NCLT overrules applicability of GAAR in case of Panasonic Merger!

Recently, the Chandigarh Bench of National Company Law Tribunal ("**NCLT**") approving the amalgamation of a loss-making company, **Panasonic India Private Limited** (Transferor Company) with the profit-making company, **Panasonic Life Solutions India Private Limited** (Transferee Company), overruled the objections raised by the Income tax Department qua the proposed merger on the ground that the proposed merger was designed for tax avoidance since – (a) the amalgamated company sought to claim benefit of carry forward losses and unabsorbed depreciation of the amalgamating company under section 72A of the Income tax Act, 1961 ("**the Act**") and, (b) the shareholders of the amalgamating company stood to benefit from exemption from levy of tax on capital gains.

In that case, the ultimate ownership of both the amalgamating and amalgamated company was held by M/s Panasonic Corporation, Japan, and the Transferor company, i.e., Panasonic India Private Limited had accumulated losses of INR 14,375 million approx. in assessment year 2020–21. During the pendency of the proposed scheme of amalgamation before the NCLT, the Income tax Department filed a report alleging, inter alia, that –

(i) the scheme of amalgamation was not at arm's length and could not be termed as a prudent acquisition on any commercial or business terms;
(ii) the main objective of amalgamation was to take the benefit of accumulated losses which were eligible for set off in future years;
(iii) proposed amalgamation was prejudicial to the interest of the Revenue so much so that the same would cause loss of INR 3,594 Million (i.e., 25% of INR 14,375 Million plus applicable surcharge and cess) on account of possible non-payment of capital gain realisable by the shareholders of the Transferor company by selling shares of the Transferee company in the future;
(iv) **the proposed merger was a vehicle to transfer accumulated losses eligible for set off by the Transferor company to the Transferee company attracting provisions of section 96(1) under Chapter X of the Act, viz, General Anti-Avoidance Rules** ("**GAAR**").

While contending the above, the Income tax Department placed reliance on the decision of the Mumbai Bench of NCLT in the case of **Gabs Investments Pvt. Limited a**nd Ors. in CSP No.995 of 2017 and CSP No.996 of 2017 in CSA Nos.791, 792 of 2017 decided on 30.08.2018 and the decision of the NCLAT in the case of **Wiki Kids Ltd.** and Ors. Vs. Regional Director, Southeast Region, and Ors. in Company Appeal (AT) No.285 of 2017 decided on 21.12.2017.

In response thereto, the Petitioner companies contended that –

(a) the proposed amalgamation was driven by commercial rationale (in detail), viz, reduction in operating and marketing cost, economies in procurement, increased value to customers, offering holistic customer solutions, enhancing shareholders value;
(b) no prejudice was caused to the Revenue since the conditions of section 2(1B) read with section 47 of the Act were fulfilled;
(c) conditions laid down under section 72A read with Rule 9C of the Income Tax Rules, 1962 ("**IT Rules**") would be fulfilled by the Petitioner companies in order to qualify for carry forward and set off of unabsorbed business losses and brought forward depreciation of the amalgamating company in the hands of the amalgamated company and all the pending tax litigation of the Transferor company was to continue in the hands of the Transferee company in the same manner;
(d) there was no loss to the Revenue with respect of capital gains in the hands of the shareholders of the Transferor company upon the ultimate sale of shares in Transferee company since non-resident shareholders were in anyway not obligated to pay capital gains taxes by virtue of the relief under the India's tax treaty with Netherlands and Singapore on transfer of shares of the Transferee company if the transaction of merger had not taken place;
(e) value in the hands of the shareholders of the Transferor company remained the same both pre and post amalgamation.

Distinguishing the decisions in the case of **Gabs Investments** (supra) and **Wiki Kids** (supra), the NCLT observed that –

(i) the rationale of the scheme justified the claim of the Petitioner companies that the scheme was for business consolidation and the tax arrangements were merely a consequential fallout of implementation of the scheme of amalgamation by placing reliance on the decision of the Supreme Court in the case of **Hindustan Lever Employees' Union V. Hindustan Lever Ltd. MANU/SC/0101/1995** where it was held that "*unless there is some illegality or fraud involved in the scheme the court cannot decline to sanction the scheme of amalgamation*";

(ii) the provisions of section 72A read with Rule 9C and section 79 of the Act were sufficient to protect the interests of the Revenue in the case of amalgamation / demerger;

(iii) since the scheme of amalgamation approved by NCLT cannot override the existing provisions of the Act, the Revenue can examine the issues arising therefrom at the time of assessment of the Petitioner companies;

(iv) **as regard GAAR, in case the assessing officer during the course of assessment/reassessment proceedings believes that GAAR should be invoked, the Income tax Department is at liberty to do so provided the case is referred to Principal Commissioner or Commissioner of Income Tax who in turn has to refer the matter to the approving panel in accordance with the provisions of section 144BA of the Act**.

Rejecting the objections raised by the Income tax Department and considering that the proposed schemer of amalgamation was in compliance with the requirements of all the relevant sections of Companies Act, 2013, the NCLT sanctioned the proposed scheme of amalgamation.

Comments:

- The above order of NCLT provides significant relief to the industry, particularly in cases where the scheme is proposed for legitimate and bonafide commercial reasons and tax benefit, if any, is only incidental in nature. Reverse merger, i.e., merger of a profit making entity into the loss making entity, cannot, per se, be the ground to object to the scheme of amalgamation so long as there is commercial rationale for the same.

- On the flip side, the Income tax Department may now seek to invoke GAAR during the assessment/ reassessment proceedings.

- NCLT re-emphasized the well accepted principle of law that assessee can arrange his affairs so as to minimise his tax liability; in its commercial wisdom if the company had decided to have a particular arrangement by which there may even be benefit of saving income tax, that itself could not be a ground for coming to the conclusion that the sole object of framing the scheme is to defraud the Income Tax Department [refer: Company petition No 215/1978 between A.W. Figgis & Co Pvt Ltd decided by the High Court of Calcutta on 31st July 1978].

For any clarification, please write to:

Mr. Rohit Jain: rohit@vaishlaw.com

Ms. Puneeta Kundra: puneeta@vaishlaw.com