

AMALGAMATION AND ITS TAX IMPLICATIONS

"Amalgamation" in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company in such a manner that -

- (i) **All the property of the amalgamating company** or companies immediately before the amalgamation **becomes the property of the amalgamated company** by virtue of amalgamation.
- (ii) **All the liabilities of the amalgamating company** or companies immediately before the amalgamation **become the liabilities of the amalgamated company** by virtue of amalgamation.
- (iii) **Shareholders holding not less than 75% in value of shares in amalgamating company** or companies (other than shares held therein immediately before the amalgamation by the amalgamated company or its nominee or its subsidiary) **become shareholders of the amalgamated company** by virtue of the amalgamation.

The following **mergers** are **not regarded as amalgamations**:

- (i) Where the **amalgamation scheme is not approved by the High Court** and Company A Ltd. **sells all its assets and liabilities** to Company B Ltd. and thereafter Company A Ltd. is **liquidated**.
- (ii) Where the **amalgamation scheme is not approved by the High Court** and Company A Ltd. **goes into liquidation and its assets are distributed to** Company B Ltd.

TAXATION OF SHAREHOLDERS

1. As per Section 47, there will be **no transfer** and hence no capital gains **when a shareholder in the scheme of amalgamation transfers the shares held by him in the amalgamating company if the following conditions are satisfied:**
 - (i) the transfer is made in consideration of allotment to him of the shares in the amalgamated company. **This condition need not be satisfied where the amalgamated company itself is holding the shares of amalgamating company** and
 - (ii) **the amalgamated company is an Indian company.**
2. As per section 49(2), **the cost of acquisition of the shares in the amalgamated company** shall be the **cost of acquisition of the shares in the amalgamating company**.

3. As per section 2(42A), in determining the period for which the shares in the amalgamated company are held, the **period for which the shares were held in the amalgamating company shall also be included.**

TAXATION OF AMALGAMATING COMPANY

As per section 47, there will be **no capital gains on transfer of a capital asset by the amalgamating company to the amalgamated company** in the scheme of amalgamation if the amalgamated company is an Indian company.

As per section 47, there will be **no capital gains on transfer of shares held in an Indian company** in a scheme of amalgamation by the **amalgamating foreign company to the amalgamated foreign company** if the following conditions are satisfied:

- i. **At least 25% of the shareholders of amalgamating foreign company** continue to remain shareholders of amalgamated foreign company; and
- ii. Such transfer does **not attract tax on capital gains in the country**, in which the **amalgamating company is incorporated.**

TAXATION OF AMALGAMATED COMPANY

1. As per section 49(1), where a capital asset became the property of the amalgamated company in a scheme of amalgamation, **the cost of acquisition of the said asset to the amalgamated company shall be the cost for which the amalgamating company acquired it.** The cost of improvements incurred by the amalgamating company shall be deemed to be the cost of improvement incurred by the amalgamated company.
2. As per section 55, **if the amalgamating company acquired the capital asset before 1.4.2001, then the cost of such asset to the amalgamated company shall be the cost for which the amalgamating company acquired the asset or the FMV as on 1.4.2001 whichever is higher.**
3. As per section 2(42A), the **period for which the capital asset was held by the amalgamating company shall also be considered** in determining the period of holding of such asset by the amalgamated company.
4. **Following expenditures which are unamortized in hands of amalgamating company in the year of amalgamation shall be allowed in the balance number of years to the amalgamated company. The said expenditure shall not be allowed in the year of amalgamation to the amalgamating company:**
 - i. Expenditure on scientific research under section 35.
 - ii. Expenditure for obtaining license to operate telecommunication services under section 35ABB.
 - iii. Expenditure for obtaining any right to use spectrum for telecommunication services under section 35ABA.
 - iv. Preliminary expenses under section 35D.
 - v. Capital Expenditure on family planning.
 - vi. Expenditure under voluntarily retirement scheme under section 35DDA.
5. **Treatment of expenses of amalgamation [Section 35DD]:** Expenses on amalgamation shall be allowed in **five successive Assessment Years** beginning

with the previous year in which amalgamation takes place. **The deduction shall be 1/5th of such expenditure on amalgamation.**

6. **Recovery by amalgamated company of any allowance/deduction earlier allowed** to the amalgamating company shall be taxable as P/G/B/P under section 41(1) in hands of amalgamated company.
7. **Bad debts Recovery:** If the **bad debts** of the amalgamating company are **recovered by the amalgamated company**, then there **will be no income** under section 41(4) as per the judgement of **P.K. Kaimal**.
8. **Debts of Amalgamating Company written off as bad debts by the Amalgamated Company:** Deduction shall be allowed to the Amalgamated Company as per **Supreme Court in Veerabhadra Rao**.
9. **Where an amalgamating company transfers a capital asset as stock in trade to the amalgamated company and such stock in trade is sold by the amalgamated company, then the cost of acquisition of stock in trade shall be the aggregate of the following:**
 - (a) Cost of acquisition of the said asset to the amalgamating company,
 - (b) Expenditure on improvement of the said asset incurred by the amalgamating company and amalgamated company and
 - (c) Expenditure incurred wholly and exclusively in connection with the transfer by the amalgamating company.
10. **In year of amalgamation, depreciation shall be computed in the hands of amalgamating company** as if amalgamation has not taken place and such depreciation shall be **apportioned between the amalgamating company and the amalgamated company** in the ratio of the number of days for which the assets were used by them.
11. **The actual cost of asset transferred by amalgamating company to amalgamated company in the hands of amalgamated company shall be:**
 - (i) WDV in hands of amalgamating company at the time when amalgamation takes place. (Depreciable asset)
 - (ii) actual cost to amalgamating company (Non-Depreciable Asset)
12. Where an undertaking which is entitled to deduction under Section 10AA/ 80-IAB/ 80-IE is transferred before the expiry of the period specified in Section 10AA/ 80-IAB/ 80-IE in the scheme of amalgamation by the amalgamating company to the amalgamated company, then
 - (i) **No deduction** under section 10AA/ 80-IAB/ 80-IE shall be available to the amalgamating company **for the previous year in which amalgamation takes place and**
 - (ii) The provisions of Section 10AA/ 80-IAB/ 80-IE **shall apply to the amalgamated company in the same manner in which they would have applied to the amalgamating company.**

Deduction under section 80-IA shall not be available to amalgamated company if amalgamating company transfers the 80-IA undertaking to amalgamated company.

13. **Section 32AD:** Where the new asset is sold or otherwise transferred in connection with the scheme of amalgamation within a period of five years from the date of its installation, the provision of these section shall apply to the amalgamated company as they would have applied to the amalgamating company.

SECTION 72A: PROVISIONS RELATING TO CARRY FORWARD AND SET OFF OF ACCUMULATED LOSSES AND UNABSORBED DEPRECIATION ALLOWANCE IN AMALGAMATION OR DEMERGER, ETC.

SECTION 72A(1):

- Where there has been an **amalgamation of a company owning**
- **an industrial undertaking or**
- **a ship or**
- **a hotel**
- **with another company or**
- **an amalgamation of a banking company with a specified bank, (specified bank means Nationalized Indian Bank)**
- **one or more public sector company or companies engaged in the business of operation of aircraft with one or more public sector company or companies engaged in similar business**
- **an erstwhile public sector company (AIR INDIA) with one or more company or companies (TATAs), if the share purchase agreement entered into under strategic disinvestment restricted immediate amalgamation of the said public sector company and the amalgamation is carried out within 5 years from the end of the previous year in which the restriction on amalgamation in the share purchase agreement ends.**
- then, notwithstanding anything contained in any other provision of the Income tax Act,
- **the accumulated loss and the unabsorbed depreciation of the amalgamating company**
- **shall be deemed to be the loss or depreciation of the amalgamated company**
- **for the previous year in which amalgamation was effected and**
- the other provisions of the Act relating to **set off and carry forward of losses** and depreciation shall apply accordingly.
- **Provided that the accumulated loss and the unabsorbed depreciation of the amalgamating company, in case of an amalgamation referred above, i.e., AIR INDIA with TATAs, which is deemed to be the loss or, as the case may be, the allowance for unabsorbed depreciation of the amalgamated company, shall not be more than the accumulated loss and unabsorbed depreciation of the public sector company as on the date on which the public sector company ceases to be a public sector company as a result of strategic disinvestment.**

Note:

- (a) "**Industrial undertaking**" means any undertaking which is engaged in
- (i) the manufacture or processing of goods; or
 - (ii) the manufacture of computer software; or
 - (iii) the business of generation or distribution of electricity or any other form of power; or
 - (iv) mining; or
 - (v) the construction of ships, aircrafts or rail systems.
- (b) "**Accumulated loss**" means so much of the loss of the amalgamating company under the head "**Profits and gains of business or profession**" (**not being a loss sustained in a speculation business**) which the amalgamating company would have been entitled to carry forward and set off under the provisions of section 72 if amalgamation had not taken place;
- (c) "**Strategic disinvestment**" means sale of shareholding by the Central Government or any State Government in a public sector company which results in reduction of its shareholding to below fifty-one per cent along with transfer of control to the buyer.

Example:

Government of India made a strategic sale of shares of AIR India Ltd. to Tata Sons Ltd. on 1st April, 2022. Air India Ltd. is a public sector company in which Government of India holds 100% shares. Following aspects may be noted:

1. The strategic dis-investment restrict the amalgamation of AIR India with Tata Sons till 31.03.2024.
2. AIR India Ltd. is amalgamated with Tata Sons on 01.04.2024.
3. AIR India has accumulated losses and depreciation of ₹ 90,000 crores as on 01.04.2022. Its accumulated losses and depreciation as on 01.04.2024 is ₹ 1,08,000 crores.

Now, conditions of 72A as amended are fulfilled as:

1. There is a sale of shares of Public Sector Company under the strategic disinvestment plan of Government.
2. In the shares purchase agreement it is mentioned that Public Sector Company cannot be amalgamated till 31.03.2024.
3. The accumulated losses and depreciation of Public Sector Company on the date it ceases to be a Public Sector Company i.e., 01.04.2022 is ₹ 90,000 crores.
4. Amalgamation is effected within 5 years from end of previous year 31.03.2023.
5. Losses and depreciation of ₹ 90,000 crores shall become the losses and depreciation of Tata Sons of Assessment Year 2025-26.

**♦ ANALYSIS OF AMENDMENTS MADE IN SECTION 79
BY FINANCE ACT, 2022 ♦**

Change in shareholding due to strategic disinvestment of PSU

Section 79 imposes certain conditions for setting off the carried forward losses in the case of a closely held company. It provides that the losses incurred by a closely held company in any year prior to the previous year shall not be carried forward and set-off against the income of the previous year, unless the shares of the company carrying at least 51% of the voting power are beneficially held by the same persons on the following two dates:

- (a) On the last day of the previous year in which loss was incurred;
- (b) On the last day of the previous year in which such brought forward loss has to be set-off.

However, there are certain exceptions to this.

The change in voting power due to strategic disinvestment of a Public Sector Undertaking (PSU) was not covered under the exceptions list provided under Section 79, prior to Finance Act, 2022.

The amendment by Finance Act, 2022 provides that Section 79 shall not apply to an erstwhile PSU, which has become so as a result of strategic disinvestment, provided the ultimate holding company of such PSU continues to hold at least 51% of the voting power. The ultimate holding company may hold 51% of voting power either directly or through its subsidiary.

Consequences of failure to hold 51% voting power

The Finance Act, 2022 has also inserted a new sub-section (3) to section 79. It provides that relaxation provided by sub-clause (f) shall cease to apply from the previous year in which the ultimate holding company of such erstwhile public sector company, immediately after completion of the strategic disinvestment, ceases to hold, directly or through its subsidiary or subsidiaries, 51% of the voting power of the erstwhile PSU.

If the relaxation ceases to apply in any previous year, the provisions of section 79(1) shall apply for such previous year and subsequent previous years.

Illustration:

In continuance to the example **given above** as AIR India Ltd is a closely held company (since its 100% share were held by Government of India) and now Tata Sons Ltd holds 100% share of AIR India Ltd, prior to amendments made by Finance Act, 2022, AIR India Ltd would not have been able to carry forward the losses. By virtue of amendment by Finance Act, 2022 in section 79, AIR India will be able to carry forward the losses even if 51% shares are not held by same persons. Air India Ltd shall continue to carry forward the losses until that previous year in which 51% or more shares of AIR India Ltd are held by Tata Sons Ltd or any of the subsidiary of Tata sons Ltd. Suppose in previous year 31.03.2024, Tata Sons or its subsidiaries cease to hold 51% shares of AIR India Ltd, then in previous year 31.03.2024, the losses shall not be carried forward by AIR India Ltd.

CONDITIONS TO BE SATISFIED BY AMALGAMATING COMPANY

1. The amalgamating company should have been **engaged in the business** in which accumulated losses occurred or depreciation remains unabsorbed **for 3 years** or more prior to the date of amalgamation.
2. The amalgamating company should hold at least **75% of book value of the fixed assets which it held two years prior** to the date of amalgamation.

CONDITIONS TO BE SATISFIED BY AMALGAMATED COMPANY

1. The amalgamated company should **continue the business** of the amalgamating company for a **minimum period of 5 years** from the date of amalgamation.
2. The amalgamated company should fulfill the prescribed conditions in case there is amalgamation of a company owning industrial undertaking.
3. The amalgamated company holds continuously for a **minimum period of 5 years** from the date of amalgamation **at least 75% of the book value of fixed assets of the amalgamating company acquired** in scheme of amalgamation.

In a case where any of the above conditions are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of amalgamated company shall be **deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.**

SECTION 72AA: CARRY FORWARD AND SET OFF OF ACCUMULATED LOSSES AND UNABSORBED DEPRECIATION ALLOWANCE IN SCHEME OF AMALGAMATION IN CERTAIN CASES

Section 72AA as introduced by Finance Act, 2020 applies if:

- (i) Any bank is amalgamated with a nationalised bank as per scheme of Central Government under section 45(7) of Banking Regulation Act. [Laxmi Niwas Bank amalgamated with DBS Bank]
 - (ii) Any nationalised bank is amalgamated with another nationalised bank.
 - (iii) Any government company carrying on general insurance business is amalgamated with another government company carrying on general insurance business.
- The accumulated losses under the head P/G/B/P and unabsorbed depreciation of amalgamating entity will be deemed as current year loss or current year depreciation of the amalgamated entity of the previous year in which amalgamation takes place.
 - The conditions of section 72A are not applicable.
 - The conditions given in definition of amalgamation in section 2(1B) are not applicable.