DEMERGER EXPENSES ALLOWABLE U/S 35DD TO RESULTING COMPANY - DELHI HC

In a significant relief for corporates undertaking restructuring exercise, the **Delhi High Court in case of Coforge Limited (formerly known as NIIT Technologies Ltd) vs. ACIT: ITA Nos.213-214/2020 decided on 05.07.2021,** while reversing the decision of the Tribunal, held that demerger expenses under section 35DD of the Income Tax Act, 1961 ("the Act") are also allowable to the 'resulting company'.

Background

Pursuant to scheme of arrangement under sections 391-394 of the Companies Act, 1956, certain units from NIIT Ltd. ('NIIT') were demerged and vested with the assessee/ resulting company [an Indian company incorporated on 13.05.1992] with effect from 01.04.2003 (appointed date). The assessee/ resulting company incurred legal and professional expenses in assessment year ('AY') 2004-05, for the purposes of demerger and claimed deduction of 1/5th thereof, each in 5 consecutive AYs 2004-05 to 2008-09, in terms of section 35DD of the Act.

The claim was allowed in regular assessments completed under section 143(3) of the Act, for the first 3 years, i.e., AYs 2004-05 to 2006-07. However, in AY 2007-08 (for the first time) and thereafter, in AY 2008-09, the assessing officer ('AO') disallowed the deduction, holding that under section 35DD of the Act, deduction is allowable only to the demerged company, viz., NIIT, and not the resulting company, i.e., the assessee. The said findings were confirmed by Commissioner of Income Tax (Appeals) ('CIT(A)').

Succinctly put, the case of the Revenue was that the word "assessee" (used in singular) in section 35DD of the Act refers only to company being demerged, i.e., the demerged company, and does not cover the 'resulting company'.

Tribunal's findings

In appeal, the Tribunal, while affirming the disallowance, held that deduction under section 35DD of the Act is allowable only to the parent demerged company and not to the resultant company, i.e., the assessee company. The reasoning was that in case of demerger, the undertaking(s) which get demerged, may result in new entity and in said circumstances, the resulting company cannot incur expenditure before its birth. Thus, since demerger of the undertaking(s) took place from the parent company NIIT, the word "assessee" under section 35DD of the Act, refers to NIIT and not the target company, i.e., the assessee, with whom the demerged undertaking got merged.

High Court

The High Court, in its detailed judgment dated 05.07.2021 reversed the aforesaid findings/ conclusions of the Tribunal and held as under:

(i) Demerger, a legal device used, very often by assessees to restructure their business operations can take place in different ways, i.e., by way of spin-off OR split-off. The present was a case of spin-off rather than split-off since one of the undertakings of the demerged company, viz., NIIT, was transferred to another existing company, viz., the assessee;

(ii) Since demerger took place between two existing companies, and that the assessee was already in existence on the date of the demerger, therefore, the finding of Tribunal that the

assessee, in this case, was non-existent and came into existence only after the demerger took place, was incorrect;

(iii) The word 'assessee' in section 35DD of the Act has been carefully used by the Legislature and the same does not only cover the demerged company, but also the resulting company - the interpretation of section 35DD of the Act should align, wherever possible, with how ordinary men of commerce construe such business structuring operations;

(iv) Further, the Court accepted the principle of consistency holding that where deduction was allowed for the initial three years of the claim, the same could not have been disallowed in the subsequent remaining years.

VA Comments/ Key Takeaways:

The aforesaid ruling will act as a significant relief for corporate restructuring inasmuch as applying the principle laid down by the Tribunal (now reversed), amalgamation/ demerger expense incurred by amalgamated/ resulting company would not have been allowed as deduction at all.

The Court has, while touching upon different ways of demerger, viz., spin off and split off, laid emphasis on such interpretation which aligns with how ordinary men of commerce construe business structuring operations.

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