

INCOME TAX UPDATE

Transfer of shares in a scheme of amalgamation is not considered as 'transfer' u/s 47 (vii) of the Act; application of Section 56(2) is not applicable



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• **Facts of the case**

During the course of scrutiny assessment proceedings, the AO observed that the Assessee-company amalgamated the following three private limited companies with itself, which were essentially owned by the relatives of the promoters of the assessee- company in the following manner:

- M/s Hitesh Engineers Private Limited: issued 1,21,60,000 equity shares in lieu of the said amalgamation.
- M/s Shruti Engineers Private Limited: issued 61,65,000 equity shares in lieu of the said amalgamation.

- M/s Vishwakarma Fabricators Pvt Ltd: issued 29,85,000 equity shares in lieu of the said amalgamation

It was observed by the assessing officer that the assessee, public limited -company has employed highly skewed swap ratio in order to benefit the erstwhile share-holders of the private limited companies. The valuations was a product of a curious mix of two methods viz. the Discounted Cash Flow Method and the Book Value Method, that is, the average value of share, as per present value of future cash flow method and adjusted book value of fixed assets method to determine the fair market value of equity shares of the Amalgamated company (Rajoo Engineers Ltd.) and Amalgamating companies (Hitesh Engineers Pvt. Ltd., Shruti Engineers Pvt. Ltd., and Vishwakarma Fabricators Pvt. Ltd.) and to decide swap ratio for exchange of equity shares.

AO noted that Rajoo Engineers is a public limited company traded widely on Bombay Stock Exchange (BSE Scrip ID: 522257). A look at data clearly shows that it is a fairly liquid stock and wherein minority share- holders either hold or trade on a regular basis. Therefore, there was a true, market based, unbiased parameter available to value the shares of the assessee, public limited company, which was ignored in order to create a swap ratio which was unfavorable to the assessee- company and was favorable to the related parties of persons having controlling share in the assessee public limited company.

Assessee was asked to show cause as to why the swap ratio should not be evaluated on the basis of market value (as on the day of allotment) of the public limited company and the book value of the amalgamating private limited companies and why the value differential should be added back in hands of the assessee- company on protective basis.

Subsequently, Assessing officer held that the excess value Rs. 18,74,73,500/-, transferred to beneficiary, related parties should be added to the returned income of the assessee- public limited company on a protective basis.

On appeal to CIT(A), the authority observed that the shares were allotted under a statutorily approved scheme of amalgamation under the Companies Act after hearing all the stakeholders. The same has become final and has been filed before the authorities like SEBI and Bombay Stock Exchange. Allotment of shares do not give rise to transfer of shares and provisions of section 56(2) has no application; there being no transfer of property in law. Further, reliance was placed on various decisions wherein the same principle was upheld time and again.

Aggrieved by the order of the Ld. CIT(A), the Revenue appealed before the Tribunal.

- Argument raised by the Revenue

Revenue argued that there was benefit passed over on individual share-holder in the scheme of amalgamation. The Revenue contended that the arrangement is a colorable device used by the assessee, to defeat the very purpose of the statute, not to pay tax on his income, is not acceptable.

- Argument raised by the Assessee

Assessee submitted that Section 56(2)(vii)(c)(ii) of the Act, applies to only to individual and HUF and that is also for a particular period, 01.10.2009 to 01.04.2017. as per Clause (vii) of Section 47 of the Act, when shares are allotted in case of amalgamation scheme, then there is no “transfer” at all, therefore, no tax should be imposed in the hands of the assessee.

The Appellant company have received shares of the amalgamated company upon a statutorily valid and approved procedure of amalgamation under the company Act, 1956. Under section 2(1B) of the

I.T.Act-1961 allowed one or more companies to merge. It is not considered as transferred. Once the share is issued at the approved price by the Court, then no one has right to raise questions regarding one received more or less in value of shares.

- Judgement of the Tribunal

The court held that the provision of section 56(2)(vii)(c)(ii) does not apply in the case of Public limited company, it is only applicable to individual and HUF- assesseees.

New shares allotment by amalgamated company does not give rise to a transfer and hence section 56(2)(vii)(c) has no application and proviso (h) excludes the transfer from rigor of deeming provision.

In case of shares issued under amalgamation, there are tripartite arrangements between amalgamated company, amalgamating company and shareholder of the amalgamating company.

The court further held that there is no anti- abuse of provision and the new share is allotted as per the

Amalgamation scheme approved by High Court after hearing of all stake holders including the Government so it is conclusive.

For complete details, please refer to the ITAT judgement dated 31/12/2024 passed in the case of *DCIT V. M/s. Rajoo Engineers Ltd* ITA No.460/RJT/2024.

<https://itat.gov.in/public/files/upload/1735713503-2UA6yv-1-TO.pdf>

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