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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% Date of Decision : 7th August, 2012.

\+ **ITA 295/2012**
\+ **ITA 296/2012**

CIT ..... Appellant
Through Ms. Rashmi Chopra, sr. standing counsel

Versus

S NET FREIGHT INDIA PVT LTD ..... Respondent
Through:

CORAM:
MR. JUSTICE S. RAVINDRA BHAT
MR. JUSTICE R.V. EASWAR

S. RAVINDRA BHAT,J: (OPEN COURT)

In these two appeals following question of law arises:

"Did the Tribunal fall into error in holding that the assessee was itself entitled to carry forward losses, from the previous year 2001-02 and 2002-03, having regard to Section 79 of the Income Tax Act?"

2. Admit.

3. With consent we have heard counsel for the parties. We have considered the materials on record.

4. The assessee carries on air freight, ocean freight and land transport business and transport related activities. The assessee inter alia claimed set-off of losses of the assessment years 2001-02 and 2002-03 in the returns filed for the assessment year

2002-03 and 2003-04 respectively. The Assessing Officer subsequently issued notice holding that income had escaped assessment and reopened the case. The Assessing Officer held that the claim for set-off of the losses was impermissible in view of Section 79 of Income Tax Act. The relevant facts for this purpose were that as on 31st March, 2001, the shareholding of the assessee was as follows: -

> As on 31.3.2001, 50% shareholding was held by Dr. Prem Chand John and the balance 50% was held by Mrs. Dakshayani Reddy.

However, as on 31.3.2002, the shareholding of the assessee had changed; M/s S-Net Freight (Holdings) Pte. Ltd. held 74% and the balance 26% was held by M/s G A Goss (S) Pte. Ltd.

This was wholly pursuant to the approval granted by the Central Government in terms of provisions of FEMA on 22nd May, 2001. The assessee had contended that original two shareholders were holding on behalf of the aforesaid two companies since holding shares in companies and transacting business in India without necessary approvals was prohibited. It was contended that by virtue of operation of Industries (Development and Regulation) Act, 1951, no foreign company could enter and transact business in India in certain sectors. It was explained that the two individuals were nominee-shareholders and the beneficial in interest vested in the two companies named above. This contention was rejected by the Assessing Officer and the appeal on this aspect was also rejected by the CIT (Appeals) by his order dated 8.2.2010.

5. The ITAT accepted the assessee's contentions and held that Dr. Prem Chand John and Mrs. Dakshayani Reddy were in fact holding the shares on behalf of foreign investors and the foreign investors fell within the description of "beneficial owner" under Section 79 of the Act. The reasoning of the Tribunal is to be found in the following extract of the impugned order:

32. The case of the assessee is that the investment by foreign companies is not permissible in the absence of approval from FIPB. It was for such a purpose that a JV agreement was entered into between M/s. S-Net Freight (India)P.Ltd., and G.A. GOSS (S)Pvt. Ltd., both Singapore incorporated companies carrying on business in the field of freight and logistics, to set up a private limited company in India, as a subsidiary of M/s. S-Net Freight (India)P.Ltd. The company was incorporated through Indian nominees of the two companies, through whom the shares were held beneficially during assessment year 2001-02. In the subsequent year, the two companies themselves became shareholders, on getting the requisite approvals from FIPB. The shareholding pattern for assessment years 2001-02 and 2002-03 is given at page 17 of the Assessee's Paper Book ('APB' for short), as submitted before both the Taxing Authorities, as follows:-

SHAREHOLDERS FUND

SHAREHOLDERS NAME	*A.Y. 2001-02 AS ON 31.3.01*	*PERCENT*	*A.Y. 2002-03 AS ON 31.3.02*	*PERCENT*
Dr. Prem Chand John	*1000*	*50%*		
Mrs. Dakshayani Reddy	*1000*	*50%*		
S-Net Freight (Holdings) Pte. Ltd.			*369260*	*74%*
G A GOSS (S) Pte. Ltd.			*129740*	*26%*
TOTAL	*2000*	*100%*	*4990000*	*100%*

33. In the submissions before the ld. CIT(A) (APB 10 to 13), the issue was explained before the CIT(A), stating, inter alia, that the Foreign Exchange Management Act , provides Rules for foreign investment in India; that as per FEMA Rules, these are sectorial caps in which Automatic Route is not available and for which specific approval of Foreign Investment Promotion Board is required. In the instant case, the process started from 05.06.2000 and ended on 20.11.2001, i.e., F.Y. 2001-02 relevant to assessment year 2002-03; that the company had allotted shares to

subscribers to the Memorandum of Association for ₹2,000/- only; that the further sum of ₹49.90 lakhs was contributed from the Foreign Shareholders as capital and the company's activities could only happen with this share capital and the whole infrastructure was built using that money; that the company had to abide by relevant laws of Foreign Direct Investment, before the shares could be allotted to the foreign shareholders; and that the subscribers to the Memorandum of Association were never intended to be the shareholders of the company at the outset.

34. These contentions of the assessee have nowhere been refuted by the ld. CIT(A) and he has only observed that it could not be accepted that the nominees were used only as a legal necessity. Now, once, the requirements of the provisions were FEMA the facts are to be stringently followed and it has been so done, it was the requirement of the Foreign Direct Investment Laws which made the assessee to act in the manner discussed above. The provisions of section 79 of the I.T. Act, therefore, cannot be said to envisage the transfer of shares by the subscribers of the Memorandum of Articles of Association as a change in the shareholding of the assessee company. The provisions of FEMA have not been shown to be non-mandatory. In order to carry on business in India, foreign company need must abide by the provisions of the said Act. Moreover, the two shareholders indeed acted only as the nominees to enable the smooth passage of the other shareholder in the subsequent year. Therefore, we do not find ourselves at one with the observations made by the ld. CIT(A) in this regard. The contention of the assessee is, therefore, accepted, particularly keeping in view the observations in "Swadeshi Match Co." (supra), wherein it was held that "holding" within the meaning of Explanation II of para D of Part II of the First Schedule I of the Finance (No.2) Act, 1962 had not been defined and, therefore, it was possible to construe that the beneficial shareholding was included in it and vis-à-vis, that however, when a provision under consideration is a provision for giving enhanced benefit by way of additional rebate to the assessee and both constructions are possible, then it is discernable to adopt the construction which will benefit the assessee; and that therefore, for the purpose of Explanation II, both legal ownership and beneficial ownership should be taken into account.

6. The revenue contends that the deletion of requirement of finding that the transfer of shareholding was not bona fide leads to a presumption of transfer and consequently the losses cannot be carried forward by virtue of Section 79 of the Income Tax Act. Ld. counsel contended that in addition the mere circumstance that the assessee had to seek approvals for the foreign investors to carry on business in this case cannot be a consideration since parliament has through the second proviso to Section 79 visualized certain situation pursuant to business arrangements, for company's restructure. It was contended on behalf of the assessee that there was no error of law and the ITAT was justified in deducing that the shareholding pattern which existed prior to 31.3.2002, was in favour of the foreign investors who infused capital by contributing ₹49.9 lakhs. It was emphasized that the Tribunal took note of the provisions of FEMA and also materials appearing on the record and that no question of law arises.

Section 79 of the Income Tax Act reads as follows:

> *"Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless – (a) on the last day of the previous year the shares of the company carrying not less than fifty one per cent of the voting power were beneficially held by persons who beneficially the shares of the company carrying not less than fifty one per cent of the voting power on the last day of the year or years in which the loss was incurred.*
>
> *Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift.*
>
> *Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a*

subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company."

In this case, the narrow question which arises is whether the company-investors came within the description of those owning "not less than 51% of the voting power" beneficially through the two individual shareholders. Ld. counsel for the assessee had sought to place reliance on the application preferred to the FIPB and also the permission granted by the Central Government. Since these were essential the method adopted – having two nominees incorporated in a company and subsequently transfer the shareholding to the real owners – fall within the description of Section 79(a) and therefore, got excepted from the prohibition from carrying forward the losses.

7. This Court has considered the reasoning of the Assessing Officer as well as the CIT(Appeals). Elaborate contentions were made by the assessee, apparently; reliance was placed on various materials on the record. However, this Court does not discern any reasoning by either of those officials or even the ITAT to conclude that at the time of original incorporation (within the assessment year 2000-01) on 16.8.2000, the arrangement between the shareholders (Dr. Prem Chand John Mrs. Dakshayani Reddy) on the one hand and real owner i.e. foreign investor companies, was always that the former were to facilitate the process awaiting approval. While such conclusion is permissible in law, lack of any discussion in the present case by the lower authorities should have led the Tribunal to either examine or remand the matter for reconsideration. As appears from a reading of the Tribunal's order and FEMA order, at the time of incorporation, the share capital was ₹2,000/-. The foreign investors infused ₹49.90 lakhs during the subsequent assessment year which was treated as share application money and later appropriated as share capital after

allotment of shares to the foreign investors. Whether this was in accord with the previously known and disclosed arrangement is not forthcoming from the record.

8. In the light of above discussion, this Court is of the opinion that matter has to be remitted to the Assessing Officer for reconsideration of the entire record and returning findings with specific reference to the arrangement, if any, which existed between original shareholders of the company and the foreign investors. The appeal is accordingly allowed; the Assessing Officer shall issue notice to the respondent/assessee and decide the matter afresh and return findings on this aspect as early as possible, in any event within 4 months from today.

S. RAVINDRA BHAT, J.

R.V.EASWAR, J.

AUGUST 07, 2012
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