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10 November 2015

Unabsorbed losses of an amalgamating company can be set off if such a company is in the business for three or more years even if its unit is engaged in the business for less than three years

Background

Recently, the Karnataka High Court in the case of KBD Sugars & Distilleries Ltd.[1] (the taxpayer) held that unabsorbed losses of the amalgamating company can be set off against the income of the amalgamated company under Section 72A of the Income-tax Act, 1961 (the Act) since the losses are pertaining to the amalgamating company as a whole and not of a particular unit or division of that amalgamating company. It is the amalgamating company, which should be in business for three years or more, prior to the date of amalgamation, and not a particular unit or division of that amalgamating company. The High Court observed that since the amalgamating company was in business for more than three years prior to the date of amalgamation, the unabsorbed losses are allowed to be set-off.

The term 'commencement of business' would be different from the term 'engaged in business'. It is the latter term which has been used in Section 72A(2)(a)[2] of the Act. 'Commencement of business' may be from the date when production may start but to say that the taxpayer is 'engaged in business' only from the date it commences production, would not be correct. The taxpayer engages itself in a particular business from the day when it gets involved in setting up of the business.

Facts of the case

- The taxpayer is engaged in the business of manufacture of beer, IML and speed zone. Under the scheme of amalgamation, which was approved by the High Courts of Karnataka and Andhra Pradesh respectively, Vani Sugars and Industries Ltd. (the amalgamating company) amalgamated with KBD Sugars & Distilleries Ltd. (the amalgamated company).

- The amalgamating company was engaged in the business of manufacturing and trading of sugar and generation of power. It was in the business of manufacturing sugar since 1984 and had commenced the business of power generation with effect from August 2003, which was by way of expansion of its business.

- During the Assessment Year (AY) 2005-06, the taxpayer amalgamated company had declared its business income of INR246.50 million and the brought forward losses of the amalgamating company, was of INR213.35 million, which was set off against the above income.

- The Assessing Officer (AO) disallowed the business loss and unabsorbed depreciation amounting to INR34.89 million as the same was business loss arisen from power generation which was brought forward and claimed for set off.

- The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal (the Tribunal) allowed the set off of such a loss and held the decision in favour of the taxpayer.

[1] CIT v. KBD Sugars & Distilleries Ltd. (ITA NO.773/2009) – Taxsutra.com

[2] The accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless-
(a) The amalgamating company -
  (i) Has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
  (ii) Has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation

High Court's ruling

- It was not in dispute that the amalgamating company was amalgamated with the taxpayer with effect from March 2005, which falls in the AY 2005-06. It is also not in dispute that the amalgamating company was in business since 1984.

- In the year 2000, the amalgamating company had started work for the establishment of its power generation business and after establishing the unit, power generation had commenced from August 2003.

- The term 'commencement of business' would be different from the term 'engaged in business'. It is the latter term which has been used in Section 72A(2)(a) of the Act. 'Commencement of business' may be from the date when production may start but to say that the taxpayer is 'engaged in business' only from the date it commences production, would not be correct. The taxpayer engages itself in a particular business from the day when it gets involved in setting up of the business.

- Under Section 32 of the Act, it is provided that the tangible asset should be 'used' by the undertaking engaged in the generation of power. For claiming depreciation under Section 32 of the Act, the asset should be 'used' for the business, meaning thereby, after business commences, which is different from engagement in business. This clarifies that the terms 'commencement of business' and 'engaged in business' are different. The former may apply for Section 32 of the Act but the latter would apply in the case of Section 72A of the Act.

- In the present case, the licence for setting up of the business of power generation, loans for the same, construction of the building and purchase of machinery, etc. had started from the year 2000 itself, which was duly reflected in the books of account of the amalgamating company.

- As such, the view taken by the CIT(A) as well as the Tribunal in this regard, that the amalgamating company was engaged in the business of generation of power much prior to three years from the date of amalgamation of the company, cannot be faulted.

- It cannot be disputed that the engagement of the amalgamating company in the business of power generation had begun from the year 2000, even though the production or generation of power i.e. the commencement of business may have been with effect from August 2003.

- Section 72A(2) of the Act indicates that it is a loss of the amalgamating company as a whole, which is to be set off or carried forward, and not of a particular unit or division of that amalgamating company. It is the amalgamating company, which should be in business for three years or more, prior to the date of amalgamation, and not a particular unit or division of that amalgamating company.

- The amalgamating company has been in the business since 1984. As the amalgamating company was in the business for more than three years prior to the date of amalgamation, the benefit of Section 72A of the Act should be granted to the taxpayer.

- Section 72A of the Act provides for a set off of the accumulated loss and unabsorbed depreciation, which is for the benefit of the taxpayer amalgamated company. Thus, when a provision is for the benefit of the taxpayer, it should be liberally interpreted in favour of the taxpayer.

- It is a well-settled law that if two views are possible, then the one in favour of the taxpayer should be adopted. Therefore, the taxpayer amalgamated company is entitled to a benefit of Section 72A of the Act.

Our comments

The Karnataka High Court while allowing a set off of the unabsorbed losses of the taxpayer acquired on amalgamation held that the unabsorbed losses pertained to the amalgamating company as a whole, and not to any division in particular. It was the amalgamating company that should have been engaged in business for three or more years prior to the amalgamation.

The High Court observed that the term 'engaged in business' is different from the term 'commencement of business'. The taxpayer was said to have engaged itself in a particular business from the day it got involved in setting up of the business.

It was also observed that as the provision relating to a transfer of unabsorbed losses in an amalgamation is a beneficial provision, it should be liberally interpreted in favour of the taxpayer. Accordingly, the taxpayer was entitled to a benefit of transfer of the unabsorbed losses.

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