IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 09.08.2007

CORAM

THE HONOURABLE MR.JUSTICE D.MURUGESAN
AND
THE HONOURABLE MR.JUSTICE P.P.S.JANARTHANA RAJA

Tax Case (Appeal) No.267 of 2004

Deputy Commissioner of Income Tax
Special Range-II, Coimbatore .. Appellant

-vs-

Sree Janardhana Mills, Upplipalayam
Coimbatore .. Respondent

Memorandum of Grounds of Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal, Madras Bench 'C' dated 18.6.2001 made in ITA No.2019/Mds/1994 for the assessment year 1991-92 against the order of the Income Tax Appeal dated 13.07.1994 and made in ITA.No.96-C/94-95 and against the Assessment Order 1991-1992, dated 31.1.1994, by Dputy Commissioner of Income Tax, Special Range - II, Coimbatore.

For Appellant :: Mr.N.Murali Kumaran
For Respondent :: Mr.Raghul Balaji

JUDGMENT

D.MURUGESAN, J.

The above Tax Case Appeal raises the following substantial question of law:-

"Whether the Tribunal was right in holding that Circular No.683 dated 8.5.1994 is prospective only not to affect assessment pending in appeal?

2. The respondent-mill filed its return of income on 26.12.91 admitting a loss of Rs.8,37,24,609/- for the assessment year 1991-92. A notice under Section 143(2) of the Income Tax Act, 1961 (for short, "I.T.Act") was issued to the assessee and in response to the same, the assessee has stated that the mill had remained closed since August, 1983 to 21.8.90, as it became sick. It went before BIFR and had ultimately restarted its operation with effect from 22.8.90 in pursuance to the order of AAIFR dated 13.6.90. Hence for the assessment year 1991-92, the assessee quantified the total loss as shown above which included the depreciation claimed for the assessment years 1985-86 to 1990-91 amounting to Rs.1,15,96,862/- and carry forward loss from the assessment years 1981-82 to 1990-91 amounting to Rs.6,81,88,117/-.

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3. The Deputy Commissioner of Income Tax, Special Range-II, Coimbatore finalised the assessment determining net loss for the year at Rs.1,38,842/- and disallowed in toto the claim of carry forward loss of the earlier years. Aggrieved by that, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Coimbatore. Placing reliance on the Circular No.523 dated 5.10.1988, the Commissioner by his order dated 13.7.1994 found that the assessee was entitled to the benefit of carry forward loss of the earlier years in terms of the said Circular and the said order was also confirmed by the Income Tax Appellate Tribunal in its order dated 18.6.2001. Aggrieved by the orders of the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal, the Revenue has preferred the above tax case appeal on the above substantial question of law.

4. The Government considering the ill effects of sickness in industrial companies such as loss of production, loss of employment, loss of revenue to the Central and State Governments and locking up of investible funds of banks and financial institutions are of serious concern to the Government and the society and the alarming increase in the incidence of sickness in industrial companies and in order to provide for timely determination by a body of experts of the preventive, ameliorative, remedial and other measures that would need to be adopted with respect to such companies and for enforcement of the measures considered appropriate with utmost practicable despatch came out with the said Act. The Act also provided for establishment of Board consisting of experts in various relevant fields with powers to enquire into and determine the incidence of sickness in industrial companies and devise suitable remedial measures through appropriate schemes or other proposals and for proper implementation thereof. It also provided the constitution of an Appellate Authority consisting of persons who are or have been Supreme Court Judges, senior High Court Judges and Secretaries to the Government of India, etc., for hearing appeals against the order of the Board.

5. Section 15 of the Act contemplates that when an industrial company has become sick, the Board of Directors of the company, 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 Board for determination of the measures which shall be adopted with respect to the company.

6. Section 16 of the Act contemplates the inquiry into working of sick industrial companies.

7. Section 17 of the Act relates to the powers of Board to make suitable orders on the completion of inquiry. Sub-section (1) of Section 17 of the Act contemplates that 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.

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8. As per sub-section (3) of Section 17 of the Act, if the Board decides under sub-section (1) that it is not practicable for a sick industrial company to make its net worth 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.

9. The above provisions show that as and when a reference is made to the Board by a sick industrial company for determination of the measures that shall be adopted in respect of a company, the Board may make inquiry for determining whether such industrial company shall become a sick industrial company. Once the Board decides that the company has become sick but it is practicable for reviving the company, it may appoint an operating agency.

10. Section 18 contemplates preparation and sanction of Schemes by the operating agency for the financial reconstruction of the company etc.

11. By virtue of the operation of the provisions of sub-section (1) of Section 32 of the said Act, the provisions of the Act and of any rules or schemes made thereunder shall have effect notwithstanding anything inconsistent therewith contained in any other law except the provisions of the Foreign Exchange Regulation Act, 1973 and the Urban Land (Ceiling and Regulation) Act, 1976.

12. In the light of the enactment of the Sick Industrial Companies (Special Provisions) Act, 1985 (for short, "SICA") which received the assent of the President on 8.1.1986, the Central Board of Direct Taxes issued the following Circular No.523, dated 5.10.1988.

To
All Commissioners and
Directors General of Income Tax

Subject: Effect of the order passed by the Board for Industrial and Financial Reconstruction under a scheme for the rehabilitation of sick units.

The Sick Industrial Companies (Special Provisions) Act, 1985, was passed by the Parliament and received the assent of the President on the 8th of January, 1986. The Act was introduced with a view to securing timely detection of sick units and speedy determination by the Board for Industrial and Financial Reconstruction (BIFR) of remedial and other measures required to be taken for their rehabilitation.

2. Under section 17(3) of the Sick Industrial Companies (Special Provisions) Act, 1985, in cases where it is not practicable for a sick industrial company to make its net worth positive within a reasonable time, the BIFR is empowered to sanction a scheme providing for such remedial measures in relation to the said sick company for its rehabilitation. Section 32(1) of this Act reads as follows:-

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"The provisions of this Act and of any rules or schemes made thereunder shall have effect notwithstanding anything inconsistent therewith in any other law except the provisions of the Foreign Exchange Regulation Act, 1973, and the Urban Land (Ceiling and Regulation) Act, 1976, for the time being in force or in the memorandum or articles of association of an industrial company or in any other instrument having effect by virtue of any law other than this Act."

The Central Board of Direct Taxes have been advised that if a scheme is sanctioned in pursuance of section 17(3) of the Act, it will have an overriding effect over the provisions of the Income Tax Act, by virtue of section 32 of the Act.

3. Consequently, if the BIFR sanctions a scheme under section 17(3) of the Act, specifically excluding or limiting the application of sections 41(1), 79 and 115J or of any one or more of these sections of the Income Tax Act, 1961, in respect of assessment years which are also specified, then the Assessing Officer will have to take due cognizance of this order and give effect to the same. Such a situation my arise in the case of a sick industrial company which has debited its account in respect of its interest liability in a particular assessment year. Subsequently, if, in a scheme sanctioned by the BIFR, banks are directed to either waive or reduce the interest liability, this remission will become chargeable to tax under section 41(1) of the Income Tax Act, in the year of reduction or waiver by the banks. It is possible that for speedier rehabilitation, the BIFR in its scheme provides that section 41(1) of the Income Tax Act, would not apply in the case of the sick company. The Assessing Officer, in these circumstances, will not subject to tax the remission or cessation of interest, liability under section 41(1) of the Income Tax Act.

4. It may, however, be clarified that section 32(1) of the Sick Industrial Companies (Special Provisions) Act, 1985 refers only to the "Provisions of this Act, and of any rules or schemes" made thereunder and not to orders passed under section 17(2). Therefore, orders passed by BIFR under section 17(2) will not have the effect of overriding the provisions of the Income Tax Act.

5. The contents of this circular may be brought to the notice of all the officers working under you.

(Sd) Vijay Mathur
Director (TPL-II)
(F.No.133/9/88-TPL)

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13. By virtue of the above provisions, the Central Board of Direct Taxes (for short, "CBDT") was of the opinion that in the event the Board or AAIFR, as the case may be, decides that a company had become sick and an operating agency could be appointed, the provisions of the Income Tax Act shall be excluded or limited to the application of sections 41(1), 79 and 115J. With the above opinion in mind, it issued the circular dated 5.10.1988. The power of CBDT to issue such circular is traceable to section 119 of the Income Tax Act, which contemplates that the CBDT may from time to time issue such orders, instructions and directions to other income tax authorities as it may deem fit for proper administration of the Act and such authorities and all other persons employed in the execution of the said Act shall observe and follow such orders, instructions and directions of the CBDT.

14. It appears that later on it was brought to the notice of the CBDT that unless and until the scheme prepared and sanctioned by the operating agency is consented by the financial institutions in terms of sub-section (2) of Section 19 of the SICA, a mere decision of the Board to appoint an operating agency will not give rise the assessee any benefit of with either excluding or limiting the application of Sections 41(1), 79 and 115J of the Income Tax Act. Hence, the Circular No.523, dated 5.10.1988 and Circular No.576, dated 31.8.1990 were withdrawn by a letter dated 30.12.1993. Thereafter, by yet another Circular No.683, dated 8.6.1994, the earlier Circulars dated 5.10.1988 and 31.8.1990 were clarified. The Circular No.683, dated 8.6.1994 reads as under:-

> "Subject: Withdrawal of Circulars Nos.523 and 576- New procedure for representation before Board for Industrial and Financial Reconstruction and the Appellate Authority for Industrial and Financial Reconstruction.
>
> The Board had issued two circulars, Circular No.523, dated October 5, 1988, and Circular No.576, dated August 31, 1990, in connection with the procedure to be followed in respect of grant of "consent" by the Central Government in cases involving financial assistance to be given under the Direct Tax Laws for rehabilitating sick industries under the Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).
>
> 2. While issuing the two circulars, the provisions of section 19(2) of the SICA were not considered. According to section 19(2), all parties concerned with giving "financial assistance" for the rehabilitation scheme should give their "consent".
>
> 3. The Board had withdrawn with immediate effect the above Circulars Nos.523 and 576, vide its letter of even number dated 30.12.1993. The said letter to AAIFR and BIFR clarified that each case of fiscal concession or "financial assistance" under the Direct Tax Laws will now be considered in each individual case on the merits for the purpose of consent as contemplated in section 19 (2) of the SICA, 1985, and consent or denial of consent will be conveyed to BIFR by the Central Government. The

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nodal agency for co-ordination between the Board for Industrial and Financial Reconstruction (BIFR) and the Central Board of Direct Taxes and Appellate Authority for Industrial and Financial Reconstruction (AAIFR) and the Central Board of Direct Taxes will be the Director General of Income Tax (Admn.), 7th Floor, Mayur Bhavan, New Delhi 110 001. Cases already decided in accordance with the Circulars Nos.523 and 576 were, however, not required to be reopened.

4. The contents of this circular may be brought to the notice of all officers working under you.

(Sd) K.Vasudevan
Director (A&PAC)
Central Board of Direct Taxes
(F.No.246/115/95-A&PAC-I)

15. The case of the assessee was considered by the Assessing Officer and his claim of carry forward loss of the earlier years was disallowed. However, both the Commissioner of Income Tax (Appeals) and the Income Tax Appellate Tribunal placing reliance on Circular No.523, dated 5.10.1988 found that the assessee was entitled to the benefit of carry forward loss of the earlier years in terms of the said circulars.

16. On the above factual background, the Revenue has preferred the appeal by raising the substantial question of law as to whether the Tribunal was right in holding that Circular No.683, dated 8.6.1994 is prospective only not to affect assessment pending in appeal.

17. The above substantial question of law gives rise to an incidental issue, a decision on the same shall have relevance, as to whether the benefit given to an assessee in Circular No.523, dated 5.10.1988 requires a pre-condition of framing a scheme and the consequential consent from the financial institution for its revival. The above consideration occasions in view of the submission of the standing counsel for the Revenue that the circular dated 5.10.88 itself was without reference to sub-section (3) of Section 19 of SICA and therefore the benefit arising out of such circular cannot be claimed as a matter of right and the CBDT is entitled to withdraw the said circular giving retrospective effect. The source of power of CBDT to issue circular is traceable to Section 119 of the Income Tax Act. That section empowers the CBDT to issue such orders, instructions and directions to other income tax authorities for proper administration of the Act, with a further direction that such authority should observe and follow such orders, instructions and directions. Apparently, a decision of the Board declaring an industry as sick had weighed the mind of the CBDT to issue circular giving tax benefit to an assessee, when the assessee company approaches the Board for declaration that the company is sick and the Board declares the company sick. Such benefit is only with reference to the sickness of the company and the CBDT had correctly understood while issuing the said circular. The subsequent appointment of an operating agency, the preparation and framing of schemes and financial assistance by the institution are all only the measures to revive the company. The circular dated 5.10.1988 was issued laying down the just and fair method of approach to a situation, when an assessee company faced financial or other crisis forcing such company to close the establishment

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itself. A plain reading of the circular shows that it has no relevance as to the appointment of operating agency, preparation of framing of schemes and making provisions for financial assistance for extension of benefit.

18. Keeping the above discussion in mind, the substantial question of law should be considered. In Navnit Lal C. Jhaveri Vs. K.K. Sen (1965) 56 ITR 198 (SC), the Supreme Court had an occasion to examine the statutory basis and background of the circulars issued by the Central Board of Revenue under the provisions of the Income Tax Act, and the scope and the effect of such circulars. In that case, the CBDT was empowered to issue circulars under section 5(8) of the Income Tax Act, 1922 and the Supreme Court observed that the circular issued by the CBDT is binding on all officers and persons employed in the administration of the Act.

19. In Ellerman Lines Ltd., vs. CIT (1971) 82 ITR 913 (SC), the observation made in Navnit Lal C. Jhaveri vs. K.K. Sen (1965) 56 ITR 198 (SC), was quoted with approval.

20. In State of Trivancore vs. CIT (1986) 158 ITR 102, the Supreme Court once again reiterated the law that the circulars, which are in the nature of concessions, could always be withdrawn prospectively.

21. In Keshavji Ravji & Co., vs. CIT (1990) 183 ITR 1 (SC), a Bench of three Judges of the Supreme Court had also taken the view that circulars beneficial to the assessee which tone down the rigour of the law and are issued in exercise of the statutory powers under Section 119 are binding on the authorities in the administration of the Act retrospectively.

22. The same view was taken by the Supreme Court in CWT vs. Vasudeo V. Dempo (1992) 196 ITR 216, that circulars issued by the department are normally meant to be followed and accepted by the authorities.

23. In K.P.Varghese vs. ITO (1981) 131 ITR 597 (SC), the Supreme Court had gone one step further and observed that circulars issued by the CBDT are legally binding on the revenue and this binding character attaches to the circulars even if they are found not in accordance with the correct interpretation of a statutory provision and they depart or deviate from such construction.

24. The above dictum of law laid down by the Supreme Court show that although the circulars are not binding on the courts or an assessee, they are certainly binding on the revenue and it is not open to the revenue to advance an argument or filing an appeal contrary to the circulars. In fact, the department cannot even take contrary stands to the circulars as well.

25. In UCO Bank vs. Commissioner of Income Tax (1999) 237 ITR 889, the Supreme Court while considering the circulars issued in exercise of power under Section 119 of the Income Tax Act regarding the interest on "sticky" advances has held that the circulars were in the nature of concessions, which could always be prospectively withdrawn.

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26. The above discussion leads us to the only conclusion that so long as a circular issued under Section 119 of the Income Tax Act is applied and enforced, it would be binding on the departmental authorities to

ensure a uniform and proper administration and application of the Income Tax Act. Such circulars cannot be withdrawn retrospectively as they could operate only prospectively. That apart, the benefit conferred by circular dated 5.10.1988 relates to only extension of benefit to an assessee on the basis of the sickness of the company as decided by AAIFR. Withdrawal of such benefit by issue of circulars giving retrospective effect would result in hardship to the assessee as well. In the light of categorical pronouncement of the Supreme Court in UCO Bank case, circulars in the nature of concession can be withdrawn prospectively only. By the circular dated 5.10.88, a procedure was laid down for extension of benefit even before the consent was obtained from the financial institution. In the circular dated 8.6.1994 the CBDT had only laid a new procedure for extension of benefit namely the benefit could be given only after the consent as contemplated under section 19(2) of the SICA is obtained and conveyed to BIFR by the Central Government. Such a procedure could always be prospective operation only. Accordingly, the substantial question of law is answered against the Revenue.

27. In view of the above, the tax case appeal is dismissed. No costs.

Sd/-
Asst. Registrar.

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Sub Asst. Registrar.

ss/kb

To

1. The Deputy Commissioner of Income Tax
   Special Range-II, Coimbatore

2. The Commissioner of Income Tax (Appeals)
   Coimbatore

3. The Income Tax Appellate Tribunal
   Madras Bench 'C'

4. The Assistant Registrar,
   Income Tax Appellate Tribunal
   Bench (B)
   Rajaji Bhavan, 3rd Floor,
   Besant Nagar, Chennai - 90.

1 CC To Mr.N.Muralikumaran, Advocate, SR NO.49778.
1 CC To Mr.Satish Parasaran, Advocate, SR NO.50283.

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GK(CO)
RVL 21.08.2007