENGAL IRON COMPANY 1

(a) Depreciation allowance in respect of the original property of the Bengal Company for 8 months from the 1st April to the 2nd December 1936 ... ..	8,62,329-0-0
(b) Unabsorbed depreciation allowance as above ... ..	85,45,150-0-0
Total ... ..	94,07,479-0-0
Less profits of the business for this period ... ..	3,76,162-0-0
Depreciation allowance left unabsorbed ... ..	90,31,817-0-0

(ii) INDIAN IRON AND STEEL COMPANY

(a) Depreciation allowed in respect of the original property of the Indian Company for the year 1936-37... ..	7,60,077-0-0
(b) Depreciation allowance in respect of the property acquired from the Bengal Company for the period 3rd December 1936 to 31st March 1937 ... ..	3,77,767-0-0

(c) Unabsorbed depreciation allowance as above -	62,00,776-0-0
Total ...	73,38,619-0-0

Less profits of the original business for the fiscal year together with that of the acquired business for the period 3rd December 1936 to 31st March 1937. 36,54,295-0-0

Depreciation allowance left unabsorbed ...	36,84,324-0-0
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9. In the figures of the appellant's claim the sum of 23,49,815.00 was calculated upon the original cost to the Indian Company of its own assets and the original cost to the Bengal Company of the assets taken over from it. On the other hand, the figure of 3,77,767.00 in the Assistant Commissioner's calculation was based upon the cost to the Indian Company of the assets which it took over from the Bengal Company. This difference of computation is a further but subsidiary matter of contention between the parties and is best dealt with in considering the major dispute. The argument on behalf of the appellant was, as their Lordships understood it, put in the following way :

10. At the beginning of the year the Bengal Company was entitled to an unabsorbed depreciation allowance of 85,45,150. If it had carried on business until the end of the year it would have been entitled to the benefit of this sum, together with the appropriate depreciation for the current year calculated upon the original cost of the assets. Then, it was said, Section 26(2) provides that the assessment is to be made on a person succeeding to the business as if he had been carrying it on throughout the previous year and had received the whole of the profits for that year. The Indian Company, it was argued, was the successor and was to be assessed as if it had carried on the Bengal Company's business for the whole year, though in fact it had only carried it on for four months. If it had carried that business on for the whole year it would have been entitled to the allowances claimed, and "as full effect could not be given to those allowances" because they exceeded the profits, then under proviso (b) to Section 10(2) (vi), that part of the allowance to which effect had not been given should be added to the amount of depreciation of the combined business for the following year and, it is added, so on for succeeding years subject to the limitation contained in proviso (c).

11. It is true, as the appellant admits, that the allowance is only to be made in respect of the property of the assessee; that the Indian Company was the assessee, and, strictly speaking, the assets of the Bengal Company only became the property of the Indian Company from 3rd December 1936. But "assessee," the company maintained, must be read distributively as meaning the owner of the property for the time being, i.e., the

assessee or his predecessor, as the case may be. In support of this contention they point out that such a construction is necessary in other parts of the sub-section, e. g., in sub section (2) (i) and (ii). The words "used as a dwelling house by the assessee" must refer to the assessee or his predecessor, or to both in cases where each is owner of the property for part of the fiscal year. So too, in sub-paras, (vii) and (vii-a). Unless "assessee" includes predecessor no depreciation could be claimed in respect of the period during which the predecessor still owned the property and the successor had not acquired it.

12. There is no doubt truth in the contention that the word "assessee" in Section 10(2) must, when there is a successor to the business charged to tax, be read in certain of the paragraphs as including both predecessor and successor, but their Lordships are not prepared to assent to the argument that it follows as a consequence that the unabsorbed depreciation allowance of the predecessor must be added to that of the successor or to agree that even in a case when the only business concerned is that which is transferred, the business when transferred, carries to the purchaser its unabsorbed allowance. Indian income-tax is assessed and paid in the next succeeding year upon the results of the year before. If then company A sold its business to company B in the first of the two years, apart from the provisions of Section 26(2), the former company could not be assessed and would not be liable for any profits it then made, because it would not be carrying on the business in the next year for which in the normal course the assessment would be made and in respect of which tax would be due, nor would company B be liable except for any period during which it had itself owned the business and made profits, because the tax under Section 10(1) is only "payable by an assessee under the head 'business' in respect of the profits or gains of any business carried on by him."

13. To meet this contingency, whether in the case of a company or an individually owned business, section 26 was passed, and is concerned not with the computation of tax, but with the person upon whom the liability is imposed. When but not until the person to pay has been ascertained do the terms of Section 10 become material in order to discover how the amount to be paid is to be computed. If this be the true method of approach, the Indian Company no doubt is liable as assessee as if it had been carrying on the Bengal Company's business throughout the previous year and had received the whole of the profits for that year. But this only means that the profits of the Bengal Company are to be ascertained in accordance with the provisions of Section 10 for the period during which it carried on the business, and that the profits

of the Indian Company are to be ascertained for the period during which it carried on that business in accordance with the same principles. Whether the latter are calculated upon the earnings of the combined business or separately for each part of it, the resultant figure, when added to the Bengal Company's profits (if any), will cause the Indian Company to be assessed as if it had carried on the Bengal Company's business for the whole year. It is itself liable for the last four months, and by the addition of liability for the previous eight months it will be assessed as if it had been carrying on the business throughout the year.

14. The object is to impose liability for the whole profits, and in finding out what they are the actual circumstances have to be considered. So far there is nothing to suggest that once the Bengal Company has ceased to carry on business its unabsorbed depreciation allowance should be carried on for the benefit of the Indian Company. But it is said that company is to be treated as if it had been carrying on the business throughout the year; in that year full effect could not be given to its depreciation allowance whether unabsorbed in previous years or acquired in the year in question, and under the direct terms of proviso (b) this allowance is to be added to that for the following year and to be deemed to be part of that allowance, and so on for succeeding years. To the answer that what is given is "such allowance" only and "such allowance" when read together with the previous language of sub section (2) (vi) can mean only an allowance in respect of depreciation of buildings etc., being the property of the assessee, it is replied that "assessee" in this as in the other sub-sections previously referred to includes predecessor as well as successor and that the proviso in conjunction with Section 26 should be read as saying: "Where full effect cannot be given in any year to the allowance proper to be given to the assessee or to his predecessors or to both, the allowance or the unused part thereof shall be added to the amount of the allowance to which the assessee is entitled for the following year."

15. Their Lordships see no reason for giving this wide meaning to the word "assessee" in the proviso to Section 10(2) (vi). Under the definition in Section 2(2) "Unless there is anything repugnant in the subject or context.... assessee means a person by whom income-tax is payable" and, in the view of the Board, there is nothing repugnant in the subject or context to prevent this definition being applicable to para. (vi). Moreover, the allowance, in addition to being given in respect of the depreciation of buildings, etc., being the property of the assessee, is to be calculated on the original cost to the assessee. If "cost to the assessee" may mean either cost to the predecessor or cost to the successor, on what cost is the depreciation to be calculated when the property

passes from one to the other in the course of the fiscal year? There may well be good ground for holding that cost to the assessee means cost to the predecessor so long as he continues to be owner of the property. Indeed, it was so held in *Commissioner of Income-tax, Bombay Presidency, Sind and Baluchistan v. Mazagaon Dock Ltd., Bombay*. But once the property has passed to the successor, he is the assessee, the depreciation is, in the words of the Act, to be calculated on the cost to him, and there is, in their Lordships' opinion, no reason for holding that the cost to the predecessor is thereafter to be adopted as the basis of depreciation, This view is in accordance with that expressed in *Commissioner of Income-tax, Madras v. Buckingham Karnatic Co. Ltd., Madras*. It is true that in both the cases referred to above, the transfer took place at the end of one fiscal year and the beginning of the next, and therefore neither case is a direct authority on the question now before the Board. But the principles are similar, and as their Lordships think, show the method upon which the computation is to be made. They are in agreement with the view of Panckridge J. in the High Court in Calcutta in considering that if and in so far as 7 ITR 374, Re Kamalapat Motilal lays down any different principles it is wrong.

16. The argument on behalf of the appellant can perhaps be most strongly put by postulating the sale at the end of the fiscal year of a business carried on by a company or individual to another individual not previously carrying on any business or to a company formed solely for the purpose of carrying it on. If the business had not been sold it would have continued to enjoy the benefit of any unabsorbed depreciation allowance. Why, it is said, should it lose that benefit because it has changed hands? No doubt the example given does indicate a case in which some hardship may be said to arise, but the object of Section 10 is not to bolster up unsuccessful businesses, it is merely to protect them, in the hands of those who find the capital, against undue taxation. The example, may be countered by quoting a case in which a bankrupt business with a large unabsorbed depreciation allowance is bought by a flourishing house in order to enhance its own allowance and decrease its taxation. Success in the latter circumstances would be at least as undesirable as failure in the former is unfortunate. But in any case, the matter must depend on the wording of the section, and not upon the consequences which follow. Their Lordships desire to refer to two more matters raised in argument.

(1) The appellant in its case placed some reliance upon the assignment to them in the agreement of 8th September 1936, by the Bengal Company of "the benefit, so far as capable of being assigned, of any claim which the Bengal

Company may have in respect of unabsorbed depreciation allowances." It was, however, admitted before the Board that these allowances were unassignable in law and it is therefore unnecessary for their Lordships to express any opinion upon the question.

(2) Those representing the respondent took the point, but without pressing it, that the claim of the appellant was prematurely brought. It was said, as was the fact, that the case now the subject of appeal was stated under Section 66(2), Income-tax Act (11 of 1922), that that section gave the right to require a case to be stated to an "assessee" only; that, even though the view most unfavorable to the appellants was taken, yet the result would still leave an unabsorbed balance in his favor: and that consequently there could be no assessment and no assessee.

17. Having regard to the conclusion which they have reached, their Lordships do not find themselves compelled, and indeed were not invited, to pronounce upon this argument. In the present instance, at any rate, it was obviously desirable that the appellant should ascertain its position at once and should not be compelled to wait possibly for years in order to discover what their financial position was. But the question is open to be taken by the income-tax authorities on another occasion if they think anything is to be gained by doing so. In the result their Lordships will humbly advise His Majesty that the appeal be dismissed. The appellant must pay the respondent's costs of the hearing before the Board.

Appeal dismissed.

Cases Referred.

(1904) 1 KB 149 : 73 LJ KB 142 : 90 LT 2: 52 WR 406: 68 JP 107 : 5 Tax Cas 1 : 20 TLR 97,

25 AIR 1938 Bombay 241 : 174 IC 905 : ILR (1938) Bom 374 : 39 Cr LJ 905 : 40 Bom LR 343 (SB),

23 AIR 1936 PC 5 : 159 IC 545 : 59 Mad 175 : 63 IA 74 (PC),