

Tax Hotline

December 06, 2022

SET-OFF OF LONG-TERM CAPITAL LOSS AND CARRY FORWARD OF MAT CREDIT ALLOWED IN SCHEME OF AMALGAMATION

- The law of succession puts the successor in the shoes of the predecessor;
- Winding up of a company distinct from amalgamation of a company wherein business of the entity continues to be carried on by the amalgamated entity;
- The benefit of carry forward and set off of capital loss earned by the business of the amalgamating company has to be allowed as per the mandate of section 74 to the amalgamated company;
- The ITA does not contain any restriction on carry forward of MAT credit in case of amalgamation

Recently, the Pune Income Tax Appellate Tribunal (“**ITAT**” or “**the Tribunal**”) has *inter-alia* allowed set off of long-term capital loss of amalgamating company in hands of amalgamated company and carry forward of minimum alternate tax (“**MAT**”) credit of amalgamating company following the principle of succession.¹

BACKGROUND

Capgemini Technology Services India Limited (“**Taxpayer**” or “**Amalgamated Company**”) is a company engaged in providing software development services and IT enabled services. Amalgamation of iGate Computer System Limited (“**Amalgamating Company**”) with Taxpayer was approved by the High Court (“**HC**”) through a scheme of amalgamation effective from April 01, 2012 (“**Scheme**”). The Assessing Officer (“**AO**”) observed that the Amalgamated Company had claimed brought forward long-term capital loss of Amalgamating Company in its income-tax return. The AO while noting provisions of section 72A² of the Income-tax Act, 1961 (“**ITA**”) denied claim of such long-term capital loss by the Amalgamated Company. The AO also held that MAT credit of the Amalgamating Company is not covered under Section 72A of the ITA. Therefore, in the absence of any specific provision entitling the Amalgamated Company to avail MAT credit of Amalgamating Company, no such credit could be allowed in the hands of the Amalgamated Company. The Commissioner of Income-tax (Appeals) (“**CIT(A)**”) concurred with the view of the AO.

RULING

On further appeal to the Tribunal, the Tribunal rejected the claim of the AO and the CIT(A) on basis of following reasons:

Set off of long-term capital loss brought forward from Amalgamating Company

- The provisions of Companies Act, 1956, provide that all the assets and liabilities of the undertaking of the amalgamating company shall stand transferred and vest in and deemed to be assets and liabilities of the Amalgamated Company.
 - The Scheme provided that all the benefits including entitlements and incentives including tax concessions of the Amalgamating Company shall be transferred to and vest in the Amalgamated Company and these benefits shall relate back to the appointed date as if the Amalgamated Company was originally entitled to all benefits to such incentive schemes.
- On basis of analysis of the Scheme, the Tribunal noted that any loss which was available to Amalgamating Company shall become available to the Amalgamated Company for necessary set off.
- The law of succession puts the successor in the shoes of the predecessor, as a result of which all the liabilities and assets of the predecessor fall upon or vest in the successor subject to the specific stipulations under the relevant statutes. In this regard, the Tribunal relied on the Supreme Court (“**SC**”) decision in case of *CIT vs. T. Veerabhadra Rao*³, wherein the SC judgment emphasizes the point that the successor-in-interest becomes entitled to all the entitlements and deductions which were due to the predecessor firm subject to the specific provisions contained in the ITA.
 - The Tribunal also delved into the difference between amalgamation and winding up. It highlighted that in case of winding up, the entity, comes to an end along with the business it is carrying on. However, in case of amalgamation, only the entity carrying on the business either ceases to exist or is divested of its business, but the business continues albeit in the hands of another entity. The Tribunal thus noted that the *per se* existence of the business of the amalgamating entity does not extinct in amalgamation in contrast to the business coming to an end in the winding up.

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- The Tribunal notes that all the benefits under the ITA due to the Amalgamating Company devolve upon the Amalgamated Company because of succession. However, it is important to find out the restrictions, if any, imposed by provisions of the ITA upon availing such benefits.
- In relation to section 72A of the ITA, the Tribunal noted that it is clear that it applies only in respect of accumulated losses and unabsorbed depreciation under the head 'Profit and gains of business or profession'. It notes that the benefit of accumulated loss and unabsorbed depreciation which would have been otherwise available to Amalgamated Company under general law of succession has been made subject to certain conditions under section 72A of the ITA.
- As per section 74 of the ITA, the Tribunal held that it is comprehensible that the amount of long-term capital loss, not set off as per the relevant provisions, is allowed to be carried forward to the following assessment years for set off subject to other conditions provided in section 74. Importantly, the Tribunal noted that the term 'assessee' used in section 74(1) which was originally referring to the Amalgamating Company which suffered the loss, shall now be substituted by the Amalgamated Company to be considered as the 'assessee'.

Considering that the business of the Amalgamating Company under amalgamation continues uninterrupted by the Amalgamated Company, the benefit of such carry forward and set off earned by the business of the Amalgamating Company has to be allowed as per the mandate of section 74 to the Amalgamated Company.

Carry forward of MAT credit of Amalgamating Company

- The Tribunal noted that since the Scheme specifically provided that credit for MAT shall be claimed by the Amalgamated Company and the business of the Amalgamating Company continues unabated by the Amalgamated Company, the Amalgamated Company should be allowed to claim MAT Credit of Amalgamating Company.
- While analysing whether there is any restriction on carry forward of MAT credit in case of amalgamation, the Tribunal took note of the fact that section 115JAA(7) prohibited carry forward of MAT credit in case of conversion of company into a limited liability partnership. On this basis, the Tribunal held that if the intention of the legislature had been not to allow MAT credit of the Amalgamating Company, it would have specifically covered the cases to amalgamation in addition to the cases of conversion of a company into LLP under section 115JAA(7).

ANALYSIS

The Tribunal decision is welcomed. The order of the Tribunal is based on the general principles of succession and in this context the Tribunal has allowed the set off of long-term capital loss of amalgamating company in hands on amalgamated company and also allowed the carry forward of MAT credit by amalgamated company. This is in consonance with the approach adopted by the SC in another case⁴ wherein the SC noted that although the outer shell of the entity is destroyed in case of amalgamation, the corporate venture continues to exist in the form of a new or the existing transferee entity.

Section 72A of the ITA constitutes an exception to general rule that business loss can be carried forward and set off only by the assessee who has incurred the loss. In the past, courts have taken a view that in absence of a specific provision capital loss of amalgamating company should not be allowed in hands of amalgamated company.⁵ However, the Tribunal notes that all the benefits under the ITA due to the amalgamating company should devolve upon the amalgamated company because of principle of succession. The interpretation of the Tribunal that section 72A of the ITA merely provides some additional conditions / restrictions for allowability of business loss in case of amalgamation seems logical and in line with the approach of SC and provisions of Companies Act. Interestingly, the Tribunal effectively permits the set-off of long-term capital loss by substituting amalgamating company as the original assessee under section 74(1) to the amalgamated company. It will be interesting to see if courts agree with this interpretation of the Tribunal.

In relation to carry forward of MAT credit in case of amalgamation, in the past, several decisions have allowed the carry forward and set off of MAT credit of the amalgamating company to amalgamated company.⁶ However, in relation to demerger, there have been divergent rulings from Courts.⁷ Considering that section 115JAA(1A) specifically makes a mention to "assessee, being a company" with respect to computation of, one may need to analyze whether the principle in Tribunal's decision can be extended to demerger cases as well (provided appropriate provisions are included in scheme of demerger) since in demergers the entity continues to exist after the relevant undertaking has been demerged.

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You can direct your queries or comments to the authors

¹ *Capegemini Technology Services India Limited vs DCIT, ITA No.1857/PUN/2017*

² Section 72A of the ITA provides for the set off and carry forward only of the brought forward loss and unabsorbed depreciation of the amalgamating company in the hands of the amalgamated company

³ (1985) 155 ITR 152 (SC)

⁴ PCIT vs Mahagun Realtors (P) Ltd. Special Leave Petition (C) No. 4063 of 2020

⁵ Clariant Chemicals (I) Ltd. Vs ACIT [2015] 152 ITD 191 (Mumbai)

⁶ Caplin Point Laboratories Ltd. v. ACIT, order dated January 31, 2014 in ITA No.667/ Mds/ 2013; Ambuja Cements Ltd. v. DCIT [2019] 179 ITD 436 (Mumbai); Skol Breweries Ltd. v/s ACIT, ITA no.2313 of 2017 (Mum.) (Trib.)

⁷ In case of *Adani Gas Ltd. v. ACIT (ITA Nos. 2241 & 2516/ Ahd/ 201)*, the Ahmedabad Tribunal allowed the transfer of MAT Credit to the resulting company on the condition that the benefit of MAT Credit would be confined on a pro rata basis only qua the demerged undertaking. However, in case of *DCIT v. TCS E-Serve International Limited (ITA No. 2779/Mum/2018)*, in absence of a specific provision with respect to carry forward of MAT credit in the scheme of demerger, the Mumbai Tribunal allowed the demerged company to continue to avail MAT credit pertaining to its demerged SEZ units even after the demerger

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