

Demerger sanctioned by NCLT is tax-compliant only if conditions in Sec. 2(19AA) are satisfied

Facts of the case - Grasim Industries Ltd. Vs. DCIT [2022] (Mumbai - Trib.)

Assessee-company engaged in the business of viscose staple fiber, chemicals, textiles, etc. The Board of Directors of the assessee approved the scheme or arrangement of demerger of the financial service segment of the assessee. The scheme of such a demerger was subsequently approved by the National Company Law Tribunal [NCLT]. In this arrangement, the assessee transferred its assets, employees, and some liabilities and issued equity shares to the shareholders.

While the scheme in public domain, Assessing Officer (AO) issued a notice to assessee asking the assessee to submit the details with respect to the composite scheme of merger and demerger. AO noticed that the financial service business does not fulfill the requirement of an undertaking as per Explanation 1 to Section 2(19AA). Thus, he held that the demerger of the "financial services business" by assessee to the resulting company is not a tax-compliant demerger.

On appeal, the CIT(A) confirmed the order of the Tribunal. The matter was reached before the Mumbai Tribunal.

Decision of the case:

- i. The Tribunal held that the order of NCLT merely approves the scheme of demerger. Such approval of NCLT does not preclude revenue from examining the scheme for tax compliances. Determining the tax liability with respect to a demerger is AO's responsibility. He is duty-bound to examine the terms and conditions of the scheme in accordance with chargeability of deemed dividend and tax neutrality.
- ii. The assessee contended that AO was rewriting the scheme which was already approved by NCLT. However, there was no such attempt by him to tinker with the scheme approved by NCLT. The circular of the Ministry of Corporate Affairs and instructions by the CBDT also states that if revenue has any objections to the scheme, the matter should be placed before NCLT.
- iii. Both these above instructions and circular does not prevent AO from applying the provisions of the income tax act to the return of income of the assessee filed in compliance with the scheme approved by NCLT.
- iv. Therefore, even if a scheme is approved by Adjudicating Authority, it cannot override the provision of the existing provisions of the act. Hence, the revenue's appeal is allowed.