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Income-tax NOC in M&A Transactions Practical Considerations

Authored by:

Mitesh Jain, Partner & Tax Practice Head

Jishaan Jain, Associate Partner

Shruti Desai, Senior Manager

Introduction

In any M&A transaction involving Indian companies, considering whether to impose an obligation on the seller to obtain a No-Objection Certificate (“NOC”) from the Indian income tax authorities under section 499 of the Income-tax Act, 2025 (“IT Act”) (erstwhile section 281 of the Income-tax Act, 1961) is often a key issue from a deal execution and risk allocation perspective. However, the complexities and challenges associated with obtaining an NOC often create friction between the buyer and seller. It is therefore important to understand the legal framework, the significance of obtaining the NOC, potential consequences of not obtaining it and the practical approaches generally adopted by the parties in M&A transactions.

Trigger for NOC under section 499 of the IT Act

The provisions of section 499 stipulate that if during the pendency of any proceedings under the IT Act or after the completion but before the issue of recovery notice by the Tax Recovery Officer, any specified asset such as land, building, plant, machinery, shares, securities, fixed deposits and virtual digital assets is transferred, such transfer may be declared void by the tax authorities as against any tax or other sum payable.

The rationale of section 499 of the IT Act is to safeguard the interests of the tax department against taxpayers who may transfer their assets to defraud the tax authorities and frustrate the recovery of taxes.

Section 499 of the IT Act also provides immunity from transfer being held as void in situations where transfer of the specified asset is made (i) for adequate consideration and without knowledge of any ongoing proceedings or outstanding tax demand; or (ii) with previous permission of the tax officer.

As adequacy of the consideration is a subjective matter and it may not always be practically possible to have complete knowledge of all tax dues and ongoing proceedings against the seller, seeking permission of the tax department by obtaining an NOC prior to transfer of the specified assets (including shares) becomes an important risk-mitigation step in appropriate cases to safeguard the transfer from the rigors of section 499 of the IT Act.

Consequences of not obtaining NOC

Under the provisions of the IT Act, the tax authorities have power to recover any tax due from a defaulting taxpayer, inter-alia, by attaching and disposing the taxpayer’s asset. Therefore, where a taxpayer transfers any specified asset without obtaining an NOC from the tax authorities, there is a risk of the tax authorities seeking to treat the transfer of the specified asset as void in terms of section 499 of the IT Act to recover the seller’s outstanding tax dues. However, it is pertinent to note that the tax authorities cannot unilaterally declare the transfer void without first obtaining a decree to this effect from a civil court [1].

Perspective of the parties to the transaction

In an M&A transaction, a buyer would generally want to acquire the asset with a clear title and free from any encumbrances. Therefore, the possibility that the tax authorities may declare the transfer of specified asset as void by invoking the provisions of section 499 of the IT Act, and the resulting risk of the buyer losing the asset, is a significant concern. Thus, given the stakes involved in a transaction, sensitivity of the issue and the grave consequences of not obtaining an NOC, a buyer would typically prefer the seller to obtain and furnish an NOC from the tax authorities particularly in higher-risk cases, generally as a condition precedent to the transaction.

For sellers, obtaining an NOC from the tax department is often an onerous task. The seller would need to make an application for obtaining the NOC with the tax department, furnish additional details and documents as and when called for by the tax authorities and may have to make multiple follow-ups. In some cases, it may take several weeks to obtain the NOC from the tax authorities. Thus, obtaining an NOC is generally challenging and time-consuming process. Therefore, sellers generally prefer to close the transaction without being required to obtain the NOC and tend to offer alternative documentation and contractual protection to the buyers.

Practical approaches

Seller has substantial outstanding tax demand

In cases where the seller has substantial outstanding tax demand or ongoing tax proceedings that may result in substantial tax demand, there is a comparatively higher risk of tax authorities subsequently invoking section 499 of the IT Act. This may expose the buyer to the seller's tax liabilities or the risk of the transfer being declared void by the tax authorities (even though buyer has paid full consideration to the seller). Hence, in such a scenario, the buyer may insist that the seller obtain and furnish a tax NOC as a Condition Precedent to closing of the transaction.

In case where the deal is to be closed in a short span of time, obtaining NOC from tax authorities before the closure of transaction may not be practically feasible. In such a case, depending upon the commercial negotiations and risk appetite of the buyer, furnishing of NOC may be agreed as a condition subsequent to the transaction. Additionally, the parties may agree on alternative protection measures such as escrow arrangements, contractual protections / indemnities etc.

Seller has nil or immaterial outstanding tax demand

In case where a seller has nil or negligible outstanding tax demand, the parties may commercially agree for the seller to furnish a certificate from an independent Chartered Accountant ("CA") on the seller's tax position and its ability to pay off the tax demands, together with contractual protections. The requirement of furnishing an NOC may even be commercially dispensed with depending upon the buyer's risk appetite.

However, furnishing a CA certificate does not substitute the legal requirement of obtaining an NOC but it only acts as a risk-mitigation measure and provides additional comfort to the buyer.

Transaction of slump sale

The provisions of section 499 of the IT Act do not expressly cover an 'undertaking' within the definition of 'asset'. However, the underlying assets forming part of an 'undertaking' may individually fall within the definition of 'asset' and may accordingly be subjected to section 499 of the IT Act. Therefore, buyers may still insist on a tax NOC in slump sale transactions.

Key takeaways

- Obtaining a tax NOC is critical in an M&A transaction, especially where there are any outstanding tax demands or ongoing tax proceedings against the seller, although the process is often cumbersome and time-consuming exercise for the seller.
- Where obtaining a tax NOC is not practically or commercially feasible, a certificate from an independent CA may be obtained to mitigate risk and the buyer may seek adequate alternative protections such as specific tax indemnities, escrow arrangements, and other contractual safeguards.

References

[1] TRO v. Gangadhar Vishwanath Ranade, [1998] 234 ITR 188 (SC)

Disclaimer

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

Key Contacts



Mitesh Jain
Partner & Tax Practice Head
mitesh.jain@dentonslinklegal.com



Jishaan Jain
Associate Partner
jishaan.jain@dentonslinklegal.com



Shruti Desai
Senior Manager
shruti.desai@dentonslinklegal.com



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