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RSM India Newsflash – ITAT Mumbai denies carry forward of losses and unabsorbed depreciation where shares were issued by the Holding company instead of the Resulting company

Newsflash

ITAT Mumbai denies carry forward of losses and unabsorbed depreciation where shares were issued by the Holding company instead of the Resulting company

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1.0 Background



1.1 A demerger is commonly undertaken as a corporate restructuring exercise to segregate and transfer an identified business undertaking from one company to another. Under the Income-tax Act, 1961, certain tax benefits are available where the transaction satisfies the conditions prescribed for a "demerger" under section 2(19AA). In particular, section 72A(4) provides for the transfer of accumulated business losses and unabsorbed depreciation relating to the demerged undertaking to the resulting company.

However, the availability of this benefit is subject to fulfilment of the prescribed conditions, including the requirement that the resulting company issues its shares to the shareholders of the demerged company in consideration of the demerger. The interpretation of the expression "resulting company" under section 2(41A) therefore assumes significance, particularly in group restructurings where the undertaking is transferred to a subsidiary while the corresponding shares are issued by its holding company.

1.2 Recently, in the case of ***Sterling Holiday Resorts Limited vs. Deputy Commissioner of Income Tax - Circle 2(3)(1)***[1], the ITAT Mumbai has upheld the lower authorities' decision to deny the carry forward and set-off of accumulated business losses and unabsorbed depreciation (UD) under section 72A(4) of the Income Tax Act, 1961 ('the Act') on the ground that the demerger consideration involved issuance of shares by the holding company rather than by the resulting company itself**.** The order specifically concerns denial of set-off of unabsorbed depreciation of approximately Rs. 5.19 crore and carry-forward of business losses of approximately Rs. 121.67 crore and unabsorbed depreciation of approximately Rs. 113.29 crore.

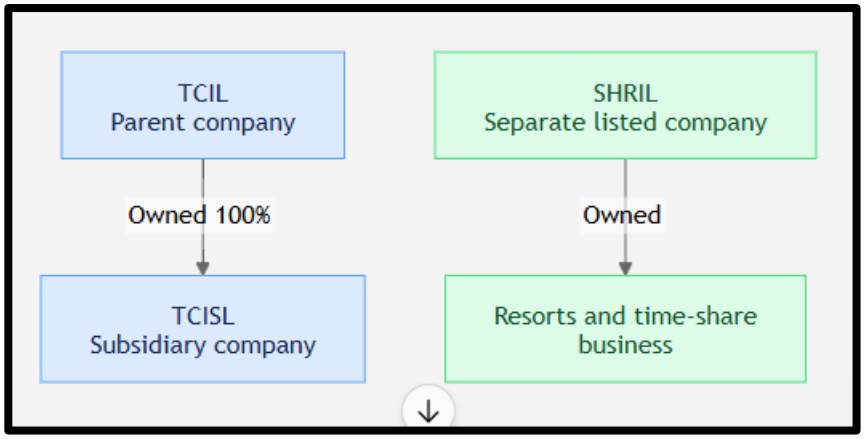
1.3 In this Newsflash, we provide a brief overview of the ITAT Mumbai ruling concerning the eligibility to carry forward and set off accumulated business losses and unabsorbed depreciation where the prescribed conditions of a demerger were not fulfilled.

[1] Assessee's Appeal - ITA No. 843/MUM/2024 (AY 2015-16), and Revenue's Cross Appeal - ITA No. 941/MUM/2024 (AY 2015-16)

2.0 Facts of the Case

2.1 Sterling Holiday Resorts India Limited ('SHRIL'), a listed company, had two business divisions/ activities, viz. 'holiday undertaking' and 'resorts & time-share undertaking'. On the other hand, Sterling Holiday Resorts Limited ('SHRL' or 'the Appellant') (formerly known as Thomas Cook Insurance Services (India) Limited ('TCISL')) was a wholly owned subsidiary ('WOS') of Thomas Cook (India) Limited ('TCIL'), a listed company.

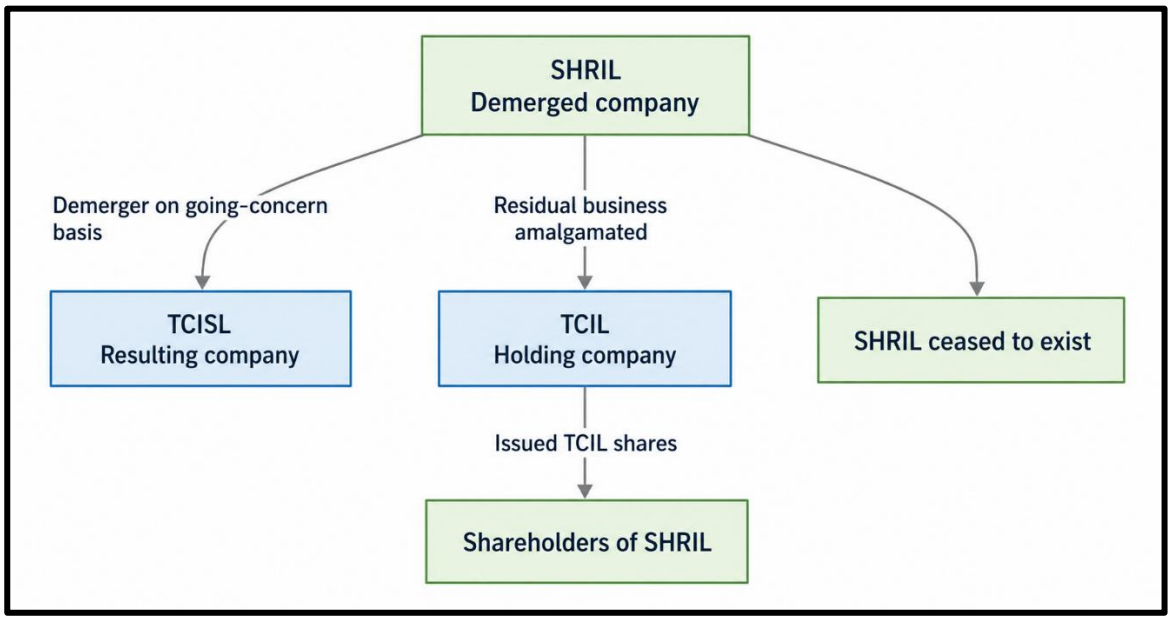
Position Before the Scheme



2.2 SHRIL, SHRL/ TCISL, and TCIL entered into a scheme of arrangement (as sanctioned by the Hon'ble Bombay High Court) wherein, interalia, the 'resorts & time-share undertaking' of SHRIL ('Demerged Company') was transferred into TCISL, the Appellant ('Resulting Company') on a going-concern basis by way of demerger. The residual business of SHRIL was simultaneously amalgamated with TCIL, pursuant to which SHRIL ceased to exist.

As consideration for the demerger, TCIL (the Holding Company of Appellant) issued its own shares to the shareholders of SHRIL. While sanctioning the scheme, the Bombay High Court left the question of whether the transaction satisfied the requirements of sections 2(19AA) and 2(41A) of the Act open for examination by the Income-tax Department.

Transaction under the Scheme



2.3 The primary issue before the Tribunal was whether the assessee (which has received the demerged undertaking) was entitled to the benefit of carry forward and set-off accumulated business losses and unabsorbed depreciation u/s 72A(4), where the shares constituting consideration for the demerger were issued to the shareholders of the demerged company by the assessee's holding company rather than by the assessee itself

3.0 Contentions of the Appellant

3.1 The Appellant contended that it being TCISL (i.e. company to which the demerged undertaking has been transferred) and its holding company TCIL both fell within the definition of 'resulting company' and could be interchangeably considered as a 'resulting company' under section 2(41A) of the Act. Accordingly, the issuance/ allotment of shares by TCIL to shareholders of SHRIL constituted due compliance of demerger conditions prescribed under section 2(19AA) (including clause (iv)) of the Act.

3.2 Relying on the decision of the Hon'ble Supreme Court of India in the case of Shri Balagnesan Metals vs. M.N. Shanmugham Chetty and Ors.[2], and Shri Illuri Subbayya Chetty & Sons. Vs. State of Andhra Pradesh[3], it was argued that as per section 2(19AA) of the Act, the term 'demerger' means transfer by a demerged company of its one or more undertakings to 'any' resulting company.

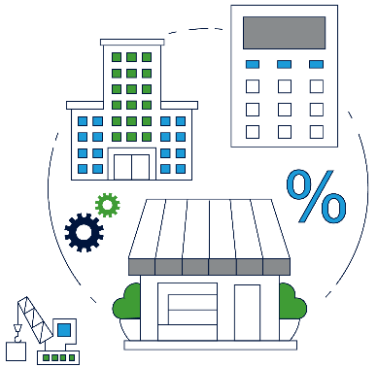
3.3 It was submitted that the term 'resulting company' as defined in section 2(41A) of the Act means 'one or more companies (including a WOS thereof)' to which the undertaking of the demerged company is transferred.

Section 2(41A) provides that:

[2] (1987) 2 SCC 707
[3] (1963) 50 ITR 93 (SC)

*"resulting company" means **one or more companies (including a wholly owned subsidiary thereof)** to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger;*

3.4 The starting phrase 'one or more companies' would include all companies (including a company which is WOS of another company or a company which is holding company of another subsidiary). In other words, it would not matter whether the undertaking is transferred to the holding company or its WOS and also which company allots shares on account of demerger. If the provisions are interpreted so as to mean that only the company to which the undertaking was demerged should allot shares, then the bracketed phrase 'including a WOS thereof' in the definition of 'resulting company' would stand redundant.



3.5 An interpretation that renders a part of the statute redundant must therefore be rejected in favour of an interpretation that gives the bracketed phrase a distinct and operative meaning. Applying this principle, the phrase 'including WOS thereof' must be given independent operative content, which it can only acquire under Appellant's construction.

3.6 The Appellant also argued that where a taxing provision is capable of two reasonable constructions, then the one favouring the assessee must be adopted. It was further pleaded that certain binding principles are directly relevant to interpretation of section 2(19AA) and 2(41A) of the Act and must be applied practically to advance their economic purpose rather than to defeat them on narrow technical grounds, viz. (i) Provisions granting deductions or relief must be construed liberally and in favour of the assessee , and (ii) Restrictive conditions must be construed so as to advance, not frustrate, the statutory objective.

3.7 The Act intends to consider a combination of holding company together with the subsidiary interchangeably as a resulting company, because the very purpose of demerger is reconstruction of business of companies into various other companies, the transactions are cashless, and the shareholders of demerged company are allotted shares in a company which will take into account the value of demerged undertaking.

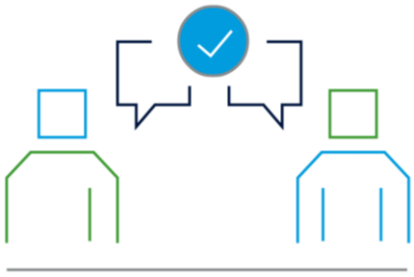
3.8 The Appellant pleaded that if the undertaking is transferred to a holding company while the shares are issued by its WOS, then it would altogether defeat the purpose of demerger since the WOS will cease to be a WOS of the holding company due to this allotment and the shares of the subsidiary company allotted to the shareholders of the demerged company could not reflect and include the value of the transferred undertaking.

3.9 The inclusion of the phrase 'including WOS thereof' cannot be for the purpose of including the category of WOS's as a resulting company, and that it is not necessary to state separately that a WOS can also be a resulting company. The demerger (which was undertaken with an objective to consolidate complementary businesses, ensure focused management, and unlock long-term value) into the Appellant and discharge of

consideration by issue of shares of TCIL should be considered as valid in terms of compliance with the provisions of section 2(19AA) r.w.s. 2(41A) of the Act. Accordingly, the Appellant should be eligible to claim carry forward of the accumulated business losses and Unabsorbed depreciation pertaining to the demerged undertaking of SHRIL under section 72A(4) of the Act.

4.0 Contentions of the Revenue

4.1 Relying on the orders of lower tax authorities, the Revenue contended that the claim of the Appellant is in violation of the express, strict, clear and unambiguous provisions of section 2(19AA)(iv) r.w.s. 2(41A) of the Act, in as much as the shares were issued by the holding company of TCISL, and not by TCISL or its WOS.



4.2 Resulting company is one or more companies to which the undertaking of the demerged company is transferred, which includes the subsidiary company and does not include its holding company. Hence, in the present case, the resulting company which was obliged to issue shares as consideration for the undertaking acquired under demerger could only be the company which has received such undertaking (i.e. TCISL) and its WOS.

4.3 The carry forward and set-off of accumulated business losses and UD shall not be allowable to the Appellant, as its demerger scheme is not in tandem with the provisions of the Act as provided in section 72A and section 2(19AA) r.w.s. 2(41A) of the Act.

5.0 Decision by the Hon'ble Tribunal ('ITAT Mumbai')

5.1 The ITAT Mumbai observed that the demerger provisions contained under section 2(19AA) r.w.s. 2(41A) and section 72A of the Act are unambiguously worded, leaving no room for any other interpretation. The Appellant has not been able to support his contention, either on the basis of a plain reading and interpretation of the provisions or through any direct judicial precedent, that the allotment of shares by the holding company would constitute sufficient compliance with the prescribed demerger conditions. The claim that there can be two possible interpretations has no substance at all.

5.2 By placing reliance on the decision of Commnr. Of Customs (Import), Mumbai vs. M/S. Dilip Kumar and Company dated 30 July 2018[4] and other jurisprudence[5], it was held that the taxation statutes need to be interpreted strictly in accordance with it's literal and plain language. Where the statutory language is clear and unambiguous, contextual or purposive interpretation cannot be invoked to assign a meaning that is inconsistent with the express wording of the provision.

[4] AIR 2018 Supreme Court 3606, 2018 (5) ABR 802, AIRONLINE 2018 SC 73

[5] Britannia Industries Ltd. vs. CIT (2005) 278 ITR 546-547 (SC), Supreme Court while deciding the civil appeals filed by the Director of Income Tax (IT)-1 Mumbai against M/s American Express Bank Ltd and M/s Oman International Bank dated 06 February 2026, Ajmera Housing Corporation and Another vs. CIT (2010) 326 ITR 642 (SC)

5.3 The language employed in a statute is the determinative factor of legislative intention. While interpreting a provision, the court only interprets the law and cannot legislate it. If a provision of law is misused and subjected to the abuse of process of law, it is for the legislature to amend, modify or repeal it, if deemed necessary.



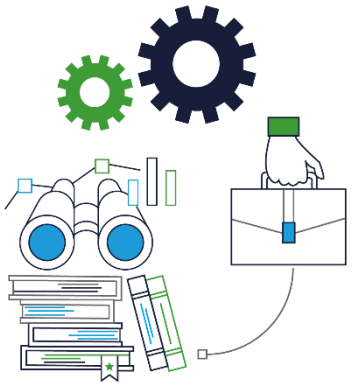
It is the cardinal rule of interpretation that where a statute provides that a particular thing should be done, it should be done in the manner prescribed and not in any other way[7]. If the construction of a statutory provision on its plain reading leads to a clear meaning, such a construction has to be adopted without any external aid[8]. Thus, the ITAT held that courts cannot add to, read into, or imply words in an unambiguous statutory provision based on presumed legislative intention.

5.4 Based on the above, the ITAT Mumbai concluded that there is no ambiguity in the demerger provisions and there is absolutely no basis for any other interpretation, in the absence of any judicial precedent supporting the assessee's interpretation. The Holding company cannot issue shares on behalf of the subsidiary as both have their own independent legal existence, liabilities and obligations vested under the law.

5.5 Accordingly, the disallowance of carry forward and set-off of accumulated business losses and Unabsorbed depreciation of the demerged undertaking to the Appellant by the lower authorities was affirmed, and the relevant ground raised by the Appellant under section 72A(4) of the Act was dismissed. However, the Appellant's appeal was partly allowed in respect of the other grounds, while the Revenue's cross-appeal was dismissed.

6.0 Key Takeaways

6.1 The ruling reflects a strict interpretation of the conditions prescribed under sections 2(19AA), 2(41A) and 72A(4) of the Act. The Tribunal held that the obligation to issue shares was required to be discharged by the resulting company receiving the demerged undertaking and could not be fulfilled by its holding company.



6.2 The decision highlights that a holding company and its subsidiary are separate legal entities, notwithstanding their relationship within the same corporate group. Accordingly, compliance by one entity may not necessarily be regarded as compliance with an obligation specifically imposed upon the other.

6.3 The ruling also indicates that sanction of a restructuring scheme under company law may not, by itself, establish eligibility for the corresponding income-tax benefits. The conditions

[7] State of Jharkhand v. Ambay Cements (2005) 1 SCC 368

[8] CIT vs. Rajasthan Financial Corporation (2007) 295 ITR 195 (Raj F.B.)

prescribed under the tax legislation would need to be independently examined and satisfied.

6.4 Corporate groups contemplating demergers, business splits or similar reorganisations, particularly structures involving the issue of shares by a parent or another group entity, may consider reviewing the proposed transaction mechanics from an Indian tax perspective.

6.5 While the ruling may also be relevant to certain cross-border reorganisations involving parent-issued shares, its applicability would depend upon the specific facts, transaction structure and relevant statutory provisions. It remains to be seen whether the Tribunal's interpretation is considered by a higher judicial forums.

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