

Remember The Grasim Demerger? It's Staring At A Tax Hit Of Over Rs 5,800 Crore

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Nearly two years after the Aditya Birla Group implemented a restructuring of group companies Nuvo, Grasim and Aditya Birla Capital, the income tax department has found fault with one leg of the transaction. Last week, Grasim Industries Ltd. informed stock exchanges of a Rs. 5,872 crore tax demand against it on account of Dividend Distribution Tax for the demerger leg of the restructuring.

Here is a brief history of the transaction..

Back in 2017, NCLT Ahmedabad approved the merger of Aditya Birla Nuvo and Grasim Industries. Demerger of Grasim's financial services undertaking to Aditya Birla Capital was also part of the [restructuring exercise](#) which received the tribunal's approval. It's this demerger that has become a point of contention for the tax authorities.

In its letter to the stock exchanges, Grasim Industries stated the grounds on which the tax department has raised the Rs. 5,872 crore demand. The tax department's view is that demerger of Grasim's financial services undertaking to Aditya Birla Capital did not comply with the definition of 'demerger' as under section 2(19AA) of the Income Tax Act. Compliance with this section is necessary to assess the transaction as tax neutral.

And so, the tax department has invoked the deemed dividend provisions contained in section 115-O of the Income Tax law to raise this demand.

Tax Neutral Restructurings

For a restructuring to be tax neutral, it must comply with the conditions specified in section 2(19AA) of the IT Act:

1. All properties, assets and liabilities of the undertaking intended to be transferred are also transferred pursuant to the demerger.
2. These properties, assets and liabilities are transferred at book value calculated immediately before the demerger.
3. The company to which the undertaking is transferred - in this case Aditya Birla Capital- issues, in consideration to the demerger, proportionate shares to at least 3/4th of the shareholders of the transferring company - in this case Grasim Industries.
4. The undertaking is transferred on a going concern basis.

The department's stand is that the value of shares allotted by Aditya Birla Capital to shareholders of Grasim in consideration of the transfer and vesting of the demerged undertaking - Grasim Financial Services- into Aditya Birla Capital amounted to a 'dividend'.

Since the tax department's notice is not public, it is difficult to ascertain specifically which condition the demerger failed to meet, Shipra Padhi, leader of tax advisory at law firm Nishith Desai Associates, told BloombergQuint

We do know that shares were issued to shareholders of Grasim. So it appears to be non-compliance with other conditions such as, those relating to whether all assets and liabilities of the financial services undertaking were transferred, and at what value, that could've prompted this tax demand.

Shipra Padhi, Leader- Tax Advisory, Nishith Desai Associates

Deemed Dividend Provisions

This alleged non-compliance with sec 2(19AA) conditions led to the tax department invoking the deemed dividend provisions under section 115-O.

Indruj Rai, tax partner at law firm Khaitan & Co, told BloombergQuint that there is no specific provision under law that taxes demergers which are not tax neutral. That has led to the department to use other provisions to bring such demergers to tax, he added.

Section 115-O makes the distribution of dividends by a company a taxable event. But, the catch is that the section taxes monetary as well as non-monetary dividends. For instance, the non-monetary dividends could include assets or shares transferred by a company to its shareholders for no consideration.

Indruj Rai, Partner, Khaitan & Co.

Under Section 115-O, the effective rate of dividend distribution tax comes to 20.5%, he added.

Grasim Industries has stated in its exchange filing that the tax demand is not tenable in law. Padhi agreed with this view.

She pointed out that the interpretation of Section 115-O in view of demergers is fairly narrow. The underlying assumption of deemed dividend tax is that the shareholders of Grasim Industries received certain assets from the company by virtue of being shareholders, and in this case - by way of shares issued by Aditya Birla Capital pursuant to the demerger.

But logically, even before the demerger, the Grasim shareholders' shareholding in the company represented value from the financial services business. So even after the de-merger, the shareholders did not get anything new or additional to warrant any additional tax.

Shipra Padhi, Tax Expert, Nishith Desai Associates

It would be appropriate to challenge this view of the income tax authorities as too technical and narrow, she added.