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# TAX FLASH NEWS

27 February 2019

## Delhi Tribunal's decision on taxability of composite scheme of arrangement which includes demerger and amalgamation

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Aamby Valley Ltd[1] (the taxpayer) dealt with the taxability of composite scheme of arrangement which includes demerger of certain entities from the taxpayer-company as well as amalgamation of the Wholly Owned Subsidiary (WOS) with the taxpayer-company.

### Background

The taxpayer belongs to Sahara Group of companies. The taxpayer is engaged in the business of construction as developers, colonisers and contractors in the field of residential and commercial complexes, townships together with all allied infrastructure. The taxpayer is also engaged in the business of running of resorts and other hospitality services, etc.

The taxpayer had a 100 per cent subsidiary which in turn had eight subsidiaries and three step down subsidiaries. The taxpayer along with wholly owned subsidiary and the Special Purpose Vehicles (SPVs) and step down subsidiaries filed a composite scheme of arrangement before the Bombay High Court for demerger of various business undertakings from the taxpayer (along with all related assets, liabilities, employees, development rights, licenses, permits and registration etc.) to the SPVs and the step-down subsidiaries and amalgamation of the WOS with the taxpayer with effect from 31 March 2011 (appointed date) on a going concern basis. The scheme was sanctioned by the High Court vide its order dated 20 January 2012.

Pursuant to the amalgamation, the taxpayer received the shares of SPVs which were recorded in the books of the taxpayer at fair value. The excess credit arising out of the recording of assets and liabilities at fair values was credited to a general reserve. The taxpayer did not offer any income in its return of income since according to the taxpayer there was no income or gain arising out of the said composite scheme of arrangement and amalgamation.

The Assessing Officer (AO) observed that the taxpayer had received the shares of SPV's without consideration or inadequate consideration. The AO made the addition for the same under the provisions of Section 56(2)(viia) of the Act. The value of the shares was determined in accordance with Rule 11UA of the Income-tax Rules, 1962 (the Rules) by taking the FMV as on 31 March 2012 ignoring the fact that the scheme was operative from 31 March 2011.

The Dispute Resolution Panel (DRP) upheld the order of the AO. Further, the DRP held that increase in general reserve on account of fair valuation of shares received on amalgamation, represent business profits and was taxable under Section 28(iv) of the Act. The DRP held that the amount carried to any reserve is required to be added back to the book profit since the creation of reserve was not routed through P&L account. Merely because it was not passed through the P&L account, it should not escape the requirement of Minimum Alternate Tax (MAT).

Aggrieved, the taxpayer filed an appeal before the Tribunal.

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[1] Aamby Valley Ltd v. ACIT (ITA No. 1148/Del/2017) – Taxsutra.com

## Tribunal's decision

### *Year of taxability*

The Tribunal held that all the assets of the amalgamating company would vest in the taxpayer amalgamated company with effect from the appointed date which is 31 March 2011. The transferor-company carrying on business and holding the assets on behalf of the transferee-company from the appointed date and the scheme would be effective from the appointed date.

The determination of the FMV of the assets of the demerged undertaking as well as recording of the entries in respect of the transfer and vesting of the assets in the SPVs will not change the appointed date as well as date of transfer and vesting of the properties for all the intending purposes because the transfer would be valid from the appointed date only.

Accordingly, transaction of the composite scheme of arrangement and amalgamation takes place in the previous year relevant to the AY 2011-12 and no transaction took place in the previous year relevant to assessment year under appeal, i.e. AY 2012-13. Therefore, no addition could be made in assessment year under appeal under any of the provisions of Law.

### *Taxability of amount credited to general reserve as business profits*

For taxability of net increase in general reserve within the provisions of Section 28(iv) of the Act, it is necessary that benefit or perquisite must arise from carrying on the business or profession. If any benefit or perquisite does not arise from the business or profession carried on by the taxpayer, the provisions of Section 28(iv) of the Act cannot be applied. The intention of the Legislature is not to apply the provisions of Section 28(iv) to a case where there is an increase in the general reserve arising due to the recording of the shares in the balance sheet of the taxpayer at their market value. When a company is amalgamated with the other company, the activity cannot be regarded as a business transaction.

Relying on the decision of the Supreme Court in the case of Godhra Electricity Company[2] it was observed that an increase in general reserve did not rise to any real income to the taxpayer. It is capital in nature. The general reserve arisen was due to the recording of investments held by the amalgamating company at its FMV. It did not give rise to any real income to the taxpayer.

### *Taxability under the provisions of Section 56(2)(viia) of the Act*

The provisions of Section 56(2)(viia) of the Act were brought into the statute to curb bogus capital building and money laundering to prevent the practice of transferring unlisted shares at prices much below their market value. For the transfer of shares, there must be a transferor and transferee and transferred assets, i.e., shares. In the case of amalgamation, it cannot be said that there is a transfer of shares as there is only statutory vesting of the assets by virtue of the amalgamation scheme.

In the instant case, due to the composite scheme of arrangement and amalgamation, it cannot be said that there was no consideration or inadequate consideration. In fact, due to the arrangement, the taxpayer transferred the assets of various undertakings to SPVs and in consideration thereof, acquired the shares of SPVs through a subsidiary and through this process, the shares of subsidiary held by the taxpayer got substituted with the shares of various SPVs which were being earlier held by the subsidiary.

The market value of the shares received by the taxpayer is not higher than the market value of the undertaking (which was transferred by the taxpayer to various SPVs) to qualify for the provisions of Section 56(2)(viia) of the Act.

Section 56(2)(viia) of the Act excludes the transaction of business reorganisation and amalgamation which are not regarded as a transfer under the provisions of Section 47 of the Act. The exemption to the shareholder was available only if the consideration for amalgamation was received in the form of shares of the amalgamated company. However, this condition of allotment of shares could not be complied with in a scenario where the amalgamated company itself is a 100 per cent shareholder of the amalgamating company, thereby leading to ambiguity on the applicability of the amalgamation exemption provision. To remove this ambiguity, the exemption provisions were amended by the Finance Act 2012, by specifically inserting the clause that issuance of shares by the amalgamated company is not required to fall within the amalgamation exemption provision where the amalgamated company itself is a 100 per cent shareholder of the amalgamating company. The Tribunal observed that the amendment to remove defect was retrospective in nature and it was clarificatory in nature and it is applicable from AY 2011-12, even though the amendment was made with effect from AY 2013-14.

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[2] Godhra Electricity Co Ltd v. CIT [1997] 225 ITR 746 (SC)

The Tribunal held that provisions of Section 56(2)(viia) of the Act could not be applied in respect of the transaction undertaken by the taxpayer as it was covered under Section 47(vii) of the Act.

Without prejudice to the above, the Tribunal held that if an addition was made under Section 56(2)(viia) of the Act, the balance sheet as on 31 March 2011 has to be considered for the purpose of determining the value of the property under Rule 11UA of the Rules.

### *Taxability for the purpose of MAT*

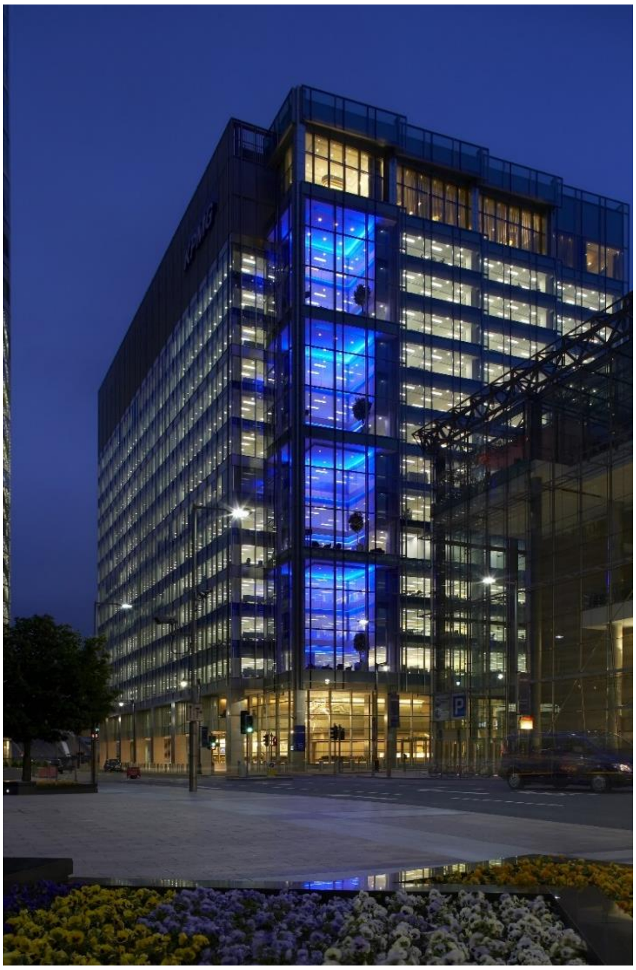
Relying on the decision of the Supreme Court in the case of Apollo Tyres[3], it was held that the net reserve in the general reserve for which the addition was made was not debited to the profit and loss account and it was directly credited to general reserve, such amount cannot be added to the profits while computing book profits under the provisions of MAT.

## Our comments

This is an important decision of the Mumbai Tribunal dealing with the taxability of credit to the general reserve by the amalgamated company on fair valuation of the assets received under the scheme of amalgamation. The Tribunal held that the transaction did not give rise to any real income to the taxpayer and thus it cannot be treated as business profits.

The Tribunal also examined the provisions of Section 56(2)(viia) of the Act and held that such provisions could not be applied in respect of the transaction undertaken by the taxpayer as it was covered under the amended Section 47(vii) of the Act. The amendment under Section 47(vii) of the Act was clarificatory in nature and therefore it was applicable retrospectively from AY 2011-12, even though the amendment was introduced with effect from AY 2013-14. Further the provisions of Section 56(2)(viia) of the Act were not applicable because the fair value of shares received was not higher than the sacrifice suffered by the taxpayer under the composite reorganisation scheme, thereby leading to no incremental benefit to the taxpayer.

The Tribunal held that reserve directly credited to general reserve account instead of P&L account cannot be considered under the provisions of MAT.



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[3] Apollo Tyres Ltd v. CIT [2002] 255 ITR 373 (SC)

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