L&S UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

23 MARCH 2022

INDIRECT TAX

Demand of excise duty on the demerged entity not sustainable when duty paid by predecessor

UPDATE NO. 13 OF 2022

Lakshmikumaran & Sridharan attorneys

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The Division Bench of the Gujarat High Court has quashed a Show Cause Notice wherein demand of central excise duty was raised on the demerged entity from the appointed date. The excise duty was paid by the predecessor and the central excise registration was taken by the demerged entity post the effective date.

The High Court further held that pre-show cause notice consultation was mandatory in accordance with Circular No. 1053/2/2017-CX dated 10 March 2017. On the issue of maintainability, the High Court held that the alternate remedy was not a bar in the present case as the facts were not in dispute and as the jurisdictional aspect pertaining to invocation of extended period of limitation was under challenge.

BRIEF FACTS

- Larsen & Toubro Ltd. proposed to demerge its Hydrocarbon Division as a separate legal entity under Section 394 of the Companies Act, 1956. The Scheme was approved by the Bombay High Court *vide* Order dated 20 December 2013.

- The appointed date as per the Scheme was fixed as 1 April 2013 and the effective date was 16 January 2014.

- During the pendency of the amalgamation proceedings before the High Court of Bombay, the excise duty for the goods cleared from the Hydrocarbon Division was paid by Larsen & Toubro under the central excise registration held by it for that factory.

- A Show Cause Notice was issued to L&T Hydrocarbons Eng. Ltd., raising a demand of excise duty for the period of 2013-2014 on the ground that the demerged company was liable to pay duty from the appointed date. Further, it was alleged that the scheme of arrangement had contravened various provisions of the Central Excise Act, 1944 and the Rules made thereunder.

ISSUES

The Court considered the following four issues in its judgment:

1. Whether the writ petition filed against the Show Cause Notice was maintainable under Article 226 of the Constitution of India?
2. Whether the absence of mandatory pre-show cause notice consultation is fatal to the Show Cause Notice?
3. Whether the extended period of limitation under Section 11A of the Central Excise Act, 1944 is invocable in the present case?
4. Whether the demand of excise duty on the demerged entity is sustainable from the appointed date?

DECISION

- The High Court held that the Writ Petition was maintainable in the present case. The court specifically noted that limitation was a question of jurisdiction and that the Show Cause Notice lacked inherent jurisdiction as the extended period of limitation was not invocable. The court further held that it had to decide only pure questions of law based on the averments made in the Show Cause Notice and that facts were not in dispute.

- On the issue of requirement of a pre-Show Cause Notice consultation, the High Court rejected Department's contention that a consultation was not required in the present case as it originated from investigation by the ADG, DGGI. The Court relied on the Circular issued by the CBIC (Circular No. F. No. 116/13/2020-CX-3 dated 11 November 2021) wherein it was clarified that merely because the case originated on account of investigation of the DGGI, it will not be a sufficient ground for not following the mandatory procedure of consultation.

- The Court held that the extended period of limitation was not invocable as the central excise department were aware about the demerger. They had granted new registration to the demerged company and allowed them to transfer Cenvat credit.

- On merits, the Court held that the demand of excise duty was unsustainable. It was held that amalgamation scheme was duly sanctioned by the company court and the transfer of assets takes place by operation of law. The Central Central Government was a party to the scheme through the Office of the Regional Director, Ministry of Corporate Affairs, Western Region Mumbai. Thus, it was not open for the SCN issuing authority to question the scheme of amalgamation. In terms of the scheme, all compliances with respect to indirect taxes done by the transferor company was be treated as compliances done by the Transferee company.

- The demand of excise duty from the successor entity was on the very same goods and of the same amount as stood paid by the predecessor. Therefore, the demand was unsustainable as this would amount to double taxation on the same goods.

L&S comments:

The judgment is an important case laying down the law for liability to pay taxes in the event of mergers/demergers. This has relevance even under the GST laws and hence companies must consider the terms of the amalgamation from taxation point of view and the impact of this case. Apart from that, the judgment also lays down important principles relating to maintainability of a Writ Petition when an alternative remedy is available.

Mr. V. Sridharan, Senior Advocate, Bombay High Court, along with Mr. Anand Nainawati from Lakshmikumaran & Sridharan Attorneys had represented the client before the Gujarat High Court.

[*L&T Hydrocarbon Engineering Ltd.* v. *Union of India* – Judgment dated 3 February 2022 in R/Special Civil Application No. 11308 of 2019, Gujarat High Court]

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