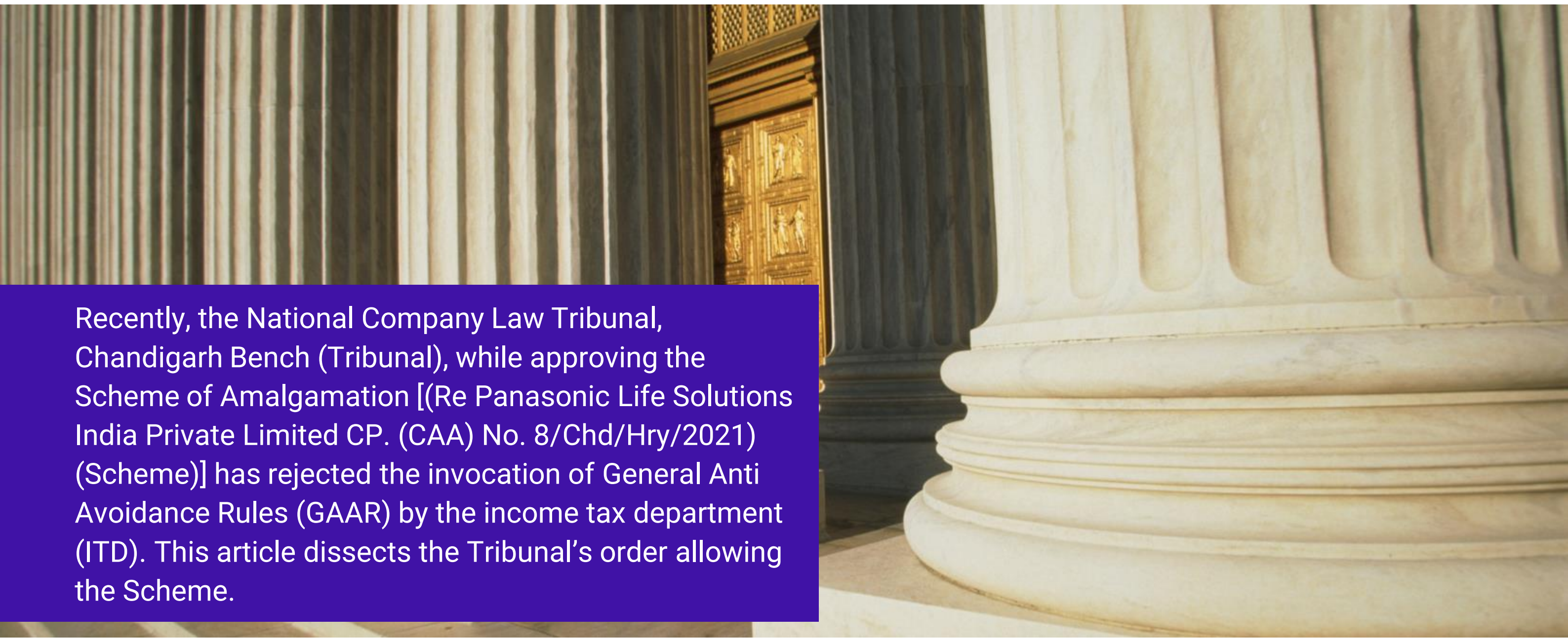
NCLT allows amalgamation while rejecting invocation of GAAR



Recently, the National Company Law Tribunal, Chandigarh Bench (Tribunal), while approving the Scheme of Amalgamation [(Re Panasonic Life Solutions India Private Limited CP. (CAA) No. 8/Chd/Hry/2021) (Scheme)] has rejected the invocation of General Anti Avoidance Rules (GAAR) by the income tax department (ITD). This article dissects the Tribunal's order allowing the Scheme.

A. Facts

- The Scheme provided merger of Panasonic India Private Limited (Transferor) with Panasonic Life Solutions India Private Limited (Transferee) under Section 230-232 of the Companies Act, 2013 (Act).
- The jurisdictional Registrar of Companies, Regional Director and Official Liquidator have given their reports and have not raised significant objections to the Scheme. Furthermore, no objection was received from the public.
- The jurisdictional ITD objected, inter alia, stating that the merger is nothing but a vehicle to transfer accumulated losses eligible for set off from Transferor to Transferee Company and invoked provisions of GAAR.

B. In a nutshell, ITD raised the following objections to the Scheme

- ITD contended that the Scheme is not at arm's length and could not be termed as a prudent acquisition on any commercial or business terms.
- ITD further alleged that the Scheme's main objective appears to be to take benefit of accumulated losses that are eligible for set off in future periods. A reference to the provisions of Section 79 and Section 72A of the Income Tax Act, 1961 has been made by ITD.
- There will be a loss of revenue on account of possible non-payment of the capital gains realizable by the shareholders of the Transferor Company while selling shares of the Transferee Company in the future as these shareholders are residents of Singapore and the Netherlands and they enjoy such benefits under the provisions in the respective Double Tax Avoidance Agreements (DTAAs).
- By issuing shares of Transferee Company, the shareholders of Transferor Company will benefit despite having a negative net worth.
- The merger is nothing but a vehicle to transfer accumulated losses eligible for set off from Transferor to Transferee Company which would attract GAAR and the provisions of Section 96(1) of the Income Tax Act, 1961. The ITD placed heavy reliance on the decision rendered by other Tribunals in the case of ***Gabs Investments Pvt. Ltd. and Ajanta Pharma Ltd. (CSP No.995 and 996 of 2017 and CSA No.791 and 792 of 2017) decided on 30.08.2018 and Wiki Kids Ltd. and Ors. Vs. Regional Director, South East Region and Ors. in Company Appeal (AT) No.285 of 2017 decided on 21.12.2017***.

C. In response to ITD's objection, the Petitioner Companies' submissions are summarized below:

- The Petitioner submitted in detail the commercial rationale driving the amalgamation, which includes a reduction in operating and marketing costs, economies in procurement, increased value to customers, and offering holistic customer solutions, besides enhancing the shareholders' value.
- The Petitioners argued that the amalgamation between the companies should fulfill the conditions laid down in Section 2(1B) of the Income Tax Act, 1961, to qualify as a tax-neutral merger. Reference is also made to section 47 of the Income Tax Act, 1961, which exempts certain transfers which, inter alia, includes Indian company who transferred capital asset in an amalgamation and shareholder who receives any shares consequent to amalgamation. It is therefore submitted that the tax neutrality in the hands of the amalgamating company and the shares of the amalgamating company is conferred by the provisions of the Act and therefore, no case can be made out of prejudice to revenue if compliances with the aforementioned provisions of the Income Tax Act, 1961 are made.
- Regarding carry forward of losses and depreciation, the Petitioners pointed out that the compliance with conditions laid down under Section 72A of the Income Tax, 1961 read with Rule 9(C) of the Rules can always be verified by the Assessing Officer (AO) at the time of completing the assessment of the petitioner companies for the relevant assessment year.
- On the allegations of revenue loss relating to capital gains in the hands of shareholders of Transferor Company upon the ultimate sale of shares in Transferee Company, Petitioners submitted that the non-resident shareholders of the Transferor Company would anyway have had no obligation to pay capital gain taxes subject to relief under India's Tax Treaty with the Netherlands and Singapore on the transfer of shares of the Transferor Company if the transaction had not taken place. The exemption available with respect to taxability of potential capital gains is on account of shareholders being residents of the foreign country and being entitled to the benefit of the respective DTAA.
- On valuation of shares, it was submitted that the determination of the swap ratio was on the basis of the share entitlement ratio issued by a registered valuer and it had duly captured the basis of computation of such valuation. Furthermore, the imputed value of shares denotes the face value of the shares being issued by the Transferee Company and not its actual value. It is further stated that the valuation report obtained in this regard ensures that the value with the shareholders of the Transferor Company remains the same both pre and post-merger transaction.
- Regarding the submissions in relation to the applicability of GAAR, it is stated that the provisions of Section 96 of the Income Tax Act are not applicable as the amalgamation "is not an impermissible avoidance arrangement," and its main purpose is not to obtain a tax benefit. Petitioners placed reliance upon ***Vodafone International Holdings B.V. Vs. Union of India & Anr. : 41 ITR 1***.
- Lastly, Petitioner placing reliance on ***Gabs Investments and Wiki Kids Ltd. (Supra)*** argued that the facts in the present case are totally different.

D. After hearing submissions of ITD and Petitioners, the Tribunal ruled in favour of the Scheme. The Tribunal's ruling is summarized as follows:

- The facts of Gabs Investments (Supra), the facts of the case are clearly distinguishable from the present case. In the case of Gabs Investments Pvt. Ltd. (Supra), the Scheme's objective was to simplify the shareholding structure and reduce shareholding tiers to streamline the promoter group's shareholding. In the present case, the petitioner companies have clearly made out a case of operational synergy between the amalgamating companies. The rationale of the Scheme has been discussed in detail, which justifies the claim of the applicants that the Scheme is for business consolidation and the tax arrangements are merely a consequential fallout of the implementation of the Scheme.
- On the argument of ITD that Scheme lacks arm's length basis, the Tribunal noted that in the case of ***CIT v. EKL Appliances Ltd. 345 ITR 241***, wherein the Court, in the context of transfer pricing provisions, frowned upon re-characterization of the transaction, inter alia, observing that the tax administrator(s) should not disregard and/or restructure legitimate business transactions or substitute other transactions for them.

- In so far as carry forward and set-off of losses are concerned, the Tribunal emphasizes that the treatment regarding carry forward and set-off of losses are clearly spelled out under Section 72A of the Income Tax Act, 1961, read with Rule 9(C) of the Rules. Furthermore, conditions regarding carrying forward and set-off losses in cases of certain companies are equally clearly spelled out in Section 79 of the Income Tax Act, 1961. These provisions, in our opinion, are sufficient to protect the interest of revenue in any case of amalgamation. The Tribunal also clarified that the Scheme's approval could not override the existing provisions of the Income Tax Act. In any case, the above issues will come up for the consideration of the AO at the time of assessment of the petitioner companies, and the Department can analyze the Scheme and is entitled to take any decision as per the provisions of the Income Tax Act on any issues including those discussed above.
- As regards the provision of GAAR, the Income Tax Department is at liberty to invoke the provisions if the AO during the course of assessment or reassessment proceedings subject to and in accordance with the provisions of the Income Tax Act, 1961.

E. GAAR In a nutshell

- It is important to understand GAAR provisions concerning the schemes of arrangement. The provisions of GAAR are laid down in Chapter X-A (sections 95-102) of the Income Tax Act, 1961. According to section 95, notwithstanding anything contained in the statute, an arrangement (such as a scheme for merger) entered into by an assessee can be declared as an 'impermissible avoidance arrangement,' and consequences relating to tax liability shall be determined subject to Chapter X-A. Hence, for GAAR to be invoked, the IT Department shall first have to declare an arrangement as an 'impermissible avoidance arrangement' under Chapter X-A.
- To understand the scope and applicability of GAAR qua schemes of arrangement, it is instructive to refer to a clarificatory circular on the applicability of GAAR, which was issued by the Central Board of Direct Taxes (Circular No. 7/2017, January 27, 2017). In this clarificatory circular, it was stated that GAAR shall not interfere with the right of the taxpayer to select or choose a method of implementing a transaction. This essentially implies that a taxpayer's choice of using a more tax-efficient method of implementing a transaction (when multiple methods are available) shall not attract GAAR.
- Furthermore, vide aforesaid circular, CBDT has clarified that if at the time of sanctioning an arrangement the Court or Tribunal has explicitly and adequately considered the tax implications, GAAR will not apply to such an arrangement. However, there is subjectivity around the terms 'explicitly' and 'adequate' used by CBDT in its clarification. In the absence of any precedents/guidelines to infer the meaning ascribed to 'explicitly' and 'adequately', there may be challenges in determining when NCLT has explicitly and adequately considered the tax implications while sanctioning the arrangement. Hence, mere approval of the merger by NCLT may not be regarded as a defense against the GAAR provisions. In this context, it is noted that, in **Re JCT Limited**, ITAT, Kolkata laid down the principle that once the High Court approves a Scheme, 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 the issuance of the final order. Furthermore, in a catena of judgments, some of the High Courts and Supreme Court have also laid down a principle that once the Scheme is approved, it assumes statutory force and is binding on all stakeholders. However, it is pertinent to note that, like in the present case, Tribunals across benches order approving Schemes specifically provide the flexibility to the revenue authorities to challenge the transaction at a later stage and do not preclude them from imposing the requisite tax as applicable on the merger transaction.

Conclusion

In conclusion, the Tribunal has rightly upheld the Scheme citing commercial rationale and business synergy, and to that extent, it is a very welcome ruling. It is also important to note that Tribunal has asserted qua Section 79, 72A of ITA to the effect that these sections contain specific anti-avoidance safeguards regarding set-off of losses, and therefore, GAAR should not be invoked unless the objective of amalgamation is only to take benefit of losses. Having said that, the important takeaway of the ruling re-emphasizes the need for a careful approach while devising the Scheme by clearly establishing the objective and commercial rationale of the arrangement. Hence, the structuring of the Scheme assumes a very important role.

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