



Tax alert: Amalgamation considered as “Business restructuring” as per OECD Guidelines

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Amalgamation of group entities regarded as organizational change and covered under the definition of “business restructuring” as per the OECD guidelines. Consideration under amalgamation is subject to transfer pricing if it is not a tax neutral merger.

In a nutshell



Holding company of the assessee merged with the assessee. Assessee paid purchase consideration to the ultimate holding company. The amalgamation was approved in the scheme of merger by the NCLT. The consideration was discharged by way of issue of equity shares, issue of compulsory convertible debentures (CCDs) and payment of cash.



The transfer pricing officer (‘TPO’) deemed the issue of CCDs and the transfer of cash as excessive and instrument of tax base erosion and proposed transfer pricing (‘TP’) adjustment.



Hon’ble Mumbai ITAT ruled that discharge of merger consideration in form of CCD and cash (over and above equity consideration) to an AE is an international transaction of business restructuring that requires the determination of arm’s length price.

NCLT order and RBI approval does not determine the arm’s length price.

ITAT found the consideration paid under amalgamation as excessive upheld the TP adjustments proposed by the TPO.



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Facts:

Dimexon Diamonds Ltd. (“Assessee” or “DDL”) was a wholly owned subsidiary of Dimexon (India) Holding Pvt. Ltd. (“DIHPL”) which in turn was a subsidiary of Dimexon International Holdings B.V., Netherlands (“DIHBV” or “Ultimate holding company”), the ultimate parent company of the Dimexon Group.

During the FY 2017-18, DDL entered a scheme of amalgamation with its holding company DIHPL which was sanctioned by National Company Law Tribunal (NCLT). As per the scheme, DIHPL got merged into DDL for which DDL paid a purchase consideration of ₹ 188.35 crore to DIHBV (the ultimate holding company) by way of Issue of equity shares of ₹ 3.35 crore¹, Issue of CCDs of ₹ 85 crore and Cash of ₹ 100 crore. Therefore, post-merger, the holding company of DDL changed from DIHPL to DIHBV.

Transfer Pricing Dispute:

- Assessee furnished two valuation reports to corroborate the valuation of the purchase consideration. However, in both the reports, the purchase consideration was stated to have been determined by the management of the companies. Therefore, no scientific method was employed to determine the purchase consideration thus making it unfit to be used for benchmarking.
- As the merger was between two group entities, and there is no change in the economic interest of DIHBV, the discharge of purchase consideration in any form other than issue of equity shares is not at arm’s length. No independent party would enter such an arrangement.
- Accordingly, the TPO held that the cash of ₹ 100 crore paid to DIHBV represents a deemed loan which warrants an interest charge on DIHBV. Further, the TPO held that the payment in the form of CCDs represents excessive payment and is not at arm’s length. Hence, the ALP of the interest paid on such CCDs was considered as Nil.

Assessee’s Contentions:

- The primary objective of the said scheme of amalgamation was to maintain simple corporate structure and eliminate duplicate corporate procedures. The scheme is duly approved by Hon’ble NCLT and therefore the TPO has no jurisdiction to re-characterise the merger transaction.
- The payment of merger consideration is on the capital account and does not result in any income and therefore is out of scope of section 92 of the I-T Act.

ITAT’s Decision:

- Section 92B of the Act covers business restructuring between two associated enterprises as an international transaction. Business restructuring has been defined in the OECD guidelines as cross border reorganization of commercial or financial relations between associated enterprises. Restructuring could be in the form of operational change (i.e. in functions, assets, and risk profile of the entity) or organizational change (i.e. in ownership structure/ management of the entity). In the present case, the business restructuring is an organizational change amongst the group entities of the Dimexon group. Hence, the transaction between the assessee and DIHBV is covered within the ambit of international transaction.
- In the present case, assessee paid consideration to its associated enterprise in three modes, i.e., equity shares, CCDs, and cash and therefore, each mode needs to be examined separately.
- NCLT order approves the scheme of amalgamation when it appears to be fair and reasonable and not violative of any provision of law or contrary to public policy. However, the order of NCLT does not waive the right of the

¹ From the order it is not clear whether it represents face value of shares or fair value of shares. Given that Section 2(1B) conditions are not challenged, it is likely that it represents face value of shares.

Income tax department to examine the tax issues arising out of the scheme of amalgamation. NCLT order doesn't mean that the consideration paid pursuant to the said scheme is also at arm's length.

- In substance, there is no change in analysis of functions performed, assets used, and risks assumed by parties pre-restructuring and post-restructuring. The assessee did not submit the valuation report prepared on any scientific basis. The valuation report mentioned that the valuation was determined by the management of the companies. The valuation report in such cases require high degree of independence in valuation. Therefore, the ITAT upheld the decision of lower authorities in rejecting the valuation report submitted by the assessee and upheld adjustment proposed by TPO.

Conclusion:

This is a notable judgement in the context of intra-group merger where the merger seems to be not a tax neutral amalgamation, and hence not satisfying the conditions under Section 47 that require the consideration under amalgamation to be discharged only through shares of the amalgamated company. The ITAT disregarded the merger swap valuation report and emphasized that since equity shares are issued to shareholder (with intrinsic value for shareholders intact), consideration in form of CCD and cash is an incremental transaction arising out of amalgamation and hence will be subject to transfer pricing analysis.

It has also stressed on the independence of various authorities viz. NCLT, RBI and Income tax department in analysing and approving a particular transaction of business restructuring. Different authorities operate in different fields. Approval by one authority cannot be regarded as approval by other authorities.



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