IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
WRIT PETITION NO. 2475 OF 2015

Dinesh Vazirani)
2nd floor, Rushi House, Darabshaw)
Lane, Off Napeansea Road,)
Mumbai 400 006) ….Petitioner

V/s.

1. The Principal Commissioner of)
Income Tax-7, Room No.501,)
Aayakar Bhavan, M. K. Road)
Mumbai 400 020)

2. The Union of India)
Through the Secretary, Ministry of)
Finance, Department of Finance)
Government of India North Block)
New Delhi 110 001) …Respondents

Mr. J. D. Mistri, Senior Advocate a/w Mr. Madhur Agarwal a/w Mr. Upendra Lokegaonkar i/b Mint and Confreres for Petitioner

Mr. Suresh Kumar for Respondents

CORAM : K.R. SHRIRAM &
N.R. BORKAR, JJ
DATED : 8th APRIL 2022

ORAL JUDGMENT (PER K. R. SHRIRAM J.) :

1. Petitioner is an individual and resident of India. Petitioner, along with two other individuals, and one company (collectively referred to as Promoters) was the promoter of a company by the name WMI Cranes Ltd. (the Company) Petitioner held 2,35,900 equity shares out of 9,99,920 issued and paid up share capital of the company of Rs.10 each. Promoters

entered into Share Subscription and Purchase Agreement (SPA) dated 11th October 2010 with M/s Konecranes Finance Corporation (Purchasers). Under the agreement, promoters agreed to sell 51% of the paid up and issued equity share capital of the company to the purchasers. Between the promoters, they held collectively 100% issued and paid up share capital of the company.

2. Simultaneously with SPA, the promoters and purchasers entered into second share purchase agreement (Second SPA) for the transfer of the remaining equity shares held by the promoters upon satisfaction of certain conditions under Second SPA so that at a future point of time, purchasers will hold 100% of the issued and paid up equity share capital of the company. SPA provided for a value of Rs.155,00,00,000/- as consideration to be paid to the promoters which effectively was working out to about Rs.3212.31 per share. SPA also provided that out of Rs.155,00,00,000/- that was payable as sale consideration, a sum of Rs.30,00,00,000/- would be kept in escrow, based on which a separate escrow agreement was entered into between promoters, purchasers and the escrow agent. At the time of closure of the deal, promoters received Rs.125,00,00,000/- as sale consideration and the shares were transferred. Balance Rs.30,00,00,000/- was kept in escrow account. SPA provided for specific promoter indemnification obligations and it provides that if there is no liability as contemplated under the specific promoter indemnification obligations (clause 7.2.1 of SPA) within a particular period, this amount of

Rs.30,00,00,000/- would be released by the escrow agent to the promoters. Clause 7.8 of SPA provides for escrow arrangement. The escrow account was to be in force for 2 years from the closing date.

These specifics were given to give a background of the matter.

3. Petitioner filed his return of income for A.Y.-2011-2012 on 29th July 2011 declaring income of Rs.22,51,60,130/-. The return of income included Rs.20,98,08,685/- as long term capital gains on the sale of shares of the company. The capital gains was computed by petitioner taking into account the proportion of the total consideration of Rs.155,00,00,000/-, including the escrow amount of Rs.30,00,00,000/-, which had not, by the time returns were filed, received by the promoters but still parked in the escrow account. The assessment was selected for scrutiny and assessment under Section 143 (3) of the Act was completed and an order dated 15th January 2014 was passed accepting total income as declared by petitioner.

4. It is petitioner's case and which has not been disputed that subsequent to the sale of the shares of the company, certain statutory and other liabilities arose in the company which was about Rs.9,17,04,240/-, for the period prior to the sale of the shares. As per the agreement, this amount was withdrawn from the escrow account and promoters, therefore, did not receive this amount of Rs. 9,17,04,240/-.

5. As assessment had already been completed taxing the capital gains at higher amount on the basis of sale consideration of Rs.155,00,00,000/- and without reducing the consideration by Rs. 9,17,04,240/-, petitioner made an

application to respondent no.1 under Section 264 of the Act. Petitioner submitted that the amount of Rs.9,17,04,240/- has been withdrawn by the company from the escrow account and, therefore, what petitioner received was lesser than what was mentioned in the return of income and, therefore, the capital gains needs to be recomputed reducing the proportionate amount from the amount deducted from the escrow account. Petitioner also pointed out that the application was being made under Section 264 of the Act because the withdrawal of the amount from the escrow account happened after the assessment proceedings for A.Y.-2011-2012 was completed and it was not possible for petitioner to make such a claim before the assessing officer or even file revised returns. Petitioner, therefore, requested respondent no.1 to reduce the long term capital gains by Rs.1,31,44,274 /- and further prayed for directions to the assessing officer to refund the excess tax paid. Petitioner also explained that the amount from the escrow account was never going to be recovered by the promoters under any circumstances and this resulted in reduction in the total realisation towards sale of company.

6. Respondent no.1 by an order dated 13th February 2015 passed under Section 264 of the Act rejected petitioner's application holding:-

(a) The Petitioner was entitled to receive consideration at Rs.3,213.31 per share as per the purchase price defined in the agreement. From the said amount, only cost of acquisition, cost of improvement or expenditure incurred exclusively in connection with the transfer can be reduced to

compute capital gains. The agreement between the seller and buyer for meeting certain contingent liability which may arise subsequent to the transfer cannot be considered for reduction from the consideration received i.e, @ Rs.3,213.31 per share in computing capital gains under Section 48 of the Act.

(b) Respondent No.1 further held that in the absence of specific provision by which an assessee can reduce returned income filed by it voluntarily, the same cannot be permitted indirectly by resorting to provisions of Section 264 of the Act. Respondent No.1 further relied on the proviso to Section 240 of the Act which states that if an assessment is annulled the refund will not be granted to the extent of tax paid on the returned income. Respondent no.1 held that this shows that income returned by an assessee is sacrosanct and cannot be disturbed and even annulment of the assessment would not have impacted the suo motu tax paid on the return income.

(c) The contingent liability paid out of escrow account does not have the effect on "amount receivable" by the promoters as per the agreement which remains at Rs.3,213.31 per share."

7. Being aggrieved by this order dated 13th February 2015 petitioner has approached this court under Article 226 of the Constitution of India.

8. Having heard the learned counsel and considering the petition, documents annexed thereto and affidavit in reply, we are satisfied that the impugned order passed by respondent no.1 is not correct and has to be quashed and set aside.

9. Respondent no.1 had erred in holding that the proportionate amount of Rs.9,17,04,240/- withdrawn from the escrow account should not be reduced in computing capital gains of petitioner. Capital gains is computed under Section 48 of the Act by reducing from the full value of consideration received or accrued as a result of transfer of capital asset, cost of acquisition, cost of improvement and cost of transfer. Respondent no.1 has erred in stating that only the cost of acquisition, cost of improvement and cost of transfer can be deducted from full consideration and, therefore, petitioner is not entitled to the proportionate reduction. Respondent no.1 has failed to understand that the amount of Rs.9,17,04,240/- was neither received by the promoters nor accrued to the promoters, as the said amount was transferred directly to the escrow account and was withdrawn from the escrow account. When the amount has not been received or accrued to the promoters, the same cannot be taken as full value of consideration in computing capital gains from the transfer of the shares of the company.

10. We observe that respondent no.1 has not understood the true intent and the content of the SPA. Respondent no.1 has not appreciated that the purchase price as defined in the agreement was not an absolute amount as the same was subject to certain liabilities which might arise to the promoters on account of certain subsequent events. The full value of consideration for computing capital gains, in our view, will be the amount which was ultimately received by the promoters after the adjustments on account of the liabilities from the escrow account as mentioned in the

agreement.

11. Respondent No.1 has gone wrong in not appreciating that income or gain is chargeable to tax under the Act on the basis of the real income earned by an assessee, unless specific provisions provide to the contrary. The Apex Court in ***CIT Vs. Shoorji Vallabhdas and Co.***[1] has observed as under:

> *"Income-Tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book keeping an entry is made about a 'hypothetical income' which does not matrialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account."*

12. In the present case, the real income (capital gain) can be computed only by taking into account the real sale consideration, i.e., sale consideration after reducing the amount withdrawn from the escrow account. Respondent no.1 has proceeded on an erroneous understanding that the arrangement between the seller and buyer which results in some contingent liability that arises subsequently to the transfer, cannot be reduced from the sale consideration as per Section 48 of the Act. We say this because the liability is contemplated in SPA itself and certainly the same should be taken into account to determine the full value of consideration. Therefore, if sale consideration specified in the agreement is along with

1. (1962) 46 ITR 144 (SC) page 148

certain liability, then the full value of consideration for the purpose of computing capital gains under Section 48 of the Act is the consideration specified in the agreement as reduced by the liability. For respondent no.1 to say that from the sale consideration only cost of acquisition, cost of improvement and cost of transfer can be reduced and the subsequent contingent liability does not come within any of the items of the reduction and the same cannot be reduced, is erroneous because full value of consideration under Section 48 would be the amount arrived at after reducing the liabilities from the purchase price mentioned in the agreement. Even if the contingent liability is to be regarded as subsequent event, then also the same ought to be taken into consideration in determining capital gain chargeable under Section 45 of the Act.

13. Further, we do not agree with respondent no.1 that the contingent liability paid out of escrow account does not affect the amount receivable as per the agreement for the purpose of computation of capital gains under Section 48 of the Act. Respondent no.1 has failed to understand or appreciate that the promoters have received only net amount of Rs.125,00,00,000/- plus Rs.20,82,95,760/- (Rs.30,00,00,000/- - Rs.9,17,04,240/-). Such reduced amount should be taken as full value of consideration for computing capital gains under Section 48 of the Act.

14. For respondent no.1 to hold that in the absence of specific provisions by which an assessee can reduce returned income filed by it voluntarily, the same cannot be permitted indirectly by resorting to provisions under Section

264 of the Act, is also erroneous. Certainly, assessee could file revised returned of income within the prescribed period, to reduce the returned income or increase the returned income. Petitioner filed an application under Section 264 because the assessment under Section 143 had been completed by the time the amount of Rs.9,17,04,240/- was deducted from the escrow account. Section 264 of the Act in our view, has been introduced to factor in such situation because if income does not result at all, there cannot be a tax, even though in book keeping, an entry is made about hypothetical income which does not materialize. Section 264 of the Act does not restrict the scope of power of respondent no.1 to restrict a relief to an assessee only upto the returned income. Where the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income even though an entry that might, in certain circumstances, have been made in the books of account. Therefore, respondent no.1 ought to have directed the Assessing Officer to recompute income as per the provisions of the Act, irrespective of whether the computation results in income being less than returned income. It is the obligation of the revenue to tax an assessee on the income chargeable to tax under the Act and if higher income is offered to tax, then it is the duty of the revenue to compute the correct income and grant the refund of taxes erroneously paid by an assessee.

15. Reliance by respondent no.1 on the provisions of Section 240 of the Act to hold that there is no power on respondent no.1 to reduce the

returned income, is fraught with error because the circumstances provided in the provisio to Section 240 indisputably do not exist in the present case. Provisio to Section 240 provides that in case of annulment of assessment, refund of tax paid by the assessee as per the return of income cannot be granted to the assessee, which is not the case at hand. There is no provision in the Act which provides, if ultimately assessed income is less than the returned income, the refund of the excess tax paid by the assessee would not be granted to such assessee. As regards the stand of respondent no.1 that the income returned by petitioner is sacrosanct and cannot be disturbed, the only thing that is sacrosanct is that an assessee can be asked to pay only such amount of tax which is legally due under the Act and nothing more. If returned income shows a higher tax liability than what is actually chargeable under the Act, then the assessee is entitled to refund of excess tax paid by it.

16. We, therefore, quash and set aside the order dated 13th February 2015 passed by respondent no.1.

17. To sum up, admittedly, petitioner has paid more capital gains than what should have been paid. Capital gains has to be calculated on the basis of what actual consideration has been received. Certainly, petitioner has not received his proportionate share to the extent from Rs.9,17,04,240/- that was reduced from the escrow account.

18. In the circumstances we hold that petitioner be entitled to refund of excess tax paid on the excess capital gains shown earlier.

19. The Assessing Officer is directed to pass fresh assessment order within 6 weeks from the date this order is uploaded on the basis that the capital gains on the transfer of the shares of the company should be computed after reducing proportionate amount withdrawn from the escrow account from the full value of the consideration and allow the refund of additional tax paid with interest. Unless there is any other claim of Revenue against petitioner that would permit Revenue to legally adjust the refund amount, the refund with interest shall be paid over within two weeks of passing the fresh assessment order.

20. Petition accordingly disposed.

(N. R. BORKAR, J.) (K.R. SHRIRAM, J.)