Is Fast-Track Demerger Considered A “Demerger” under IT Act 1961 & IT Act 2025?

Oct 08, 2025

Yog Bakshi
Manager, K C Mehta & Co LLP

Dhwani Patel
Assistant Manager, K C Mehta & Co LLP

Anirudha Dandekar
Assistant Manager, K C Mehta & Co LLP

The introduction of the new Income Tax Act, 2025 (ITA25), along with the accompanying report issued by the Parliamentary Select Committee (PSC Report), as well as the accompanying clarifications provided by the Ministry of Finance (MoF) have an impact on the interpretation of certain key provisions under the existing Income Tax Act, 1961 (ITA61), which were hitherto viewed in a particular manner.

Sec. 2(35) of the ITA25 which defines demergers, proposes to cover only such demergers which take place under the provisions of Sec. 230 to 232 of the Companies Act, 2013 (CA13). When professionals and industry representatives suggested a modification in this to include fast-track demergers as well, the MoF as well as the Select Committee rejected[1] this proposal and clarified that making such a change would amount a policy modification and not just a language alteration/simplification (which was the object of ITA25). It was clarified that fast-track demergers (Sec. 233 of CA13) have never been tax-neutral even under ITA61 because the intention of legislature is to award tax neutrality to only those demergers which are court-monitored. It is pertinent to note that there was always an ambiguity in respect of tax neutrality for Sec. 233 demergers with professionals having views favouring both sides. However, there was no clarification from the MoF until this PSC Report was promulgated.

In this article, the authors deliberate on – What was the position on tax neutrality of fast-track demergers prior to the PSC report clarification? What is the impact (if any) of the PSC report on the interpretation of the definition of demerger under ITA61? What is the position under ITA25?

As far as possible, we endeavour to bring out interesting arguments on both sides for these contentious issues.

Before moving into the technicalities, we will briefly touch upon the fast-track process for mergers/demergers.

Even prior to such clarification, there used to be no clarity as to whether a fast-track demerger falls under the demerger definition under ITA61. The views expressed in the PSC Report preliminarily seems to have an impact on interpretation of the current provisions as well. Considering that a significant number of demergers take place the fast-track mode and considering that tax-neutrality is one of the strongest reasons for demerger being an attractive tool, we have dissected in detail the implications of fast-track demerger – before and after ITB is implemented.

Fast Track Demergers – Introduction

Demergers involve hiving off a company's (demerged company) business undertaking to another company (resulting company), against an issue of the resulting company's shares to the shareholders of the demerged company. Not long ago, demergers could only take place through schemes of arrangements which required sanction from the jurisdictional high courts. With the advent of the NCLT, now the sanctioning authority for schemes is the jurisdictional NCLT instead of the high courts. These court sanctioning processes generally take a very long time (as high as 12 months or even more!). One of the main reasons for this is the fact that these judicial authorities also hear other significant matters involving bankruptcy/insolvency, oppression & mismanagement etc., which hold greater priority than mere corporate restructuring like mergers/demergers. Since 2016, a new route for merger/demerger was introduced wherein the schemes fulfilling certain conditions and involving mergers, demergers, etc. can take place via the approval of Regional Director. No court involvement required. This is referred to as the fast-track route (typically takes 4-5 months or less!). Fast-track route helps not only in reducing the burden on the aforementioned judicial authorities but also helps the businesses to carry out the restructuring more efficiently.

Position prior to the PSC Report – 1961 Act

Tax neutrality for demerger was introduced under ITA61 with effect from 1st April 2000, under Finance Act, 1999. Sec. 2(19AA) defined "demerger" and in doing so opened with the words *"means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956 (1 of 1956)".* Even after the repeal of CA56 and re-enactment of CA13, the reference to CA56 provisions was not updated in the definition. Subsequently, provisions pertaining to fast-track route came into force with effect from 15th December 2016. And still there was no review, update or clarification from the legislature or the CBDT on whether this reference would include 233 demergers. It was only on 21st July 2025 when the PSC Report was promulgated that we came to know of this tacit assumption of the legislature that 233 demergers were never included in the 2(19AA) definition.

Since, sec. 2(19AA) of the ITA61 continues to refer to Sections 391 to 394 of the CA56 we refer to the provisions of General Clauses Act, 1897 for guidance as to its interpretation in context of CA13 provisions. As per Section 8 of the General Clauses Act, 1897, *when an enactment is repealed and re-enacted, the references to the old provisions are to be construed and read as references to the provisions re-enacted, unless a different intention appears*. Reading literally, a reference to Section 391 to 394 of the CA56 should be read as if reference is made to the '*corresponding provisions*' of the re-enacted law, i.e., the CA13. There was no fast-track route in CA56. It was introduced for the first time under CA13. Hence, sec. 233 of CA 13 finds no provision like itself in CA56. That being the case, one would argue that Sec. 233 was never a part of Sec. 2(19AA). Proponents of this view, further support it by stating that the legislature always intended to make fast-track demergers taxable because these are not court-monitored[2].

However, if one subscribes to this view, then the fall out is as under –

1. While fast-track demergers would be taxable, fast-track mergers would still benefit from tax neutrality[3].
2. While the CA13 intends to extend the benefit of efficiency to fast-track demergers, ITA61 offsets this benefit by imposing a tax liability on fast-track demergers[4].

The above appears difficult to reconcile. This suggests that the intention of legislature, in all likelihood, does not align with the literal interpretation as aforesaid. That being the case, one may rely on Sec. 8 of General Clauses Act, 1897 which requires us to read the corresponding re-enacted provisions in place of the repealed ones *"unless a different intention appears".* This could be one possible defence to say that sec. 233 can be read into sec. 2(19AA). To further justify this view, one may also re-frame the rationale and say that sec. 391 to 394 of CA56 effectively covered all the provisions in relation to schemes of amalgamation/arrangement. Hence, the legislature intended to cover all the provisions in relation to schemes of amalgamation/arrangement, and sec. 233 being one such provision should also be read into sec. 2(19AA). This proposition may appear far-fetched to the literal interpretation theorists but considering that sec. 233 is only an alternate procedure it may not be fair to completely disregard this proposition altogether.

Aforementioned were the possible views and defences in relation to the tax-neutrality (or not) of fast-track demergers.

We may now evaluate the impact of the PSC Report on these views.

Impact of Parliamentary Select Committee Report

The objective behind the new ITA25 is to simplify the language of ITA61 provisions to make it more reader friendly. A Parliamentary Select Committee (PSC) was formed to review the Income-Tax Bill, 2025 (the "Bill"), during which expert stakeholders from across the nation submitted recommendations which were deliberated by the committee. The Ministry officials have provided a clause-by-clause explanation for all clauses of the Bill. The Committee's observations, along with the explanations and a comparison between the existing provisions and the proposed changes, were compiled and published in a 4000-page PSC Report.

Courts have often relied on Legislative Committee reports to aid in the interpretation of statutes. In the case of *Pepper (Inspector of Taxes) v. Hart*[5], the House of Lords upheld placing reliance on statements made in House of Commons when the language of the statute was ambiguous and literal interpretation of the provision led to absurd results.

The hon'ble Supreme Court of India in *Kalpana Mehta v. Union of India*[6] held that a PSC report is valid evidence in the Court of Law, which can be used as an external aid to interpret the legislative intent of the Parliament.

The apex court in, *K.P. Varghese v. ITO*[7] has held that speeches made by members of the legislature during the debate of a Bill are inadmissible for interpreting statutory provisions. However, it allowed the speech of the mover of the Bill, explaining the reasons for introducing the Bill, to be used to understand the mischief the legislation seeks to address and its intended objectives.

Basis this, one could argue that the speech of the Bill's mover may be relied upon, unlike the statements of other Members of Parliament. Similarly, the responses provided by the Ministry of Finance in the PSC Report are certainly relevant to cull out the legislative intent behind the provision in question.

But does this mean that whatever is mentioned in the PSC report, is in fact legislative intent itself? Or can

there be an intent other than the one which is expressed in the report?

We may refer to another case where the hon'ble apex court[8] clarified that the Statement of Objects and Reasons accompanying a Bill, when introduced in Parliament, cannot be used to interpret the substantive provisions of the statute. It can only be referred to for understanding the background and circumstances leading to the legislation. The Statement cannot be used to alter the meaning of the statute or to limit the legislative intent expressed in the statute itself. The law passed by Parliament reflects the collective intention of the legislature, and individual statements, even by a Minister, cannot restrict the broad language of the statute.

So, while PSC Report is an external aid to interpretation of provisions, one must not consider that to be an expression of legislative intent itself since the PSC is but a select group of members from the Lower and Upper Houses of the Parliament.

In summary, PSC report is an undeniable external aid to interpretation, but the document in its entirety or its excerpts cannot be regarded as the expression of legislative intent in itself.

We shall now examine the impact of the PSC Report on the purposive interpretation of the 1961 Act.

Fast Track demergers – Purposive Interpretation 1961 Act

Fiscal statutes are subject to rule of strict interpretation. However, if a plain and literal reading produces an absurd or illogical result, the Courts may adopt a contextual interpretation that aligns with the object and purpose of the legislation. This has been affirmed by the apex court in the undernoted judgement[9].

It is important to note the observation of Justice M. Jagannadha Rao in the 183rd Report of the Law Commission of India, which states, *"....The intention of legislature assimilates two aspects; one aspect carries the concept of 'meaning', i.e., what the word means and another aspect conveys the concept of 'purpose' and 'object' or the 'reason' or 'spirit' pervading through the statute. The process of construction, therefore, combines both the literal and purposive approaches".*

Analyzing the same in this context, clarifications made in the report must pass the muster of meaning along with purpose or object for it to be construed as legislative intent and must align with existing laws. Any differential treatment of a transaction should be based on a clear distinction with a rational basis for the same.

Moreover, as highlighted earlier, the clarification in the PSC report treats fast-track demergers as taxable since the process is not court-monitored but fast-track mergers, also not court-monitored, continue to remain tax-neutral. The aim could not have been to make one aspect taxable while leaving the other tax-exempt.

Therefore, it can be argued that this clarification may not have an impact on demergers already completed, given that the purposive interpretation of the 1961 Act has traditionally supported granting exemptions under such provisions. At the same time, one could also reasonably contend that a literal interpretation of the provision, rather than a purposive one, is equally valid.

Both perspectives present plausible arguments.

2025 Act

The 2025 Act now specifically refers only to Sections 230–232 of the Companies Act, 2013, while leaving out Section 233. A literal reading makes it clear that fast-track demergers are not covered within the definition of demerger and hence making it taxable. Under the 2025 Act, purposive interpretation is not

possible, since the wording of the statute is clear and precise, as stretching it would override Parliament's express intent.

Conclusion

What is interesting to note is that there have been a lot of fast-track demergers since 2016 and yet there are no reported judicial precedents deliberating on the aspect of their tax-neutrality. This may be because the assessee itself offered such demergers as taxable, or could it be that the Revenue Department also held the view that fast-track demergers are covered by sec. 2(19AA)? Either way, the lack of litigation on the subject is something fascinating.

In conclusion, the taxability of demergers under the ITA25 remains clear, disallowing a purposive interpretation due to the clear language of the statute, making it taxable, while demergers undertaken through ITA61 remain in a state of uncertainty, largely dependent on the interpretation of the provision through various rules of interpretation. As this issue unfolds, it will be fascinating to observe how courts interpret the provision.

---

[1] Para 2.5.12.2 of the PSC Report

[2] This rationale is also given by the MoF in its clarification – Refer Pg. 109 of the PSC Report

[3] Because Sec. 2(1B) of ITA61 which defines "amalgamation", does not refer to any provision of Company law.

[4] One may argue that the legislature has the authority to determine the policy and grant tax neutrality only to transactions it deems appropriate. However, differential treatment of similar transactions because of literal reading of the provisions leads to absurdity (if not arbitrariness). Thus, a purposive interpretation of the law becomes essential.

[5] [1992] UKHL 3

[6] AIR 2018 SC 2493

[7] [TS-11-SC-1981-O]

[8] State of West Bengal v. Union of India, AIR 1963 SC 1241

[9] Commissioner of Customs (Import) v. M/s. Dilip Kumar and Ors ((2018) 9 SCC 1)