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News Alert
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Going concern test applies to transfer, not to the demerged unit

In brief

In the recent case of KBD Sugars & Distilleries Limited¹, the Bangalore bench of the Income-tax Appellate Tribunal (the Tribunal) held that in a demerger, set-off of brought forward losses of a demerged undertaking is permitted if the undertaking is hived off 'as a going concern'. It is not necessary that the undertaking that is demerged is a going concern at the time/date of transfer.

Facts

- KBD Sugars & Distilleries Limited (Company or taxpayer) acquired a rectified spirit unit through demerger from Maruthi Organics Limited (MOL).
- MOL, the demerged company, was in the business of manufacture of Indian made foreign liquor. It had stopped its operations since 1999 and had applied to Board for Industrial and Financial Reconstruction (BIFR) for its revival.

¹ KBD Sugars & Distilleries Ltd v. AC IT [TS-595-ITAT-2013 (Bangalore-Trib.)]

- MOL hived off its rectified spirit unit to the taxpayer through a scheme of arrangement approved by the Andhra Pradesh High Court, w.e.f. 1 April, 2005 (the appointed date).
- At the time of demerger, the transferred undertaking had brought forward business losses of approximately INR 7 crores. The taxpayer claimed set-off of the said losses post demerger against its other profits from business.
- The tax officer (TO) disallowed the claim for set-off of such losses by the taxpayer on the basis that the demerged unit/undertaking was not a going concern on the date of transfer/the appointed date. The Commissioner of Income- Tax (Appeals) upheld the TO's order.

Issue

- Whether the undertaking that is demerged should be a going concern at the time of transfer for the purpose of section 2(19AA) read with 72A of the Income-tax Act, 1961 (the Act)?

Taxpayer's contention

- The taxpayer contended that the *non-obstante* clause in section 72A(4) of the Act overrode the definition of demerger under section 2(19AA) of the Act.
- Furthermore, section 2(19AA) of the Act itself uses the words, 'on a going concern basis'. It only means that the transfer should be on the basis of a going concern and does not mean that the transferred undertaking should be a going concern as on the date of transfer.
- The intention in the present case was to revive the demerged undertaking of MOL by utilising the financial strength of the taxpayer.

- Furthermore, the provisions of sections 72A & 2(19AA) of the Act have to be read harmoniously in order to ensure that the benefits intended by the Legislature reach those intended to receive them².

Revenue's contention

- Contesting the taxpayer's interpretation of the *non-obstante* clause, the Revenue contended that where a term had been defined in the Act, the same meaning should be ascribed to it wherever the term appeared, unless specifically mentioned otherwise.
- Furthermore, one of the conditions for a transfer to be regarded as a demerger was that the undertaking should be a going concern. In the present case, the demerged undertaking had not been in operation since 1999 and hence, could not be regarded as a going concern. Thus, the demerger did not satisfy the demerger requirements as defined under section 2(19AA) of the Act.
- Going concern always means to say 'alive', whether profit-making or not. It was not within the intention of the Act to allow the set-off of accumulated losses of a dead concern.
- The intention of the demerger may be revival of a weak concern, but for the purpose of set-off of brought forward losses, the provisions of the Act had to be satisfied.
- The mere blessing of the High Court for the scheme did not satisfy the definition of amalgamation/ demerger as required under the Act.
- Hence, set-off of accumulated losses of the demerged undertaking of MOL was not allowable to the taxpayer.

² Relies on findings in the case of JCIT v. Valdel Engineers & Constructors (P) Ltd. [2012] 27 taxmann.com 148 (Bangalore-Trib)

Tribunal ruling

- It is very clear from a simple reading of section 72A of the Act that the section does not state that the undertaking being demerged ought to be a going concern at the time of demerger.
- Instead, it only states that the undertaking being demerged should be transferred in a manner 'similar to the manner in which a going concern' is transferred. The 'transfer' should be 'on a going concern basis'.
- The definition of demerger under section 2(19AA) of the Act would be satisfied if the undertaking being demerged was hived off 'as a going concern', i.e., it should constitute a business activity capable of being run independently.
- Furthermore, it was mentioned in the scheme of arrangement that the undertaking being demerged shall vest in the taxpayer on a 'going concern basis'. The approval of the High Court vouches for the transfer being on a going concern basis.
- The Tribunal also placed reliance on the ruling of the Delhi High Court³, wherein it was held that the definition of demerger under the Act would be satisfied if the undertaking that was being demerged was hived off as a going concern, which means that it constituted a business activity capable of being run independently for the foreseeable future. To ensure that it was a going concern, the Court, while sanctioning a Scheme, can certainly examine whether essential and integral assets such as plant, machinery and manpower, without which it would not be able to run as an independent unit, had been transferred to the demerged company.

- Hence, the vesting of the undertaking of MOL was a demerger within the meaning of section 2(19AA) of the Act and hence, the losses of the demerged undertaking were allowed to be set off by the taxpayer.

Conclusion

For a transfer to be regarded as a 'demerger' under the Act, the demerged undertaking should be transferred on a going concern basis and it is not necessary that the demerged undertaking itself is a going concern. Even a non-operational undertaking transferred on a going concern basis can fall within the meaning of 'demerger'. The going concern test applies to the transfer and not to the demerged undertaking.

³ Indo Rama Textile Ltd., *In re* [2012] 23 taxmann.com 390 (Delhi)

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