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JUDGMENT SHEET
IN THE LAHORE HIGH COURT, LAHORE
JUDICIAL DEPARTMENT

PTR No.147 of 2013

Commissioner Inland Revenue, Zone-II, LTU, Lahore

Versus

M/s Shezan International Ltd., Lahore

J U D G M E N T

Date of hearing: 29.03.2023.
Applicant by: Mr. Imran Rasool, Advocate.
Respondent by: Mr. Hameed Bukhsh, Advocate.

MUHAMMAD SAJID MEHMOOD SETHI, J.- Through instant Reference Application under Section 133 of the Income Tax Ordinance, 2001 (**"the Ordinance of 2001"**), following questions of law, urged to have arisen out of impugned order dated 04.12.2012, passed by learned Appellate Tribunal Inland Revenue, Lahore **("Appellate Tribunal")**, have been proposed for our opinion**:-**

1. Whether on the facts and in the circumstances of the case, the learned Appellate Tribunal Inland Revenue was justified in deleting the addition made on account of capital gain tax under Section 37 of the Income Tax Ordinance?

2. Whether on the facts and in the circumstances of the case, the learned Appellate Tribunal Inland Revenue, without having any material before it for cross checking, is justified in holding that the addition covers the parameters of Section 97 of the Ordinance and delete the addition without making any comparison with them?

2. Brief facts of the case are that respondent-taxpayer, a public limited company, deriving income from manufacturing and sale of juices, pickles, jams, ketchups etc., filed income tax return for the tax year 2004 declaring income at Rs.79,967,801/-, which was taken to be deemed assessment as per Section 120 of the Ordinance, however, it was found to be erroneous insofar as prejudicial to the

interest of revenue. Consequently, the assessment was amended by putting in additions on account of capital gains under Section 37 of the Ordinance of 2001 thereby disallowing the expense on R&M of the vehicles. The respondent-taxpayer filed appeal before Commissioner (Appeals), who, vide order dated 13.06.2011, disposed of the appeal in the manner that addition made under Section 21(k) of the Ordinance was confirmed whereas addition of lease rentals & vehicle expenses at Rs.828,735/- was deleted, and regarding donation, it was directed that credit of donation made to approved institutions may be allowed while calculating the tax liability of the taxpayer. Feeling aggrieved, respondent preferred second appeal before learned Appellate Tribunal, which was disposed of vide order dated 04.12.2012 and the addition of Rs.99,640,500/- made by the Additional Commissioner Inland Revenue under Section 37 of the Ordinance of 2001, which was confirmed by the Commissioner (Appeals), was deleted being illegal and *void ab-initio*.

3. Learned Legal Advisor for applicant-department submits that learned Appellate Tribunal was not justified in deleting the addition made on account of capital gains under Section 37 of the Ordinance of 2001. He adds that without making any comparison, Appellate Tribunal has deleted the addition without having any material before it for the purpose of cross-checking in order to satisfy the parameters provided in Section 97 of the Ordinance *ibid*, which is absolutely without any legal justification.

4. Contrarily, learned counsel for respondent-taxpayer defends the impugned order by contending that merger of wholly owned subsidiary is fully covered under the provisions of Section 97 of the Ordinance of 2001, thus, no gain or loss shall be taken to arise on disposal of its assets.

5. Arguments heard. Available record perused.

6. Perusal of record reveals that respondent-company had a subsidiary company with the name and style of ‘M/s Hattar Juices

(Pvt.) Limited', which was merged into respondent-company pursuant to Court's order. The ACIR held that as per scheme of arrangement approved by the Board, ordinary shares of M/s Hattar held legally or beneficially by respondent-company were cancelled and in lieu, all assets and liabilities of M/s Hattar vested in M/s Shezan International Ltd., Lahore, thus, disposal in terms of Section 75 took place as respondent parted with the ownership of those shares at that time. Commissioner (Appeals) while dealing with the issue of capital gains on merger, observed that the value of assets received in lieu of shares is the consideration received against the cancellation of shares, and that the respondent-company became the owner of assets of M/s Hattar after scheme of amalgamation was affected. Whereas learned Appellate Tribunal held that the conditions enumerated in Section 97 of the Ordinance of 2001 were fully fulfilled, thus, Section 37 of the Ordinance was not attracted.

7. It is apparent that pursuant to this Court's order dated 02.12.2003, passed in **C.O. No.65 of 2003**, M/s Hattar Fruit Products Limited merged into respondent-company under the scheme of arrangement for merger / amalgamation. It is well-settled that merger of two or more companies is essentially a process of corporate reconstruction whereby assets of merging companies were either clubbed or brought together in the surviving or new company, however, proprietary rights of assets remained intact. No financial transaction could be said to have taken place between the merging companies. As such in the scheme of merger arrangement, there does not take place any sale, disposition, exchange or relinquishment or extinguishment of any right on the part of the amalgamating companies that gives rise to any income or gain resulting in a taxable event. If upon merger, the net assets of the merging companies remain unaltered as also the proprietary interest of the shareholders in the amalgamated company remains the same, a corporate merger does not give rise to any taxable event.

8. A merger does not give rise to any financial transaction to create a taxable event and no cash payment is involved in any manner. Amalgamation does not involve any sale or purchase and any surplus of value of shares issued by the amalgamated company over the value of one asset transferred does not result in any taxable gain. Reliance is placed upon a judgment of Delhi High Court reported as *CIT (Delhi) v. Bhahrat Development (Pvt.) Limited* **(135 ITR 456)**, which was subsequently upheld by the Supreme Court of India in a number of decisions.

9. While dealing with somewhat similar proposition, the Division Bench of Bombay High Court in judgment reported as *Forbes Forbes Campbell and Company Ltd. v. Commissioner of Income-Tax* **[(1983) 37 CTR Bom 212]**, while referring to page 411 of the judgment of Calcutta High Court reported as *Shaw Wallace & Co. Ltd. v. Commissioner Of Income-Tax* **[(1979) 119 ITR 399]**, has observed as under:-

> "9. According to Banerji J. (p. 411) :
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> *"The entire capital and assets of the transferor-companies having vested in the assessee, as a result of the said amalgamations, the assessee became the sole owner of the capital of the transferor-companies. There was, therefore, no extinguishment of the right of the assessee in participating in the capital on the liquidation of the transferor-companies.*
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> *The assessee was a party to the said schemes of amalgamation and consented and agreed to the same whereunder, as noted earlier, no shares were to be issued to the assessee in lieu of or in exchange for the shares held by it in the transfer-companies. The shares held by the assessee in the transferor-companies represented the capital invested by the assessee in the said companies and by the said amalgamations the assessee became the sole owner of the entire capital of the transferor-companies. By virtue of the said amalgamations the assessee as the transferee-company became the sole repository of all the rights which flowed from or were imbedded in the shares held by the assessee in the transferor-companies."*
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> 10. In other words, it has been observed by the learned judge of the Calcutta High Court that the result of the amalgamation was not securing of any additional amount or asset by the assessee-company but blending of the assets

> of the transferor-company with it, and, in pursuance of that scheme of amalgamation, there was the abolition of the shares in the transferor-company which shares earlier represented the said assets. Whether the assets of the transferor-company exceeded its liabilities or whether the assets were less than the liabilities would seem to make no difference and there would be no capital gains or capital loss to the assessee-company, since the assessee-company continued to enjoy in a different manner what it already owned. We may point out that earlier, at p. 409, Justice Sen of the Calcutta High Court has looked behind the facade of the transaction and lifted the corporate veil to come to the identical conclusion. In his view, there was rearrangement of the capital base, for instead of keeping the capital in the name or in the control of its subsidiaries, the assessee brought back the same under its direct control. He has also opined that, in this situation, there cannot be any element of gain or loss."

10. Amalgamation of the wholly-owned subsidiary company with its parent company does not result in transfer for consideration and, therefore, does not give rise to any capital gains. The liability to capital gains tax (if any) can only be on the transferor company (subsidiary), which in the instant case has lost its identity and ceased to exist. M/s Hattar, which got amalgamated with the respondent-company, is a hundred percent subsidiary of the respondent. By virtue of the amalgamation, all the assets and liabilities of M/s Hattar became the assets and liabilities of the respondent-company. Where the amalgamating company, which is a hundred percent subsidiary, merges with the holding company (amalgamated company), no question of any profit or gain would arise because the amalgamating company (wholly owned subsidiary), on amalgamation ceases to exist, and its identity merges completely with the amalgamated company; where however, in case the amalgamating company receives nothing but the shareholders receive shares of the amalgamated company, there is no question of capital gains in the hands of the amalgamating company since it is the shareholders who receive consideration (if any). That in an amalgamation where no shares are issued by the amalgamated company, because the amalgamating company was a

wholly owned subsidiary, no question of capital gains can arise because the amalgamating company does not receive any consideration.

11. The Supreme Court of India, in judgment reported as *General Radio & Appliances Co. Ltd. v. M.A. Khader (Dead) By Lrs* **(1986 AIR 1218 = 1986 SCR (2) 607)**, while examining the effect of amalgamation, observed that after the amalgamation of two companies, the transferor-company ceases to have any identity and the amalgamated company acquires 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. Undoubtedly, when two companies amalgamate and merge into one, the transferor-company loses its entity as it ceases to have its business.

12. Learned Legal Advisor for applicant-department has failed to point out any illegality or legal infirmity in the order passed by learned Appellate Tribunal, which even otherwise is unexceptionable, thus, needs no interference.

13. In view of the above, our answer to the purposed questions is in ***affirmative*** i.e. against applicant-department and in favour of respondent.

This Reference Application is ***decided*** against applicant-department.

14. Office shall send a copy of this judgment under seal of the Court to learned Appellate Tribunal as per Section 133 (5) of the Ordinance of 2001.

(Jawad Hassan)
Judge

(Muhammad Sajid Mehmood Sethi)
Judge

Approved for Reporting

Judge

A.H.S./Sultan