



# Tax Flash News



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## High Court upheld the CBDT order rejecting relaxation of conditions to carry forward losses

### Executive summary



In a recent decision<sup>1</sup>, the Delhi High Court upheld the CBDT order rejecting the petitioner's application for the relaxation of conditions required to be fulfilled to carry forward the business losses of the amalgamating company by the petitioner (being the amalgamated company).

The petitioner had sought additional time to meet the production level requirements but failed to do so even within the extended period.

The Delhi High Court emphasised that the relaxation of conditions for availing the tax benefits is an exception and should be guided by the purpose of the rules or conditions being relaxed.

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<sup>1</sup> W.P.(C) 399/2022

## Facts of the case



During the financial year 2007-08, four Indian companies were amalgamated into the petitioner through a court-sanctioned scheme with appointed date being 1 April 2007.

These amalgamating companies had substantial tax losses and unabsorbed depreciation, which the petitioner, being the amalgamated company, sought to carry forward and set off as per the provisions of the Income-tax Act, 1961 (the Act).<sup>2</sup>

As per the Act (Section 72A), when an amalgamation or demerger takes place, the accumulated business losses or unabsorbed depreciation of amalgamating or demerging company can be carried forward and set-off by the amalgamated or resulting company.

This is permissible subject to the fulfilment of the prescribed conditions<sup>3</sup> to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

One of the key conditions was that the amalgamated company must achieve a production level of at least 50 per cent of the installed capacity of the

amalgamating entities within four years from the amalgamation date and maintain it for one additional year.

However, the Central Government, on an application made by the amalgamated company, may relax this condition where the company has genuinely tried to meet the production levels but faced obstacles that prevented it from doing so.

The petitioner failed to fulfil the production level requirement for one of the amalgamating companies within four years and sought an extension but later modified its request to:

- reduce the 50% production requirement to 36 per cent as on 31 March 2011; or
- alternatively, the same be relaxed to 42 percent as on 31 March 2012.

The Central Board of Direct Taxes (CBDT) rejected<sup>4</sup> the application on the ground that the petitioner failed to achieve the 50 per cent capacity even upto financial year 2015-16.

Aggrieved by this decision, the petitioner filed a writ petition challenging the rejection order.

<sup>2</sup> Section 72A of the Act

<sup>3</sup> Rule 9C of the Income-tax Rules, 1962

<sup>4</sup> vide order dated 25 October 2019. The petitioner's request for reconsideration was also rejected vide a letter dated 30 June 2021

## Petitioner's contentions



The rejection of the relaxation request was arbitrary, unreasonable, and lacked proper reasoning.

The petitioner had made genuine and substantial efforts. It invested more than the accumulated losses of the amalgamating company for upgrading and improving the efficiency and productivity of the plant in question.

Business challenges, including power shortages, water and fuel scarcity, high transportation costs, and market competition, currency fluctuation, volatility in international market, hindered capacity utilisation. There was paucity of time as there was a lapse of one and half years between the appointed date and the effective date of amalgamation.

The production level had increased significantly (from 23.5 per cent in FY 2006-07 to 45.56 per cent in FY 2014-15), showing consistent efforts towards revival.

Citing the Supreme Court's decision in *Mahindra & Mahindra Ltd.*<sup>5</sup>, it was argued that discretion to relax conditions should be exercised liberally to serve the objective of business revival.

The purpose of the amalgamation was genuine, aimed at business revival.

<sup>5</sup> *CIT v. Mahindra & Mahindra Ltd.* (1983) 4 SCC 392

## Revenue's contention



The petitioner had failed to achieve 50 per cent production level even by FY 2015-16, well beyond the extended timeline requested.

The relaxation application was filed a day before the expiration of the stipulated four-year period, suggesting lack of proactive compliance effort.

The petitioner kept modifying its relaxation request based on the production level achieved rather than meeting the prescribed conditions.

The amalgamation was not primarily aimed at business revival but rather at simplifying the corporate structure of the petitioner's group.

## Decision



The court upheld the rejection of the relaxation request and dismissed the petition as unmerited.

The Central Government can relax the condition having regard to (a) genuine efforts made by the amalgamated company to attain the prescribed level of production (b) the circumstances preventing such

efforts from achieving the same. The expression 'having regard to' suggests that these two factors are relevant, but not exhaustive for granting the relaxation.

The powers to relax a rule or condition is meant to be an exception and should be exercised reasonably, objectively and to the extent necessary. The need to use this power should be guided by the purpose of the rules or conditions being relaxed.

The exercise of such discretionary powers is not amenable to judicial review unless the court finds that the exercise is capricious, mala fide, arbitrary and/or unreasonable or if the authority in charge has made mistakes by considering irrelevant factors or ignoring important ones.

The Supreme Court decision in the case of *Mahindra & Mahindra Ltd.* was rendered in the context of the main provision of the Act (section 72A). It emphasised that the Central Government should consider financial unviability from a commercial standpoint and interpret the main section broadly to cover all intended cases. However, exceptions to the rule should not be interpreted as broadly, as the principles for interpreting a main rule and its exceptions differ. The issue in the current petition is not about the conditions required to

qualify for the benefits under section 72A of the Act, but rather about the authority to relax the rule that sets an objective criterion for accessing these benefits.

In the instant case, the provisions provide that the discretion for relaxation should be exercised only in exceptional cases where genuine efforts have been made, and extenuating circumstances exist; the petitioner's case did not merit such an exception.

The petitioner's application for relaxation was filed late (one day before the expiration of the stipulated four-year period). The petitioner did not seek any relaxation either at the time of amalgamation or immediately thereafter. Even after the expiry of extension period sought, it failed to meet the 50% production threshold.

The rejection order did not suggest that the two factors mentioned above were ignored. The order was issued after the extended period had expired, allowing the concerned authority the advantage of hindsight. Consequently, the application based on these two guiding factors had little relevance once the extended period had passed.

The amalgamation's primary objective was corporate simplification rather than revival of unviable businesses, making it less relevant to the intent of the relevant provision.

## Our comments



The judgment reaffirms that tax incentives must align with the legislative intent and relaxations powers are discretionary, not to be granted liberally.

Businesses seeking tax benefits must ensure that they meet the prescribed conditions proactively rather than seeking retrospective relaxations based on partial compliance.



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