IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "A", PUNE

BEFORE SHRI INTURI RAMA RAO, ACCOUNTANT MEMBER
AND
SHRI S. S. VISWANETHRA RAVI, JUDICIAL MEMBER

आयकर अपील सं. / ITA No.2121/PUN/2017
निर्धारण वर्ष / Assessment Year: 2006-07

DCIT, Circle- 1(1), Pune.	Vs.	M/s. Cummins Sales & Services (I) Ltd. (Formerly known as Cummins Diesels Sales & Services Ltd.), 35A/1/2, Erandwane, Pune- 411038. PAN : AAACC7262K
Appellant		Respondent

Revenue by : Shri Shivraj B. Morey
Assessee by : Shri Ketan Ved

Date of hearing : 02.06.2022
Date of pronouncement : 27.06.2022

आदेश / ORDER

PER INTURI RAMA RAO, AM:

This is an appeal filed by the Revenue directed against the order of ld. Commissioner of Income Tax (Appeals)-1, Pune ['the CIT(A)'] dated 23.06.2017 for the assessment year 2006-07.

2. The Revenue raised the following grounds of appeal :-

1. *The Ld. Commissioner of Income-tax (Appeals) erred on facts and in the circumstances of the case and in law in arbitrary restricting the disallowance u/s. 14A to Rs.70,000/- from Rs.6,60,520/-.*
2. *The Ld. Commissioner of Income-tax (Appeals) erred on facts and in the circumstances of the case and in law in not confirming the disallowance of set off of brought forward business losses of*

Rs.16,54,99,878/- and unabsorbed depreciation of Rs.3,47,20,047/- pertaining to demerged undertaking

3. *The Ld. Commissioner of Income-tax (Appeals) erred on facts and in the circumstances of the case and in law in deleting the disallowance of setoff of brought forward business loss and unabsorbed depreciation without appreciating the facts of the case that the demerged company was used as a colorable device to reduce and set-off the losses against profits of another company.*

4. *The appellant craves to add, amend, alter or delete any of the above grounds of appeal during the course of appellate proceedings before the Hon'ble Tribunal."*

3. Briefly, the facts of the case are as under :

The respondent-assessee is a company incorporated under the provisions of the Companies Act, 1956. It is engaged in the business of sale and services of diesel engines, its spare parts and related equipments. The return of income for the assessment year 2006-07 was filed on 23.11.2006 declaring total income of Rs.55,44,54,789/-. The said return of income was revised on 28.10.2007 at total income of Rs.29,84,61,310/-. Against the said return of income, the assessment was completed by the Addl. Commissioner of Income Tax, Range-1, Pune ('the Assessing Officer') vide order dated 30.12.2009 passed u/s 143(3) of the Income Tax Act, 1961 ('the Act') at total income of Rs.49,78,29,562/- after disallowing set-off of brought forward business losses of Rs.16,54,99,878/- and unabsorbed depreciation losses of Rs.3,47,20,047/- pertaining to demerged undertaking

under sub-section (4) of section 72A of the Act. The Assessing Officer also made addition of Rs.6,60,520/- u/s 14A with which we are concerned. The factual background of the above additions is as under :

During the previous year relevant to the assessment year under consideration, an undertaking, namely, Highway Solutions of Cummins Auto Services Ltd. (CASL) a 100% subsidiary of the respondent-assessee company was demerged and vested with the respondent-assessee company w.e.f. 01.04.2005. The scheme of demerger was approved by the Hon'ble High Court of Bombay. The respondent-assessee claimed the set-off of brought forward business losses of Rs.16,54,99,878/- and unabsorbed depreciation losses of Rs.3,47,20,047/- relating to demerged undertaking against the taxable income as provided under sub-section (4) of section 72A of the Act. During the course of assessment proceedings, the Assessing Officer found that the assets of demerged undertaking were held for sale, which according to Assessing Officer clearly indicated that there was no intention to continue the business of demerged undertaking thereby defeating he has the object behind enactment of the provisions of section 72A(4) of the Act. Accordingly, the Assessing Officer concluded that the scheme of demerger was not carried out for genuine purpose as contemplated

under sub-section (5) of section 72A of the Act. The Assessing Officer was also of the opinion that the conditions stipulated in the case of amalgamation under sub-section (2) of section 72A should be squarely applied to the case of demerger covered under sub-section (4) of section 72A of the Act. Accordingly, the Assessing Officer denied the claim of set-off of brought forward of business losses and unabsorbed depreciation losses. The Assessing Officer also made a disallowance of Rs.6,60,520/- u/s 14A read with Rule 80D(2)(iii) of the Income Tax Rules, 1962 ('the Rules') while accepting the contention of the appellant that no disallowance of interest is warranted in view of the fact that own funds are far in excess of the investments. However, the Assessing Officer made the disallowance of indirect expenses by applying Rule 8D(2)(iii) which is inserted w.e.f. assessment year 2007-08. However, the Assessing Officer relied upon the Special Bench of Mumbai Tribunal in the case of ITO vs. Daga Capital Management Pvt. Ltd. (SB-Mum. ITAT) wherein it has held that Rule 8D is procedural provisions is applicable in all the pending matters.

4. Being aggrieved by the above disallowances, an appeal was filed before the ld. CIT(A) who vide impugned order held that the provisions of Rule 8D cannot be applied retrospectively, however, restricted the disallowance to sum of Rs.70,000/-.

As regards to the disallowance claim for set-off of brought forward business losses and unabsorbed depreciation losses pertaining to demerged undertaking vested with the respondent-assessee, the ld. CIT(A) held that once the demerger had been approved by the Hon'ble Bombay High Court, it is not within the jurisdiction of the Assessing Officer to question the motive behind the demerger. In the absence of any notification by the Central Government as provided under sub-section (5) of section 72A, the Assessing Officer cannot apply his own guidelines in order to arrive at whether or not the demerger is for genuine purpose. Accordingly, the ld. CIT(A) directed the Assessing Officer to allow the set-off brought forward business losses and unabsorbed depreciation losses relating to the demerged undertaking.

5. Being aggrieved, the Revenue is in appeal before us in the present appeal.

6. Ground of appeal no.1 challenges the decision of the ld. CIT(A) restricting the disallowance to sum of Rs.70,000/- u/s 14A of the Act.

7. The ld. CIT-DR submits that the ld. CIT(A) ought not to have restricted the disallowance u/s 14A read with Rule 8D(2)(iii) to sum of Rs.70,000/- without any basis.

8. On the other hand, ld. AR submits that the provisions of Rule 8D have only prospective application and could not have been applied in the assessment year prior to the assessment year 2008-09.

9. We heard the rival submissions and perused the material on record. The provisions of section 14A prescribe that where an assessee earns exempt income, the expenditure incurred in connection with earning of exempt income cannot be allowed. However, the provisions prescribing the method of computation of quantum of disallowance are prescribed under Rule 8D w.e.f. 1.4.2007. These provisions are held to be prospective and should not be applied for any assessment year prior to the assessment year 2008-09, as held by the Hon'ble Supreme Court in the case of CIT vs. Essar Teleholdings Ltd., 90 taxmann.com 2 (SC). However, the ld. CIT(A) rightly held that the provisions of Rule 8D have no retrospective application and restricted disallowance to sum of Rs.70,000/- on ad-hoc basis. Since the respondent-assessee is not in appeal challenging amount of disallowance, we have no option, but to confirm the findings of the ld. CIT(A). Thus, we do not find any merit in the ground of appeal no.1 raised by the Revenue. Accordingly, the ground of appeal no.1 raised by the Revenue stands dismissed.

10. Ground of appeal no.2 and 3 challenges the findings of the ld. CIT(A) directing to allow set-off of brought forward business losses of Rs.16,54,99,878/- and unabsorbed depreciation losses of Rs.3,47,20,047/- relating to the demerged undertaking.

11. The ld. CIT-DR submits that the motive behind the scheme of demerger is only to avail the tax benefit and not for genuine purpose as the assets were held for sale as shown in the Balance Sheet as on 31.03.2006, which clearly indicated that the respondent-assessee had no intention of carrying on the business of demerged undertaking. He further submitted that even though the Central Government has not prescribed any condition to determine whether or not scheme of demerger is genuine purpose, since the material on record clearly establishes that the scheme demerger is not for genuine purpose, the respondent-assessee is not entitled for benefit of set-off of brought forward business losses and unabsorbed depreciation losses. The ld. CIT(A) had failed to appreciate the purport of the provisions of section 72A(4) of the Act. Therefore, the order of the ld. CIT(A) should be reversed.

12. On the other hand, ld. AR submits that since the Central Government had not laid down the guidelines or conditions for the purpose of determining whether the scheme of demerger is for genuine purpose or not. It is beyond the scope of the Assessing

Officer to go into behind the scheme of demerger. He further submitted that when the scheme of demerger was approved or sanctioned by the Hon'ble High Court, it is binding on everyone including the authorities of the income-tax department. The Hon'ble Bombay High Court had accorded its sanction to the scheme of demerger, which means that the same has been done under statutory operations by virtue of the provisions of section 391 of the Companies Act. The ld. AR also placed reliance on the decision of the Hon'ble Bombay High Court in the case of Sadanand S. Varde vs. State of Maharashtra, 247 ITR 609 (Bom.) and the decision of Co-ordinate Bench of Kolkata ITAT in the case of DCIT vs. M/s. JCT Ltd. in ITA No.84/Kol/2019 order dated 08.07.2020.

13. We heard the rival submissions and perused the material on record. The issue in the present grounds of appeal no.2 and 3 relates to the claim of set-off of brought forward business losses and unabsorbed depreciation losses pertaining to demerged undertaking pursuant to scheme of demerger as sanctioned by the Hon'ble High Court. The claim was disallowed by the Assessing Officer by holding that the scheme of demerger was not for genuine business purpose, but only to avoid tax liability as the respondent-assessee company is profit making company. The Assessing Officer had

reached to this conclusion based on the information contained in the Balance Sheet as on 31.03.2006, wherein it is mentioned that the assets of the demerged undertaking were held for sale. No doubt this information is clearly revealed that there was no intention on part of the respondent-assesseee company to continue the business of demerged undertaking. The material on record also indicates that the respondent-assessee company had not carried on any business of demerged undertaking after date of approval of demerger by the Hon'ble High Court on 12.01.2007. It is also settled position of law that the scheme of demerger once approved by the Hon'ble Jurisdictional High Court, it cannot be re-visited by any statutory authority. But the provisions of income-tax act had prescribed the conditions under which the set-off of brought forward business losses can be allowed in the case of amalgamation and demerger etc which means that mere fact that amalgamation or demerger *ipso facto* does not entitle an assessee to claim benefit of the set-off of brought forward business losses. We also perused the copy of scheme of demerger approved by the Hon'ble Jurisdictional High Court wherein there was no condition mentioned about the issue of set-off of brought forward business loses and unabsorbed depreciation losses. In other words, mere fact that the scheme of demerger/amalgamation was accorded approval by the Hon'ble

Jurisdictional High Court does not automatically entitled the assessee to claim the set-off of brought forward business loess. In the cases, amalgamation of scheme u/s 72A(1) in order to avail tax benefit of set-off of brought forward business losses, the Government had prescribed conditions like continuous holding the assets before and after amalgamation, carrying on the business of amalgamation company for minimum period of 5 years from the date of amalgamation etc, such conditions are not stipulated in the case of demerger which is governed by sub-section (4) of section 72A of the Act. The sub-section (5) of section 72A empowers the Central Government to prescribe the conditions and guidelines to determine whether the scheme of demerger is genuine purpose or not?. In the context of scheme of amalgamation, the Hon'ble Delhi High Court in the case of IEL Ltd. vs. Union of India, 195 ITR 232 (Delhi) held that the benefit of section 72A cannot be availed if the sole idea of the amalgamation was only to avail the benefit of carried forward business losses and unabsorbed depreciation losses as it is not for genuine purpose. The Hon'ble Delhi High Court (supra) held as under : -

> *"13. The object and purpose of introducing Section 72A under the Income Tax Act is considered by the Division Bench of Delhi High Court in its judgment in the case of IEL Ltd. v. Union of India [1992] 195 ITR 232/64 Taxman 307. The relevant portion of this judgment in para 10 is reproduced below :*
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> *"10. ... ...*

While examining the application under s. 72A, the purpose and intent of insertion of the section has to be kept in view. Sec. 72A was enacted with a view to provide an incentive to robust companies to take over and amalgamate with the companies which would otherwise become a burden on the economy. It is no doubt true that when a declaration under s. 72A is granted, the amalgamated company does receive benefits, inasmuch as it is able to take advantage of the unabsorbed depreciation and accumulated losses. But this is precisely the incentive which is given to the healthy companies and, we feel, that the legislative intent of giving such incentive should not ordinarily be set at naught. The Specified Authority and the Central Government should take an overall view of the matter and come to a pragmatic and practical conclusion as to whether the conditions specified in s. 72A are satisfied or not. We may here note that where the provisions of s. 72A are not misused, there is further safeguard which are provided in s. 72A of the Act. Once a declaration under s. 72A has been accorded, then before getting the benefit under that provision, the amalgamated company has to fulfill the conditions specified in sub-s. (2) of s. 72A. One of the important conditions stipulated in sub-s. (2) of s. 72A is obtaining of a certificate from the Specified Authority to the effect that adequate steps had been taken by the amalgamated company for the rehabilitation or revival of business of the amalgamating company. In other words, the benefit of s. 72A will not be obtained if the sole idea of amalgamating was not the revival of the amalgamating company but was only to take benefit of the carry forward losses and unabsorbed depreciation.

The revival of a sick unit or positive efforts in this behalf are the pre-conditions to the benefits under s. 72A being availed of. We, therefore, feel that an application under s. 72A should be considered most sympathetically from a businessman's point of view. If a company has become commercially insolvent or is likely to become commercially insolvent, then every effort should be made to prevent such a situation from arising and if an amalgamation takes place and conditions under sub-s. (1) of s. 72A are satisfied, then we see no reason as to why a declaration should not be accorded."

14. The ratio of the decision of the Hon'ble Delhi High Court in the case of IEL Ltd. (supra) was quoted with approval by the Hon'ble Jurisdictional High Court in the of Ballarpur Industries Ltd. vs. CIT, 398 ITR 145 (Bom.) by holding as under :-

> *"14. The Division Bench of Delhi High Court has held in the aforesaid decision that once the declaration is granted under Section 72A of the Income Tax Act, the amalgamated company thus received the benefit inasmuch as it is able to take advantage of the unabsorbed depreciation and accumulated losses. Upon fulfillment of the conditions specified in sub-section (2) of Section 72A, it holds that the benefit of Section 72A will not be obtained if the sole idea of amalgamating was not the revival of the amalgamating company but was only to take benefit of the carry forward losses and unabsorbed depreciation. This decision supports the view which we have taken."*

15. We have gone through the provisions of sub-sections (1), (2) and (4) of section 72A. We are unable to discern any difference in the object behind the enactment of provisions of sub-section (1) of section 72A governs the scheme of amalgamation, the provisions of sub-section (4) deals with the case of demerger. Both the provisions have been enacted with same objective. The object behind enactment of section 72A was explained by the Hon'ble Supreme Court in the case of CIT vs. Mahindra & Mahindra Ltd., 144 ITR 225 (SC) while dealing with challenging the provisions of section 72A, the following paragraphs of the judgement in the case of Mahindra & Mahindra Ltd. (supra) has been extracted :-

> *"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 Don- viability. From the budget speech of the Finance Minister, the Notes on Clauses of the Finance Bill (No. 2) of 1977 and the Memorandum explaining to provisions of the said Bill it will appear clear that sickness among industrial undertaking was regarded as a matter of grave national concern inasmuch as closure of any sizable 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 Government of uneconomical burden of taking over and running sick units but save the Government 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 where under 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" had 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 or potentially 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'."

16. We are of the considered opinion that the objective behind enactment of entire provisions of section 72A is the same even after the insertion of sub-section (4) of section 72A dealing with cases of demerger. The object behind enactment under the provisions of section 72A is clear from the memorandum explaining the

provisions of Finance (No.2) Bill of 1997. It is clear that the only object is revival of sick units and relieving the Government of uneconomical burden of taking over the and running the sick units but save the Government from social costs in terms of loss of production and unemployment. In the present case, admittedly, after the scheme of demerger, the appellant had not carried on any business of demerged undertaking and the fact that the assets transferred to the demerged unit were held for sale goes to demonstrate the intention of the appellant that they had no intention of carrying on business of demerged undertaking. The scheme of demerger was carried out only with sole object to avail the benefit of set-off of brought forward business losses and unabsorbed depreciation losses of demerged undertaking. Therefore, for this very reason, the Assessing Officer had denied the benefit of set-off of brought forward business losses. According to us, the reasoning of the Assessing Officer is consistent with object behind enactment of provisions of section 72A of the Act. Furthermore, sub-section (5) of section 72A has been enacted empowering the Assessing Officer to deny the benefit of set-off of brought forward business losses, which means that merely because the scheme of demerger was approved by the Hon'ble High Court *ipso facto* would not entitle the assessee for the benefit of set-off of brought forward

business losses, contrary to the objects behind the enactment of the provisions of section 72A of the Act. Furthermore, the fact that the Government of India has not laid down the criteria to determine under what circumstances demerger can said to be for non-genuine purpose, does not alter the position for the reason that the Hon'ble Jurisdictional High Court in the case of Ballarpur Industries Ltd. (supra) had approved the principle that the benefit of set-off of brought forward business losses cannot be allowed when sole idea behind the scheme of amalgamation is only to avail the benefit of set-off of brought forward business losses.

17. The ld. CIT(A) had granted the benefit of set-off of brought forward business losses in a perfunctory manner without looking into the objects behind the enactment of provisions of section 72A and appears to have been carried out by the submissions of the assessee that once the scheme of demerger is approved by the Hon'ble High Court, the assessing authority cannot go behind the scheme of demerger ignoring the provisions of section 72A, which governed the set-off of brought forward business losses in the case of amalgamation/demerger etc, which prescribes the conditions to avail the benefit of the scheme. In the circumstances, we find that the order of ld. CIT(A) is illegal and unreasonable. Therefore, the

order of the ld. CIT(A) is reversed and the ground of appeal no.2 and 3 filed by the Revenue stands allowed.

18. In the result, the appeal filed by the Revenue stands partly allowed.

Order pronounced on this 27th day of June, 2022.

Sd/-	**Sd/-**
(S. S. VISWANETHRA RAVI)	**(INTURI RAMA RAO)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

पुणे / Pune; दिनांक / Dated : 27th June, 2022.
Sujeet

आदेश की प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant.
2. प्रत्यर्थी / The Respondent.
3. The CIT(A)-1, Pune.
4. The Pr. CIT-1, Pune.
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, "**A**" बेंच, पुणे / DR, ITAT, "**A**" Bench, Pune.
6. गार्ड फ़ाइल / Guard File.

आदेशानुसार / BY ORDER,

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Senior Private Secretary
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune.