

Sec. 56(2)(vii b) inapplicable to excess of net assets over consideration paid on amalgamation – Ahmedabad ITAT

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Summary

The Ahmedabad bench of Income Tax Appellate Tribunal (ITAT) has held that issue of shares at face value by an amalgamated company to shareholders of the amalgamating company in pursuance to a scheme of amalgamation would not fall under the anti-abuse provisions¹ of the Act. In holding so, the ITAT also upheld the decision of the Commissioner of Income Tax (Appeals)² wherein it was held only real income is taxable under the Act and not notional income arising due to, for instance, revaluation of stock.

The ITAT also observed that in cases of amalgamation there is a tripartite agreement between the amalgamated company, amalgamating company and shareholders of amalgamating company. Thus, it held that such agreements are not contemplated by the anti-abuse provisions.

Facts of the case

- The taxpayer³, in the instant case, is the amalgamated company.
- The Gujarat High Court⁴ approved the scheme of amalgamation of the amalgamating company⁵ with the taxpayer with effect from 01 April 2012.
- Pursuant to the scheme, assets worth INR 60.26 crore and liabilities worth INR 6.05 crore were acquired by the taxpayer against the issue of 1.5 crore shares issued at face value of INR 10 each.
- All the assets (except land) and liabilities of the amalgamating company were taken at book value.

Scheme of amalgamation

¹ section 56(2)(viib) of the Income-tax Act, 1961 (the Act)

² CIT(A)

³ M/s Ozone India Limited

⁴ vide order dated 07 September 2012

⁵ M/s Kalavir Estate Private Limited

Land parcels were taken at revalued price.

- The scheme provided for accounting the amalgamation as per the “Pooling of Interest” method of accounting⁶.
- Accordingly, excess net assets acquired by the taxpayer over the value of shares issued was accounted as ‘capital reserve’ and treated as capital receipt.

Held by the tax officer

The tax officer observed as follows:

- The taxpayer has derived benefit of excess net assets.
- The fair value⁷ of share of the taxpayer is INR 6.81 per share. Accordingly, the tax officer determined the value of shares so issued at INR 10.21 crore⁸.
- The difference between net assets and value of shares issued is taxable under the anti-abuse provisions of the Act⁹.

Held by the CIT(A)

⁶ provided in Accounting Standard -14 (Accounting for Amalgamations)

⁷ Computed as per Rule 11UA of the Income-tax Rules, 1962

⁸ 1.5 crore *INR 6.81 per share

⁹ section 56(2)(viib)

The CIT(A) held in favour of the taxpayer and held as follows:

- The excess net asset is largely due to revaluation of land parcels. It cannot be said that revaluation of land at market value gives rise to ‘real income’ which is a necessary pre-requisite for taxing an income. For this, the CIT(A) relied on various decisions¹⁰.
- Capital reserve account which is notional cannot be considered as share premium or consideration for the issue of shares.
- Anti-abuse provisions are applicable only when shares are issued at a premium. In the instant case, since shares are ‘issued’ at face value, anti-abuse provisions would not be invoked.
- Placing reliance on a Mumbai ITAT decision¹¹, the CIT(A) held that in absence of specific taxing provisions, where the land is revalued on

¹⁰ Chain Rup Sampatram Vs. CIT [224 ITR 481], CIT Vs. Hind Construction Ltd. [83 ITR 211], CIT Vs. Birla Gwalior Pvt Ltd. [89 ITR 266] and CIT, Bombay City Vs. Shoorji Vallabhdas & Co. in 46 ITR 144, CIT Vs. Leena Sarabhai [221 ITR 520]

¹¹ Makers Development Services Pvt . Ltd. Vs. Dy. CIT [40 ITD 185]

amalgamation and acquired at higher value, there will not be any tax implication on such notional gain.

Aggrieved by the order of the CIT(A), the tax department preferred an appeal before the Ahmedabad ITAT.

Taxpayer's contention

- The taxpayer argued¹² that in an amalgamation, the consideration is to be **discharged** by the taxpayer by issue of its shares. This is different from a typical situation where shares are subscribed by paying subscription money to the issuer company.
- It was also contended that since shares have been issued at face value and there is no share premium received, anti-abuse provisions would not be applicable.

ITAT's observation and order

- Placing reliance on a Supreme Court decision¹³, the ITAT held that the legal fictions are only for a definite purpose

and they are limited to the purpose for which they are created and should not be extended beyond the legitimate field.

- It concluded that the anti-abuse provisions were inserted¹⁴ to tax excessive tax premium received 'unjustifiably' without carrying underlying value. Thus, it held that the anti-abuse provisions are not applicable when shares are issued a face-value and not at premium.
- The ITAT examined the issue from various perspective and noted as follows:
 - The issue of shares does not trigger any consideration, rather the obligation to give consideration triggers the issue of shares.
 - There is a tripartite arrangement between amalgamated company, amalgamating company and the shareholders of amalgamating company. Such tripartite arrangements are not contemplated by the anti-abuse provisions since

¹² in terms of section 2(1B) of the Act and AS-14

¹³ CIT vs Refrigeration (P) Ltd. (1985) 155 ITR 711

¹⁴ after considering the Memorandum explaining provisions of Finance Bill, CBDT circular 3/2012

dated 12 June 2012 and the finance minister's budget speech

the consideration (in the form of an undertaking) is received from the amalgamating company and the shares are issued to the shareholders of the amalgamating Co.

- Issue of shares by the taxpayer to shareholders of the amalgamating

company is not regarded as 'transfer'¹⁵.

- Thus, the ITAT concluded that the issue of shares at 'face value' by the taxpayer to shareholders of the amalgamating company would not be covered under the anti-abuse provisions.

Our comments

The decision is based on the principal that tax authorities cannot simply invoke anti-abuse provisions under the Act without adequately analysing the substance, form and the intent of a transaction. A careful distinction needs to be made between legitimate business transactions and transactions carried out for the purpose of avoiding taxes.

¹⁵ Section 47(vii) of the Act

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