

Court approved Scheme of Amalgamation cannot be termed as ‘colorable device’: Kolkata ITAT

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Summary

The Kolkata bench of the Income Tax Appellate Tribunal (ITAT) has rejected invocation of General Anti-Avoidance Rules (GAAR) provisions on a transaction undertaken pursuant to a Scheme of Amalgamation. The ITAT has allowed set-off of brought forward unabsorbed depreciation of the taxpayer against income from long term capital gains earned by the transferor company.

It reiterated that a Scheme of Amalgamation once approved by the High Court, becomes binding on everyone including the statutory and revenue authorities. Further, in such situation, it is illegal and without any factual basis to hold such a Scheme to be a 'colorable device'.

Facts of the case

- The taxpayer¹, a public company engaged in the business of manufacturing and sale (including export) of textile, yarns, readymade garments etc. During Assessment Year (AY) 2011-12, a wholly owned subsidiary² of the taxpayer amalgamated with it from 1 April 2010 under a Scheme of Amalgamation approved by the High Court(s) of Punjab and Haryana and of Delhi.
- The subsidiary, during the year, converted its leasehold land into freehold land and sold the same thereby earning a long-term capital gain (LTCG).
- The taxpayer filed its original return of income for Assessment Year (AY) 2011-12 declaring 'Nil' income under the normal provisions. The taxpayer further computed book profit of INR 210,666,882 and consequent tax liability of INR 41,986,951 under the provisions of Minimum Alternate Tax (MAT). In the

¹ JCT Limited, a member of Thapar Group

² M/s Gupta & Syal Ltd

return of income, the taxpayer set-off the entire LTCG against the brought forward unabsorbed depreciation of the taxpayer.

- The return was selected for scrutiny³. The tax officer made various disallowance in the final assessment order⁴ and assessed the total income of INR 21,37,16,635/- under MAT provisions, thereby raising a demand of Rs. 429,970/-.
- The Commissioner (Appeals) granted partial relief both to the tax department as well as to the taxpayer.
 - The Commissioner (Appeal) relied on a Kolkata ITAT decision⁵ and held that the land so transferred shall be long-term capital asset.
 - Further, the Commissioner (Appeals) held that the entire scheme of amalgamation was a colorable device to avoid payment of capital gains tax on sale of land by setting off such gains against the brought

forward losses of the taxpayer.

Further, while the Commissioner (Appeals) acknowledged that GAAR provisions are not applicable in the year under consideration, however; he formed a view that he had a right to pierce the corporate veil and look through the entire transaction, solely on substance other than form.

- Aggrieved by this order, both the tax department and the taxpayer preferred an appeal before the Kolkata ITAT.

Revenue's contention

- **Capital gains were short term in nature:** The tax officer contended that the ownership of land came to the company only in 2010, when the nature of land was changed from leasehold to freehold. Therefore, since the land was sold within 36 months from the date of its ownership, the resultant gain will be short term capital gain only.
- **Amalgamation was a colorful device to avoid payment of tax:** As held by the

³ under section 143(2) of the Income-tax Act, 1961 (the Act)

⁴ dated 30 March 2014 issued under section 143(3) of the Act

⁵ Kolkata ITAT in the case of *Stewarts & Lloyds of India Ltd. vs. CIT*

Commissioner (Appeals), since the scheme is a colorable device, no set-off of losses shall be allowed in respect of capital gains.

ITAT's observations and order

- The ITAT observed the High Court's order and noted that it had specifically ordered that all incomes and profits of the transferor company shall be treated as income and profits of the taxpayer. Thus, it held that the decision of the Commissioner (Appeals) was against the Scheme of Amalgamation approved by the High Court. Thus, the ITAT held that the CIT(A) cannot take a contrary view. It further held that there is no basis to conclude that the amalgamation as approved by the High Court is a colorable device.
- The ITAT also referred to various judicial precedents⁶ wherein it was held that a

Scheme is approved by the High Court only after ensuring that the same is not prejudicial to the interest of the members or public interest. Once a Scheme is sanctioned by the High Court, it is binding on everyone including the statutory authorities.

- Further, the ITAT held that invoking provisions of GAAR when they are not applicable for the impugned AY is also bad in law.
- Thus, it directed that tax officer to grant benefit of set off and carry forward of losses in respect of the said capital gains both under the normal and MAT provisions.
- The ITAT also upheld the view of Commissioner (Appeals) with regards to the nature of the capital gains being long term and allowed this ground in favour of the taxpayer.

⁶ Electrocast Sales India Ltd. Vs. DCIT (ITA 2145/Kol/ 2014), Wood Polymer Limited 109 ITR 177 (Guj), Pentamedia Graphics Ltd vs ITO (236 CTR 204 (Mad), Supreme Court

(J.K. Bombay (P) Ltd. vs New Kaiser-Hind Spg & Wvg & Co)

Our comments

The ruling clearly lays down the principle that once a Scheme is approved by the High Court, it cannot be said to be against public interest and is binding on the members, creditors and all the statutory authorities, including the revenue authorities. The income tax authorities have full opportunity to file their objection during the amalgamation process i.e., before issuance of the final order.

However, it is pertinent to note that presently, the National Company Law Tribunal (NCLT) order approving Schemes, specifically provide the flexibility to the revenue authorities to challenge the transaction at a later stage and does not preclude them from imposing the requisite tax as applicable on the merger transaction.

The ruling also emphasises non-applicability of GAAR provisions on the transactions that have taken place during the period before the GAAR provisions became applicable.

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