K.R.RAMAMANI MEMORIAL NATIONAL TAXATION MOOT PROBLEM 2022-23

The Assessee Vulcan Energy P Ltd filed a SLP before the Hon'ble Supreme Court of India against the order of the Hon'ble Madras High Court passed in PCIT vs M/s. Vulcan Energy Pvt. Ltd.in TCA 1112 of 2011 for the AY 2003-04. Leave was granted by the Hon'ble SC and the caseis posted for final hearing to deal only with the following legal question raised:

"Whether the High Court was right in holding that a portion of the sale consideration retained in the Escrow Account for meeting liabilities and obligation has accrued to the assessee in year of entering into slump sale agreement i.e., impugned AY 2003-04 and hence should be takeninto account for the purpose of computation of Capital Gains in AY 2003-04 itself?"

Annexure: Impugned HC Order

Note: There is no dispute on wording, facts of Agreement and this is only on a question of law not facts.

IN THE HIGH COURT OF JUDICATURE AT MADRAS
Tax Case Appeal No.1112 of 2011
DATED :9.8.2021 CORAM
Principal Commissioner of Income Tax, Chennai. ...Appellant vs.
M/s. Vulcan Energy Pvt. Ltd ...Respondent
APPEAL under Section 260A of the Income Tax Act, 1961 against the order dated 3.6.2009passed by the ITAT, Chennai 'D' Bench in I.T.A.No.594/Mds/2007 for the AY 2003-04.
For Appellant :Mr.AzizAlam,Standing, Counsel
For Respondent :Mr.Vikram Vijayaraghavan, Advocate

Judgment:
The appeal from the Tribunal by the Department was admitted on the question of law being *"Whether the Tribunal was right in confirming the appellate authority's Order that a portion of the sale consideration retained in the Escrow Account for meeting liabilities and obligation has not accrued to the assessee in year of entering into slump sale agreement i.e., impugned AY 2003-04 and hence should not be taken into account for the purpose of computation of Capital Gains in AY 2003-04?"*

In short, the principal question that arises for the consideration of this Hon'ble Court relates to an interesting issue relating to computation of tax liability upon long term capital gains consequent to sale of assets by Assessee in terms of S. 50B of the Income Tax Act. The brief facts are:

- The Petitioner assessee sold a Refractories Plant, located at Palghat, Kerala, to M/s SAPR Refractories India Ltd. ("Purchaser") on a Slump Sale basis for a consideration of Rs.31.45 Crores in impugned AY 2003-2004 (FY 2002-2003) effected in April 2002.
- Out of the sale consideration of Rs.31.45 Crores, the Purchaser retained sum of Rs.3.25 Crore in an Escrow Account which was maintained in Deutsche Bank. The said escrow amount was retained as indemnity against potential claims, breach of warranties, other liabilities etc., that would arise consequent to the sale of the Plant to the Purchaser. Amounts from the escrow account would be released only after due verification and audit by appointed auditor(s) for this.
- The Petitioner in the impugned AY 2003-2004 offered a sum of Rs. 28.2 Crores i.e. Rs. 31.45 Crores less Rs. 3.25 Crores retained in escrow, under head long-term capital gains on the sale of the Plant.
- It is a matter of record that Petitioner had offered the entire escrow amount of Rs. 3.25 Crore, in next year AY 2004-05 for capital gains computation when amounts were paid to Petitioner subsequently.
- The Petitioner assessee submitted before the AO that it did NOT have a right to receive the amounts maintained in the escrow account in AY 2003-2004. The said account was maintained with Deutsche Bank, Mumbai which was towards settlement of claims towards warranty and other obligations. The Petitioner submitted that the Business Sale

Agreement of 1.4.2022 had standard terminology and submitted the following relevant clauses in this regard:

"6.1 Purchase price – The Purchase price for the sale by the seller of the Business is INR 31,45,00,000/- (Indian Rupees Thirty OneCroreForty Five Lakhs Only) which amount represents the sum of the value of the assets and value of Net Working capital. The Purchase price calculated as provided above shall be considered full and final consideration for the business.The Purchaser shall have no obligation to make any other payments to the Seller with respect to liability for any taxes or levies whatsoever which may be assessed against the income or profit realized by the Seller as a result of the Transaction. The Purchaser shall be responsible for payment of stamp duties and registration fees payable to the Office of the Sub –Registrar for the registration of the Land Sale Deed transferring the ownership of the property from Vulcan Energy to SEPR as provided by law.

6.2 Retention Sum – The Retention sum shall be INR 3,25,00,000/- (Indian Rupees Three Crores Twenty Five Lakhs Only) which shall be held in the Retention Account on the terms and conditions provided in this Agreement. The interest accrued on the Retention Sum shall belong to the Seller and shall be paid to the Seller as per the Retention Account Agreement."

….

15.1 The Retention sum shall be paid by the purchaser into the Retention Bank Account held in Deutsche Bank atdate of signing this Agreement for the purpose of ensuring that sufficient funds will be available tohold harmless and indemnify the purchaser against any damages or Losses arisingfrom any or all of the following:

a. *Liability on product warranty given by Vulcan Energy*
b. *Dues payable to Government / Governmental agencies for non-compliance of law before the date of sale by Vulcan Energy.*
c. *50% indemnification of the liability arising on account of Environment, health and safety hazards"*

Thus, it was submitted that the Agreement dated 01.04.2002 has detailed contingencies which could arise and hence a certain amount was kept in escrow. The Agreement further had a detailed modus operandi as to how these contingencies would be evaluated and auditors appointed for issuing certificates in this regard for implementing release from escrow based on contingencies over 18 months from signing of Agreement. These are undisputed facts by Department and thus according the Petitioner Counsel that on a pure question of law, following the plethora of decisions cited, it could not be certain of receiving escrow amount as there was no right to receive; thus it was not accruing to the assessee this year as essentially this escrow amount was not "real income" at all and it would be illogical to tax it this impugned year AY 2003-04 with the assessee having correctly offered next year leaving the Department none the worse.

- However the Assessing Officer did not agree and in the impugned year AY 2003-04 i.e., when the slump sale agreement was arrived at initially, he disallowed the said reduction of the retention money in escrow, and recomputed the capital gain tax on the entire Rs.31.45 Crores (being Rs.28.2crores received in impugned year + Rs.3.25 crores in escrow account) holding that the amount of Rs.3.25 Crores which was kept in an Escrow account pursuant to the sale agreement would only constitute an application of its income, and the whole consideration has accrued to the assessee immediately on the execution of the agreement for sale. It is wholly irrelevant according to the AO that the escrow amount was offered next year; the issue is the amount for taxation in the impugned year.
- The Petitioner carried the order of the Assessing Officer, impugning the addition of Rs. 3.25 Crores in AY 2003-2004, in Appeal before the CIT(A), who was pleased to rule in favour of the Petitioner.
- The CIT(A) relied upon the judgment of this Hon'ble Court in *CIT vs.Hindustan Housing and Land Development Trust (161 ITR 524 SC)* and the decision on retention money contract of Madras High Court in *CIT vs Ignifluid Boilers (I) Ltd 283 ITR 295* as well as referring to "real income" decisions of SC wherein it was held that income tax cannot be levied on hypothetical income*(CIT v. Shoorj iVallabhdas and Co. (1962) 46 ITR 144 (SC), Godhra Electric vs CIT (225 ITR 746 SC), Commissioner of Income Tax v. Excel Industries, (2014) 13 SCC 459)* and noted that in *CIT Vs. Balbir Singh Maini (2018) 12 SCC 354* the SC reaffirmed this legal position. The Department appealed to the Tribunal which upheld the CIT(A) simply and hence Department is in appeal before this Hon'ble High Court.

We have heard both parties in detail. **We find ourself in agreement with the Department's appeal on the following basis:**

a. We note that the Purchase price calculated as provided above in the agreement shall be considered *full and final consideration* for the business. Thus, it seen that AFTER fixing the sale consideration, the parties mutually agreed to retain a specific quantum of money in an escrow account to meet any contingencies. Therefore, for all purposes, we find that the entire sale consideration had accrued in favour of the assessee during the year under consideration. In our view, the retention clause does not save the assessee in our view nor do we agree with the assessee Counsel argument that full and final consideration merely sets the bar on what is the total payment to be made by buyer to seller and not what amount accrues in impugned AY as per Income Tax Act, 1961
b. Towards this we rely on the interpretation the wording in Section 48 ("Mode of computation") of capital gains in the Income Tax Act:
"48. The income chargeable under the head "Capital gains" shall be computed, by deducting from the full value of the consideration

received or accruing as a result of the transfer of the capital asset the following amounts, namely :—

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the asset and the cost of any improvement thereto;"

and note that as far as 'full value of consideration' what is to be taken note of is the total consideration received, though it may be received or may accrue as a result of transfer. 'Full value' means the whole price without deduction whatsoever. In fact, we are of the view that even if certain payments have been made from escrow account, it will not make or in any manner reduce from the full value of consideration.

c. The decision of this Hon'ble Court in *Hindustan Housing & Land Development Trust* and other decisions on real income theory can be distinguished by understanding that total sale consideration was considered to be full and final and therefore, for all purposes the entire sale consideration had accrued in favour of assessee during the impugned year AY 2003-04 itself.
d. Further the decisions of *Anup Engineering Ltd. vs. CIT (247 ITR 0457 Gujarat HC)*, *CIT vs. Ignifluid Boilers (I) Ltd. [(2006) 283 ITR 295 (Mad)]* and other decisions on retention money contracts can be distinguished given that the Petitioner's Business Sale Agreement specified that full and total sale consideration is payable and subsequent conduct of the parties in earmarking a particular sum of money in an Escrow account cannot change the facts and circumstances of the case.
e. We further find merit on decisions relied by the Department on capital gain involving mortgages such as in *CIT vs. NMA Mohammed Hanifa (247 ITR 66 Madras HC)* wherein the discharge of a mortgage on property sold by the seller could not be reduced from capital gains as the transferor/seller received the full value of consideration as per S.48 of the Act and the amount so applied for discharge of the mortgage forms part of the total consideration irrespective of whether the vendee or the vendor discharges the mortgage. We prima facie do not agree with the Petitioner's counsel submission that mortgage discharge cases were entirely not relevant to this issue as S.48 reads *full value of the consideration received or accruing* and that the consideration accruing is only the "real income" which amounts to 28.2 crores with the escrow amount not forming part of the "*full value of consideration accruing".*

We therefore find no infirmity in the Order of the AO holding entire amount of Rs.31.45 crores, including escrow of Rs.3.25 crores, as taxable under head Capital Gains in year of slump sale ieAY 2003-04. In the result, substantial question of law answered in favour of the revenue and against the assessee.

Sd/-

9.8.2021, Madras