

Landmark and favorable advance ruling in the case of non-resident STAR Group entities on amalgamations and tax planning

The Authority for Advance Rulings ('AAR') has delivered an important ruling on the availability of the tax benefits in cross border mergers

Facts of the case

- Star Television Entertainment Limited, BVI ('STEL'), Star Asian Movies Limited, BVI ('SAML') and Star Asia Region FZLLC, UAE ('SAR') are the owners of the Indian language channels Star Plus, Star Gold and Star One & Star Utsav respectively. Xing Kong Chuan Mei Group Co Ltd, StarTV.com Holdings Ltd and Star Television Technical Services Ltd (the 'Shareholders') are the sole shareholders of STEL, SAML and SAR respectively.
- Under a scheme of amalgamation ('Scheme') currently pending for approval before the Bombay High Court, it is proposed that STEL, SAML and SAR (the 'Amalgamating Companies' or 'Foreign Companies') alongwith their assets and liabilities be amalgamated and merged with Star India Private Limited ('SIPL' or the 'Amalgamated Company') in order to achieve synergies of operation, enhanced operational flexibility and create a stronger base for future growth of the Amalgamated Company.
- SIPL in turn will issue shares to the Shareholders which will reduce the holding of SIPL's current shareholders to 51.09% of the post-merger equity.
- With effect from the appointed date ie April 1, 2009 the Amalgamating Companies shall stand amalgamated with the Amalgamated Company and all the properties, assets, outstandings, liabilities, duties and obligations concerning the Amalgamating Companies shall stand transferred to and vested in the Amalgamated Company.

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Issues before the Authority for Advance Rulings ('AAR')

Whether the amalgamation, as defined under Section 2(1B) of the Income-tax Act, 1961 (the 'Act'), of STEL, SAML and SAR with SIPL, an Indian company, will result in any liability under the Act in the hands of the applicants and their share holders?

Applicants' contentions

The Applicants contended that since the proposed merger satisfies all the conditions of an 'amalgamation' provided under the provisions of the Act, no taxable income arises either in the hands of the Foreign Companies or the Shareholders by reason of specific exemptions provided under the Act.

Revenue's contentions

The Revenue contended that:

- The applications be kept on hold till the Scheme is sanctioned by the Bombay High Court as the Revenue proposes to intervene and present its case of adverse financial repercussions to the Revenue in the event of approval of the Scheme.
- If the Scheme is given effect then it might lead to evasion of the tax presently due from the Amalgamating Companies
- The Scheme is a make-believe one having no legitimate purpose apart from tax evasion and avoidance. That the Applicants have taken resort to the Scheme for the mere purpose of availing the benefit of tax exemption by putting on the mantle of amalgamation on transfer of shares of the Amalgamating Companies to SIPL.

Ruling

On the Revenue's plea for declining the Ruling

The AAR held that declining the ruling would practically amount to the Statutory Authority refusing to exercise the jurisdiction vested in it by law. The AAR further clarified that the ruling was being sought under the assumption that the Scheme would be sanctioned by the Bombay High Court and is also pronounced subject to the approval of the Scheme by the Bombay High Court.

Giving effect to the Scheme might lead to tax evasion

The AAR ruled that since the Scheme provides for takeover of liabilities by the

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Amalgamated Company, there is no material to reasonably conclude that the prospect of recovery of income tax arrears would be better if the corporate status and structure of the Foreign Companies is kept in tact. That it is not permissible for the AAR to draw an inference that the amalgamation is only a ruse or a deliberate plan to evade the payment of income tax arrears.

Whether the amalgamation is a pure and simple design to avoid capital gains tax

The AAR noted that the Revenue has not disputed the fact that going by the Scheme and considering the nature of the transaction, *ex facie*, the transfer of capital asset in the instant case, falls within the exemption provided under the Act. The AAR further observed that the Revenue did not have objection to the transfer of assets / shares, rather had an objection to the garb of amalgamation which resulted in a benefit of exemption to the Applicants. Quoting numerous legal precedents and highlighting the definite business purpose of the restructuring, the AAR rejected the plea of the Revenue that the amalgamation was a mere device with the sole objective of avoiding capital gains tax.

The AAR also stated that it is within the legitimate freedom of the contracting parties to enter into a transaction, which has the effect of extending to the party the benefit of exemption under the taxation statute. The contracting party is not bound to enter into a transaction in such a way that it results in tax liability while foregoing the benefit of exemption under law.

BMR comments and analysis

The ruling assumes significance in view of reiteration by the AAR of the important principle that tax payers can organize their affairs in a manner to avail the benefit of exemption available under taxation laws. It is also a booster for cross border mergers and restructurings.

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