Judicial Decisions

Applicability of Section 45(4) on revaluation of assets credited to partner's capital prior to assessment year (AY) 2021-22

CIT v. Mansukh Dyeing & Printing Mills [2022] 145 taxmann.com 151(SC)
In favour of Revenue

Relevant Facts

The assessee was a partnership firm consisting of 4 partners. Under the Family Settlement on 02.05.1991, the share of one of the existing partners was reduced and 3 new partners were admitted. Subsequently on 01.11.1992, there was further reconstitution in the firm in which 3 partners of the firm (other than the newly admitted partners) retired and another 4 new partners were admitted. Thereafter, on 01.01.1993, the firm revalued its assets and the surplus on revaluation was credited to the accounts of the partners in their profit-sharing ratio. 2 of the existing partners decided to withdraw a part of their capital. The assessing officer (AO) taxed the increase in the value of the assets on account of revaluation under Section 45(4) as capital gain on transfer of asset by the partnership firms to its partners.

Note:
Section 45(4) seeks to tax under the head capital gains profits or gains arising from the transfer of a capital asset by way of distribution of capital assets amongst partners on the dissolution of a firm or otherwise.

Held

With respect to increase in the value of the assets on account of revaluation, the Supreme Court held that the credit to the partners' capital account on revaluation can be said to be in effect distribution of the assets as such credit was available to the partners for withdrawal. The Supreme Court further affirmed the decision of Bombay High Court in case of A. N. Naik Associates & Others [2004] 265 ITR 346 upholding the wider interpretation of Section 45(4) to cover distribution of assets on retirement of partner.

CNK comments

The main controversy was around interpretation of Section 45(4) of the Act as it existed prior to the amendment by the Finance Act, 2022. The scope of this section had been a subject matter of judicial controversy.

The Supreme court upheld the wider interpretation of Section 45(4) for cases prior to AY 21-22 and held that the revaluation of assets credited to the capital accounts of the partners would fall within the category of 'otherwise' i.e., otherwise than by way of dissolution.

The cases of reconstitution of firms for AY 2021-22 & subsequent assessment years may not be governed by the said decision and may need to be considered separately after the substitution of Section 45(4) by the Finance Act, 2022 and introduction of section 9B.

Successor/ amalgamated company steps into predecessor's shoes on amalgamation and eligible to carry forward long-term capital loss & MAT credit of amalgamating company

CIT vs Capgemini Technology Services India Limited [TS-918-ITAT-2022(PUN)] In favour of Assessee

Relevant Facts

The assessee claimed brought forward long-term capital loss of Rs.109.86 crore which included long term capital loss of Rs.104.46 crore from the erstwhile company iGate Computer Systems Ltd (ICSL) which got amalgamated with the assessee company on the first day of the financial year under consideration. The AO held that Section 72A only allows carry forward and set off of loss under the head 'profits and gains of business or profession' in case of amalgamation and there is no provision for allowing carry forward of long-term capital loss in the hands of amalgamated company. The AO did not accept the contention of the assessee that the long-term capital loss could be carried forward under Section 74.

Further, the AO disallowed MAT credit available in the hands of the erstwhile ICSL which was amalgamated with the assessee company.

Held

For brought forward long-term capital loss

The Tribunal held that the successor becomes entitled to all the entitlements, benefits, deductions, etc. which were due to the predecessor. Even in case of amalgamation, all the benefits which were due to an amalgamating company devolve upon the amalgamated company due to succession, unless any restrictions are imposed in the Act. The Tribunal observed that the benefit of accumulated loss & unabsorbed depreciation of the amalgamating company, which would have been otherwise available to the amalgamated company under the general law of succession, are restricted by certain conditions set out in Section 72A. Section 72A exclusively applies to accumulated losses & unabsorbed depreciation under the head "Profit and gains of business or profession". It does not govern other tax entitlements, privileges or benefits in the hands of the amalgamating company.

Further, Section 74 deals with carry forward of loss under the head capital gains (which has no such restrictions). Since the business of the amalgamating company under amalgamation continues without interruption by the amalgamated company, the benefit of carry forward and set off of long-term capital loss available to the amalgamating company has to be allowed as to the amalgamated company.

For MAT credit

The Tribunal held that the assessee-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 Section 115JAA.

Section 115JAA(7) specifically prohibits the Minimum Alternate Tax **(MAT)** credit only in case of a conversion of a private company into Limited

Liability Partnership **(LLP)** and does not extend such prohibition to the cases of amalgamation Therefore, held that the MAT credit of the amalgamating company has to be allowed in the hands of the amalgamated company.

CNK comments

The above ruling provides clarity regarding carry forward of capital losses in hands of the amalgamated companies. Further, the ruling also adds clarity on carry forward of MAT credit in cases of succession [other than cases of conversion of private limited company/ unlisted public company into LLP, where carry forward of MAT credit is specifically barred as per section 115JAA(7)].

Demerger sanctioned by the National Company Law Tribunal (NCLT) is tax-compliant only if conditions in Section 2(19AA) of the Act are satisfied. AO has power to examine scheme for tax compliance

Grasim Industries Ltd. vs DCIT [2022] 145 taxmann.com 289 (Mumbai - Trib.)
In favour of Assessee and Revenue

Relevant Facts

The assessee demerged the financial services business to Aditya Birla Capital Limited **(ABCL)** and transferred all the assets, employees, officers along with the liabilities, obligations, litigations, etc. pertaining to the financial services business (FSB). In terms of the demerger scheme, ABCL issued equity shares to the shareholders of the assessee.

The AO was of the view that the demerger was not in compliance with Section 2(19AA) of the act since FSB was not a business undertaking.

The assessee contended that the allegation of the AO that the FSB is not an undertaking and therefore demerger is not tax neutral, amounts to rewriting NCLT approved scheme. Further, the assessee contended that once the scheme has been approved by the NCLT, the AO cannot seek to over-reach or depart from the explicit provisions of the scheme.

Held

After analysing the nature of FSB transferred by way of demerger, the ITAT held that FSB was a business undertaking, and the demerger satisfied the conditions of Section 2(19AA).

However, the Tribunal also held that the approval of the NCLT does not preclude the Revenue from examining the scheme for tax compliance. Ministry of Corporate Affairs Circular and CBDT Instruction provide that if tax department has any objections to the arrangement, it should make such objections before the NCLT. The Tribunal held that non-filing of objections does not divest the AO's power to examine whether the sanctioned demerger scheme satisfies tax neutrality conditions under Section 2(19AA).

CNK comments

The decision highlights that the approval of NCLT does not preclude the revenue from examining the scheme for tax compliance.

For deemed dividend under Section 2(22)(e), accumulated profits only up to the end of the year preceding the previous year in which advance is given should be considered

Dr. L.S. Ravi Prakash vs. DCIT [TS-867-ITAT-2022(Bang)]
In favour of Assessee and Revenue

Relevant Facts

The assessee was in receipt of advance from 3 companies in AY 2011-12 and earlier years. The assessee was a director and a shareholder in these companies. The assessee submitted that the said advances were received from 3 companies pursuant to an agreement for sale of land. The AO treated the advances received from the group companies in AY 2011-12 as well

as in the earlier years totaling to Rs 7.97 crores as deemed dividend under Section 2(22)(e). The accumulated profits as on 31.03.2010 were Rs. 81.04 lakhs. Before the Tribunal, the assessee raised following arguments:

- The advances were for the acquisition of property and therefore a business advance, which cannot be considered as deemed dividend;
- Only the advances received during the year could be brought to tax as deemed dividend and not the advances received in the earlier years; and
- Only the accumulated profit up to 31.03.2010 being the end of the immediately preceding previous year should be considered for calculation of deemed dividend

Held

The Tribunal held that during the year under consideration, no property had been purchased by the assessee for the sole benefit of 3 companies from whom the advance was received. Therefore, the Tribunal rejected the argument of the assessee that the advance was a business advance.

The Tribunal however agreed with the contention that only the advances received during previous year relevant to AY 2011-12 could be considered for determining the deemed dividend under Section 2(22)(e) and the carried forward balance of advances from earlier years cannot be considered.

The Tribunal also held that the accumulated profits would include profits only up to 31.3.2010 and profit for the year in which advance is given cannot be considered, as the profit for the current year accrues only at the end of the year.

CNK comments

The Tribunal has also affirmed the position that profits for the current year are not to be included for the purpose of calculating 'accumulated profits' under section 2(22)(e).

It is also interesting to consider whether advance provided in the earlier years but not treated as deemed dividend in the past are to be reduced from the balance of accumulated profits for computing deemed dividend in a subsequent year.

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