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15 July 2020

General Anti-Avoidance Rule cannot be applied retrospectively

The Kolkata Bench of the Indian Income-tax Appellate Tribunal (ITAT) rendered its decision that tax authorities need to follow the directions of the scheme of amalgamation as approved by the High Court and that the general anti-avoidance rule cannot be applied retrospectively

Facts of the case:

- JCT Limited (taxpayer)[1] is a public listed company and is engaged in the business of manufacturing and selling (including export) of textiles, yarns, nylon and polyester filament yarn, polyester chips, nylon chips, readymade garments, etc.
- During the Financial Year (FY) 2010-11, corresponding to Assessment Year (AY) 2011-12, Gupta & Syal Ltd ('GSL'), a wholly owned subsidiary of the taxpayer was amalgamated with the taxpayer with effect from 1 April 2010, under a scheme of amalgamation (approved by the Punjab and Haryana High Court and by the Delhi High Court).
- GSL had no substantial business activities and earned income from sale of investment and rent only. During the FY 2010-11, GSL sold a land, details of which are as follows:
  - GSL had initially acquired the perpetual leasehold rights of the property on 15 January 1966 for a consideration of INR 545,000 (~US$ 7,230).
  - Pursuant to government decision, the said land was converted to free hold property on 26 November 2010 by payment of conversion charges of ~INR 23.9 million (~US$ 0.32 million).
  - GSL sold the land on 14 March 2011 for a consideration of INR 1.2 billion (~US$ 15.92 million) and computed long term capital gain (LTCG) of ~INR 1.07 billion (~US$ 14.32 million) after claiming relevant cost inflation indexation benefit.
- However, post amalgamation of GSL with the taxpayer, the entire gain on sale of land was set-off against the brought forward unabsorbed depreciation of the taxpayer while computing tax as per the normal provisions of the Income-tax Act, 1961 (ITA). Further, while computing book profits as per the minimum alternate tax (MAT) provisions as well, the said capital gains on sale of land was set-off against the brought forward loss / depreciation as per books.
- During the course of audit, the Assessing Officer (AO) held that the ownership of land was acquired only when the land was converted from leasehold property to freehold property in November 2010. Accordingly, since the land was sold within 36 months from the date of becoming the owner, the AO:

[1] M/s JCT Limited v. DCIT (ITA No. 84 / Kol / 2019 and ITA No. 2389 / Kol / 2018)

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- Treated the capital gains as short term capital gains (STCG) and denied the cost inflation indexation benefit;
- Computed the STCG at ~INR 1.17 billion (~US$ 15.59 million); and
- Taxed the gains from sale of land at 30% (i.e. tax rate applicable for STCG) instead of 20% (i.e. tax rate applicable for LTCG) as computed by the taxpayer.

Apart from the above, the AO had not disputed any other element of the capital gain computation.

- On appeal, the Commissioner of Income-tax Appeals [CIT(A)] was of the view that the AO had examined the issue in a narrow sense. The CIT(A) did not allow losses to be set-off against the capital gains and subjected the capital gains to tax in the hands of the taxpayer under both the normal as well as MAT provisions, on the grounds that:
  - The entire purpose of amalgamation of GSL with the taxpayer was a colourful device to avoid payment of tax. Hence, the corporate veil was to be lifted to look through the entire transaction, based on substance rather than form.
  - The merger was done to avoid capital gains tax on sale of land, by setting off gains with brought forward loss of GSL.

  The CIT(A) acknowledged that the GAAR provisions were not applicable for the year under consideration. However, he drew strength from the same to arrive at the said finding.
- With respect to the nature of capital gain (i.e. STCG or LTCG), the CIT(A) held that the provisions of the ITA in this regard used the word 'held' as against 'owned'. Therefore, ownership of property was not relevant as mentioned by the AO. The CIT(A) relied on the decision in Stewarts & Lloyds of India Ltd. v. CIT[2] in this regard.

  Accordingly, since GSL held the property since 1966 on perpetual lease, the CIT(A) treated the gains as LTCG.
- Aggrieved by the CIT(A)'s order, the taxpayer as well as the AO filed an appeal before the Kolkata Bench of Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that the amalgamation scheme (of GSL with the taxpayer) as approved by the High Court, had specifically ordered that all incomes and profits of GSL be treated as income, profit, costs etc. of the taxpayer for all purposes. In view of the same, it held that the CIT(A) could not take a contrary view to the High Court order and the view of the CIT(A) was against the law.
- Further, the ITAT noted that in an earlier case[3] it was held that:
  - The scheme of amalgamation was approved by the Hon'ble High Court only after ensuring that the same is not prejudicial to the interests of the members or to public interest. Hence, the

[2] Stewarts & Lloyds of India Ltd. v. CIT [ITA No. 372 / Kol / 2009]

[3] Electrocast Sales India Ltd v. DCIT (ITA No. 2145 / Kol / 2014)

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merger scheme approved by the Hon'ble High Court having in mind the larger public interest, cannot be disturbed by the Revenue merely because the taxpayer was not entitled for certain benefits.

  – If there were any objections from the income tax department, they could raise the same at that stage prior to sanction of scheme by the Hon'ble High Court. Once the scheme was approved, it implied that the same was done after duly considering the representations from the government / Revenue.

- Applying the principles laid down in the earlier case[3], the ITAT held that:
  – The conclusion of the CIT(A) that the current case of merger approved by the High Court was a colourable device, was illegal and was without any basis.
  – The GAAR provisions were not applicable for the year under consideration (i.e. FY 2010-11 corresponding to AY 2011-12) and therefore, could not be invoked.
  – While the CIT(A) had held that the merger was a sham transaction, he had taxed capital gains in the hands of the taxpayer. These were contradicting findings.

  Accordingly, the ITAT allowed the taxpayer to set-off carried forward losses against the capital gains both under the normal as well as MAT provisions.

- With respect to whether the gains were STCG or LTCG, the ITAT upheld the order of the CIT(A) and held that the gains from sale of property were to be treated as LTCG. The ITAT additionally relied on the case of Amar Nath Agrawal v. CIT[4] in this regard.

Comments:

- Whether once a scheme of arrangement has been approved by the High Court, the directions thereof can be disregarded by tax authorities owing to tax benefit available to the taxpayer, has been a litigative issue. This ruling reiterates that tax authorities cannot disregard the directions of the High Court as per the approved scheme of arrangement.
- Further, this ruling lays down the principle that the GAAR provisions cannot be invoked on retrospective basis.

[4] Amar Nath Agrawal v. CIT [2015] 51 taxmann.com 120 (Allahabad)

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