Saraswati Industrial Syndicate Ltd.

Vs

Commissioner of Income-Tax, Haryana, Himachal Pradesh and Delhi III.

Civil Appeal No. 91 of 1976

(K. N. Singh, Dr. T. K. Thommen, Kuldip Singh JJ)

04.09.1990

JUDGMENT

KULDIP SINGH J. –

This appeal is directed against the judgment and order of the Punjab and Haryana High Court dated April 15, 1975 [CIT v. Saraswati Industrial Syndicate Ltd. [1982] 136 ITR 366 (Appx.)] answering the income-tax reference made to it by the Income-tax Appellate Tribunal.

Briefly, the facts giving rise to this appeal are that the appellant, Saraswati Industrial syndicate, is a limited company carrying on the business of manufacture and sale of sugar and machinery for sugar mills and other industries. Another company, namely, the Indian Sugar and General Engineering Corporation (hereinafter referred to as "the Indian Sugar Company") was also manufacturing machinery parts for sugar mills. On September 28, 1962, under the orders of the High Court, the Indian Sugar Company was amalgamated with the appellant- company. After the amalgamation, the Indian Sugar Company lost its identity, as it did not carry on any business. Prior to the amalgamation, the Indian Sugar Company had been allowed expenditure to the extent of Rs. 58,735 on accrual basis in its earlier assessment. The company had shown the aforesaid amount as a trading liability and the said trading liability was taken over by the appellant company. After amalgamation, the appellant-company claimed exemption of the amount of Rs. 58,735 from income-tax for the assessment year 1965-66 on the ground that the amalgamated company was not liable to pay tax under section 41(1) of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), as the expenditure had been allowed to the erst- while Indian Sugar Company which was a different entity from the amalgamated company. The Income-tax Officer disallowed the appellant's claim for exemption. The assessee filed an appeal before the Appellate Assistant Commissioner who confirmed the order of the Income-tax Officer. The assessee, thereafter, preferred an appeal before the Income-tax Appellate Tribunal. The Tribunal allowed the appeal on the construction of section 41(1) of the Act. The Tribunal held that, after the amalgamation of the Indian Sugar Company with the assessee- company, the identity of the amalgamating company was lost and it was no longer in existence and therefore, the assessee-company was a different entity not liable to tax on the aforesaid amount of Rs. 58,735. On the Department's application, the Tribunal referred the following question to the High Court (at p. 369 of 136 ITR) :

> "Whether, on the facts and circumstances of the case, the Tribunal was justified in law in holding that the amount of Rs. 58,735 was not chargeable to tax under sub-section (1) of section 41 of the Income- tax Act, 1961, for the assessment year 1965-66 ?"

The High Court answered the question in favour of the Revenue holding that the exemption from tax liability claimed by the appellant- assessee was chargeable to tax under section 41(1) of the Act. The High Court held that, on the amalgamation of the two companies, neither of hem ceased to exist; instead both the amalgamating and amalgamated companies continued their entities in a blended form. It further held that the amalgamated company was a successor-in-interest of the amalgamating company and since the assets of both the companies were merged and blended to constitute a new company, the liabilities attaching thereto must, therefore, be on the amalgamated company. On these findings, the High Court held that the amalgamated company, namely, the assessee, was liable to pay tax on Rs. 58,735 which came into its hands from the assets of the Indian Sugar company. The assessee made an application before the High Court under section 261 of the Act read with section 109 of the Code of Civil Procedure for a certificate to appeal to this court but the High Court dismissed the same. The appellant thereupon approached this court by means of a special leave petition under article 136 of the Constitution. This court granted leave. Hence this appeal.

Section 41(1) of the Act reads as follows : "41(1). Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee, and subsequently during any previous year the assessee has obtained, whether in cash or in any other manner whatsoever. Any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him, shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not."

Section 41(1) has been enacted for charging tax on profits made by an assessee, but it applies to the assessee to whom the trading liability may have been allowed in the previous year. If the assessee to whom the trading liability may have been allowed as a business expenditure in the previous year ceases to be in existence or if the assessee is changed on account of the death of the earlier assessee, the income received in the year subsequent to the previous year or the accounting year cannot be treated as income received by the assessee. In order to attract the provisions of section 41(1) for enforcing the tax liability, the identity of the assessee in the previous year and the subsequent year must be the same. If there is any change in the identity of the assessee, there would be no tax liability under the provisions of section 41. In CIT v. Hukumchand Mohanlal, [1971] 82 ITR 624, this court held that the Act did not contain any provision making a successor in business or the legal representative of an assessee to whom the allowance may have been already granted liable to tax under section 41(1) in respect of the amount remitted and received by the successor or by the legal representative. In that case, the wife of the assessee on the death of her husband, succeeded to the business carried on by him. Another firm which had recovered certain amounts towards sales tax from the assessee's husband succeeded in an appeal against its sales tax assessment and thereupon the firm refunded that amount to the assessee which was received during the relevant accounting period. A question arose as to whether the amount so received by the assessee could be assessed in her hands as a deemed profit under section 41(1) of the Act. This court held that section 41 did not apply because the assessee sought to be taxed was not the assessee as contemplated by section 41(1), as the husband of the assessee had died;

therefore, the Revenue could not take advantage of the provisions of section 41(1) of the Act.

The question is whether, on the amalgamation of the Indian Sugar Company with the appellant-company, the Indian Sugar Company continued to have its identity and was alive for the purposes of section 41(1) of the Act. The amalgamation of the two companies was effected under the order of the High Court in proceedings under section 391 read with section 394 of the Companies Act. The Saraswati Industrial Syndicate, the transferee-company, was a subsidiary of the Indian sugar Company, namely, the transferor-namely, the transferor-company. Under the scheme of amalgamation, the Indian sugar Company stood dissolved on October 29, 1962, and it ceased to be in existence thereafter, though the scheme provided that the transferee-company, the Saraswati Industrial Syndicate Ltd., undertook to meet any liability of the Indian Sugar Company which that company incurred or it could incur, before the dissolution or not (sic) thereafter.

Generally, where only one company is involved in a change and the rights of the shareholders and creditors are varied, it amounts to reconstruction or reorganisation or scheme of arrangement. In an amalgamation, two or more companies are fused into one by merger or by one taking over the other. Reconstruction or amalgamation has no precise legal meaning. Amalgamation is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company become substantially the shareholders in the company which is to carry on the blended undertakings. There may be amalgamation either by the transfer of two or more undertakings to a new company, or by the transfer of one or more undertakings to an existing company. Strictly, "amalgamation" does not cover the mere acquisition by a company of the share capital of the other company which remains in existence and continues its undertaking but the context in which the term is used may show that it is intended to include such an acquisition. See Halsbury's Laws of England, 4th Edition, Volume 7, para 1539. Two companies may join to form a new company, but there may be absorption or blending of one by the other and both amount to amalgamation. When two companies are merged and are so joined as to form a third company or one is absorbed into the other or blended with another, the amalgamating company loses its entity.

In General Radio and Appliances Co., Ltd. v. M. A. Khader [1986] 60 Comp Cas 1013, the effect of amalgamation of two companies was considered. General Radio and Appliances Co., Ltd., was the tenant of a premises under an agreement providing that the tenant shall not sub- let the premises or any portion thereof to any one without the consent of the landlord. General Radio and Appliances Co., Ltd., was amalgamated with National Ekco Radio and Engineering Co., Ltd., under a scheme of amalgamation and order of the High Court under sections 391 and 394 of Companies Act, 1956. Under the amalgamation scheme, the transferee-company, namely, National Ekco Radio and Engineering Company, had acquired all the interest, rights including leasehold and tenancy rights of the transferor company, and the same vested in the transferee-company continued to occupy the premises which had been let out to the transferor-company. The landlord initiated proceedings for eviction on the ground of unauthorised sub-letting of the premises by the transferor-company. The transferee-company set up a defence that, by amalgamation of the two companies under the order of the Bombay High Court, all interests, rights including leasehold and tenancy rights held by the transferor-company, blended with the transferee- company and, therefore, the transferee-company was a legal tenant and there was no question of any sub-letting. The Rent Controller and the High Court both decreed the landlord's suit. This court, in appeal, held that under the order of amalgamation made on the basis of the High Court's order, the transferor-company ceased to be in existence in the eye of law and it effaced itself for all practical purposes. This decision lays down that, after the amalgamation of the two companies, the transferor-company ceased to have any

identity and the amalgamated company acquired a new status and it was not possible to treat the two companies as partners or jointly liable in respect of their liabilities and assets. In the instant case, the Tribunal rightly held that the appellant-company was a separate entity and a different assessee and, therefore, the allowance made to Indian Sugar Company which was a different assessee could not be held to be the income of the amalgamated company for purposes of section 41(1) of the Act. The High Court was in error in holding that, even after amalgamation of the two companies, the transferor-company did not become non-existent but instead it continued its entity in a blended form with the appellant-company. The High Court's view that, on amalgamation, there is no complete destruction of the corporate personality of the transferor-company but instead there is a blending of the corporate personality of one with another corporate body and it continues as such with the other is not sustainable in law. The true effect and character of the amalgamation largely depends on the terms of the scheme of merger. But there cannot be any doubt that, when two companies amalgamate and merge into one, the transferor-company loses its entity as it ceases to have its business. However, their respective rights and liabilities are determined under the scheme of amalgamation but the corporate entity of the transferor-company ceases to exist with effect from the date the amalgamation is made effective.

In view of the above discussion, we agree with the Tribunal's view that the amalgamating company ceased to exist in the eye of law and therefore, the appellant was not liable to pay tax on the amount of Rs. 58,735. The appeal is, accordingly, allowed and we set aside the order of the High Court and answer the question in favour of the assessee and against the Revenue.

There will be no order as to costs.

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