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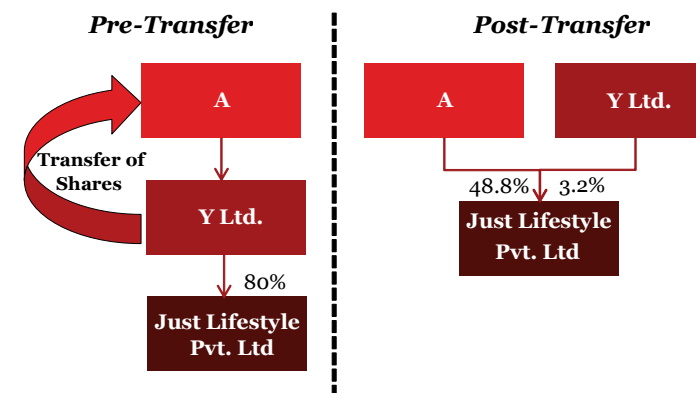
Change in shareholding triggers section 79 of the Income-tax Act 1961 even if within the group

In brief

In a recent decision in the case of Just Lifestyle Pvt. Ltd.¹ (the “company” or “taxpayer”), the Income-tax Appellate Tribunal (Tribunal) of Mumbai denied carry forward of loss by a closely held company pursuant to a change in more than 49% of shareholding, and rejected the taxpayer’s contention that the share transfer within the group did not result in a change of beneficial ownership.

¹ Just Lifestyle Pvt. Ltd. v. DCIT [TS-562-ITAT-2013(Mum)]

Structure



Facts

During the year under consideration, Y Ltd., holding 80% of the share capital in the company, transferred 48.8% of its shares to its shareholder “A” and the balance to others, thereby reducing its shareholding to 3.2%. During the year under consideration, the taxpayer set off its current year’s income against the brought forward losses and the unabsorbed depreciation relating to earlier years. The Tax Officer (TO) accepted the set-off of current year income against the unabsorbed depreciation of earlier years, but did not allow brought forward loss to be set off against current year income, on the grounds that shareholders holding 49% or more voting rights had changed during the year under consideration.

According to Indian tax provisions, a closely held company is not eligible to carry forward and set off its business losses if 51% or more of its voting power in the year in which set-off is claimed is not “beneficially held” by the same shareholders who beneficially held 51% or more voting power on the last day of the previous year in which the loss was incurred.

The first appellate authority upheld the TOs’ position on the ground that although the shareholding had changed within the group, the fact remained that more than 49% of the shareholding had changed during the year.

Issue

Was a change in the shareholding pattern hit by section 79 of the Income-tax Act, 1961 (the Act), which would disentitle the assessee to the set-off of brought forward losses, even if shares carrying 51% voting power continue to be held by the same group?

Taxpayer’s Contention

There was a change in the shareholding of the company, but the same was within the group, as 48.8% shares were transferred to its shareholder, “A”. Even with the change in shareholding, the same group continued to control the

company and a substantial holding remained within the group. The taxpayer was therefore entitled to set off the brought forward loss.

The reference to ‘shareholders’ in section 79 of the Act relates to the beneficial shareholding in shares, which means that section 79 of the Act would not apply if shares carrying 51% voting power continue to be held by the same group which held the shares carrying 51% of the voting power in the year in which losses were incurred. Within the same group, there may be any amount of changes to the shareholding. The shareholding remained within the group and therefore, the beneficial holding did not change.

Revenue’s Contention

There was a change in the shareholding pattern of the company, *albeit* within the same group.

Tribunal’s Ruling

A company is a distinct legal entity; its identity is separate from the identity of its shareholders or members. While the transferor and the transferee may belong to the same group, it could not be said that the shareholding pattern had not changed. Shareholder “A” controls the shares of Y Ltd, which is a separate legal entity. It cannot be considered that the shareholding has not changed as the holding remains within the group. Change in more than 49% of the shareholding of a company will trigger section 79 of the Act.

Conclusion

The Tribunal denied carry forward of loss, holding that the provisions relating to change in beneficial shareholding would be triggered even if shares representing 51% or more of the voting rights remained within the same group.

This ruling is important for taxpayers contemplating group re-organisation that may result in change of more than 49% of ownership of a closely held company having unabsorbed losses.

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