Analysis of ITAT Decision in Reckitt Benckiser Healthcare India Pvt. Ltd.

Introduction

The present case pertains to the taxability of the purported demerger of the treasury undertaking of Reckitt Benckiser Healthcare India Pvt. Ltd[i]. (hereinafter referred to as "the assessee"). The core issue before the Ahmedabad Income Tax Appellate Tribunal (ITAT) was whether the transaction in question qualified as a tax-neutral demerger under Section 2(19AA) of the Income-tax Act, 1961 or whether it constituted a transfer of capital assets, thereby attracting liability under Section 45 of the Act. Additionally, the tribunal examined whether the issuance of shares by the resulting company in favor of the shareholders of the demerged entity resulted in a deemed dividend distribution within the meaning of Section 2(22) of the Act.

The assessee had contended that the transaction was a valid demerger sanctioned by the jurisdictional High Court and thus eligible for capital gains tax exemption under Section 47(vib). However, the Assessing Officer (AO) and Commissioner of Income Tax (Appeals) [CIT(A)] concluded that the demerger failed to satisfy the statutory conditions prescribed under Section 2(19AA). Consequently, the transaction was characterized as a transfer of capital assets, thereby rendering it taxable under Section 45. The Revenue authorities further held that the transaction also attracted dividend distribution tax (DDT) liability under Section 2(22), as the issuance of shares by the resulting company effectively amounted to a distribution of assets by the assessee.

The ITAT upheld the findings of the Revenue authorities, reiterating the principle that the tax treatment of a transaction is determined by its substance rather than its form. The tribunal emphasized that mere approval by the High Court does not preclude tax authorities from examining the taxability of a corporate restructuring transaction.

Legal Framework and Statutory Provisions Considered

The ITAT's ruling was based on a detailed analysis of various statutory provisions of the Income-tax Act, 1961, particularly Sections 2(19AA), 45, 47(vib), and 2(22). Each of these provisions is examined below.

Section 2(19AA) – Definition of Demerger

Section 2(19AA) provides the statutory framework for determining whether a corporate reorganization qualifies as a demerger for income tax purposes. The provision lays down the following mandatory conditions:

1. Transfer of all assets and liabilities: All the property and liabilities of the undertaking must be transferred to the resulting company immediately before the demerger.
2. Transfer at book value: The assets and liabilities must be transferred at the values appearing in the books of account.
3. Going concern requirement: The undertaking must be transferred as a going concern.
4. Issuance of shares to shareholders: The resulting company must issue shares to the shareholders of the demerged company in proportion to their existing shareholding.

5. Non-transfer of individual assets: A demerger must involve the transfer of an undertaking, and not merely individual assets or investments.

The ITAT observed that the demerger of the treasury undertaking did not comply with these conditions, as the assessee retained liabilities while transferring only assets, thereby failing the statutory test for a valid demerger.

Section 45 – Chargeability to Capital Gains Tax

Section 45 of the Act provides for the taxation of capital gains arising from the transfer of a capital asset. The assessee claimed capital gains tax exemption under Section 47(vib), which applies only if the transfer qualifies as a demerger under Section 2(19AA). Since the transaction did not meet the conditions prescribed under Section 2(19AA), the ITAT ruled that the transfer of assets constituted a taxable event under Section 45.

Section 47(vib) – Exemption for Demergers

Section 47 provides for certain transactions that are not regarded as transfers for the purpose of capital gains taxation. Under Section 47(vib), the transfer of a capital asset by a demerged company to a resulting company is not treated as a transfer if the demerger satisfies all the conditions laid down in Section 2(19AA). Since the present transaction failed to meet these conditions, the exemption under Section 47(vib) was denied, and the capital gains were brought to tax under Section 45.

Section 2(22) – Deemed Dividend

The tribunal also examined whether the issuance of shares by the resulting company to the shareholders of the demerged entity could be considered a deemed dividend under Section 2(22). Under this provision, any distribution of accumulated profits by a company to its shareholders is treated as dividend for tax purposes. Since the assessee did not receive any consideration for the transfer of assets, but instead, shares of the resulting company were issued directly to its shareholders, the ITAT held that this amounted to a distribution of assets to shareholders, thereby attracting dividend distribution tax liability.

ITAT's Observations and Findings

The tribunal, after a detailed examination of the facts and legal provisions, upheld the findings of the Assessing Officer and CIT(A). The following key observations were made:

1. Retention of Liabilities by the Assessee

- The ITAT noted that the assessee had selectively transferred assets but retained liabilities, which was in clear violation of Section 2(19AA)(ii).
- A valid demerger requires the transfer of both assets and liabilities; selective transfer invalidates the tax-neutral status of the transaction.

2. Transaction was Not a Demerger but a Transfer of Capital Assets

- The tribunal found that the treasury undertaking was not an independent business unit, but rather an investment portfolio.
- The assessee continued to engage in investment activities even after the demerger, indicating that the transaction was not a genuine separation of business operations.

3. High Court Approval Does Not Override Tax Law

- The ITAT reiterated that merely obtaining approval from the High Court does not preempt tax authorities from determining the tax implications of a transaction.
- Reference was made to Thomas Cook Insurance Services (2015), where the Bombay High Court clarified that sanctioning a demerger scheme does not bind the tax department in determining tax liabilities.

4. Applicability of Dividend Distribution Tax

- The tribunal upheld the Revenue's argument that the direct issuance of shares by the resulting company to the shareholders of the demerged entity constituted a distribution of assets, thereby attracting liability under Section 2(22).

Judicial Precedents Considered

The ITAT relied on established principles laid down in various landmark rulings, including:

1. McDowell & Co. Ltd. v. CTO (1985)

- The Supreme Court held that tax planning is legitimate, but tax evasion through artificial structuring is impermissible.
- The ITAT applied this principle to hold that the transaction was structured primarily to avoid tax.

2. CIT v. Mahindra & Mahindra Ltd. (2018)

- The Supreme Court reaffirmed that tax benefits for demergers are conditional on compliance with Section 2(19AA).
- The ITAT applied this ruling to reject the assessee's claim for tax exemption.

Conclusion

The ITAT's ruling underscores the principle that tax benefits associated with demergers are subject to strict statutory compliance. The decision reaffirms that a demerger must be a genuine business reorganization and not merely a tax planning mechanism. The tribunal's findings highlight that corporate restructuring transactions must conform not only to corporate law requirements but also to tax law provisions to qualify for tax-neutral treatment. The ruling will serve as a clear directive that taxpayers must ensure full compliance with statutory provisions when seeking to claim tax exemptions, thereby reinforcing the broader principle that tax administration operates autonomously within its legal framework.

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