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DIRECT TAX ALERT

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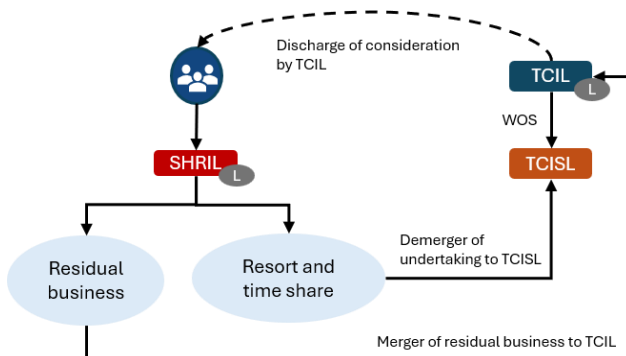
Mumbai ITAT denies carry forward of accumulated business losses and unabsorbed depreciation in demerger involving issuance of shares by parent company

Mumbai ITAT denies carry forward of accumulated business losses and unabsorbed depreciation in demerger involving issuance of shares by parent company

Mumbai Income-tax Appellate Tribunal (“ITAT”) in the case of *Sterling Holiday Resorts Limited v. DCIT*¹ inter-alia held that where the conditions prescribed under Section 2(19AA) read with Section 2(41A) of the Income-tax Act, 1961 (“the Act”) for a tax-neutral demerger are not strictly complied with, the assessee would not be entitled to carry forward and set off the accumulated business losses and unabsorbed depreciation of the demerged undertaking under Section 72A(4) of the Act. The ITAT held that issuance of shares by the holding company (instead of the company which received the undertaking pursuant to the demerger) was not compliant with the statutory requirements of tax-neutral demerger and therefore denied the benefit of carry forward of losses to the assessee company.

Background

- Sterling Holiday Resorts India Limited (“SHRIL”), a listed company, Thomas Cook (India) Limited (“TCIL”), a listed company, and Sterling Holiday Resorts Limited, formerly known as Thomas Cook Insurance Services Limited (“TCISL” or “the taxpayer”) which is a wholly owned subsidiary (“WOS”) of TCIL - entered into a court approved scheme of arrangement sanctioned by the Hon’ble Bombay High Court, with an appointed date of 1st April 2014.



- As depicted in the diagram, demerged undertaking was transferred to TCISL, whereas shares were issued by TCIL to the shareholders of SHRIL, and not by the taxpayer itself.
- At the time of the approval of the demerger, the High Court left it to the tax department to examine whether the transaction satisfied the definition of demerger under Section 2(19AA) read with Section 2(41A) of the Act.
- For Assessment Year ("AY") 2015–16, the taxpayer claimed the carry forward and set-off of the accumulated business losses and unabsorbed depreciation related to the undertaking of the demerged company under Section 72A(4) of the Act.
- For Assessment Year ("AY") 2015-16, the Assessing Officer (“AO”) denied the taxpayer’s claim for carry forward and set-off of accumulated business loss and unabsorbed depreciation aggregating to INR 240.15 crore which includes set-off of brought forward unabsorbed depreciation of INR 5.19 crore against the current year’s income, carry forward of business losses of INR 121.67 crore and carry

¹ ITA Nos. 843 /Mum/2024, order dated 25 June 2026 (AY 2015-2016)

forward of unabsorbed depreciation of INR 113.29 crore, relating to the demerged undertaking under Section 72A(4) of the Act. The AO denied this claim on the ground that the conditions of Section 2(19AA) read with Section 2(41A) of the Act were not fulfilled. This decision of AO was also affirmed by the CIT(A).

Issue under consideration:

- Whether, for the purposes of Sections 2(19AA) and 2(41A) of the Act, the taxpayer and its holding company, TCIL could be regarded as the “resulting company”?
- If the answer to the above question is affirmative, whether the taxpayer is entitled to carry forward and set off the accumulated business loss and unabsorbed depreciation of the demerged undertaking where the demerged undertaking was transferred to and vested in the taxpayer, but the shares in consideration of the demerger were issued not by the taxpayer but by its holding company, TCIL.

Revenue’s contentions:

- A plain reading of the provisions indicates that the “resulting company” refers to one or more companies to which the undertaking of the demerged company is transferred and includes its subsidiary company; it does not cover its holding company.
- Section 2(41A) read with Section 2(19AA) of the Act mandates that the company obliged to issue shares as consideration for the demerged undertaking is the company which receives the demerged undertaking or its WOS. Since the taxpayer received the undertaking but the shares were issued by TCIL (its holding company), and not by the taxpayer or its WOS, the statutory conditions for a tax-neutral demerger were not fulfilled.
- The benefit under Section 72A(4) of the Act is available only where all the conditions prescribed under Sections 2(19AA) and 2(41A) are strictly satisfied.

- Revenue additionally held that Section 72A of the Act covers only business losses and not long-term capital losses.

Taxpayer’s contentions:

- Both the taxpayer (recipient of the undertaking) and its parent company, TCIL (issuer of the shares), qualified as a “resulting company” under Section 2(41A) of the Act, since that definition covers “one or more companies (including a wholly owned subsidiary thereof)”.
- The requirement under Section 2(19AA)(iv) stood satisfied since TCIL, also being a resulting company, had issued shares to the shareholders of the demerged company in accordance with the approved scheme.
- Section 2(19AA) of the Act defines the term “demerger” to mean transfer by a demerged company of its one or more undertakings to **any** resulting company and the word “any” ought to be read liberally, relying on the Supreme Court’s (“SC”) decisions in Shri Balaganesan Metals² and Illuri Subbayya Chetty & Sons³.
- The provisions governing tax-neutral restructuring should be interpreted purposively and liberally and any ambiguity should be resolved in favour of the taxpayer. Reliance was placed on the SC decisions in Bajaj Tempo Ltd.⁴, Gwalior Rayon⁵ and Vegetable Products⁶ which mandate that incentive provisions for restructuring and economic growth be construed to advance, not frustrate, statutory objectives.
- If Section 2(19AA) of the Act has to be interpreted as to mean that only company to which the undertaking was demerged should allot shares, then the bracketed phrase “including wholly owned subsidiary thereof” in Section 2(41A) would become wholly redundant and purposeless.

² Shri Balaganesan Metals v/s. M. N. Shanmugham Chetty and Ors. (1987) 2 SCC 707

³ Shri Illuri Subbayya Chetty & Sons. vs. State of Andhra [1963] 50 ITR 93 (SC)

⁴ Bajaj Tempo Ltd. v/s. CIT [1992] 196 ITR 188 (SC)

⁵ CIT v/s. Gwalior Rayon Silk Mfg. Co. Ltd. [1992] 196 ITR 149 (SC)

⁶ CIT v. Vegetable Products Ltd. [1973] 88 ITR 192 (SC)

- The phrase "one or more companies (including a wholly owned subsidiary thereof)" does not only mean WOS. It would include all companies including a company which is WOS of another company or for that matter a company which is a holding company of another company. Further, the Act considers a combination of holding company together with its WOS, interchangeably as a resulting company because the very purpose of providing for demerger is to promote reconstruction of the business of companies into various other companies.
- If the undertaking were transferred to the holding company while shares were issued by its WOS, the issuer WOS would cease to remain wholly owned of its holding company after issuing shares. Further, the shares of the WOS would not reflect the value of the undertaking which has been demerged to the holding company. Accordingly, such interpretation would defeat the purpose of the demerger.

Mumbai ITAT's ruling:

- The ITAT noted that the entire controversy was centred on whether issuance of shares by the holding company could be regarded as compliant with the conditions prescribed under Sections 2(19AA) and 2(41A) of the Act.
- The provisions are worded unambiguously leaving no room for any other interpretation. The contention of the taxpayer is also not supported by any judicial precedent of higher courts and none have been cited or relied upon. The mere claim that there can be two interpretations possible has no substance at all.
- Reliance of the taxpayer on the cited decision in the case of Vegetable Products and other cited decisions of SC on liberal interpretation of the Act is misplaced and not relevant to the facts of the case.

- The ITAT, relying on judicial precedents such as Dilip Kumar & Co.⁷, Ajmera Housing Corporation⁸, Britannia Industries Ltd⁹, Union of India vs. Dharmendra¹⁰, CIT vs. Rajasthan Financial Corporation¹¹, State of Jharkhand v. Ambay Cements¹², held that the taxing statutes must be interpreted strictly and nothing can be read into or implied where the statutory language is plain and unambiguous.
- A holding company and its subsidiary are distinct legal entities having separate legal existence and obligations. Accordingly, the holding company cannot discharge a statutory obligation cast upon the subsidiary company and its obligations are restricted to its own legal liabilities and obligation under the law.

Conclusion

- The ITAT has taken a view that a holding company issuing shares in respect of demerger of a undertaking in its WOS is not in compliance of extant provisions and accordingly upheld the disallowance of set-off of brought forward unabsorbed depreciation of INR 5.19 crore and confirmed the disallowance of carry forward of business loss of INR 121.67 crore and unabsorbed depreciation of INR 113.29 crore under Section 72A(4) of the Act.

For Dhruva Insights, please refer to the next page

⁷ Commnr. Of Customs (Import), Mumbai vs M/S. Dilip Kumar and Company dated 30 July, 2018 in AIR 2018 SUPREME COURT 3606, 2018 (5) ABR 802, AIRONLINE 2018 SC 73,

⁸ Ajmera Housing Corporation and Another vs. CIT (2010) 326 ITR 642 (SC)

⁹ Britannia Industries Ltd. vs. CIT (2005) 278 ITR 546-547 (SC)

¹⁰ Union of India vs. Dharmendra Textiles Processors and Others (2008) 306 ITR 277 (SC)

¹¹ CIT vs. Rajasthan Financial Corporation (2007) 295 ITR 195 (Raj F.B.)

¹² State of Jharkhand v. Ambay Cements (2005) 1 SCC 368

The ruling holds that the benefit of carry forward and set-off of losses and unabsorbed depreciation under Section 72A(4) of the Act is available only where the conditions prescribed under Sections 2(19AA) and 2(41A) of the Act are strictly satisfied.

The ITAT did not specifically examine the taxpayer's argument that both the transferee company and its holding company could qualify as a "resulting company" under Section 2(41A), or the contention that a contrary interpretation would render the reference to "one or more companies (including a wholly owned subsidiary thereof)" redundant. Instead, the argument was rejected primarily in the absence of supporting judicial precedent.

The ITAT has relied on the strict interpretation of the language and the judicial precedents supporting such a view. Issue of shares by a WOS in respect of demerger of an undertaking in the parent may not be commercially feasible as the shares of the WOS would not capture the value of undertaking which resides in the parent. This aspect has not been appreciated by the ITAT and if appropriately canvassed may help in settling the argument in favour of the taxpayer.

The definition of the resulting company has to be seen qua each demerger and hence the language used in Section 2(41A) of the Act must be interpreted appropriately. It will be interesting to see how the judiciary interpret this question of law.

The taxpayers should closely monitor future judicial developments on this issue while structuring similar transactions.

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