



Mergers and Acquisition Alert

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The Supreme Court (SC) holds that income on account of waiver of interest liability due by amalgamating company after amalgamation, should be adjusted against the losses taken over by amalgamated company pursuant to section 72A of the Act

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Executive Summary

- The SC recently pronounced a ruling in the case of Mcdowell & Company Limited¹ (the Assessee) with respect to taxability of income on account of waiver of interest due to financial institutions by the amalgamating company, under section 41(1) of the Income-tax Act, 1961 (the Act).
- The SC held that since the Assessee is given the benefit of accumulated losses of amalgamating company by virtue of section 72A of the Act, the Assessee will need to consider the income accrued under section 41(1) of the Act in the hands of amalgamating company while computing actual accumulated losses available for carry forward.

¹ Mcdowell & Company Limited v. CIT (Civil Appeal No. 3893 of 2006)

Facts

- Hindustan Polymers Limited (HPL) had become a sick company and proceedings were pending before the Board for Industrial and Financial Reconstruction (BIFR) under the Sick Industrial Companies Act (SICA).
- HPL owed to banks and financial institutions and the interest which had accrued on the loans was reflected as expenditure in its books of account.
- The High Court of Bombay and Madras had approved the scheme of amalgamation of HPL with the Assessee with effect from 1 April 1977.
- The Assessee had approached the central government, before moving to the High Court, with the scheme of amalgamation, for claiming benefit of setting off and carry forward of losses of HPL, under section 72A of the Act. The central government granted the said benefit to the Assessee.
- Under the scheme of amalgamation, the banks which advanced loans to HPL, agreed to waive off the interest which had accrued prior to 1 April 1977.
- In the return filed by the Assessee for AY 1983-84, it carried forward for set off, the accumulated losses which it had taken over from HPL pursuant to section 72A of the Act. This was not objected by the Assessing Officer ('AO').
- However, the AO during the reassessment proceedings, treated the above mentioned waiver of interest by banks as income under section 41(1) of the Act, in the hands of the Assessee, and adjusted the same from the accumulated losses transferred upon amalgamation.
- Commissioner of Income-tax (Appeals) upheld the order of the AO.
- However, the Income-tax Appellate Tribunal (ITAT), held that the aforesaid income under section 41(1) of the Act is not income in the hands of the Assessee, but may be treated as income in the hands of HPL. Since HPL was a different assessee and different entity, the Assessee herein was not liable to pay any taxes on the said income.
- In further appeal, the High Court ruled in favour of the Revenue.

SC Ruling

The SC held that when the Assessee is allowed the benefit of accumulated losses, the income which accrued to it had to be adjusted and only thereafter net losses could have been allowed to be set off.

Comments

This ruling assumes importance while analyzing taxability of income under section 41(1) of the Act in the hands of the amalgamated company where the amalgamated company is given the benefit of losses of the amalgamating company, by virtue of section 72A the Act.

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