

## Tax Hotline

April 21, 2022

### LEGAL STATUS POST AMALGAMATION – CEASE TO EXIST OR NOT?

- The SC holds that the outer shell of corporate entity ceases to exist after amalgamation;
- Corporate venture of transferor / amalgamating entity continues to exist in form of new or the existing amalgamated / transferee entity;
- Considering the provisions of the ITA, the SC concluded that (a) the business-including the rights, assets and liabilities of the transferor company do not cease, but continue as that of the transferee company and (b) the transferee is deemed to carry on the enterprise as that of the transferor by virtue of deeming fictions under certain provisions of the ITA

The Supreme Court of India (“SC”) has recently held that an assessment order cannot be quashed solely on the ground that it is passed in the name of the amalgamating entity, which ceased to exist post the effective date mentioned in the scheme of merger<sup>1</sup> (“Ruling”).

The SC allowed the appeal of the Indian revenue authorities (“Revenue”) against the Delhi High Court’s (“HC”) order affirming the ruling by the Income Tax Appellate Tribunal (“ITAT”) which quashed the assessment order against the Taxpayer (defined below). The SC differentiated its landmark ruling in *Principal Commissioner of Income Tax v. Maruti Suzuki India Limited*<sup>2</sup> (“Maruti Suzuki Case”), and also concluded that the question whether the corporate death of an entity upon amalgamation *per se* invalidates an assessment order cannot be determined on bare application of provisions of the Companies Act, 2013 / 1956, but would depend on the terms of the amalgamation and the facts of each case. Accordingly, the SC while allowing the appeal in favour of Revenue, set aside the HC order, and restored the matter to ITAT, to be heard on merits.

### BACKGROUND

Mahagun Realtors Private Limited (“MRPL” or “Taxpayer”) was engaged in development of real estate. MRPL amalgamated with Mahagun India Private Limited (“MIPL”) by the HC’s order dated May 11, 2007 effective April 1, 2006<sup>4</sup>. Search and seizure operations under section 132 of the Income-tax Act, 1961 (“ITA”) were carried out in the Mahagun group of companies (including MRPL and MIPL) on August 28, 2007, wherein the directors of MRPL and MIPL made combined statement. Pursuant to such operations, notice was issued to MRPL on March 02, 2009 to file its income-tax return (“ITR”) for the assessment year (“AY”) 2006-07. MRPL filed the ITR on May 28, 2010 disclosing its permanent account number and date of incorporation. Importantly, in the details of business reorganization, the ITR did not provide details of the amalgamation of MRPL into MIPL. The assessing officer (“AO”) made several additions and passed an assessment order dated August 11, 2011 with assessee being mentioned as ‘MRPL, represented by MIPL’.

Aggrieved by the order of the AO, appeal was filed by the Taxpayer before the Commissioner of Income-tax (Appeals) (“CIT(A)”), with the appellant’s name being, ‘MRPL represented by MIPL’. The CIT(A) set aside some amounts brought to tax by the AO. On further appeal by the Revenue and cross objections by the Taxpayer before the ITAT, Taxpayer’s cross objection was allowed on the single point, that MRPL was not in existence when the assessment order was made, as it had amalgamated with MIPL. The Revenue appealed to the HC, but HC also dismissed the appeal on same grounds, relying upon the SC’s decision in the *Maruti Suzuki Case*, hence, an appeal to the SC was preferred by the Revenue.

### ARGUMENTS OF THE PARTIES

#### Arguments by Revenue

- Assessment order was passed in name of both entities, MRPL and MIPL. Hence, MRPL was duly represented by the MIPL, no prejudice was caused to any of the parties by the assessment order. Further, such mistakes, defects or omissions are curable under section 292B of the ITA when the assessment is in substance and effect, in conformity with or according to the intent and purpose of the ITA.
- In the *Maruti Suzuki Case*, the SC rejected the Revenue’s appeal on the ground that the final assessment order referred only to the name of the amalgamating company and there was no mention of the amalgamated company, whereas in this case, in both the draft and the final assessment orders, names of both the amalgamating and amalgamated company were mentioned.
- Further, facts of the *Maruti Suzuki Case* are distinguishable from the present case, as in that case the Revenue was

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duly informed about the merger and change in name of the company, and yet the AO passed the assessment order in name of the amalgamating company. In present case, the AO or the Revenue were not informed about the amalgamation. Even when the search and seizure operations were carried out, the directors of MIPL (and MRPL, which had ceased to exist) clearly held out that both entities existed.

- On initiation of assessment proceedings on MRPL, the Taxpayer continued to make submissions before the AO under the name of MRPL. Further, on March 20, 2007 (after receipt of amalgamation order), postdated cheques were issued in the name of MRPL. After merger, they were neither taken back nor fresh cheques were submitted from the amalgamated company i.e. MIPL.
- Even the appeal to CIT(A), as well as the cross objections to ITAT were made by the Taxpayer in its own name describing itself as 'MRPL, represented by MIPL'.

### Arguments by the Taxpayer

- Upon sanction of amalgamation scheme, the amalgamating company i.e. MRPL stood dissolved without winding up in terms of the Companies Act, 1956. Hence, amalgamating company i.e. MRPL cannot be regarded as a 'person' in terms of Section 2(31) of the ITA.
- Issue of notice under section 153A of the ITA in the name of MRPL, a non-existing entity, was invalid and initiation of proceedings against non-existent entity was void-ab-initio.
- Assessment order framed in the name of amalgamating company (MRPL) was invalid in terms of Section 170 of the ITA, which provides that the successor (MIPL), and not the predecessor (MRPL), shall be assessed in respect of the income of the previous year after the date of succession.
- Once the amalgamation is effective, the notice should to be issued in the name of amalgamated company.
- Reliance in this regard was placed on the Delhi HC decision in case of *Spice Infotainment Limited v. Commissioner of Income-tax*<sup>5</sup> wherein the Delhi HC held that held that assessment framed in the name of the amalgamating company which was ceased to exist in law, was invalid and untenable and such defect would not be cured in terms of section 292B of the ITA. Further, the fact that amalgamated company participated in the assessment proceedings would not operate as estoppel.
- The Taxpayer's case is covered by the *Maruti Suzuki Case* and hence, the SC should follow the ratio in that decision, and reject the revenue's appeal.

### RULING

The SC held that an assessment order cannot be quashed solely on the ground that it is passed in the name of the amalgamating entity, which ceased to exist post the effective date based on the following reasons:

- The SC differentiated amalgamation from winding up of a corporate entity, based on the fact that although the outer shell of the entity is destroyed, the corporate venture continues to exist in the form of a new or the existing transferee entity. Hence, the SC observed that it is essential to look beyond the mere concept of destruction of corporate entity which brings to an end or terminates any assessment proceedings.
- The SC noted that certain civil law analogies provide that upon amalgamation, the cause of action or complaint does not *per se* cease. Further, generally the legal quest has been to locate if a successor or representative exists in relation to the particular cause or action, upon whom the assets / liabilities might devolve.
- Referring to its previous decision<sup>6</sup>, a corollary from section 159 of the ITA was considered by the SC which provides that upon death of predecessor, the liability to pay tax is cast upon his / her legal representatives.
- Taking into consideration various provisions under the ITA, such as definition of amalgamation, set off and carry forward of losses, and judicial precedents, the SC observed that post amalgamation:
  - a. the business-including the rights, assets and liabilities of the transferor company do not cease, but continue as that of the transferee company;
  - b. by deeming fiction through several provisions in the ITA, the treatment of various issues, is such that the transferee is deemed to carry on the enterprise as that of the transferor.
- On basis of perusal of past rulings, the SC held that the combined effect of section 394(2) of the Companies Act, 1956, section 2(1B) of the ITA and various other provisions of the ITA, is that despite amalgamation, the business, enterprise and undertaking of the transferor or amalgamating company – which ceases to exist, after amalgamation, is treated as a continuing one, and any benefits by way of carry forward of losses (of the transferor company), depreciation, etc., are allowed to the transferee.
- While the SC accepted that there is no doubt that MRPL amalgamated with MIPL and ceased to exist, it distinguished the facts of the present case from the *Maruti Suzuki Case*. The SC stated that in the Maruti Suzuki Case, the AO was intimated about the amalgamation, however, even then notice was issued to the amalgamating company. Whereas in present case, no intimation by the Taxpayer regarding amalgamation was provided for the relevant year for which notice was issued.
- The SC also distinguished the other cases relied upon by the Taxpayer stating that in other cases, the amalgamated companies had participated in the proceedings before the Revenue and the courts held that the participation by the amalgamated company will not be regarded as estoppel against law. However, in the present case, the participation in proceedings was by MRPL i.e. the amalgamating company not the amalgamated company.
- The SC noted that the AO issued the assessment order to attribute specific amount to be charged to tax. The order expressed to be of MRPL, but represented by the transferee (MIPL), which clearly indicates that the AO adopted a particular method (of naming MRPL in the assessment order) of expressing the tax liability.
- The SC took detailed note of the facts of this case including the sequence of events and noted that the Taxpayer

fully participated in the proceedings (for the year ending March 31, 2006) which were specifically in respect of the business of the erstwhile MRPL. It was only at the time when the Taxpayer filed the cross-objection before the ITAT (in the appeal preferred by the Revenue), for the first time, an additional ground was urged that the assessment order was a nullity because MRPL was not in existence. The SC reiterated that at no point in time before this was it stated that MRPL was not in existence, and its business assets and liabilities, taken over by MIPL.

- The SC held that the amalgamation was known to the Taxpayer, even at the stage when the search and seizure operations took place, as well as statements were recorded by the Revenue of the directors and managing director of the Mahugun group of companies. The SC stated that the ITR filed by the Taxpayer suppressed the fact of amalgamation. Though MRPL ceased to be in existence, in law, yet, appeals were filed on its behalf before the CIT, and a cross appeal was filed before ITAT. Accordingly, the SC held that the order issued by AO was not invalid.

## ANALYSIS

The SC has brought out a very nuanced difference between the corporate death of an entity upon amalgamation vis-a-vis winding up of a company as per provisions of the Companies Act, 2013. The SC distinguished the Maruti Suzuki Case stating that the Revenue was not informed by the Taxpayer regarding the amalgamation for AY 2006-07 and the Taxpayer continued to participate in survey / search proceedings (initiated after receipt of amalgamation order) in its own name. While the Taxpayer has suppressed the amalgamation in its ITR, the provisions of the Companies Act, 2013<sup>7</sup> require the company to issue notice of meeting of creditors / shareholders (for approving / rejecting the amalgamation) along with copy of the scheme of amalgamation to the income-tax authorities. Therefore, it is not clear on what basis revenue authorities were contending that they were not aware of the amalgamation.

The Ruling is yet another case wherein courts and revenue authorities have placed high regard to the conduct of the taxpayer. While the SC did not dispute the settled principle that pursuant to amalgamation, the amalgamating entity ceases to exist, having regard to the facts of the case, the SC has passed an adverse decision. Therefore, it is important for taxpayers to ensure that appropriate documentation is maintained regarding business reorganisations, the tax positions in the ITR filed with tax authorities are appropriately thought through and the statements by their senior employees / personnel are aligned with the tax positions.

Section 170 of the ITA provides the manner of taxation (i.e. who is assessable) in cases of succession of a business (or profession) to a person who succeeds and carries on the business (from its predecessor). It envisages separate assessments on both, the predecessor and the successor (for which they both separately compute their taxes, apply deductions, and pay taxes as per their applicable rates). The issue regarding the validity of assessment / re-assessment proceedings initiated on predecessor entities during the pendency of reorganization proceedings before the adjudicating authorities have been subject to litigation in the past. In order to clarify this issue, the Finance Act, 2022, amended section 170 of the ITA (with effect from April 1, 2022) to provide that where assessment / re-assessment proceedings are initiated on predecessor entity during the pendency of reorganization proceedings, such proceedings shall be deemed to have been made on the successor entity. The amendment to section 170 of the ITA should put an end to further litigation on this issue going forward. The amendment also appears to be in line with the reasoning of the SC in the Ruling and spirit of the definition of 'demergers' in Section 2(19AA), and 'amalgamation' in Section 2(1B) which envisage all assets and liabilities of the demerging/amalgamating entity (predecessor) to stand transferred to the resulting entity (successor).

Nevertheless, while the Ruling reiterates the importance of conduct of taxpayers in proceedings, it is hoped that tax authorities do not interpret the Ruling liberally and misuse the principle enunciated by the SC to open past assessments. Opening of assessments in name of both amalgamating and amalgamated entities should not become an accepted practise by tax authorities.

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You can direct your queries or comments to the authors

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<sup>1</sup> Special Leave Petition (C) No. 4063 of 2020

<sup>2</sup> 2019 SCC Online SC 928

<sup>3</sup> Please note that we have noticed certain mismatches with respect to few dates in the Ruling, the dates mentioned in this hotline are the dates referred to by the SC (not by the Taxpayer)

<sup>4</sup> Clause 2 of the amalgamation order noted that all liabilities and duties of the transferor company i.e. MRPL are transferred to and become the liabilities and duties of the transferee company i.e. MIPL

<sup>5</sup> [2012] 247 CTR 500 (Del)

<sup>6</sup> Commissioner of Income Tax, v. Hukamchand Mohanlal [1972 (1) SCR 786]

<sup>7</sup> Section 230(5) of Companies Act, 2013

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