

Commissioner of Income Tax, Bombay

Vs

M/s Italindia Cotton Co. (P) Ltd

Civil Appeal No. 1520 (NT) of 1986

(CJI R. S. Pathak, Sabyasachi Mukharji JJ)

05.09.1988

JUDGMENT

PATHAK, C. J –

1. This appeal by special leave is directed against the judgment of the Bombay High Court construing the provisions of Section 79 of the Income Tax Act, 1961 in favour of the assessee.
2. 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 shareholders, who may be described as the Chunilal Group, the Babubhai Group and the Purushottam Group. There was a change in the shareholding of the three companies during the accounting year ending March 31, 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.
3. The assessee suffered a loss in the accounting year ending March 31, 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 shareholding of the assessee during the accounting year ending March 31, 1963 relevant to the assessment year 1963-64, the question arose whether the assessee was entitled to the benefit or carrying forward that loss for the purpose of computing its assessable profits for that assessment year. The Income Tax Officer held that Section 79 of the Income Tax Act, 1961 disentitled the assessee from claiming such a set-off. He said that 51 per cent 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 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 per cent 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 Section 79 the Tribunal observed that the denial of the set-off a loss incurred in an earlier year was subject to two exceptions, the first being that the beneficial holding representing not less than 51 per cent 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 shareholding 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 Section 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.

4. 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 Section 79 must apply for disentitling the loss of a prior year being allowed as set off in accordance with the substantive provisions of Section 79 of the Income Tax Act, 1961?

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

6. 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. The 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 he 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 shareholding was not effected with a view to avoiding or reducing any liability to tax.

7. Section 79 is an exception to the scheme enacted in Chapter VI for the carry forward and setting off or 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 Section 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 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 shareholding 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 clause (a) or clause (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 relation to the carry forward and set-off of losses. The benefit is available notwithstanding the change in shareholding in The previous year, if shares representing not less than 51 per cent 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.

8. 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 these 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 shareholding 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 shareholding 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 per cent 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 shareholding would stand removed.

9. But there may be a change in the shareholding, and it may result in a change of control of the company. Yet every such change or shareholding need not fall within the prohibition. There can be a case where persons already owning a shareholding carrying less than 51 per cent of the voting power in the company may enlarge their shareholding 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 shareholding 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 effected 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 shareholding will tend to bring about the result which Section 79 was designed to prevent. In our opinion, to avoid falling within the scope of Section 79 it is sufficient for the assessee to show that the case attracts either clause (a) or clause (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 *CIT v. Subhlaxmi Mills Ltd.* and by the Madras High Court *CIT v. Saravanabhava Mills Pvt. Ltd.*

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

11. The appeal is dismissed with costs.

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