


Tax Insights

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Successor steps in predecessor's shoes – amalgamated company being successor is eligible to claim brought forward long-term capital loss and MAT credit of predecessor amalgamating company – Pune bench of the Tribunal

In brief

The Pune bench of the Income-tax Appellate Tribunal (Tribunal)¹ held that, by virtue of the provisions of section 74 of the Income-tax Act, 1961 (the Act), long-term capital loss of predecessor-amalgamating company is available for set off in the hands of the successor-amalgamated company. The Tribunal also held that the minimum alternate tax (MAT) credit of the amalgamating company has to be allowed in the hands of the amalgamated company.

In detail

Facts

- The taxpayer (amalgamated company) was a company engaged in the business of providing software development and IT-enabled services.
- Pursuant to the order of the High Court (scheme), another company (transferor company) was merged with the amalgamated company with effect from 1 April 2012.
- The scheme, as approved by the High Court, provided that with effect from the appointed date of 1 April 2012, all the tax benefits, loss etc. of the transferor company will be transferred to and vested in the amalgamated company as if the transferee company was originally entitled to all the benefits to such incentive schemes and policies subject to the continued compliance by the transferee company of all the terms and conditions.

Tax department's contention

- The set-off of brought forward long-term capital loss pertaining to the transferor company is denied to the transferee company as the provisions of section 72A of the Act do not provide set-off and carry forward of long-term capital losses in the hands of the amalgamated company.
- In the absence of any specific provision entitling the amalgamated company to avail MAT credit of the

¹ ITA No.1857/PUN/2017

transferor company, the MAT credit of the transferor company is not allowed in the hands of the amalgamated company.

Issues before the Tribunal

- Whether the benefit of brought forward long-term capital loss of the transferor company is available for set off in the hands of the amalgamated company under section 74 of the Act?
- Whether the MAT credit of the transferor company is allowed in the hands of the amalgamated company post-merger?

Tribunal's ruling

Allowability of brought forward capital losses

- All the assets and liabilities of the transferor company vested in the amalgamated company, which 'will be claimed by the transferee company and these will relate back to the appointed date as if the transferee company was originally entitled to all the benefits'.
- The scheme provided that any exemption which was benefit by way of set-off or carry forward, as the case may be, of any unabsorbed depreciation or investment allowance or 'other allowance or loss' which is available to the transferor company will be available to the transferee company.
- On an analysis of the relevant clauses of the scheme, it is evident that any loss which was available to the transferor company will become available to the amalgamated company for necessary set-off. When the business of the entity continues despite its closure, then all the obligations and privileges attached to the business of the erstwhile entity must go along with the business in the hands of the new entity carrying on such business.
- Even otherwise, the law of succession puts the successor in the shoes of the predecessor, which results in the successor being entitled to all the entitlements, benefits or privileges which had accrued to the predecessor. In the manner in which the liabilities of predecessor under the Act become liabilities of the successor, the successor also becomes entitled to the entitlements, benefits or privileges of the predecessor under the Act, subject to restriction, if any.
- The Supreme Court² had held that if debt had been taken into account in computing the income of the predecessor firm, which was subsequently written off as irrecoverable by the successor firm, the successor will be entitled to the deduction. This judgment emphasises the principle that the successor becomes entitled to all the entitlements and deductions which were due to the predecessor.
- When the business of the entity continues despite the closure of the entity or divesting of the business, then all the obligations and privileges attached to the business of the erstwhile entity must go along with the business in the hands of the new entity carrying on such business, save as otherwise provided under the Act.
- Section 72A of the Act is not the only section providing for benefits, privileges or entitlements under the Act in the case of amalgamation.
- All the benefits under the Act due to the amalgamating company pass on to the amalgamated company on account of the succession, subject to restrictions, if any, imposed by the provisions of the Act. The benefit of accumulated loss and unabsorbed depreciation of the amalgamating company, which would have been otherwise available to the amalgamated company under the general law of succession, has been circumscribed by certain conditions set out in section 72A of the Act. It is not a panacea for all the tax-related issues of amalgamation, so as to have application insofar as the other tax entitlements, privileges or benefits in the hands of the amalgamating company are concerned.
- Section 74 of the Act deals with losses under the head 'capital gains'. It specifically provides that in case of a capital loss to the taxpayer, the whole loss will be carried forward to the following assessment year.

² CIT v. T. Veerabhadra Rao [1985] 155 ITR 152 (SC)

- Since the business of the amalgamating company under amalgamation continues uninterrupted by the amalgamated company, the benefit of such carry forward and set-off earned by the business of the amalgamating company has to be allowed as per the mandate of section 74 to the amalgamated company.
- The term 'the taxpayer' as used in sub-section (1) of section 74 of the Act, which originally referred to the transferor company which suffered the loss, will now substitute the amalgamated company to be considered as the taxpayer entitled to set-off of the brought forward long-term capital loss not only because of the scheme of amalgamation is providing but also because of the taxpayer becoming a successor-in-interest of such loss.
- Accordingly, it was held that the long-term capital loss of the amalgamating company, i.e. transferor company, is available for set-off in the hands of the amalgamated company.

Entitlement of MAT credit

- The Tribunal observed that the facts of denial of MAT credit were materially similar to the grounds of not allowing set-off of long-term capital loss.
- All the benefits and privileges available to the amalgamating company have been held to pass on to the successor amalgamated company.
- Section 115JA(2) of the Act provides that where any amount of tax is paid under section 115JA by a taxpayer, then credit in respect of tax so paid will be allowed to him. Because of the taxpayer-amalgamated company stepping into the shoes of the amalgamating company, it will satisfy the requirement of allowing credit to 'him' in accordance with the provisions of this section.
- Section 115JAA(7) of the Act contains a specific prohibition on the entitlement of MAT credit in case of conversion of a private company or unlisted public company into a limited liability partnership (LLP). This provision's intent was to restrict the allowance of MAT credit to the successor only on conversion of a company into LLP and not any other case of succession, including the amalgamation.
- Thus, in the absence of any specific prohibition under the Act, there remains no doubt whatsoever that the MAT credit of the amalgamating company has to be allowed in the hands of the amalgamated company.

The takeaways

This is a welcome ruling from the Pune bench of the Tribunal, holding that the law of succession puts the successor in the shoes of the predecessor, which results in the successor being entitled to all the entitlements, benefits or privileges that had accrued to the predecessor. This may provide clarity on the claim of various deductions. The ruling seeks to provide much desired clarity on issues relating to allowability of losses and MAT credit utilisation post-amalgamation of companies.

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