

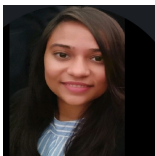
New Act, Old Problems: What the Income Tax Act, 2025 Did Not Fix for M&A and Succession

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Binoy Parikh

Partner, Katalyst Advisors



Shital Patel

Senior Consultant

I. Introduction

The Income-tax Act, 2025 ("New Act") took effect on 1 April 2026, replacing the Income-tax Act, 1961 ("1961 Act"). The stated objective was modernisation and simplification. The Select Committee reviewed the Bill, received representations, and tabled its report. The President gave assent. And on the first day of the new financial year, India's direct tax statute changed.

The question, from the perspective of M&A and succession planning, is whether the change was semantic or structural. Having perused various provisions, the short answer is this: the New Act is a redraft, not a reform. Sections have been renumbered. Language has been tidied. The policy architecture remains untouched. And the structural gaps that have plagued transaction structuring for years have been carried forward with the same fidelity as the provisions themselves. This article identifies such continuing gaps.

II. The Fast-Track Gap

In September 2025, MCA expanded the fast-track merger route under Section 233 of the Companies Act, 2013 to include, inter alia, demergers. The underlying rationale was to reduce the dependence on the NCLT for straightforward reorganisations, cut timelines, and bring such transactions within the purview of the Regional Director ("RD"). In this context,

the expansion was welcome, since NCLT-approved demergers for listed companies can take close to a year even when they are mirror-image transactions with no commercial controversy. The problem, however, is that while MCA expanded the corporate law gateway, several other statutes that govern or interact with NCLT-approved schemes, including the New Act, remained frozen in their pre-expansion state.

The definition of 'demerger' under the New Act (Section 2(35), corresponding to Section 2(19AA) of the 1961 Act) is available only for schemes sanctioned under Sections 230 to 232 of the Companies Act, 2013. A demerger confirmed by the RD under Section 233 of the Companies Act, 2013 falls outside this definition. The consequence is that the transferor company, the resulting company, and the shareholders all lose tax neutrality. Further, any payout to shareholders as part of the arrangement risks being characterised as deemed dividend under Section 2(22) of the 1961 Act at the applicable rate of up to 36%, depending on the effective tax bracket. In effect, the fast-track route, for all practical purposes, becomes a tax trap for demergers.

The misalignment extends well beyond tax. Regulation 10(1)(d)(ii) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 exempts acquisitions pursuant to an 'order of a court or tribunal'; a Section 233 confirmation is issued by the RD, which is neither a court nor a tribunal, and therefore, the open offer exemption may not be available. Regulation 37 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires prior SEBI approval for schemes under Sections 230 to 234 that are approved by the NCLT; the said language does not extend to schemes confirmed by 'any other competent authority,' and consequently, whether SEBI would process such a filing at all remains an open question. Certain state governments extend concessional stamp duty rates to transfers pursuant to 'orders of a Tribunal'; a Section 233 confirmation, not being a Tribunal order, may not qualify, though some states have adopted broader language. The FEMA NDI Rules extend the automatic route for mergers and demergers approved by a 'competent authority,' which is arguably broad enough to cover the RD, but the position is not entirely free from doubt.

The net result is a peculiar regulatory dissonance: the Companies Act says 'proceed,' while the tax law, the Takeover Code, the LODR, and certain stamp duty regimes say 'not so fast.' The New Act had the opportunity to align the tax definition of 'demerger' with the expanded corporate law route. It did not.

III. The Demerger Definition

The definition of 'demerger' under the New Act requires the transfer of an 'undertaking' of the transferor company on a going concern basis, with its properties and liabilities. The definition of 'undertaking,' in turn, contemplates a self-contained business operation. This creates a fundamental structural limitation in the context of holding company reorganisations.

Consider a diversified group that holds its businesses through subsidiaries or special purpose vehicles ("SPVs"). This is not an unusual structure; it is, in fact, the mandated or preferred structure in several regulated sectors. Banks, NBFCs, and insurance companies are required to operate through separate legal entities by their respective regulators. Infrastructure groups typically hold assets in project-level SPVs for regulatory and liability ringfencing purposes. Diversified conglomerates hold businesses through subsidiaries for reasons ranging from listing requirements to joint venture obligations. In each of these cases, the commercial reality is a genuine business operation, but the legal form at the holding company level is a shareholding. If such a group wishes to split into two families or two business verticals by demerging the holding company, the question arises: does the transfer of shares of subsidiaries constitute the transfer of an 'undertaking'? The commercial logic suggests it does.

The fix would involve expanding the definition of 'undertaking' to include shares of subsidiaries or SPVs where such entities represent genuine business operations, while appropriately excluding non-business holdings and treasury investments so as to prevent misuse. The New Act merely re-introduces the same definition without expanding it to reflect the underlying commercial reality.

As a further consequence, losses 'directly relatable' to the demerged undertaking, which would otherwise transfer automatically to the resulting company, become orphaned if the transfer does not qualify as a demerger at all, as defined. The loss does not merely stay with the transferor; it becomes stranded in an entity that no longer carries on the business to which the loss related.

IV. The Consideration Gap

In cross-border and domestic M&A, the practice of structuring consideration as partly deferred or partly contingent is well-established and commercially sound. Earnouts tied to post-closing performance milestones, escrow holdbacks pending satisfaction of indemnity obligations, and deferred payments linked to regulatory approvals are standard features of share purchase agreements across jurisdictions. They exist because a buyer and seller, having conducted due diligence and negotiated at arm's length, may not agree on a single upfront price, and the deferred or contingent component bridges that valuation gap.

Under the New Act, as under the 1961 Act, capital gains tax is triggered at the point of 'transfer.' The full value of consideration, including deferred and contingent components, is assessed at that point. The seller, therefore, pays tax on consideration that has not been received.

The problem is compounded by a characterisation risk on the contingent component. If the contingent payout is not treated as part of the original capital gains computation (because it was uncertain at the time of transfer and the tax return was filed without it), there is a risk that when it is eventually received, it is taxed as 'income from other sources' at slab rates rather than at the concessional capital gains rate. The seller thus faces a binary adverse outcome: either pay tax upfront on money not received, or pay a higher rate of tax when the money eventually arrives.

Multiple jurisdictions have addressed this. A safe harbour for genuine deferred or contingent consideration, aligning the point of taxation with the point of receipt, would have eliminated this entire category of structural gymnastics. The New Act provides none.

V. The Valuation Trap

Two provisions in the New Act create a pincer on share transfers, but their mechanics are distinct.

Section 92(2)(m) of the New Act (corresponding to Section 56(2)(x) of the 1961 Act) taxes the buyer on the delta if shares are received below FMV. For listed shares, the reference price is the market price on the date of the transaction. The problem is timing: the price is locked at signing, but closing occurs weeks or months later, after board and shareholder approvals, in-principle approval of the stock exchanges, CCI clearance, and other conditions are satisfied. If the market price rises between signing and closing, which is a likely scenario, the acquirer faces deemed income on a delta that reflects market movement, not any non-arm's length arrangement. The provision was designed as an anti-abuse measure against below-market-value gifts; in a commercially negotiated acquisition between unrelated parties, its application penalises the acquirer for the fact that regulatory approvals take time.

Section 79 of the New Act (corresponding to Section 50CA of the 1961 Act) operates on the seller's side for unlisted shares: if the transfer price is below FMV, the FMV is deemed to be the full value of consideration for computing capital gains. The reference price here is the adjusted net book value, a synthetic construct that sees through to underlying assets: listed shares marked to traded price, unlisted subsidiaries valued at their own adjusted NBV (creating a recursive cascade), and immovable properties marked to stamp duty reckoner value. A promoter selling shares of an unlisted holding company with a 30-year-old factory plot and a listed subsidiary may find the adjusted NBV at INR 160 per share, while the commercially negotiated DCF-based price is INR 100. Under Section 79, the seller is taxed as if INR 160 was received.

In transactions involving unlisted companies with underlying listed investments or

immovable properties, both provisions bite simultaneously: the buyer is taxed on the delta under Section 92, the seller on the same delta under Section 79. The same gap, taxed twice, in two different hands, on a transaction that was arm's length at signing. A safe harbour exempting genuine commercially negotiated transactions, or pegging FMV to the signing date rather than the closing date, would resolve this. The New Act provides neither.

VI. Disjointed Relatives

The definition of 'relative' under the New Act produces an internally inconsistent result in the context of inter-generational transfers, which is precisely the context in which it matters most for succession planning.

Consider an uncle who wishes to transfer shares to his nephew. If the uncle gifts the shares directly, the transfer is exempt under Section 92(2)(m) of the New Act (corresponding to Section 56(2)(x) of the 1961 Act), because the definition of 'relative' for this purpose is tested from the recipient's perspective. The nephew looks up: the uncle is the brother of his parent, and the brother of a parent qualifies as a 'relative' under the said definition. The transfer is therefore not subject to deemed income taxation. It is worth noting, however, that the reciprocal transfer (i.e., nephew to uncle) would not qualify for the exemption, since from the uncle's perspective, the nephew, being a lineal descendant of a sibling, falls outside the definition. This asymmetry itself is jarring, but the deeper problem lies in the interaction with trust-based transfers.

Now consider the same uncle contributing the same shares to a trust established for the benefit of the same nephew. The trust contribution is taxable, because the definition of 'relative' for the purpose of contribution to a trust is tested from the contributor's (i.e., the uncle's) perspective. From the uncle's vantage point, the nephew falls outside the definition of 'relative,' and the contribution is accordingly not exempt. Same shares, same relationship, same economic substance, but a different route produces a different tax outcome.

The irony is that the inconsistency is not across different statutes; it is within the New Act itself. Sections 355 and 515 of the New Act define 'relative' more broadly to include lineal descendants of siblings. The Select Committee of the Rajya Sabha flagged this asymmetry during its review of the Bill. It was parked as a 'policy issue' and left unresolved. For succession planning, where trusts are the primary vehicle for inter-generational wealth transfer in Indian business families, and where the collateral branch (uncles, aunts, cousins) is often integral to the family's economic arrangements, this definitional inconsistency distorts the choice of succession vehicle in a material way.

VII. The Family Arrangement Vacuum

Indian business families are, with increasing frequency, undertaking formal succession planning and family arrangements. These range from amicable partitions of family businesses across branches, to structured governance frameworks with associated asset reallocation, to post-dispute settlements that redistribute shareholdings, properties, and business interests among family members. The common thread is that beneficial ownership at the family level does not change; what changes is the allocation of specific assets to specific branches or individuals within the family.

The tax law has no statutory framework for recognising such family arrangements as tax-neutral events. The neutrality, such as it is, derives entirely from case laws that have held family settlements to be outside the purview of 'transfer' for capital gains purposes. The reasoning, broadly, is that a family arrangement crystallises pre-existing rights rather than creating new ones, and therefore does not constitute a 'transfer' within the meaning of the Act, and from a recipient's perspective, it is not a 'receipt' without adequate consideration.

The difficulty with a case-law-evolved framework is that its boundaries are inherently uncertain, its application is intensely fact-specific, and its availability is routinely contested by the revenue authorities during assessment proceedings. In practice, genuine family arrangements, even those documented through registered memoranda of family settlement are litigated as colourable devices, assessed as deemed transfers, and subjected to protracted proceedings. The absence of a statutory safe harbour means that business families either avoid formal structuring altogether (thereby creating succession risk and potential for future disputes) or structure around the law rather than within it (thereby adding unnecessary layers of complexity and cost). The New Act had the opportunity to codify the principles evolved over multiple case laws, and to create a comprehensive succession framework with appropriate anti-avoidance safeguards. It chose not to.

VIII. The Grandfathering Uncertainty

In both mergers and demergers, the existing shares of one entity are extinguished or diluted, and new shares of another entity are issued in their place. The shareholder never acquires these new shares through a purchase; they arise by operation of the scheme. This mechanical reality creates unresolved friction with two grandfathering provisions, one domestic and one treaty-based, that hinge on the date of "acquisition".

Domestically, listed equity shares acquired before 31 January 2018 benefit from a cost step-up: the deemed cost is the higher of actual cost or the market price on that date. The purpose was to protect unrealised gains accumulated before the reintroduction of long-term capital gains tax on listed shares. In a merger or a demerger, the shareholder receives new shares of the transferee company in exchange for old shares of the transferor

company. In neither case were the new shares "acquired" before 31 January 2018; they did not exist before the scheme took effect. Logically, the cost and holding period should relate back to the original acquisition, since the statutory mechanism for cost allocation on both mergers and demergers operates by reference to net book values of the entities involved, and the transaction itself is tax-neutral. But the provision is not express on this point, and no administrative clarification exists.

The same problem arises for treaty investors. The India-Mauritius, India-Cyprus, and India-Singapore amendments grandfathered capital gains exemptions for shares acquired before 1 April 2017. New shares issued pursuant to a merger or demerger are technically "issued" after that date, even if the original shares were acquired years before. Whether the grandfathering protection extends to the new shares is a question that the treaty amendments do not address, and no competent authority clarification or mutual agreement procedure has resolved it. A Mauritius-based investor holding pre-2017 shares in a listed Indian company that undergoes a demerger faces genuine uncertainty on whether the reorganisation has inadvertently stripped its treaty protection.

The New Act could have addressed both questions with a single clarificatory provision confirming that the date of acquisition, for purposes of both the domestic grandfathering and the treaty grandfathering, relates back to the original acquisition in the case of a tax-neutral reorganisation. It did not.

IX. The Loss Carry-Forward Cap

The provisions governing carry-forward of losses on amalgamation (Section 72A of the 1961 Act, now re-enacted under the New Act under section 116) restrict the benefit to amalgamations involving specified categories of entities: industrial undertakings, ships, hotels, and certain banking companies. The underlying rationale was to facilitate consolidation in sectors where the government wished to encourage M&A activity. The difficulty is that the list was drawn up at a time when the Indian economy was dominated by manufacturing and heavy industry. Absent from this list are NBFCs, technology companies, financial services firms, professional services firms, and the entire services sector, which collectively constitute a significant and growing share of India's corporate landscape. An amalgamation involving a loss-making entity in any of these excluded sectors cannot avail of the loss carry-forward benefit under Section 72A, regardless of the commercial rationale for the amalgamation. The result is that M&A involving loss-making entities in these sectors is structurally less attractive, since the accumulated losses, which could otherwise have been set off against future profits of the amalgamated entity, lapse on amalgamation.

Separately, the provisions governing carry-forward of losses on change in shareholding (Section 79 of the 1961 Act, now re-enacted as section 119(3) restricts the carry-forward of losses if there is a change in shareholding exceeding 51%. The provision is designed to

prevent trafficking in loss companies. The problem arises in the context of intra-group restructurings: mergers, demergers, and holding company reorganisations frequently result in changes to the shareholding pattern at the entity level, even though the ultimate beneficial ownership remains identical. A promoter who holds 60% of Company A, which in turn holds 100% of Company B, may restructure such that the promoter directly holds 100% of Company B. The beneficial owner has not changed. The shareholding at the Company B level has. Under Section 79 of the 1961 Act, the losses of Company B stand extinguished on a technicality. No carve-out exists for genuine group restructurings where the beneficial owner remains the same.

Further, Section 79 of the 1961 Act permitted “persons” in the plural to collectively satisfy the 51% beneficial ownership continuity test. Section 119(3) of the New Act substitutes “the person” in the singular. On a literal reading, this appears to require a single shareholder to satisfy the 51% threshold in both years. The consequence for promoter-driven companies is material: where shareholding is spread across family members or holding entities, each holding below 51% individually but together exceeding that threshold, the losses may lapse despite no real change in beneficial ownership. Whether this shift from “persons” to “the person” reflects conscious policy tightening or inadvertent drafting is not apparent from the legislative record.

Expanding the loss carry-forward eligibility across sectors (or removing the sectoral restriction entirely, subject to anti-abuse safeguards), introducing a beneficial ownership look-through provisions on account of group restructurings, and perhaps re-introducing the “fresh-lease” of 8 years concept in the New Act would go on to facilitating M&A, be it third-party transactions, or internal group restructuring.

X. ESOP Anomaly

Employee Stock Option Plans (ESOPs) in India are taxed at two stages: first, on exercise, when the difference between the fair market value and the exercise price is taxed as salary; and again on sale, when subsequent appreciation is taxed as capital gains. The structure is not conceptually unusual. The anomaly lies elsewhere: liquidity.

Where the employer is listed, the employee can ordinarily monetise shares around the time of exercise and fund the tax. Where the employer is unlisted, that option does not exist. The employee is taxed upfront, often at peak marginal rates, on a paper gain without any corresponding cash realisation, and may remain locked in for years until an exit event occurs. The result is a cash-flow burden disconnected from actual economic receipt.

Other jurisdictions have, in different ways, shown greater sensitivity to this mismatch by deferring taxation or linking it more closely to monetisation, particularly in the context of

illiquid equity. India has, in limited circumstances, recognised this liquidity mismatch by allowing deferment of the tax payment obligation in respect of ESOP perquisites for employees of eligible start-ups until sale, exit, or expiry of a specified long-stop period. The significance of that regime is not the carve-out itself, but the legislative acceptance of the underlying principle: taxing illiquid equity at exercise can create a genuine cash-flow distortion. The difficulty is that the same mismatch exists across unlisted companies more broadly, but the relief does not. India's framework therefore continues, in most cases, to impose tax at exercise even where no market exists to support that liability.

A coherent solution would be to defer the incidence of tax, at least for employees of unlisted companies, until sale, exit, or the lapse of a defined outer time limit. That would not forgo revenue. It would merely align taxation with liquidity. The New Act does not do so.

XI. The Big Picture

The New Act, as it stands, represents Phase 1: a semantic overhaul. The sections have been renumbered, the language modernised, and the structure made more navigable. That exercise, in itself, was long overdue and is welcome. But the work is incomplete. Phase 2, the substantive policy restructuring of India's tax provisions governing corporate reorganisations, succession, and deal structuring, remains to be undertaken.

India's M&A activity has matured considerably over the past decade. Transactions are no longer limited to plain-vanilla share purchases or single-entity mergers. Listed companies are merging into listed companies with complex swap ratios and treaty investor bases. Cross-border deals routinely involve earnouts, escrows, and contingent consideration. Holding company reorganisations are being undertaken to streamline legacy group structures that have accumulated over generations. The commercial sophistication of the deal ecosystem has outpaced the statutory framework within which it operates.

On the succession and family arrangement front, the urgency is, if anything, greater. Business families across India are actively engaging in formal succession planning, governance structuring, and inter-generational wealth transitions. These are not adversarial exercises; in many cases, they are collaborative arrangements designed to preserve businesses across generations and provide clarity to the next generation of leadership. The absence of a statutory framework forces these arrangements into the penumbra of case law, where their tax neutrality depends on the specific facts, the specific bench, and the specific assessment officer. That is not a foundation on which multi-generational business transitions should rest.

The gaps identified in this article, from the fast-track misalignment to the loss carry-forward restrictions, are individually addressable. None of them requires a fundamental rethinking of the tax base or a departure from established revenue principles. What they require is a policy acknowledgment that inorganic growth through M&A, group reorganisations through demergers and mergers, and inter-generational transitions through family arrangements and trusts are legitimate economic activities that deserve a coherent, predictable, and commercially workable tax framework. Phase 1 gave a cleaner statute. Phase 2 should give a smarter one.