Indian Shaving Products Limited

Vs

Board of Industrial and Financial Reconstruction and Another

Civil Appeal No. 5638 of 1994

(S.P. Bharucha, S. Saghir Ahmad JJ)

03.01.1996

JUDGEMENT

BHARUCHA, J.:-

1.This appeal by special leave impugns an order of the Appellate Authority for Industrial and Financial Reconstruction. The impugned order upheld the order of the Board for Industrial and Financial Reconstruction, established under the Sick Industrial Companies (Special Provisions) Act, 1985 (hereinafter called the said Act), by which the benefit of the provisions of Section 72A of the Income-tax Act. 1961, was not extended to the appellant upon the amalgamation of Sharp Edge Limited with it.

2. Notice upon this appeal was issued to the Central Board of Direct Taxes and it was duly served. it has not entered appearance.

3. Section 72A of the Income-tax Act states "that where there has been an amalgamation of a company owning an industrial undertaking with another company and the Central Government, on the recommendation of the specified authority, is satisfied that the following conditions are fulfilled. namely:-

> "(1) the amalgamating company was not, immediately before such amalgamation, financially viable by reason of its liabilities, losses and other relevant factors:
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> (b) the amalgamation was in the public interest; and
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> (c) such other conditions as the Central Government may, by notification in the Official Gazette, specify, to ensure that the benefit under this section is restricted to amalgamation which would facilitate the rehabilitation or revival of the business of the amalgamating company, then, the Central Government may make a declaration to that effect, and thereupon, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and the other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly .....".

" Specified authority" has been defined for the purposes of Section 72A to mean such authority as Central Government might, by notification in the Official Gazette, specify.

4. The said Act was enacted to make, in the public interest, special provisions with a view to securing the timely detection of sick and potentially sick companies owning industrial undertakings, the speedy determination by a board of experts of the preventive, ameliorative, remedial and other measures which were needed to be taken with respect to such companies and the expeditious enforcement thereof. Section 4 constitutes the Board for Industrial and Financial Reconstruction (BIFR) and Section 5 constitutes the Appellate Authority. Chapter III deals with references, inquiries and schemes. The Provisions of Section 15(1) state that where an industrial company has become a sick industrial company, its Board of Directors shall within sixty days from the date of finalisation of the duly audited accounts of the company for the financial year as at the end of which the company has become a sick industrial company, make a reference to the BIFR for determination of the measures which should be adopted with respect to the company. A "sick industrial company" was defined by Section 3 (o) to mean an industrial company which had at the end of any financial year accumulated losses equal to or exceeding its entire net worth and had also suffered cash losses in such financial year and the financial year immediately preceding such financial year. This definition was substituted in 1994 so that it now means an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth. Section 16 requires the BIFR to make such inquiry as it may deem fit for determining whether any industrial company has become a sick industrial company, inter alia, upon receipt of a reference with respect to such company under Section 15. The BIFR may, for the disposal of such inquiry, require an operating agency to enquire into and make a report with respect to such matters as the BIFR may specify. The inquiry is required to be completed within sixty days from its commencement and an inquiry is deemed to have commenced upon receipt by the BIFR of a reference, Section 17 so far as is relevant reads thus :

"17, Powers of Board to make suitable order on the completion of inquiry--

(1) If after making an inquiry under Section 16 the Board is satisfied that a company has become a sick industrial company, the Board shall, after considering all the relevant facts and circumstances of the case, decide, as soon as may be by order in writing, whether it is practicable for the company to make its net worth exceed the accumulated losses within a reasonable time.

(2) If the Board decides under sub-section (1) that it is practicable for a sick industrial company to make its net worth exceed the accumulated losses within a reasonable time, the Board, shall, by order in writing and subject to such restrictions or conditions as may be specified in the order, give such time to the company as it may deem fit to make its net worth exceed the accumulated losses.

(3) If the Board decide under sub-section (1) that it is not practicable for a sick industrial company to make its net exceed the accumulated losses within a reasonable time and that it is necessary or expedient in the public interest to adopt all or any of the measures specified in Section 18 in relation to the said company it may, as soon as may be, by order in writing, direct any operating agency specified in the order to prepare, having regard to such guidelines as may be specified in the order, a scheme providing for such measures in relation to such company. Section 18 states that

where an order has been made under Section 17 (3) in relation to any sick industrial company, the operating agency specified in the order shall prepare a scheme with respect to such company providing for the measures set out therein. The following measure is referred to in clause (c) (i),namely, "the amalgamation of the sick industrial company with any other company." The scheme prepared by the operating agency is required to be examined by the BIFR and its copies sent with such modifications, if any, as may have been made by the BIFR to the sick industrial company, the operating agency and to the other company concerned in the proposed amalgamation and, after consideration of objections, the BIFR is required to sanction the scheme, which would come into force on such date as it might specify. Section 32(2) reads:

"Where there has been under any scheme under this Act an amalgamation of a sick industrial company with another company, the provisions of Section 72-A of the Income-tax Act, 1961 (43 of 1961), shall, subject to the modifications that the power of Central Government under that section may be exercised by the Board without any recommendation, by the specified authority referred to in that section, apply in relation to such amalgamation as they apply in relation to the amalgamation of a company owning an industrial undertaking with another company .

5. Sharp Edge Ltd. was incorporated in 1956 to manufacture carbon steel blades. Its controlling interest was held by different companies at different times. From August 1986 onwards the shareholding was taken over by the appellant. Subsequent to 1983 Sharp Edge was not doing well. As on 31st March, 1989, its accumulated loss amounted to Rs. 298 lakhs against its paid up capital of Rs. 212 lakhs. A reference was made to the BIFR under Section 15(8) of the said Act. Sharp Edge having become as a sick industrial company. On 9th July, 1991, the amalgamation of Sharp Edge with the appellant company was discussed by the BIFR. After considering all the submissions made to it, the BIFR noted that it was not possible for Sharp Edge to make its net worth positive on its own and it was in the public interest to take such measures as might be feasible for its rehabilitation. Accordingly, in exercise of the powers under Section 17(3) of the said Act. ICICI was appointed as the operating agency with the task of examining the viability of Sharp Edge and for preparing a scheme to rehabilitate it. On 13th November, 1991, the BIFR observed that Sharp Edge's performance had significantly improved during the last two years mainly because of the management and financial support from the appellant and its net worth had become positive. The appellant was also doing quite well and had the necessary financial strength to rehabilitate its closely held subsidiary (Sharp Edge) without further financial reliefs and concessions. The BIFR then said : "In view of the consensus among the concerned parties for the long term benefits to the sick company flowing from its merger with the parent company, the Bench acceded to the request of the company to allow the amalgamation of the two companies but without granting any benefits under Section 72A of the Income-tax Act. "The operating agency was, accordingly, directed to submit a revised draft rehabilitation-cum-merger scheme.

6. On 2nd April, 1992, the appellant wrote to the BIFR and submitted that it should reconsider the request for the benefit of the provisions of Section 72A of the Income-tax Act favourably, for the reasons stated by it. On 23rd April, 1992, the BIFR considered the material on record and observed that no objection was received to the notified rehabilitation scheme and that the required consents and approvals of the concerned parties to the said scheme had been obtained. It said: "The company's request for grant of benefit under Section 72A of the Income-tax Act, was not considered justified by the Bench as it was a closely held company. Its liabilities were mainly in respect of its

parent company, namely, Indian Shaving Products Ltd. (ISPL). It had been showing a cash profit for the last 3 years and its net worth had since become positive, as also ISPL was a strong base company. The BIFR sanctioned the scheme, to come into force with immediate effect. Under the terms of the scheme the amalgamation took effect on Ist April, 1991.

7. Against the order of the BIFR declining to grant the benefit of Section 72A of the Income-tax Act to the amalgamation, the appellant preferred an appeal. The appellate authority noted that the BIFR had given five reasons for declining the benefit under Section 72A, namely, (1) that Sharp Edge was a closely held company; (2) its liabilities were mainly in respect of the appellant; (3) Sharp Edge had been showing a cash profit for the last three years; (4) its net worth had since become positive; and (5) the appellant was a strong base company. In relation to these reasons, the appellate authority said;

> "None of these factors can be considered totally irrelevant or extraneous except possibly the fact that both these companies are closely companies and also the fact that all the liabilities of the sick industrial company are in respect of its parent company, namely, the amalgamating company, the ISPL. It may also be stated that, as on the date of amalgamation, that is, on April 1, 1991, the sick industrial company's net worth had not yet become positive."
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> The appellate authority concluded its order thus:
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> "Financial viability or non-viability is determined by the three factors of profitability, liquidity and solvency. It has been shown above that the sick company had generated cash profits in the preceding two years prior to the date of amalgamation, i.e., prior to 1-4-91 , and thus was in a stage of incipient sickness and potentially viable. This was thus the basis for the acceptance and sanction of the rehabilitation scheme.
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> 27. Public interest has to be judge from a different stand-point. It has to be examined whether, if this Income-tax benefit were not to be granted, the rehabilitation-cum-merger scheme would succeed or fail and if, in the event of the latter, the economic and social costs to the community would be such as to warrant the grant of the benefit. On the facts of the case, with both the companies having generated cash profits immediately preceding amalgamation, it can be safely said that the rehabilitation scheme would certainly go through, even without the grant of this benefit and that such a grant, if made, would be at the cost of the public exchequer and be thus altogether unwarranted and undeserved. It was not the intention of the legislature while conferring this discretionary power on the BIFR/AAIFR, that it should be used so as to grant unintended benefits to profit making companies. Such an exercise of discretion would be unreasonable and would call for judicial interference. This is not the case here. The BIFR has wisely and properly exercised this discretion in not granting this benefit, as part of the rehabilitation exercise. Its order, in this regard, does not, therefore call for any interference and has to be affirmed, which we accordingly do.
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> 28. The appeal, for all the above reasons, does not have any merit and is, therefore, dismissed as such".

8. Section 72A of the Income-tax Act was considered by this Court in Commissioner of Income-tax.

Bombay v. Mahindra and Mahindra Ltd., 144ITR 225: (AIR 1984 SC 1182). This case arose prior to the coming into force of the said Act, that is to say, it was a case when sanction under Section 72A was required to be given by the Central Government upon the recommendation of the specified authority thereunder. Learned counsel for the appellant relied upon the following passage in the judgment: (At. P. 1190 of AIR)

> "Before undertaking a scrutiny of these reasons for ultimately deciding whether the impugned conclusion of the specified authority and the Central Government is liable to be interfered with or not it will be useful to indicate briefly the object with which this new provision of S. 72A was introduced in the Act as it will throw light on what was the mischief or situation that was intended to be remedied by its introduction as also the true concept of financial non-viability. From the Budget speech of the Finance Minister, the Notes on Clauses of the Finance (No. 2) Bill of 1977 and the Memorandum explaining the provisions of the said Bill it will appear clear that sickness among industrial undertakings was regarded as a matter of grave national concern inasmuch as closure of any sizeable manufacturing unit in any industry entailed social costs in terms of loss of production and unemployment as also waste of valuable capital assets, and experience had shown that taking over of such sick units by Government was not always a satisfactory or economical solution; it was felt that a more effective method would be to facilitate amalgamation of sick industrial units with sound ones by providing incentives and removing impediments in the way of such amalgamation which would not merely relieve the Govt. of uneconomical burden of taking over and running sick units but save the Govt. from social costs in terms of loss of production and unemployment. With such objective in view, in order to facilitate the merger of sick industrial units with sound ones and as and by way of offering an incentive in that behalf, S. 72A was introduced in the Act. whereunder, by a deeming fiction, the accumulated loss or unabsorbed depreciation of the amalgamating company is treated to be a loss or, as the case may be, allowance for depreciation of the amalgamated company in the previous year in which the amalgamation was effected; but the amalgamated company, although a successor in interest, would be entitled to carry forward and set off the accumulated loss and unabsorbed depreciation of the amalgamating company only where the amalgamating company was not, immediately before such amalgamation, financially viable and the amalgamation was in public interest. The expression "financial non-viability" has not been defined in the Act but the Finance Minister's speech, the Notes on clauses of the Bill and the Memorandum explaining the provisions thereof make it clear that the financial non-viability of an undertaking has been equated with the 'sickness' of such undertaking and obviously in the context of its revival by a sound undertaking the sickness must be of a temporary character and not any basic or permanent sickness. An undertaking which is basically non-viable will ordinarily be incapable of revival and would face a closure; in other words, the financial non-viability spoken of by the section must refer to sickness brought about by temporary adverse financial circumstances that disables the unit to stand and work on its own. This is also made clear by the provision contained in cl.(a) of sub-s.(1) which states that the financial non-viability of the amalgamating company has to be judged by reference to "its liabilities, losses and other relevant facts."

9. Under Section 72 of the Income-tax Act, to give to the amalgamated company the benefit of the loss or, as the case may be, allowance for depreciation of the amalgamating company for the

previous year in which the amalgamation was effected for the purposes of the Income-tax Act, the Central Government must, upon the recommendation of the specified authority, be satisfied that the amalgamating company was not, immediately before the amalgamation, financially viable by reason of its liabilities, losses and other relevant factors, and that the amalgamation was in the public interest. By reason of Section 32(2) of the said Act, where there has been under any scheme thereunder an amalgamation of a sick industrial company with another company, the provisions of Section 72A of the Income-tax Act shall apply in relation to such amalgamation, subject to this modification that power of the Central Government is to be exercised by the BIFR without the necessity of a recommendation by the specified authority mentioned in Section 72A of the Income-tax Act. This is because, for the purposes of according sanction to a scheme of amalgamation of a sick industrial undertaking with any other company under Section 18 of the said Act, the BIFR has to be satisfied that the amalgamating company is not financially viable, which is the effect of Section 3(0) of the said Act, and that the amalgamation is necessary or expedient in the public interest, which is the effect of Sections 17 and 18 of the said Act read together, Sanction of a scheme of amalgamation under Section 18 of the said Act necessarily implies that the requirements of Section 72A of the Income-tax Act have been met and the BIFR must exercise the power conferred upon it by Section 32(2) of the said Act and make the declaration contemplated by Section 72A of the Income Tax Act.

10. The conditions for sanctioning a scheme under Section 18 of the said Act being the same as those required for a declaration under Section 72A of the Income-tax Act, the BIFR could not have sanctioned the scheme of amalgamation of Sharp Edge with the appellant but declined to make the declaration under Section 72A of the Income-tax Act with regard to that amalgamation.

11. The appeal is allowed. The order under appeal as also the order of the BIFR declining to make a declaration under Section 72A of the Income-tax Act in respect of the amalgamation of Sharp Edge Ltd. with the appellant are set aside and the BIFR is directed to make declaration.

12. No order as to costs. Appeal allowed.