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Date: July 12, 2010

CERTIFICATE

TO WHOMSOEVER IT MAY CONCERN

Re: To determine and certify the cost of acquisition of shares allotted to the shareholders pursuant to the Demerger of ASIAN HOTELS LIMITED (AHL), in accordance with the Scheme approved by the Hon'ble jurisdictional High Court, vide its order dated January 13, 2010.

A. ABOUT ASIAN HOTELS LIMITED, THE BACKGROUND AND OUR UNDERSTANDING

Asian Hotels Limited ("AHL"/the "Company"), a public limited company incorporated under the Companies Act, 1956 with its registered office at New Delhi, India was engaged in hospitality business and has three hotels situated each at New Delhi, Kolkata and Mumbai.



its order dated January 13, 2010 the Hon'ble jurisdictional High Court approved the amended scheme of demerger filed by AHL (hereinafter referred to

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as “Scheme”) alongwith Transferee Company – I, i.e., Chillwinds Hotels Limited (hereinafter referred to as “Chillwinds”), now renamed as Asian Hotels (West) Limited and Transferee Company – II, i.e., Vardhman Hotels Limited (hereinafter referred to as “Vardhman”), now renamed as Asian Hotels (East) Limited.

In this regard we, as Statutory Auditors of Asian Hotels Limited, had verified the information as given in the Segmented Undertaking-wise Balance Sheet of Asian Hotels Limited as on October 31st, 2009 (being the Appointed Date of Demerger) from the books of accounts maintained by Asian Hotels Limited and issued a certificate to the effect that the Segmented Undertaking wise Balance Sheet of Asian Hotels Limited, duly certified by the Managing Directors of the Company, was based on and extracted from the books of accounts of the Company and adjusted in accordance with the Scheme of Arrangement and Demerger as filed with the Hon’ble High Court of Delhi.

The said Certified Segmented Undertaking –wise Balance Sheet of the Company has also formed part of the Scheme as Schedule V thereof.

After Demerger, the name of AHL was changed to Asian Hotels (North) Limited (“AHL Residual”)

B. PURPOSE

This Certificate (“Opinion”) has been prepared at the request of Asian Hotels (East) Limited, Asian Hotels (West) Limited and Asian Hotels (North) Limited, to determine and certify the cost of acquisition of the shares allotted to the shareholders of erstwhile AHL pursuant to the demerger, in terms of sections 49(2C) & 49(2D) of the Income Tax Act, 1961.



C. CONFIDENTIALITY AND PRIVILEGES

At the outset, we specify that this Opinion has been furnished for the sole benefit of the Asian Hotels (East) Limited, Asian Hotels (West) Limited and Asian Hotels (North) Limited and shall not be used or referred to for any other purpose.

In particular, this Opinion is not intended for general circulation or publication nor is it to be reproduced or used for any other purpose other than its intended purpose and may not, without our prior written consent, be (a) relied on by another person; or (b) filed with any person or authority or quoted or referred in any other document. We will not assume any responsibility or liability for losses occasioned by any party as a result of circulation, publication, reproduction or use of this Opinion contrary to the provisions of this Paragraph. This disclaimer shall apply in all circumstances including, without limitation, where the Opinion is relied upon by any other person or filed with any other person or quoted or referred to in any other document. The Opinion, however, may be put up on the Company website for the information of shareholders, though, shareholders are advised to seek independent professional assistance in the matter before relying on this Opinion.

Further our comments are based on our understanding of the background as outlined herein with due reliance placed on independent opinion obtained by the Asian Hotels (North) Limited from Amarchand & Mangaldas & Suresh A Shroff & Company. In case of change in our understanding, our comments would need to be revisited accordingly. The implications in this note are purely a matter of interpretation and not binding on any regulatory or tax authorities. Our comments are based on our interpretation of the present provisions of the Income Act, 1961 only and may need review upon future change in law, issue of notification, or any decision of judicial/quasi-judicial authorities. We have no responsibility to update this note for events or



circumstances occurring after the date of this note, unless specifically requested by the three entities as stated above.

D. RELIANCE

This Opinion has been prepared for our clients based on information as supplied to us by them and its management and executives and the various discussions held in this regard.

Further, as stated above, reliance has been placed on an independent opinion obtained by the Asian Hotels (North) Limited from Amarchand & Mangaldas & Suresh A Shroff & Company, on interpretation of the sections 49(2C) & 49(2D) of the Income Tax Act, 1961, to enable us to determine and certify the cost of acquisition of shares allotted to the shareholders of erstwhile AHL pursuant to the demerger.

E. FACTS OF THE CASE

In terms of the scheme of demerger, the businesses held at Kolkata and Mumbai were proposed to be demerged into transferee companies, i.e., Vardhman and Chillwinds respectively.

Consequently, upon the sanction of the scheme effective from the Appointed Date, i.e., October 31, 2009, the Mumbai business of AHL (hereinafter referred to as the "**Mumbai Undertaking**") stood transferred and vested in Chillwinds, and the Kolkata business of AHL (hereinafter referred to as the "**Kolkata Undertaking**") stood transferred and vested in Vardhman.

In accordance with the clause 5.4.2 of the approved Scheme, the shareholding pre demerger and pursuant to demerger stood altered as under:



Equity Shareholders

Pre demerger shareholding in AHL	Post demerger holding (refer sub clause (i) of clause 5.4.2 of the Scheme)
For every 2* shares equity shares of Rs. 10/- held in AHL	(a) 1 equity share of face value of Rs. 10/- in Vardhman, credited as fully paid up; (b) 1 equity share of face value of Rs. 10/- in Chillwinds, credited as fully paid up; and (c) 1 equity share of face value of Rs. 10/- each of AHL Residual Undertaking credited as fully paid up.

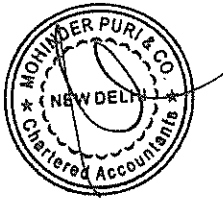
**Prior to capitalization of General Reserves as contemplated in clause 5.5.1 of the scheme*

Accordingly, for every shareholder who held 2 shares in AHL prior to the demerger, the share holding pattern of such shareholder stood modified as under:

- 1 share in Chillwinds
- 1 share in Vardhman
- 1 share in AHL residual

F. CERTIFIED SEGMENTED UNDERTAKING-WISE BALANCE SHEET AS AT OCTOBER 31ST, 2009

The Certified Segmented Undertaking-Wise Balance Sheet as at October 31st, 2009 is reproduced herein below:



ASIAN HOTELS LIMITED
CERTIFIED SEGMENTED UNDERTAKING-WISE BALANCE SHEET
AS AT 31ST OCTOBER, 2009

(Rs. In Lakhs)

	Asian Hotels Limited Residual	Mumbai Undertaking	Kolkata Undertaking	Total
LIABILITIES				
SHAREHOLDERS' FUND				
Equity Share Capital				2,280.36
Add: Transferred from General Reserve as per contra (Refer clause 5.5.5 (a) of the Scheme)				1,140.18
	1,140.18	1,140.18	1,140.18	3,420.53
Equity Share Capital allocated (Refer clause 5.5.1 of the Scheme)				
1% cumulative Redeemable Non-Convertible Preference Shares (NCPS) Capital (Refer clause 5.4.2 of the Scheme)	495.00	495.00	10.00	1,000.00
Fully Convertible Preference Share Capital (FCPS) Pending allotment				
Representing Capital (Refer clause 5.4.2 of the Scheme)	625.93	2.78	2.78	631.48
Representing Share Premium (Refer clause 5.5.5.(e) and (f) of the Scheme)	33,174.05	147.23	147.23	33,468.52
	33,799.98	150.01	150.01	34,100.00
RESERVES AND SURPLUS				
- Capital Reserve (Refer clause 5.5.5 of the Scheme)	1.41	1.41	1.41	4.23
- Share Premium on NCPS (Refer clause 5.5.5(c) and (d) of the Scheme)	3,960.00	3,960.00	80.00	8,000.00
- General Reserve				(1,140.18)
Less: Transferred to Equity Share Capital as per contra (Refer clause 5.5.5 (a) of the Scheme)	2,556.61	2,556.61	2,556.61	7,669.82
- General Reserve allocated (Refer clause 5.5.5(b) of the Scheme)	-	7,297.37	55,117.30	62,414.67
Add: Transfer post de-merger being the excess of assets over liabilities (Refer clause 5.5.6 of the Scheme)	2,556.61	9,853.98	57,673.90	70,084.49



	Asian Hotels Limited Residual	Mumbai Undertaking	Kolkata Undertaking	Total
- Tourism Development Utilised Reserves (Refer clause 5.5.5(b) of the Scheme)	5,332.02	5,332.02	5,332.02	15996.06
- Capital Redemption Reserve for redeemed NCPS (Refer clause 5.5.5(b) of the Scheme)	495.00	495.00	10.00	1,000.00
- Capital Redemption Reserve for redeemable NCPS	498.32	820.36	13.32	1,332.00
- Revaluation Reserve (Refer clause 5.5.5(g) of the Scheme)	81,988.03	-	-	81,988.03
- Revaluation Reserve (Refer clause 5.5.5(g) of the Scheme)	(62,414.67)	-	-	(62,414.67)
Less: Transfer post de-merger being the excess of assets over liabilities moving out (Refer clause 5.5.6 of the Scheme)	19,573.36	-	-	19,573.36
- Surplus in Profit & Loss Account (Refer clause 5.5.5(b) of the Scheme)	9,339.40	9,339.40	9,339.40	28,018.20
	41,756.11	29,802.17	72,450.05	144,008.34
LOAN FUNDS				
Secured Loans	16,184.36	345.34	-	16,529.70
NET DEFERRED TAX LIABILITY	1,266.41	2,871.98	2,151.39	6,289.78
SHOP SECURITY DEPOSITS	591.58	-	-	591.58
CURRENT LIABILITIES AND PROVISIONS				
- Current Liabilities	12,489.26	3,090.87	1,297.80	16,877.93
- Provisions	12,436.36	211.21	102.70	12,750.27
	24,925.62	3,302.08	1,400.50	29,628.20
Total	120,159.24	38,106.76	77,302.14	235,568.13

(Rs. In Lakhs)

	Asian Hotels Limited Residual	Mumbai Undertaking	Kolkata Undertaking	Total
ASSETS				
FIXED ASSETS				
Gross Block	105,072.53	36,390.97	20,158.84	161,622.33
Less: Depreciation	6,818.84	6,448.43	4,694.76	17,962.03
Net Block	98,253.68	29,942.54	15,464.08	143,660.30
Capital Work-in-Progress	553.24	10.80	163.57	727.61
	98,806.93	29,953.35	15,627.65	144,387.92
INVESTMENTS (including Subsidiaries)	-	2,506.00	26,963.61	29,469.61
CURRENT ASSETS, LOANS & ADVANCES				
- Inventories	506.34	221.63	183.43	911.40



- Sundry Debtors	1,041.78	909.34	265.80	2,216.92
- Cash and Bank Balances	254.77	587.13	32,758.17	33,600.08
- Loans and Advances	19,549.41	3,929.30	1,503.49	24,982.20
TOTAL	21,352.31	5,647.41	34,710.88	61,710.60
120,159.24	38,106.76	77,302.14	235,568.13	
Contingent Liabilities:				
(a) Outstanding Capital Expenditure	545.17	172.93	-	718.10
Commitments	617.18	-	-	617.18
(b) Claims against the Company not acknowledged as debts	11,011.75	833.16	243.01	12,087.92
(c) Export obligation in respect of EPCG Licenses				

G. SECTION 49(2C) AND 49(2D) OF THE INCOME TAX ACT

In order to calculate the cost of acquisition of shares allocated to the original shareholders of the demerged company in the resulting company, pursuant to a scheme of demerger, section 49(2C) provides as under:

*"49(2C) The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the **same proportion** as the **net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.**"*

Hence, the formulae prescribed under the Act to calculate the cost of acquisition of shares in the resulting company is as under:

$$\text{Original cost of acquisition} \quad * \quad \frac{\text{Net Book Value of assets transferred}}{\text{Net worth of the demerged company prior to demerger}}$$



Based upon the formula prescribed, in the instant case, the shareholders would need to determine the cost of acquisition of shares allotted to them as a result of the demerger in the Mumbai undertaking and the Kolkata undertaking as under:

1. **Cost of acquisition allocated to shares allotted in the Mumbai undertaking**

Original Cost of Acquisition * $\frac{\text{Net Book Value of assets transferred to Chillwinds}^1}{\text{Net worth of AHL prior to demerger}}$

2. **Cost of acquisition allocated to shares allotted in the Kolkata undertaking**

Original Cost of Acquisition * $\frac{\text{Net Book Value of assets transferred to Vardhman}^2}{\text{Net worth of AHL prior to demerger}}$

3. **Cost of acquisition of shares remaining to be held in AHL residual**

Section 49(2D) of the Act provides for determination of such part of shares that continue to be held by the shareholders in AHL residual post the demerger:

*"49(2D) cost of acquisition of the **original shares** held by the shareholder in **the demerged company** shall be deemed to have been **reduced by the amount as so arrived at under sub-section (2C)**"*

Accordingly, for the part of the shareholding that continues to be held in AHL residual by the shareholder of AHL, the cost of acquisition of such share shall be calculated as under:

Original cost of acquisition incurred **less** [cost of acquisition of shares allotted in Chillwinds (*relatable to Mumbai undertaking*) determined in 1 above + cost of acquisition of shares allotted in Vardhman (*relatable to Mumbai undertaking*) determined in 2 above]



Relatable to the Mumbai undertaking
Relatable to the Kolkata undertaking

An analysis of the above provisions of the Act highlight the importance of the following two accounting ratio, i.e.

- a) **Net Book Value** of assets transferred to Chillwinds (*relatable to Mumbai undertaking*) & Vardhman (*relatable to Kolkata undertaking*); and
- b) **Net worth** of AHL immediately prior to the demerger

In order to calculate, the said ratios, financial statement of the separate undertakings need to be referred to.

Calculation of net book value of assets transferred

The term net book value of assets has not been defined in the Act. As a necessary consequence of the principle that words are understood in their ordinary and natural meaning in relation to the subject-matter, in legislation relating to a particular trade, business, profession, art of science, words have a special meaning in that context are understood in that sense. Such a special meaning is called the technical meaning to distinguish it from the more common meaning that the word may have³.

Based upon the above, in order to understand 'net book value of assets' for purposes of section 49(2C) of the Act, reliance may be placed upon the guidance note issued by Institute of Chartered Accountants of India ("ICAI") on 'Terms Used in Financial Statements GN (A) 5 (Issued 1983)', wherein, net assets have been defined as under:

"Net Assets

*The excess of book value of assets (other than fictitious assets) of an enterprise over its liabilities. This is also referred to as **net worth** or **shareholders' fund**."*



Based upon the above definition, in the given case, net book value of assets transferred has for purposes of section 49(2C) of the Act has been calculated as under (refer extract of balance sheet produced above):

³ Union of India v. Garware Nylons Ltd. AIR 1996 SC 3509

a. Net Book Value of assets transferred to Chillwinds (relatable to Mumbai undertaking)

Particulars	Amount (in Rs. Lakhs)
Total assets transferred to Mumbai undertaking	38,106.76
Less: Liabilities transferred to Mumbai undertaking	6,519.4
Net Book Value of assets transferred	31,587.36

b. Net Book Value of assets transferred to Vardhman (relatable to Kolkata undertaking)

Particulars	Amount (in Rs. Lakhs)
Total assets transferred to Kolkata undertaking	77,302.14
Less: Liabilities transferred to Kolkata undertaking	3,551.89
Net Book Value of assets transferred	73,750.25

In addition to the Net Book Value of assets transferred, the other ratio to be determined is the net worth of AHL immediately prior to the demerger:

Calculation of net worth of the demerged company, i.e., AHL, prior to the demerger:

For the purposes of calculating net worth, Explanation to section 49(2C) of the Act provides as under:

*"Explanation. - For the purposes of this section, "net worth" shall mean the aggregate of the **paid up share capital** and **general reserves as appearing in the books of account** of the demerged company immediately before the demerger"*

Accordingly, in order to calculate the **net worth** of AHL immediately prior to the demerger, as per the formula prescribed, the sum of paid up share capital and general reserves need to be considered.



The term 'General reserve' has not been defined under the Act. Accordingly, in order to interpret the term, reliance may be placed on the guidance note issued by the ICAI. The said guidance note defines general reserves as under:

“General Reserve

A revenue reserve which is not earmarked for a specific purpose”

Based upon the said definition, only such reserves which are revenue in nature and not earmarked for specific purposes are general reserves. In other words, reserves which are freely available for distribution to the shareholders may be referred to as a general reserve and thereby accounted for while calculating the **net worth**.

In the balance sheet extract of AHL, prior to the demerger, following were the list of reserves appearing:

- a) General reserves
- b) Surplus in P&L account
- c) Capital reserve
- d) Capital redemption reserves
- e) Tourism Development Utilized reserves
- f) Share premium on Non Convertible Preference Shares
- g) Share premium on Fully Convertible Preference Shares
- h) Revaluation reserves

General reserves & Surplus in P&L account

In relation to the above reserves, general reserves and surplus in P&L account are in the nature of general reserves since as per the definition (*supra*) they are revenue in nature and not earmarked for specific purpose. Accordingly, the same have been considered while calculating the net worth of AHL immediately prior to the demerger



General reserve

The Guidance Note on terms used in financial statements defines "capital reserve" as under:

"Capital Reserve: A reserve of a corporate enterprise which is not available for distribution as dividend"

Based upon the above definition, since a capital reserve is not available for free distribution to shareholders, the same has not been treated as a general reserve and hence not accounted for while calculating the net worth of AHL.

Capital redemption reserve

The Guidance Note on terms used in financial statements defines "capital redemption reserve" as under:

"Capital Redemption Reserve

A reserve created on redemption of the redeemable preference shares of a corporate enterprise **out of its profits which would otherwise have been available for distribution as dividend."**

The above definition highlights that the capital redemption reserve is constituted of profits which would otherwise have been available for free distribution. Since such a reserve would qualify as a general reserve as per the definition of 'general reserve' (produced above), the same may be accounted for while calculating the net worth of AHL.

Tourism Development Utilization reserve

As per the confirmation of the management, we understand that the profits out of which this reserve has been created is available for free distribution amongst the shareholders and hence the reserve is a general reserve in nature and accordingly accounted for while calculating the net worth of AHL. We have been given to understand that Tourism Development Utilization Reserve has been fully utilized and become a free reserve now.



Securities Premium/ Shares Premium

Under the Guidance Note on terms used in financial statements issued by the ICAI, securities premium has simply been defined to be the 'excess of issue price of shares over their face value'. Since the said definition does not comment upon the nature of reserve, the definition of net worth under the Companies Act, 1956 may be of relevance, the said definition reads as under:

"2(29A) "net worth" means the sum total of paid up capital and free reserves after deducting the provision or expenses as may be prescribed.

Explanation – for the purposes of this clause, "free reserves" means all reserves created out of the profits and share premium account but does not include reserves created out of revaluation of assets, write back of depreciation provisions and amalgamation"

Based upon the above definition, it may be inferred that share premium/ securities premium is made out of reserves available for free distribution. Accordingly, the same has been included in the calculation of 'net worth'.

Revaluation reserves

On a perusal of the definition of 'net worth' contained under section 2(29A) of the Companies Act, 1956 (extracted above), it is unerringly evident that the net worth specifically exclude any reserves which are created out of revaluation of assets from its definition.

It is circumspect to note that under the Guidance Note on Terms Used in Financial Statements, the term revaluation reserve has been defined as under:

"Revaluation Reserve

A reserve created out of the revaluation of assets or net assets of an enterprise represented by the surplus of the estimated replacement cost or estimated market value over the book values thereof."



The foresaid definition does not elaborate upon the nature of revaluation reserve hence reliance may be placed on Accounting Standard ("AS") 10 issued by the ICAI on accounting for fixed assets. Under 13.7, the AS provides as

*“13.7 An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner’s interest under the heading of revaluation reserves **and is regarded as not available for distribution.....**”*

Further, the ICAI has also issued Guidance Note on Treatment of Reserve Created on Revaluation of Fixed Assets GN(A) 3 (Issued 1982). The relevant extract of the Guidance Note are usefully reproduced hereunder:

*“8. **When accumulated losses and depreciation (including arrears of depreciation) are adjusted against Revaluation Reserve it will amount to setting off actual losses against unrealised gains. If dividend is declared out of the current profits after adjusting accumulated losses or arrears of depreciation against the Revaluation Reserve, it will mean that dividend is declared out of profits which should, in fact, have been utilised in setting off past losses and arrears of depreciation. In effect, the company will be declaring dividend out of profits which are not available for distribution. By adopting this method, the company will be declaring dividend out of unrealized gains appearing in the accounts in the form of Revaluation Reserve.** Accordingly, accumulated losses or arrears of depreciation should not be set off against Revaluation Reserve.....”*

*11. **The Revaluation Reserve is not available for payment of dividends.** This view is also supported by the Companies (Declaration of Dividend out of Reserves) Rules, 1975. Similarly, accumulated losses or arrears of depreciation should not be set off against Revaluation Reserve. However, the revaluation reserve can be utilised for adjustment of the additional depreciation on the increased amount due to revaluation from year to year or on the retirement of the relevant fixed assets.....”*

Based upon the above clarification issued by the ICAI, it is clear that the amount credited to the revaluation reserve on account of revaluation of fixed assets is an unrealized gain not available for distribution as dividends.



Accordingly, it is clear that the revaluation reserve is only a notional gain and since the amount standing in the credit of revaluation reserve is not freely available for distribution amongst shareholders, the same does not qualify as a general reserve. Accordingly, the revaluation reserve has been excluded while calculating the net worth of AHL.

On the basis of the above analysis, the net worth of AHL immediately prior to the demerger has been calculated as under:

Particulars	Amount (in Rs. Lakhs)
Equity share capital	2,280.36
Cumulative redeemable non convertible preference shares	1,000.00
Fully convertible preference shares	631.48
NCPS premium	8,000.00
FCPS Premium	33,468.52
General Reserves	8,810.00
Tourism Development Utilized reserves	15,996.06
Capital redemption reserve	2,332.00
Surplus in P&L account	28,018.20
NET WORTH	100,536.62

Accordingly, in order to determine the cost of acquisition of shares allotted in Mumbai and Kolkata Undertaking to shareholders of AHL in accordance with provisions of section 49(2C) of the Act, the relevant ratios required are as under:

- a) **Net Worth** of AHL immediately prior to the demerger **Rs. 100,536.62 Lakh**
- b) Total **Net Book Value of assets transferred** by AHL **Rs. 105,337.61 Lakh** on account of following transfers:



- Net Book Value of assets transferred to Chillwinds on account of the transfer of Mumbai undertaking per the scheme of demerger – **Rs. 31,587.36 Lakh**

➤ Net Book Value of assets transferred to Vardhman on account of the transfer of Kolkata undertaking per the scheme of demerger – **Rs. 73,750.25 Lakh**

As may be seen from the above workings, the net book value of assets transferred by AHL under the scheme of the demerger is more than the net worth of AHL immediately prior to the demerger.

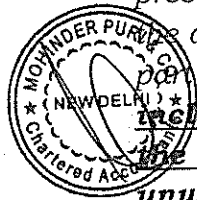
As a result of the above, in the case of AHL and the instant demerger, the ratio prescribed under section 49(2C) of the Act is such that the numerator is more than the denominator.

In such a case, the sum total of the ratio that are allocated to Vardhman and Chillwinds exceeds 100% and is as under

Particulars	%age of cost of acquisition (section 49(2C) of the Act)
Chillwinds - relatable to Mumbai undertaking	31% [31,587.36/ 100,536.62*100]
Vardhman - relatable to Kolkata undertaking	73% [73,750.25/ 100,536.62*100]
Total	104%

It is to be noted that the Bombay High Court in the case of **CIT vs. Sudarshan Chemical Industries Ltd⁴**, in relation to a case relating to formula prescribed for deduction from tax under section 80HHC of the Act held as under:

“The export turnover is the numerator in the above formula whereas the total turnover is the denominator. The above formula has been prescribed to arrive at the profits from exports. In the circumstances, the above two items, namely, sales tax and excise duty, cannot form part of the total turnover. In fact, if the denominator was to include the above two items and if the numerator excluded the above two items then the formula would become unworkable....”



⁴ (245) ITR 769

Hence, the proposition of the High Court has been that in cases of apportionment which require that the numerator calculated is only a percentage of the total denominator, the numerator cannot exceed the denominator.

The said principle was also upheld by the Hon'ble Supreme Court in the case of ***CIT vs. Catapharma India (P) Ltd⁵***.

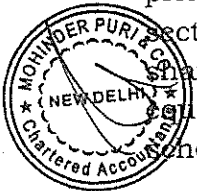
Applying the principle laid down in these cases, it is clear that since the intention of provisions contained in section 49(2C) and section 49(2D) of the Act is to apportion the total cost incurred by the original shareholders of AHL (i.e., 100% of the cost) amongst Chillwinds, Vardhman and AHL residual, the formulae prescribed cannot lead to a result whereby the numerator is in excess of the denominator.

On a harmonious reading of section 49(2C) and section 49(2D) of the Act, the total cost of acquisition as determined in pursuance to the above two sections, cannot be less than or more than the actual cost of acquisition.

In addition to the above, provisions of section 49(2D) of the Act also need to be analyzed and read with provisions of section 49(2C) of the Act

Section 49(2D) of the Act provides that the cost of acquisition of shares in the demerged company shall be the original cost of shares in demerged company less the cost of acquisition arrived at in accordance with provisions of section 49(2C) of the Act.

Accordingly, since the cost of acquisition of shares acquired originally in AHL, prior to the demerger, should not exceed 100%, formula prescribed under section 49(2D) read with section 49(2C) leads to a cost of acquisition of (4%) for shares that continue to be held by shareholders in AHL residual, i.e., in case of equity shareholders, 1 share for every 3 shares held, as per clause 5.4.2(i) of the scheme.



⁵ (292) ITR (641)

Resultantly, the cost of acquisition of shares originally held in AHL would be split amongst the three companies as under:

Particulars	%age of cost of acquisition (section 49(2C) & 49(2D) of the Act)
Chillwinds, i.e., in relation to net assets of the Mumbai Undertaking transferred in accordance with the scheme of demerger <i>(part of the original shareholding in AHL as per clause 5.4.2 of the scheme)</i>	31%
Vardhman, i.e., in relation to net assets of the Mumbai Undertaking transferred in accordance with the scheme of demerger <i>(part of the original shareholding in AHL as per clause 5.4.2 of the scheme)</i>	73%
AHL residual, i.e., portion of share continued to be held in AHL residual	(4%)
Total	100%

In view of the foregoing and in accordance with the formula prescribed under section 49(2C) and 49(2D) of the Act (and the definition of net worth), the calculations as detailed above result in:

- a) The sum of the cost of acquisition of original shares (pertaining to Mumbai and Kolkata Undertaking) in the resulting company exceeds 100% of the cost of acquisition incurred by the shareholders to acquire original shares in AHL, prior to the demerger; and
- b) The residual cost of acquisition of shares in AHL residual is a negative figure resulting to a negative cost of acquisition

H. INCOME TAX IMPLICATIONS

If the cost of acquisition as derived above is taken into account, from a tax perspective the same shall result in the following:



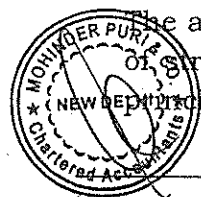
1. **Shareholders holding original shares in AHL shall be able to claim a deduction for the cost of acquisition⁶ which is more than the original cost incurred by the shareholders to acquire shares in AHL originally.**

Such a result arrived at, on a strict interpretation of section 49(2C) of the Act, is absurd since it allows the shareholders to claim a deduction of 104% of the cost of acquisition which is much more than the actual cost of acquisition incurred by the shareholders to originally acquire shares in AHL (prior to demerger).

In addition, such cost of acquisition is allowed against only part of the total holding (in resulting company) pursuant to the scheme of demerger.

Further, it is also to be noted that the interplay between section 49(2C) and section 49(2D) of the Act give a result which is not only absurd but also incongruous. Section 49(2D) of the Act refers to section 49(2C) and since the explanation providing the definition of net worth is provided after section 49(2D), it is clear that section 49(2C) and 49(2D) of the Act are interrelated. Such an interpretation would emasculate section 49(2D) and would render it redundant.

It is also a well accepted principle of interpretation that the statute must be read as a whole. Accordingly, if the calculation of net worth for the purposes of section 49(2C) of the Act gives a result by which the formula prescribed under section 49(2D) fails, there is a need for harmonious construction whereby inconsistency and repugnancy of provisions of the Act is avoided.



The aforesaid principle of interpretation serves as an exception to the basic rule of strict interpretation which is to be applied in taxing statutes. The relevant principles of statutory interpretation and how they have evolved with time

⁶Section 48 of the Act which provides for the mode of computation of capital gains reads as under
"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:
Provided that in the case of an assessee....."

based upon international decisions and decisions of the Hon'ble Supreme Court of India are usefully extracted.

Since in the given case, the literal interpretation of provisions under section 49(2C) and section 49(2D) of the Act are leading to absurdity and resulting in a cost of acquisition, the sum of which is more than the cost of acquisition incurred by the original shareholders, one needs to look at how such a provision needs to be interpreted in accordance with the recognized principles of statutory interpretation.

It is to be noted that in connection with taxing statutes, the rule of strict interpretation is the most widely accepted principle.

A taxing statute has to be strictly construed. This rule has been expressed in different language in different cases:

*"The subject is not to be taxed without clear words for that purpose ..."*⁷

*"If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be; on the other hand, if the Crown seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly, such a construction is not admissible in a taxing statute where you can simply adhere to the words of the statute."*⁸



⁷ Per Lord Halsbury in *Tenant v Smith* (1892) AC 150 (HL) at p 154; *St Aubyn v AG* (1952) 2 AER 473 at p 485.

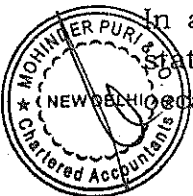
⁸ Lord Cairns in *Partington v AG* (1869) LR 4 HL 100 at P 122 referred to in *IRC v Duke of Westminster* (1936) AC 1 (HL) at p 24; 19 TC 490; *Potts Executors v IRC* (1951) 32 TC 211 (HL); (1951) 1 AER 76(HL) at p81; *Ramson v Higgion* (1974)3 AER 949 (HL) at p 970; *Bank of Chettinad Ltd v CIT* (1940) 8 ITR 522 (PC); *CIT v Provident Investment Co Ltd* (1957)32 ITR 190 (SC); *Fernandez (AV) v State of Kerala* AIR 1957 SC 657; *Gursahai Saigal v CIT* (1963) 48 ITR 1 (SC); *CIT v M & G Stores* AIR 1968 SC 200; *J K Steel Ltd v Union of India* AIR 1970 SC 1173.

“In a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used”.⁹

“The subject is not to be taxed unless the words of the taxing statute unambiguously impose the tax on him.”¹⁰

However, there exist exceptions to the rule of strict construction and the same has been observed by the Supreme Court in the case of **ITC Ltd v CCE**¹¹ wherein the Supreme Court found two exceptions to the rule of strict construction. The **first** is that the rule of strict construction does not apply to a provision which merely lays down the machinery for the calculation or procedure for the collection of tax. The **second** exception is that if two constructions are possible and a strict construction will lead to an absurd result then the construction which is in keeping with the object of the statutory provision or in keeping with equity could be accepted.

It is to be noted here that section 49(2C) and section 49(2D) of the Act have the savor of machinery provisions and not charging provisions, hence the rule of strict interpretation shall not apply to interpretation of these sections.



In addition to the above, the exceptions to strict interpretation of the taxing statute are also found in the following rules predicated by the Courts on various occasions:

⁹ Per Rowlatt, J, in *Cape Brandy Syndicate v IRC* (1921) 1 KB 64 at p 71, cited, referred to and approved in numerous cases in England as well as in India. See also *CST v Modi Sugar Mills Ltd* AIR 1961 SC 1047; *State V Jullundur Vegetables Syndicate* AIR 1966 SC 1295; *Commissioner v Top Ten Promotions* (1969) 3 AER 39 (HL) at p 49; *CIT v M G Mills* AIR 1971 SC 2434; *Janapada Sabha v C P Syndicate* (1971) 1 SCC 509; *Mangin v IRC* (1971) 2 WLR 39 (PC); 1971 AC 739; *VP Theatre v State of Punjab* (1990) 185 ITR 428 (MP); *CIT v Vishwanath* (1993) 201 ITR 920 (All); *CIT v Orissa State Warehousing Corpn* (1993) 201 ITR 729 (Cd); *CED v Roshan Jahangir Gandhi* (1994) 205 ITR 428 (SC); *Lakshmi Bai (HH) v CWT* (1994) 206 ITR 688 (SC).

¹⁰ Per Lord Simonds in *Russel v Scott* (1948) 2 AER 1 (HL) at p 5.

¹¹ (2004) 3 RC 337 (SC).

- (i) **Rule of beneficial interpretation** — If there is any ambiguity in law, there is no tax in law.¹²

Liberal construction so as to effectuate the objects is permissible, when there is genuine difficulty about interpretation or two opinions are capable of being held.

In fiscal statutes it is not permissible to supply deficiencies so as to make it effective. In such cases, the benefit goes to the taxpayer.¹³ The benefit of doubt in a taxing statute should always go to the taxpayers.¹⁴

Rule of reasonable construction

A fair and reasonable construction of the language in the statute is a basic principle of interpretation.

If a taxpayer cannot be brought under the tax net, revenue has to be reconciled to this position of law.¹⁵ Where two views are reasonably possible, the one which favors the assessee has to be adopted.¹⁶

Ambiguity has always to be resolved in favour of the assessee.¹⁷

- (ii) **Construction leading to absurdity be avoided:**

A statute should be read as a whole to ascertain its true meaning and content. Whenever a statute comes up for consideration, it must be remembered that it is not within human powers to foresee the manifold sets of facts which may arise, and, even if it were, it is not possible to provide for them in terms free from all ambiguity.



¹² *Mathuram Agrawal v State of MP* AIR 2000 SC 109.

¹³ *J & K Steel Ltd v Union of India* AIR 1970 SC 1173.

¹⁴ *ITO v Devinatha (TS)* AIR 1968 SC 623; *Municipal Committee v. Phoolchand* (1962)2 SCJ24.

¹⁵ *Vikrant Tyres Ltd v First ITO* (2001) 247 ITR 821 (SC).

¹⁶ *Birla Cement Works v CBDT* (2001) 248 FUR 216 (SC).

¹⁷ *Southern Roadways Ltd v CWT* (2001) 251 ITR 213 (Mad).

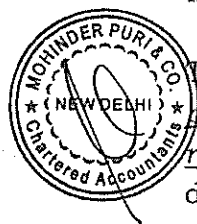
No statute should be interpreted in such a manner as to render any provision completely meaningless or redundant.¹⁸

In **Varghese (KP) v ITO**,¹⁹ the Supreme Court observed;

“It is a well settled rule of construction that where the plain literal interpretation of a statutory provision produces a manifestly absurd and unjust result which could never have been intended by the legislature, the court may modify the language used by the legislature or even do some violence to it, so as to achieve the obvious intention of the legislature and produce a rational construction. The court may also in such a case read into the statutory provisions a condition which, though not expressed, is implicit as constituting the basic assumption underlying the statutory provision. While the consequences of a suggested construction cannot alter the meaning of a provision, they can be taken into account to help in fixing its meaning”

Legal maxim: Ut res magis valeat quam pereat

The above rule also finds place in the subject maxim. The Hon'ble Supreme Court, in the case of **CIT v. S. Teja Singh**²⁰ has observed that a construction which results in rendering a provision redundant must be avoided.



Their Lordships held that the principle of ut res magis valeat quam pereat, i.e. to make the statute effective rather than making it redundant, is to be followed in construction of the statutes. In the decision, the Court held as follows:

¹⁸ *CIT (Addl) v Bhagat Swarup Charanjit Singh and Co* (1982) 133 ITR 13 (Del); *Union of India v Manik Dattatreya Lollikar* (1988) 172 FIR 1 (Bom).

¹⁹ (1981) 131 ITR 597 (SC)

²⁰ [1959] 35 ITR 408

". . . Vide *Courtis v. Stovin* [1889] 22 QBD 513, and in particular, the following observations of Fry, LJ at page 519:

The only alternative construction offered to us would lead to the result that the plain intentions of the Legislature has entirely failed by the reason of slight in exactitude in the language of the section. If we were to adopt this construction, we should be construing the Act in order to defeat its object rather than with a view to carry its object into effect.'

*Vide also Craies on Statute Law, page 90, and Maxwell on the Interpretation of Statutes, Tenth Edition, pp. 236-237. 'A statute is designed' observed Lord Dunedin in *Whitney v. IRC*[1925] 10 Tax Cases 88, to be workable, and the interpretation thereof by a court should be so as to secure that object, unless crucial omission or clear direction makes that end unattainable."*

It is to be noted that here again the emphasis of the Hon'ble Supreme Court was on an interpretation which make the statute workable, rather than making it redundant, and on an interpretation which advances the object of the provision rather than defeats the same²¹.

Based upon the above principles of statutory interpretation as laid down by the Courts in various jurisdictions including the Supreme Court of India, the principles of **interpretation require that the taxing statute should be interpreted literally unless:**

- a) **There is ambiguity in the provision:** In such a case, interpretation which is beneficial to the tax payer shall apply, also referred to as the rule of liberal/ reasonable interpretation

²¹ *CIT vs. Papilion Investments (P) Ltd.* (Income Tax Appeal No. 226 of 2006)



- b) The rules of interpretation also require that **regard to consequences** should also be given. Any strict interpretation which results in hardship, inconvenience, absurdity, anomaly, should be avoided.
- c) The rule of **harmonious construction** also requires that where an interpretation leads to repugnancy or inconsistency, such interpretation should be avoided and the law should be interpreted to harmonize any conflict that may arise.

In view of the above rules of interpretation, it is to be noted that the strict interpretation of section 49(2C) and 49(2D) of the Act, given the current facts of the case, lead to a result which is absurd and hence the rule of strict interpretation cannot be followed.

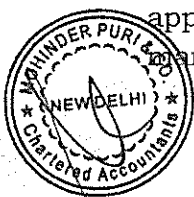
Further, the interplay between section 49(2C) and 49(2D) of the Act also lead to a repugnancy and hence the rules of interpretation require that the sections need to be interpreted in a manner such that the provisions are harmonized and there is no conflict between the same.

Following the maxim, *ut res magis valeat quam pereat*, since in the current case, the construction renders the provisions of section 49(2C) and 49(2D) of the Act redundant, the same should be avoided. In such a case, the construction should be such that it makes the provision effective instead of redundant.

Accordingly, in the facts of the case, the rule of strict interpretation cannot be applied. Hence, one would need to interpret the said provisions of the Act in a manner that they:

- **Do not lead to absurdity; and**
- **Make the provision effective instead of redundant.**

In order to achieve such an interpretation, it is imperative that the sum of the cost of acquisition of shares arrived at under section 49(2C) of the Act should be limited to 100% of the cost of acquisition and not exceed the same.



In order to achieve the above, in our opinion it would be salutary to reduce the excess 4% in the ratio of the cost of acquisition attributable to each undertaking. The same may be done as under:

Particulars	%age of cost of acquisition (A)	Adjustment of the excess 4% in ration of 3.1:7.3 (B)	%age of cost of acquisition after adjustment (A) Less 20 (B)
Chillwinds	31%	(1%)	30%
Vardhman	73%	(3%)	70%
Total	104%	(4%)	100%

2. **The cost of acquisition of the share that the shareholders continue to hold in AHL residual is negative.**

As discussed above, a strict interpretation of the provisions of section 49(2D) of the Act read with section 49(2C) result in a negative cost of acquisition for shares that the original shareholders of AHL continue to hold in AHL residual.

Negative cost of acquisition:

For the purposes of the Act, a negative cost of acquisition cannot be considered while calculating capital gains since the same, as a result of the mode of computation prescribed under the Act, would result in the tax payer paying capital gains which exceed the total sales consideration received by the tax payer in connection with the sale of the capital asset.

The above situation came under consideration in the case of **Zuari Industries Ltd. v. ACIT (2006) 9 SOT 563** before the Income Tax Appellate Tribunal ("ITAT").

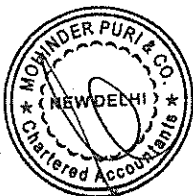
The said case related to slump sale and in accordance with the formula prescribed for calculation of net worth under section 50B of the Act, the facts of the case led to a negative net worth.



The ITAT in the case held that the net worth cannot be negative so as to increase the sale consideration by such negative figure of 'net worth' for computing capital gains for the following reasons:

(i) "Capital gain is always a portion of sale consideration and, therefore, portion can never be higher than the whole. Gain would arise only where sale consideration is more than the cost. By no stretch of imagination, it can be said that capital gain would be more than the sale consideration. No man of prudence can ever think of capital gain higher than the sale consideration. Capital gain can either be excess of sale consideration over the cost or "nil" if sale consideration is equal to cost. Where the cost is more than sale consideration, it would be a case of loss. No other situation can be visualized. Therefore, capital gain can never be more than the sale consideration.

(ii) The Legislature has used the expression "net worth" which by deeming fiction is to be considered as cost of acquisition and cost of improvement for the purpose of computing capital gain under section 48. Section 48 of the Act provides for deduction of cost of acquisition/improvement from the full value of consideration received or accruing as a result of transfer of capital assets. The cost of a property, as per dictionary meaning, means the price paid by a buyer to the seller. Therefore, it must be a positive figure. That is why the Legislature has provided for deduction of cost from sale consideration. Similarly, the word "worth", as per dictionary meaning, also means value of goods or asset or property, which also suggests positivity. No person would buy any property which is worthless. Further, the word "worth" is qualified by the word "net" which would mean the net value of the property which is being sold or purchased. At best, value of the property can be "Nil" but in our opinion, there is no concept of negativity with reference to the expression "net worth" or "cost of acquisition".



(iii) Had the Legislature also intended negative cost of acquisition, it would have used the words "by deducting from or adding to, as the case may be" in section 48 of the Act instead of the words "by deducting from" actually used by it. The language used by Legislature in section 48, thus, itself shows that it never intended negative cost of acquisition. Since "net worth" in section 50B is deemed to be the cost of acquisition as per subsection (2) thereof, it must also have been intended by the Legislature in positive

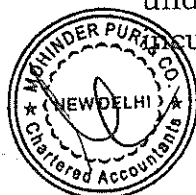
Therefore, the expression "reduced by" used by the Legislature in Explanation 1 to section 50B, in our opinion, has been used in the sense that net worth should be arrived at positive figure or at best be reduced to "Nil". Consequently, where the liabilities are more, then the value of assets as computed under section 50B, the net worth, in our opinion would be considered as "Nil".

The observations of the ITAT were followed again in the case of ***Paperbase Co. Ltd. v. ACIT (2008) 19 SOT 163.***

I. SUMMARY AND CONCLUSION

In light of the above discussions and given facts of the current case, from an income tax perspective, our opinion with regard to the cost of acquisition is as under:

- The total cost of acquisition as computed under section 49(2C) of the Act, to be allocated to the resultant shareholding in Chillwinds (relatable to the Mumbai undertaking) and in Vardhman (relatable to the Kolkata undertaking), should be limited to the total cost of acquisition originally incurred by the shareholder to acquire shares of AHL prior to demerger.



As discussed above, the detailed undertaking wise apportionment of the cost of acquisition can be considered as under:

Particulars	%age of cost of acquisition (A)	Adjustment of the excess 4% in ration of 3.1:7.3 (B)	%age of cost of acquisition after adjustment (A) Less (B)
Chillwinds	31%	(1%)	30%
Vardhman	73%	(3%)	70%
Total	104%	(4%)	100%

- Further, the cost of acquisition of remaining shareholding in AHL residual, pursuant to the demerger, though negative would need to be restricted and treated as NIL.



FOR MOHINDER PURI & COMPANY
CHARTERED ACCOUNTANTS

Vikas Vig
VIKAS VIG
PARTNER
M. NO. 16920

Place: New Delhi
Date: July 12, 2010