Tax Hotline

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NO RETROSPECTIVE INVOCATION OF THE GAAR – HOLDS KOLKATA TRIBUNAL

- Kolkata Tribunal allows set-off of long-term capital gain of transferor / amalgamating company against brought forward unabsorbed depreciation of transferee / amalgamated company.
- Rejects contention of Revenue that amalgamation was a colourable device.
- Denies the invocation of GAAR provisions in respect of Assessment Year prior to year in which statutory provisions were made effective.

Recently, the Kolkata bench of the Income-tax Appellate Tribunal ("**Kolkata Tribunal**")[1] in cross-appeals filed by revenue authorities and taxpayer, upheld the sanctity of a scheme of amalgamation approved by the Punjab & Haryana High Court and the Delhi High Court. The Tribunal categorically rejected the Revenue's attempt at invoking provisions of the General Anti-Avoidance Rule ("**GAAR**") retrospectively on the contention that the amalgamation was a colourable device, being illegal and without any factual base.

BACKGROUND

JCT Limited ("**Assessee**") was a public limited company engaged in the manufacturing and selling of textiles, yarns, readymade garments etc. and exports of these products. It had a wholly owned subsidiary ("**WOS**") which did not have any substantial business activity and earned income from sale of investment and rent received.

During the Assessment Year ("**AY**") 2011-12, the WOS ("**Transferor company**") was amalgamated with the Assessee ("**Transferee Company**") with effect from April 1, 2010 under a scheme of amalgamation ("**Scheme**") approved by the Punjab & Haryana High Court and the Delhi High Court (hereinafter collectively referred to as "**High Courts**"). The WOS had acquired perpetual lease-hold rights of certain land in 1966, and pursuant to the government's decision to convert the land into freehold property the WOS sold the land on March 14, 2011 realizing long-term capital gains ("**LTCG**"). However, post amalgamation, the LTCG was set-off against the brought forward unabsorbed depreciation of the Assessee. In computing book profit for determining Minimum Alternate Tax ("**MAT**") liability as well, the LTCG was substantially set off against the brought forward losses / depreciation as per books.

The Assessing Officer ("**AO**") challenged the tax computation of the Assessee and held that gains on sale of the land were short-term capital gains. The first appellate authority (the "**CIT(A)**"), while stating that the AO examined the issue in a very narrow sense, held that the amalgamation was a colorable device to avoid payment of tax. The CIT(A) was of the view that he had the right to pierce through the corporate veil and look through the form of the entire transaction, and solely at the substance. While acknowledging the fact that the GAAR provisions were not applicable to AY 2011-12, the CIT(A) nonetheless drew strength from these 'future' provisions and held that the amalgamation was undertaken to avoid payment of LTCG on sale of the land. Accordingly, the CIT(A) held that no set-off of losses would be allowed and that the LTCG would be taxed both under the normal as well as MAT provisions.

RULING BY KOLKATA TRIBUNAL

- The Kolkata Tribunal held that the decision of the CIT(A) was against the terms of the Scheme approved by the High Courts. It specifically took note of the fact that the High Courts had ordered that all incomes and profits of the Transferor company would for all purposes, be treated as the income, profit, costs etc. of the Transferee company / Assessee. It accordingly held that the CIT(A) could not have taken a view contrary to the High Courts.
- The Tribunal relied on a co-ordinate bench decision in *Electrocast Sales Ltd*,[2] which held that losses of the amalgamating company would belong to the amalgamated company, and that the provisions of sections 72 and 74 of the Income-tax Act, 1961 would come into play with respect to set-off of the same against the income of the amalgamated company. The co-ordinate bench of the Kolkata Tribunal had noted that a scheme of amalgamation is approved only after ensuring the same is not prejudicial to the interest of public and a scheme formulated for 'tax evasion' would not be held to be in public interest.
- Based on the aforesaid decision of the co-ordinate bench in *Electrocast Sales Ltd*, the Tribunal held that the conclusion of the CIT(A) that the amalgamation in question, approved by the High Courts was a colorable device, was without any factual or legal basis.
- With respect to the invocation of the GAAR, the Kolkata Tribunal held that the invocation of GAAR provisions for a year in which such provisions were not applicable was bad in law.
- Accordingly, the Tribunal directed the AO to allow set-off of carried forward losses against the LTCG under both MAT and normal provisions of the Income-tax Act, 1961.

ANALYSIS

The Kolkata Tribunal's denial of retrospective invocation of the GAAR provisions is a positive signal to taxpayers.

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Since the introduction of the GAAR and other anti-abuse provisions under domestic and international tax laws, concerns of aggressive approaches by Revenue authorities have been on the rise, which have also been fueled by recent negative rulings by the Authority for Advance Rulings denying benefits under tax treaties. Unfortunately, the Kolkata Tribunal order while positive, does not delve into the issue of GAAR in much detail.

It is pertinent to note that the Central Board of Direct Taxes ("**CBDT**"), while clarifying implementation of the GAAR provisions, has specifically stated that where a High Court has explicitly and adequately considered tax implications while sanctioning a scheme of arrangement, the GAAR would not apply to such an arrangement.[3] In the instant case, the Kolkata Tribunal order is not clear on whether the High Courts specifically dealt with the tax issues prior to sanctioning the Scheme. Interestingly, the National Company Law Tribunal ("**NCLT**") had rejected a scheme of amalgamation between Ajanta Pharma Limited and Gabs Investment Private Limited on the ground that the scheme was designed purely for the avoidance of tax and was not in the public interest – an order seen as an indirect invocation of the GAAR.[4] However, the National Company Law Appellate Tribunal ("**NCLAT**") vide a December 2019 order upheld the NCLT's order approving a scheme of demerger among Reliance group companies, rejecting the Revenue's plea that the scheme had been devised as a tool to evade taxes.[5]

Another aspect to be noted is that the Kolkata Tribunal seems to rely on the superior authority of the High Courts, to say that the sanction of a scheme of amalgamation by High Courts cannot be questioned by a lower authority like the CIT(A). Since amalgamation and other corporate reorganization schemes now go to the NCLT for sanction, one wonders whether a sanction by the NCLT would hold the same sanctity as the Kolkata Tribunal has accorded to the High Courts' decision in this case.

As the GAAR provisions have come into effect from April 1, 2017, it will be interesting to see how going forward income-tax authorities and courts will view M&A transactions, including those sanctioned by the NCLT or any other regulators as applicable, from a GAAR lens. For M&A that involve parties from outside India, a claim for tax treaty benefits may also need to pass the muster of anti-abuse standards under the tax treaties.

– Ipsita Agarwalla & Varsha Bhattacharya
You can direct your queries or comments to the authors

[1] ITA No. 84 / Kol / 2019, ITA No. 2389 / Kol / 2018
[2] ITA No. 2145 / Kol / 2014
[3] CBDT Circular No 7 of 2017 dated January 27, 2017
[4] CSP No. 995 of 2017 and CSP No. 996 of 2017 in CSA No. 791 and 792 of 2017
[5] Company Appeal (AT) Nos. 113 and 114 of 2019, dated December 20, 2019

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