Tribunal accords strict interpretation to section 2(41A) to deny tax neutrality to demerger where shares are issued by the "holding company" instead of the company to whom the undertaking is demerged; denies carry forward of losses under section 72A of the Income tax Act, 1961

Corporate demergers have long served as an effective mechanism for business reorganisation, enabling companies to segregate business verticals, streamline operations and facilitate strategic investments in a tax-efficient manner. It is not uncommon for group restructurings to involve transfer of an undertaking to a wholly owned subsidiary ("**WOS**") while the consideration is discharged through issuance of shares by its holding company—a structure that has, on several occasions, received approval under the Companies Act, 2013. Whether such commercially accepted structures also satisfy the conditions of a tax-neutral demerger under the Income-tax Act, 1961 ("**the Act**"), however, has remained an unsettled issue.

In the recent decision in the case of **Sterling Holiday Resorts Ltd.**[1], the Mumbai Bench of the Tribunal has outlined strict interpretation to section 2(41A), which is likely to have significant impact on the position of tax-neutrality under the Act in respect of corporate demergers. The Tribunal opined that where the undertaking is transferred to the WOS but the consideration therefor is discharged by issuance of shares by its holding company, the statutory conditions prescribed under sections 2(19AA) [which defines "demerger"] and 2(41A) [which defines the term "resulting company"] of the Act are not fulfilled. Consequently, the Tribunal denied to the resulting company, benefit of carry forward and set-off of accumulated business losses and unabsorbed depreciation under section 72A(4) of the Act pertaining to the demerged company.

Background

Pursuant to a scheme of arrangement sanctioned by the Bombay High Court, Sterling Holiday Resorts India Limited **("SHRIL")** transferred its resorts and time-share undertaking to Thomas Cook Insurance Services Limited **("TCISL")**, WOS of Thomas Cook (India) Limited **("TCIL")**, while its residual business was amalgamated with TCIL.

Although the undertaking vested in TCISL, the consideration for the demerger was discharged by TCIL through issuance of its shares to the shareholders of SHRIL in accordance with the approved scheme.

In the ensuing assessment, the Assessing Officer ("**AO**") denied the benefit of section 72A(4) on the ground that the statutory requirement under section 2(19AA)(iv) of the Act, requiring the resulting company to issue shares to the shareholders of the demerged company, had not been complied with, inasmuch as such shares were issued by TCIL, and not TCISL. The Commissioner (Appeals) affirmed the assessment, leading to the appeal before the Tribunal.

[1] Sterling Holiday Resorts Ltd. v. DCIT (ITA Nos. 843 & 941/Mum/2024, order dated 25 June 2026)

Assessee's submissions

The assessee submitted that the restructuring was undertaken for genuine commercial purposes, including consolidation of complementary businesses, focused management and unlocking long-term value. It was argued that the dispute turned solely on the interpretation of the expression "resulting company" provided under section 2(41A) of the Act.

The principal submissions advanced before the Tribunal were:

- Section 2(41A) defines "resulting company" to mean **"one or more companies (including a wholly owned subsidiary thereof)"**, indicating that the Legislature contemplated more than one resulting company in an appropriate case.
- Where the undertaking vests in the WOS and shares are issued by its holding company, both entities should be regarded as constituting "resulting company" for purposes of section 2(19AA) of the Act.
- A restrictive interpretation would limit the purport of the words "*one or more companies (including a wholly owned subsidiary thereof)*" and render the operation of the scheme of demerger redundant, which would be contrary to the settled principle that every word employed by the Legislature must be given rational meaning.
- Since section 2(19AA) is a beneficial provision intended to facilitate tax-neutral corporate reorganisations, the same should receive liberal construction consistent with the principles laid down by the Supreme Court in **Bajaj Tempo Ltd.**[2], **Gwalior Rayon Silk Mfg. Co. Ltd.**[3], and **Vegetable Products Ltd.**[4]
- The scheme had already received judicial approval under the Companies Act and several Courts had sanctioned similar restructuring arrangements involving issuance of shares by the holding company.

Tribunal's ruling

After analysing sections 2(19AA), 2(41A) and 72A, the Tribunal, rejecting the assessee's interpretation, upheld the Revenue's stand, observing that demerger qualifies for tax neutrality only upon strict fulfilment of every statutory condition prescribed under section 2(19AA) of the Act. One such mandatory condition is that in terms of section 2(41A) of the Act, resulting company is the company to whom the demerged undertaking is transferred or a subsidiary thereof, and it is this resulting company which must issue its shares to the shareholders of the demerged company in consideration of the transfer of the undertaking.

According to the Tribunal, since the demerged undertaking, admittedly, vested in TCISL, TCISL alone constituted the resulting company under section 2(41A) for purposes of fulfilment of the conditions under section 2(19AA) of the Act. However, since the shares were issued by TCIL, the holding company and not by TCISL, in the opinion of the Tribunal, the statutory requirement under section 2(19AA)(iv) of the Act remained unfulfilled.

The Tribunal further observed that neither the language of sections 2(19AA) and 2(41A) of the Act nor any binding judicial precedent supported the proposition that holding company could

[2] Bajaj Tempo Ltd. vs. CIT [1992] 196 ITR 188 (SC)
[3] CIT vs. Gwalior Rayon Silk Mfg. Co. Ltd. [1992] 196 ITR 149 (SC)
[4] CIT v. Vegetable Products Ltd. [1973] 88 ITR 192 (SC)

discharge the statutory obligation of issuing shares on behalf of the resulting company. Acceptance of such an interpretation, according to the Tribunal, would amount to reading words into the statute, which is impermissible in the interpretation of taxing statutes.

Placing reliance on the decisions of the Supreme Court in **Commissioner of Customs v. Dilip Kumar & Co.**[5], **Ajmera Housing Corporation**[6], **Dharmendra Textiles Processors**[7], and **American Express Bank**[8], the Tribunal reiterated that exemption and incentive provisions under taxing statute are required to be construed strictly and Courts cannot extend the scope of such provisions by adopting purposive or equitable interpretation where the statutory language is plain and unambiguous.

Accordingly, the Tribunal upheld the denial of carry forward and set-off of accumulated business losses and unabsorbed depreciation under section 72A(4) of the Act in the hands of the resulting company.

VA Comments

The decision represents the first detailed judicial examination of the tax consequences arising where an undertaking is transferred to the WOS while consideration is discharged by issuance of shares by its holding company.

The controversy essentially stems from the scope of the definition of "resulting company" under section 2(41A) of the Act. Given the absence of any authoritative High Court or Supreme Court decision directly interpreting sections 2(19AA) and 2(41A) in this context, the controversy is far from settled. Considering the significant implications of the ruling for domestic and cross-border group restructurings, particularly those involving listed holding companies or overseas parent entities and the competing interpretational arguments, further litigation before the High Court is likely and the final word on the issue may yet remain to be spoken.

For any further clarification, please write to:

Ms. Poonita Harsh Kundra, Partner
poonitaharshkundra@vaishlaw.com

Mr. Aniket D Agrawal, Partner
aniket.agrawal@vaishlaw.com

[5] Commissioner Of Customs (Import), Mumbai vs M/S. Dilip Kumar and Company dated 30 July, 2018 in AIR 2018 SUPREME COURT 3606, 2018 (5) ABR 802, AIRONLINE 2018 SC 73
[6] Ajmera Housing Corporation and Another vs. CIT (2010) 326 ITR 642 (SC)
[7] Union of India vs. Dharmendra Textiles Processors and Others (2008) 306 ITR 277 (SC)
[8] CIT vs. Rajasthan Financial Corporation (2007) 295 ITR 195 (Raj F.B.)

Corporate, Tax and Business Advisory Law Firm

DELHI	MUMBAI	BENGALURU
1st, 9th, 11th Floor, Mohan Dev Building, 13, Tolstoy Marg, New Delhi, 110001 (India)	106, Peninsula Centre, Dr. S.S. Rao Road, Parel, Mumbai, 400012 (India)	Bhive Premium Ramanashree (MG Road) No. 2/1, Brunton Road, Off MG Road, Opposite Old Passport Office Bengaluru, 560001 (India)
+91 11 42492525 delhi@vaishlaw.com	+91 22 42134101 mumbai@vaishlaw.com	+91 80 40903588 / 89 bangalore@vaishlaw.com