Mergers & Acquisitions – Case Laws

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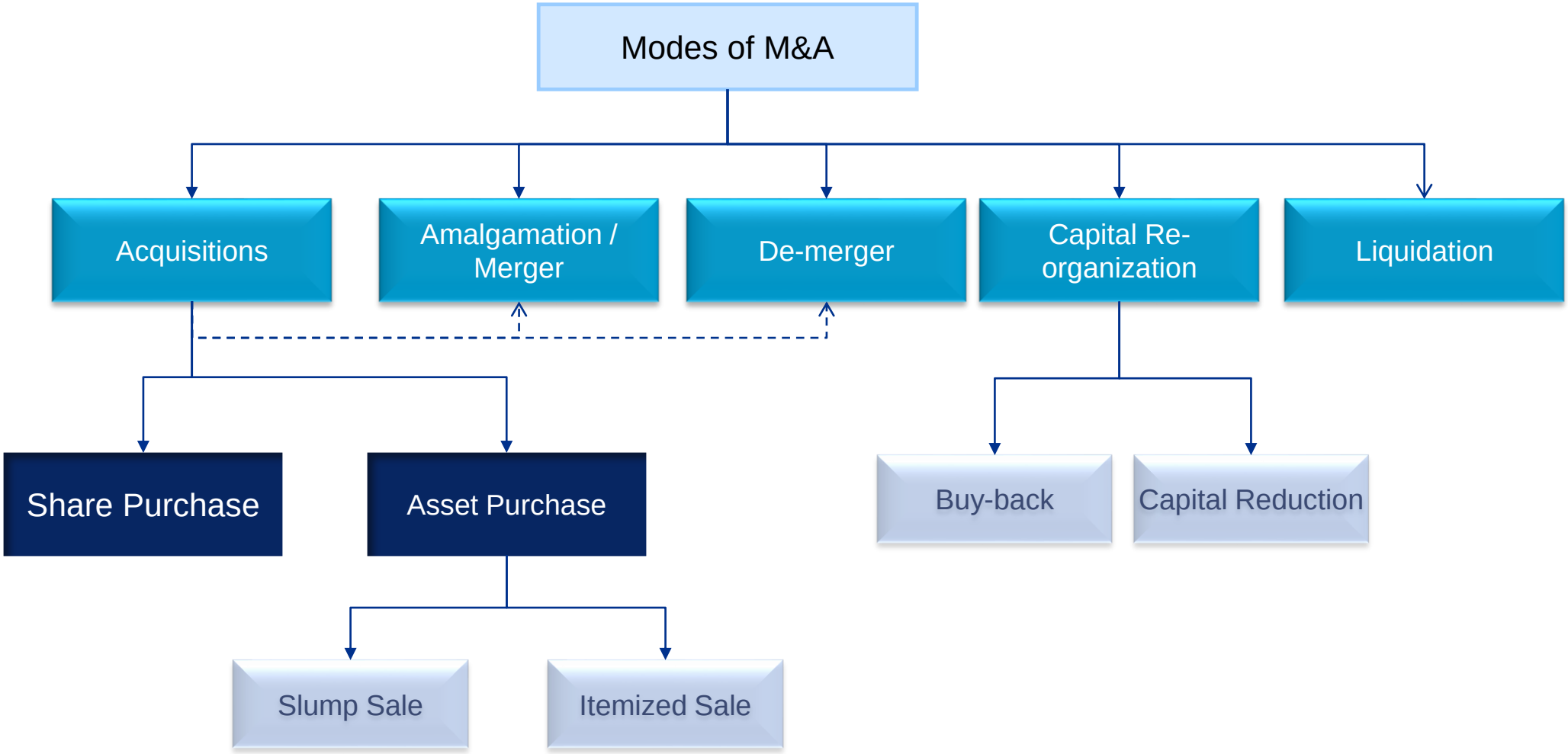
Mergers & Acquisitions (M&A)

Modes

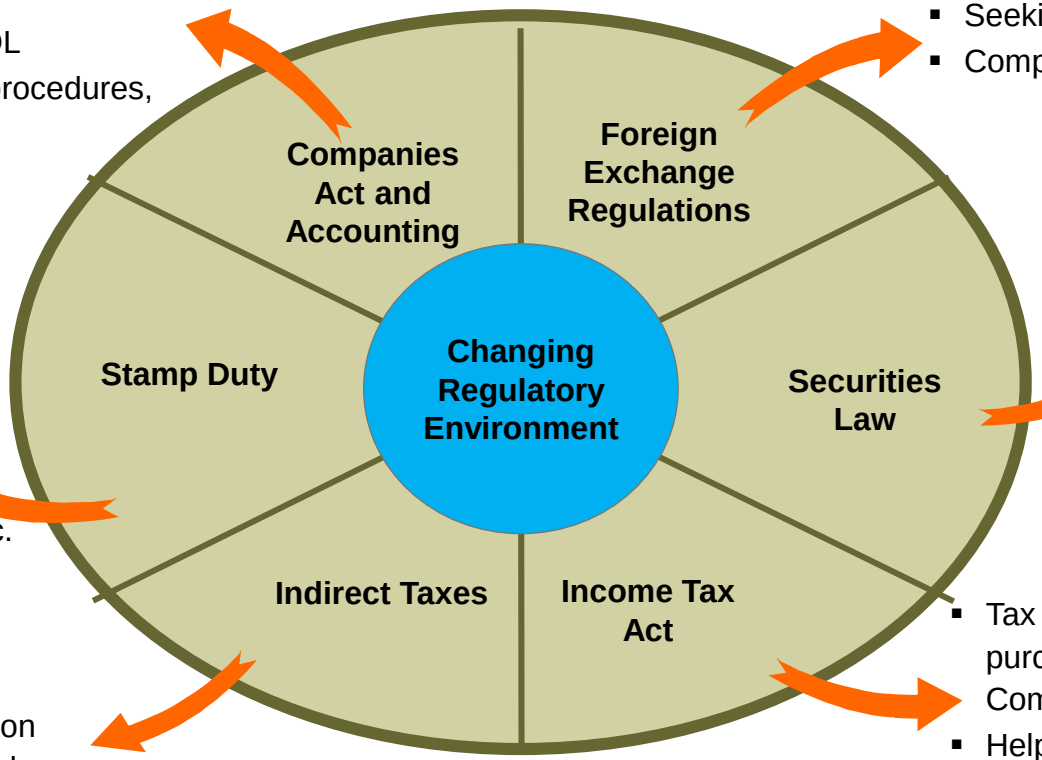


Mergers & Acquisitions (M&A)

Key considerations under M&A Structuring……..its beyond Tax

- Scheme of arrangements u/s 391 – 394 of the Companies Act
- Approvals from RD/ ROC/ OL
- Complying with prescribed procedures, resolution, filings etc
- Accounting implications and disclosures.

- Understanding the FDI Regulations
- Seeking necessary RBI/ FIPB approvals
- Complying with prescribed guidelines



- Compliance with SEBI Regulations/approvals
- Stock exchange compliances

- Understanding state specific stamp duty laws
- Planning levies/ registration charges
- Adjudication proceedings etc.

- Tax implications in the hands of the Seller, purchase / Transferor Transferee / Company, shareholders
- Helping maximize depreciation benefit
- Continuity of Carry forward of losses
- Tax neutrality of restructuring and continuity of fiscal benefits

- Sales Tax / VAT applicability on business transfer, mergers / demergers
- Service tax regulations

Impact on stakeholders such as shareholders, creditors and employees also important

Amalgamation / Merger

Amalgamation – Important Aspects

- **Appointed date** is the date from which the scheme becomes effective.
  - **Accounting** : Accounts of the company would be merged from the appointed date
  - **Income tax** : Transferor Company ceases to exist from the appointed date and the Transferee Company would be assessed to tax on the merged income from the appointed date. [**Marshall Sons & Co. (India) Ltd. v. ITO [1997] 233 ITR 809 (SC)]**
    - Direct taxes like Advance tax, TDS etc - Appointed date applicable, however practical difficulties
    - Indirect taxes like VAT, CST, Service tax etc. - Effective date applicable
- **Effective date** is the date on which the scheme of merger becomes operative, e.g. the date on which the order of the High Court is filed with the Registrar of Companies
- **Accounting of Amalgamation to be as per AS 14 issued by ICAI**
  - Purchase Method
  - Pooling Method

Can Appointed Date be prospective?

Amalgamation – Implications in the hands of the Transferor

- Transfer of capital asset to the amalgamated Indian company is exempt [Sec. 47(vi)]
- Income from the Appointed Date assessed in the hands of the Transferee
- Depreciation available to the Transferor company on pro rata basis up to the Appointed date [Sec. 32]

Amalgamation – Implications in the hands of the Transferee

- Written Down value of Depreciable assets [Section 43(6)]
  - Acquired by the Transferor Company in the year of merger – Actual cost to the Transferor Company
  - Acquired by the Transferor Company in years prior to the merger – Actual cost to the Transferor Company less all depreciation actually allowed
- Cost of Capital asset – Cost to the Transferor [Section 49(1)]
  - Period of holding of the Transferor Company also to be included [Section 2(42A)]
- Capital Asset to Stock in trade – Cost of capital asset in Transferor company to be the cost of stock in trade for Transferee company [Section 43C]
- Capital asset to Depreciable assets – to be the same as the cost of the Transferor Company [Explanation 7 to Section 43(1)]
- Expenditure on amalgamation – tax deductible in five equal instalments [Section 35DD]

Amalgamation – Implications in the hands of the Transferee (contd.)

- Co A engaged in manufacturing of Tea
- As per the Income-tax provisions, only 40% of the profits are liable to tax
- Co A mergers into Co B
- Appointed date – April 1, 2014
- What will be the WDV of Fixed assets of Co A in the hands of Co B????

WDV in books of Co A

A.Y.	Gross Block	Depreciation	Net Block
2012-13	2000	300	1700
2013-14	1700	250	1450
2014-15	1450	210	1240

1696 = 2000 – (300+250+210)*40%

CIT vs Doom Dooma India Ltd. [2009] 178 Taxman 261:

Words 'depreciation actually allowed' would mean depreciation deducted in arriving at the taxable income or the depreciation deducted in arriving at the income (composite income); since in cases where Rule 8 applies income which is brought to tax 'business income' is only 40% of the composite income, only 40% depreciation allowed at prescribed rate is required to be taken into account because that is depreciation 'actually allowed'

Amalgamation – Implications in the hands of the Transferee (contd.)

- Subsequent cessation of a trading liability (taken over by the Transferee) of the Transferor company shall be taxable in the hands of the Transferee Company [section 41(1)]
- Unabsorbed book losses can be carried forward and utilized by Transferee Company – **Dy. CIT vs. Beck India Limited (2008) 26 SOT 141 (Mum.)**
- Unabsorbed losses and depreciation as per Income-tax shall be available to the Transferee company subject to **satisfaction of certain conditions** – Fresh lease of life to losses available
- Tax deductibility of goodwill arising on merger
  - ITA does not explicitly deal with the issue of whether depreciation under s. 32 is available on goodwill
    - The Supreme Court in the case of **Smifs Securities Ltd.** (2014) (24 taxmann.com 222) (SC) held as follows:
      - Goodwill is a depreciable asset under s. 32(1)(ii).
      - The difference between the cost of an asset (net assets) and the amount paid constitutes goodwill.
      - The amalgamated company, in the process of amalgamation, had acquired a capital right in the form of goodwill because of which its market worth stood increased

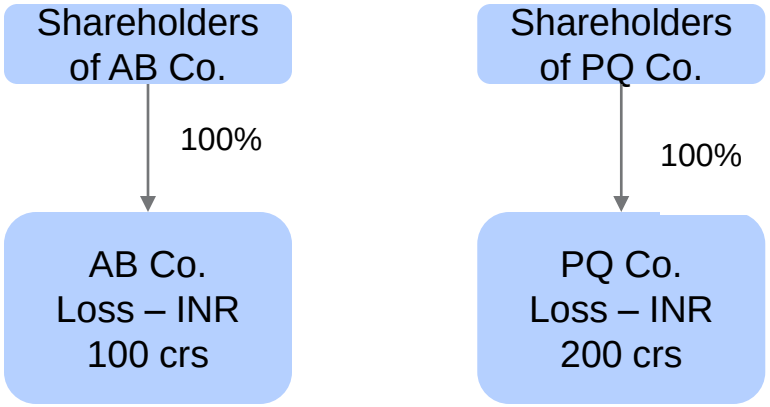
Amalgamation – Implications in the hands of the Transferee (contd.)

- The above view has been recently affirmed by ITAT Mumbai in the case of *DCIT vs Toyo Engineering India Limited (ITA No 3279/M/2008)* wherein it held that depreciation should be allowed on Goodwill arising on amalgamation
- Provisions of Explanations to sec 43(1) and 43(6) not dealt in Supreme Court decision - one may argue that these provisions are attracted only in situations where goodwill is recorded in the hands of the transferor company and it should not apply where no goodwill was recorded in the books of the transferor entity

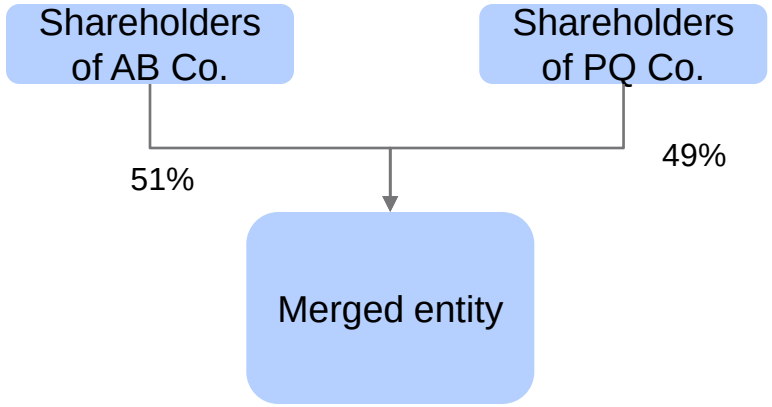
- MAT credit can be carried forward and utilized by the Transferee company – **SKOL Breweries Ltd [2008] 28 ITAT India 998 (Mum.)**

Amalgamation –Definition [section 2(1B)]

Pre – amalgamation structure

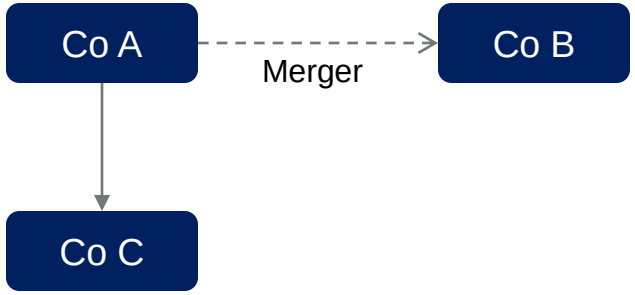


Post – amalgamation structure

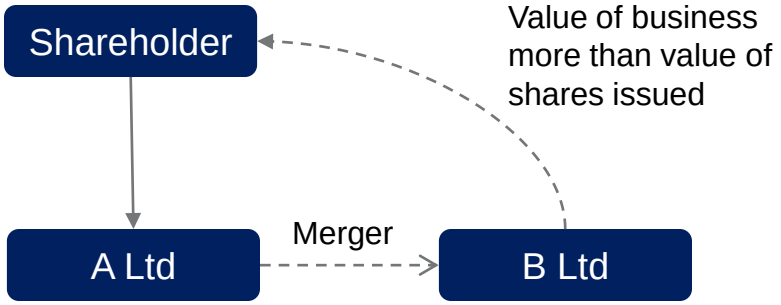


Scenario 1	Scenario 2	Scenario 3
AB Co. merges with PQ Co.	PQ Co. merges with AB Co.	AB Co. and PQ Co. merge to form ABPQ Co.
Loss of INR 100 crs available Loss of INR 200 crs to lapse	Both the losses - INR 100 crs & INR 200 crs available for carry forward & set-off	Both the losses - INR 100 crs & INR 200 crs available for carry forward & set-off

Amalgamation – Implications in the hands of the Transferee (contd.)



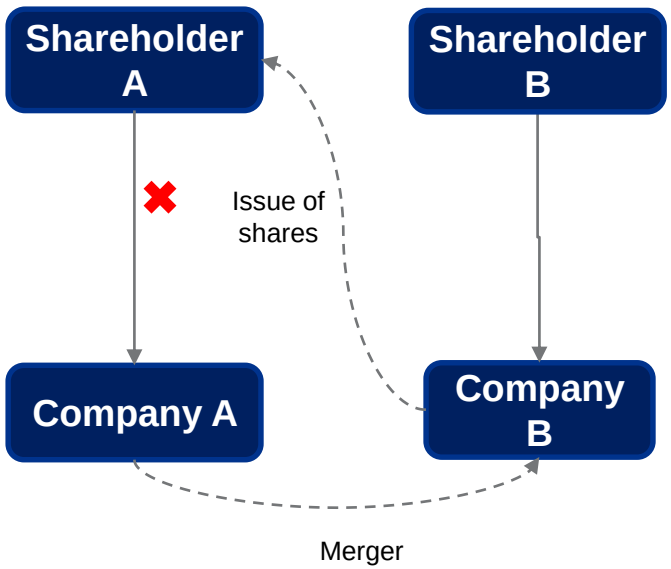
Shares of a closely held company transferred pursuant to the merger – Whether section 56(2)(viia) applicable?



Issue of nominal shares – Whether section 56(2)(viib) applicable?

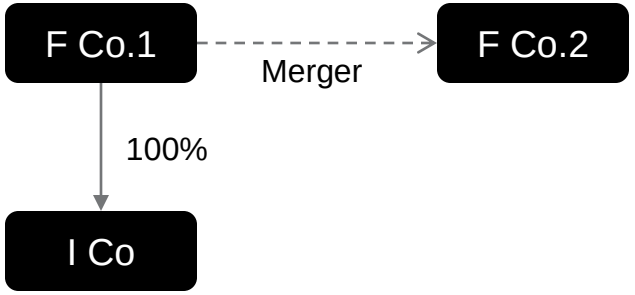
Amalgamation – Implications in the hands of the Shareholder

- Amalgamation results in extinguishment of rights in the shares of Transferor company, Resulting in transfer – **CIT vs. Mrs. Grace Collis and Ors. 248 ITR 232 (SC)**
- Section 47(vii) – Such transfer is exempt if :
  - Shares allotted as consideration for amalgamation; and
  - Amalgamated company is an Indian company
- Cost of shares received in the Transferee Company - same as the cost of shares of the Transferor Company [Section 49 (2)]
- Period of holding – to include the period of shares of the Transferor Company [Section 2(42A)]
- Consideration paid in form of bonds, debentures etc other than shares would be taxable as capital gains - **CIT vs Gautam Sarabhai Trust 173 ITR 216 (Guj)**
  - Issue of Preference shares is exempt
- Section 56(2)(viia) – not applicable in the hands of Shareholder A on receipt of shares in Company B

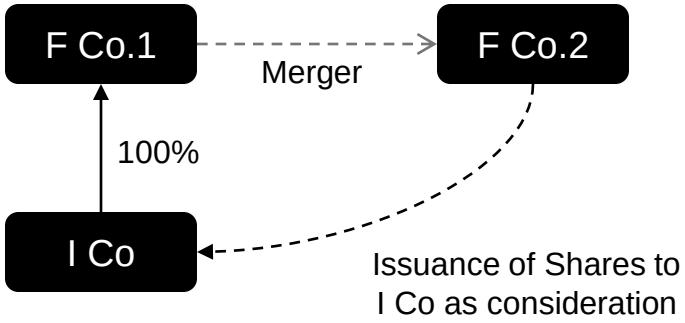


Amalgamation of Foreign Companies

- Shares in ICo transferred from F Co.1 to F Co.2 pursuant to merger of F Co.1 with F Co.2
- Transfer exempt u/s 47(via) if following conditions are satisfied:
  - 25% shareholders of Transferor company continue as shareholders of Transferee company
  - Such transfer does not attract tax in the F Co.1 country

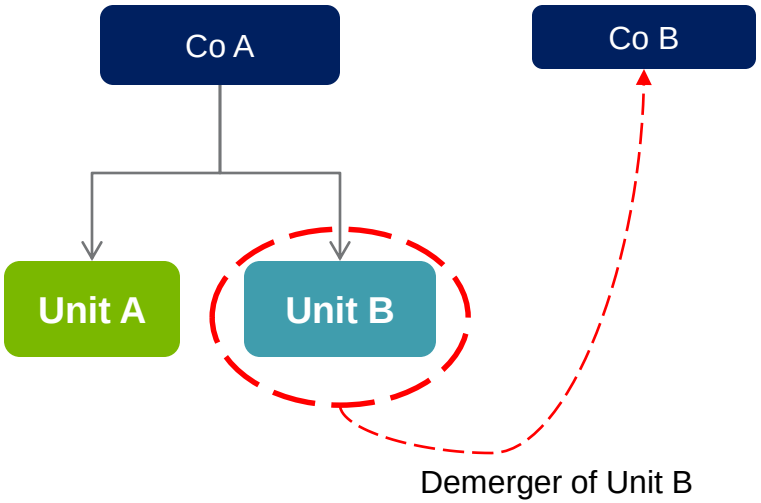


- F Co 1 merges with F Co 2
- F Co 2 issues its shares to I Co as consideration merger of F Co1
- No specific exemption under Section 47 for receipt of shares of F Co 2



Demerger

Demerger



Meaning

- Transfer of one or more undertakings from the Demerged company to the Resulting company
  - **undertaking** includes part / unit / division / business activity but does not include individual assets or liabilities or any combination thereof not constituting a business activity [Indo Rama Textile Ltd., In re [2012] 23 taxmann.com 390 (Delhi)]

Conditions

- Transfer of all properties and liabilities at ***book values***
  - **Whether Transferee company can record at fair value**
- Discharge of consideration by issue of shares on proportionate basis (except where Resulting company is the Hold Co)
- Allotment of shares to shareholders holding not less than 3/4th in value of the shares in the Demerged company
- Transfer to be going concern basis

Demerger – Implications in the hands of the Demerged Company

- Transfer of capital asset to Resulting Indian company is exempt [Section 47 (vib)]

- Depreciation in respect of assets transferred to be apportioned in the ratio of number of days used by Demerged company [section 32 – Proviso 4]

- Cost of acquisition of shares in the demerged company to be the split in the ratio of net assets transferred pursuant to demerger bears to the networth of the demerged Co. before the demerger [section 49(2C) and 49(2D)]

- WDV of the block of assets in the hands of Demerged company shall be reduced by WDV of the assets transferred in demerger [Explanation 2A to section 43(6)]

- Expenditure on demerger – Tax deductible in hands of Demerged company in five equal instalments [Section 35DD]

- Loans / borrowings not specifically relatable to the transferred undertaking to be apportioned in the ratio of assets transferred to total value of the asset

Demerger – Implications in the hands of the Resulting Company

- Depreciable assets: Depreciation on WDV of assets received immediately before the Demerger [Explanation 2B to Section 43(6)]
- Unabsorbed losses and depreciation as per Income tax shall be available to the Resulting company – No fresh lease of life available [section 72A(4)]
- Cost of Acquisition in certain cases
- Capital Asset to stock-in-trade: No provision similar to Sec 43C in case of Amalgamation
- Capital Asset to capital asset : not covered under [Sec 49 (1)] - Cost to the previous owner?
  - **CIT v/s Surat Cotton Spinning & Weaving Mills Pvt. Ltd [118 ITR 746]** – cost in the books of transferor company
  - Period of holding not available - [Section 2(42A)]
- Capital Asset to Depreciable asset - Cost of capital asset in Demerged company to be the Actual cost for depreciation – [Explanation 7A to Sec 43(1)]

Implications u/s 56(2)(viib) on issue of shares as consideration?

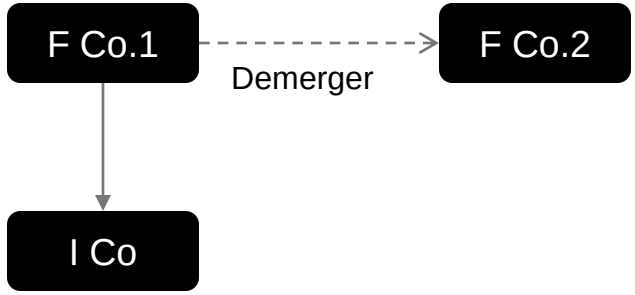
Demerger – Implications in the hands of the Shareholder

- Receipt of shares in the Resulting Indian company, pursuant to Demerger is exempt as there is no transfer [section 47(vid)]
- Cost of shares in Resulting company = (Cost of shares in Demerged company) x (Net Book Value of assets transferred / Net Worth of Demerged company pre - demerger) [Section 49 (2C)]
- Section 2(42A) - Period of holding of shares in Demerged company to be considered for computing period of holding in Resulting company
- Cost of shares in Demerged company to be reduced by cost of shares in Resulting company as computed in [Section 49(2D)]
- No deemed dividend implications on issue of shares by Resulting company [Clause (v) to section 2 (22)]

Can consideration be paid in form of bonds, debentures etc. other than shares?

Foreign Demerger

- Shares in ICo transferred from F Co.1 to F Co.2 pursuant to demerger of a unit of F Co.1 to F Co.2
- Transfer exempt u/s 47(via) if following conditions are satisfied:
  - 75% shareholders of Demerged company continue to remain as shareholders of the Resulting company
  - Such transfer does not attract tax in the F Co.1 country
- No implication under Sec. 56(2)(viia) to F Co 2



Demerger – Case Study*

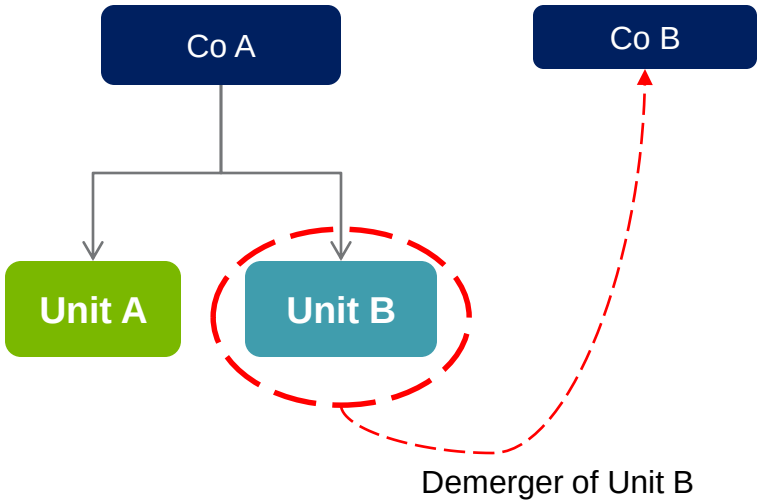
Facts:

- Net worth of Unit B on the Appointed date is negative
- No consideration issued by Co B to either Co A or the shareholders of Co A

Issues:

- Whether the said transfer qualifies as a "demerger" u/s 2(19AA)?
- If not, can the said transfer be considered as Slump sale?
- Whether the said transfer is taxable in the hands of Co A?

It was held that the said transaction was taxable under the head capital gains. Since it was not possible to compute the cost of acquisition, no tax was levied.



***Avaya Global Connect Ltd vs Asst CIT [2008] 26 SOT 397 (Mum.)**

Slump Sale and Slump Exchange

Slump Sale – Definition [section 2(42C)]

Means transfer of **one or more undertakings**

As a result of **sale**

For a **lump sum consideration**

Without values being assigned to the individual assets and liabilities in such sales

Determination of value of asset for the purpose of stamp duty shall not be regarded as assignment of values to individual assets –explanation to Sec 2(42C)

Slump Sale – Important terms

Going Concern requirements

- Normally, litigation in slump sale transaction arises on two components-
  - What quantifies as an Undertaking for the purpose of Section 2(42C)
  - If consideration is not lump sum and determined on the basis of individual values of assets / liabilities

Definition of “Undertaking“ is wide enough to include even a business activity which in normal parlance may not resemble an “Undertaking” e.g. R&D division

Transfer to be regarded as slump sale even if certain assets are not transferred provided it does not impair the operation/ continuity of the business transferred

Slump Sale – Tax Implications in the hands of Seller [section 50B]

- Consideration less 'cost of acquisition' would be Capital Gains in hands of Seller
  - Cost of Acquisition = **'Networth'** of the undertaking
  - Networth = Aggregate value of total assets less aggregate value of total liabilities. Value of assets for the purpose of computation of Networth

Asset Type	Value to be considered
Depreciable Asset	WDV of the block of Assets as under section 43(6)
Capital Asset u/s 35AD	NIL
Other Assets	Book value of such assets

- If undertaking is held for more than 3 years, gain would be LTCG and in other cases as STCG
- Future depreciation to be calculated by the seller after reducing the tax WDV of the assets transferred
- Chartered Accountants report in Form 3CEA needs to be obtained for the valuation of net worth
- Possible to claim exemptions against long term capital gain under Sec 54EC

Indexation benefit not available and revaluation of assets, if any to be ignored

Slump Sale – Tax Implications in the hands of Seller (contd.)

Section 50B vs Section 50C

- Where there is a transfer of an "Undertaking" including land, building or both, under the slump sale whether section 50C applicable?

  - The capital asset, which is the subject matter of charge of capital gains is an 'Undertaking' and not the land and building
  - No identifiable consideration received or accrues as a result of the transfer of land or building
  - It would be impossible to say whether the consideration received or accruing for the land or building is more than or less than the value adopted or assessed by the stamp valuation authority
  - In view of the above, Section 50C should have no application where there is a slump sale of an undertaking

Year of Taxability

- Normally, the year in which the BTA is executed, that year is considered as a taxable year for the slump sale.
- However if any conditions are attached with the transfer of undertaking and the same is stated in the BTA, then the year in which the conditions are fulfilled, is considered as a year of taxability

Slump Sale – Tax Implications in the hands of Seller (contd.)

Section 50D – Inserted by Finance Act 2012 w.e.f 1st April 2013

- Where the consideration received or accruing as a result of transfer of capital asset is **not ascertainable or cannot be determined,** for the purpose of computing capital gains tax, **fair market value of the said asset** as on the date of transfer shall be **deemed to be the full value of consideration**

Networth of the Undertaking transferred is Negative

- Where the value of the assets transferred in a Slump sale is less than the liabilities the net worth for the purpose of computation of tax under section 50B shall be considered to be Nil –[**Zuari Industries Limited vsACIT 298 ITR (AT) 97 (Mum)]**
- However, the Special bench of Mumbai Tribunal in the case of **DCIT v. Summit Securities Limited (ITA No. 4977/Mum/2009)** has reversed the law laid down in the above decision and has held that the negative figure in the net worth shall not be ignored

It can be considered to be NIL

Slump Sale – Tax Implications in the hands of Buyer

- Allocation of cost among the assets acquired
  - No methodology prescribed
- Assets (tangible and intangibles) acquired could be recorded at their fair values (As per AS 10)
  - Backed by an independent valuation report which allocates purchase consideration to various assets / liabilities
  - Balance purchase consideration, if any, attributable to goodwill

Possible to capture value of brands and claim tax depreciation on intangibles acquired

Expenditure on slump sale – allowable?

- No specific provision for the allowability of such expenses in the Act
- Based on the judicial precedent, the expenses incurred in connection with slump sale are not deductible as business expenditure under section 37(1) of the Act

Source: DCIT vs Max India Ltd. (112 TTJ 726) (2007) (Amritsar ITAT)

Slump Sale – Tax Implications in the hands of Buyer (contd.)

Treatment of brought forward losses

- No specific provision in the Act
- Past unabsorbed losses cannot be transferred to the acquirer on transfer of an “Undertaking”

Continuity of benefits

- Continuance of the existing tax benefits under section 10A, 10B, 80IA, 80IB etc
- Though the intention is that the benefit is attached to the undertaking only, the said intention is not reflected in the provisions of the Act in respect of the slump sale

Section 281 – Transfer as void in certain cases

Section 281 of the Income-tax Act provides for transfer as void in certain cases

*"Where, **during the pendency of any proceeding under this Act** or after the completion thereof, but before the service of notice under rule 2 of the Second Schedule, **any assessee** creates a charge on, or **parts with the possession** (by way of sale, mortgage, gift, exchange or any other mode of transfer whatsoever) of, **any of his assets** in favour of any other person, such charge or **transfer shall be void as against any claim in respect of any tax or any other sum payable by the assessee** as a result of the completion of the said proceeding or otherwise"*

Exception to the above if the transfer is made:

- for adequate consideration **and** without notice of the pendency of such proceeding or, as the case may be, without notice of such tax or other sum payable by the assessee; or
- with the previous permission of the Assessing Officer.

"Assets" means ***land, building***, ***machinery, plant, shares***, *securities and fixed deposits in banks*, to the extent to which any of the assets aforesaid does not form part of the stock-in-trade of the business of the assessee

Section 281 – Prior approval of tax authorities

Key points emerging in respect of provisions of Section 281 based on past judicial precedents

- Declaration of transfer as void must be sought in a court - merely by passing an order under section 281, tax authorities cannot consider a transfer as void
- The seller would have opportunity to be heard before the transaction is held void
- The transfer as contemplated under section 281 is not void ab initio. So if the claims are settled then the title of the transferee should remain unaffected

CIRCULAR NO. 4/2011 dated 19th July, 2011 lay down the guidelines for prior permission under Section 281

- The seller to file the application at least 30 days prior to the date of transaction
- Seller to pay undisputed outstanding demand
- In case disputed demand outstanding, the seller to obtain stay for same and indemnify outstanding demand by way of bank guarantee / sufficient assets / by tax department retaining first charge on assets to be transferred, to the extent of such demand.
- The tax authorities should grant permission within 10 workings days of payment of demand / indemnification of the demand.

Whether Income-tax return filed is pending proceedings?

Slump Sale vs Slump Exchange

- The provisions of Sec 50B for computation of capital gains upon transfer of business specifies receipt of consideration in cash
  - Consideration in any other manner like shares bonds etc is not covered. It would tantamount to slump exchange
- Taxability of slump exchange
  - Mechanism to compute cost of business transferred is not provided in the Income tax act. Hence computation mechanism fails – **Bharat Bijilee, Zinger Investments Ltd, etc.**

Slump Exchange – Concept and Taxability

Meaning

- ✓ Not defined under ITA
- ✓ Consideration is issued in the form of shares
- ✓ No specific provision for the purpose of computing capital gains, however, sales consideration to be calculated based on fair value of shares issued

Whether transfer of undertaking by way of slump exchange is liable to tax under the ITA?

- Section 45 of the Act create a charge on capital gains arising on transfer of a capital assets
- The definition of Transfer under section 2(47) of the Act specifically includes exchange and thus its transfer can give rise to taxable capital gains
- However section 2(42C) defines 'Slump Sale' to mean transfer of one or more undertakings as a result of 'sale' for a lump sum consideration and section 50B deals with its computation mechanism
- Section 50B is applicable only to 'sale' and not to any other mode of transfer
- From the above, it can be concluded that Section 2(42C) and Section 50B would not be applicable where the business undertaking is transferred in exchange for consideration in kind

Slump Exchange - Taxability

Whether the gain on transfer of slump exchange is taxable under section 48 of the ITA?

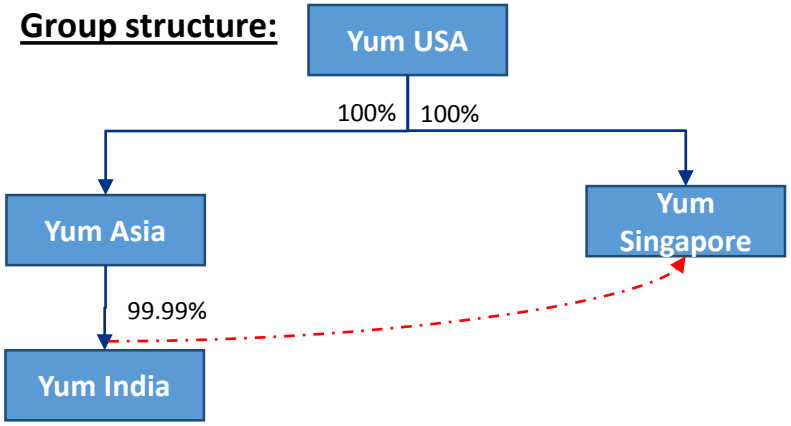
- The gain from transfer by way of slump exchange is a gain from transfer of an undertaking
- For assessment of such gains there is a specific provision in the Act i.e Section 50B and that provision is not applicable for slump exchange
- Thus if the gain on transfer cannot be computed under section 50B, such gain cannot be computed under the residuary provisions of section 48 of the Act (**Hamilton & Co. (P) Ltd vs CIT(1992) 194 ITR 391 (Cal))**

Recent Case Laws

Change in Shareholding of Closely held Company – Section 79

Yum Restaurants Pvt Ltd - Sec 79 – Dated 13 Jan 2016

Group structure:



Recently, the Karnataka High Court, in the case of AMCO Power Systems Ltd (7 Oct 2015)., had held that the section 79 did not apply when the holding company, along with its wholly-owned subsidiary, continued to hold 51% of the voting power, even though there was a change of more than 51% direct shareholding of the concerned company

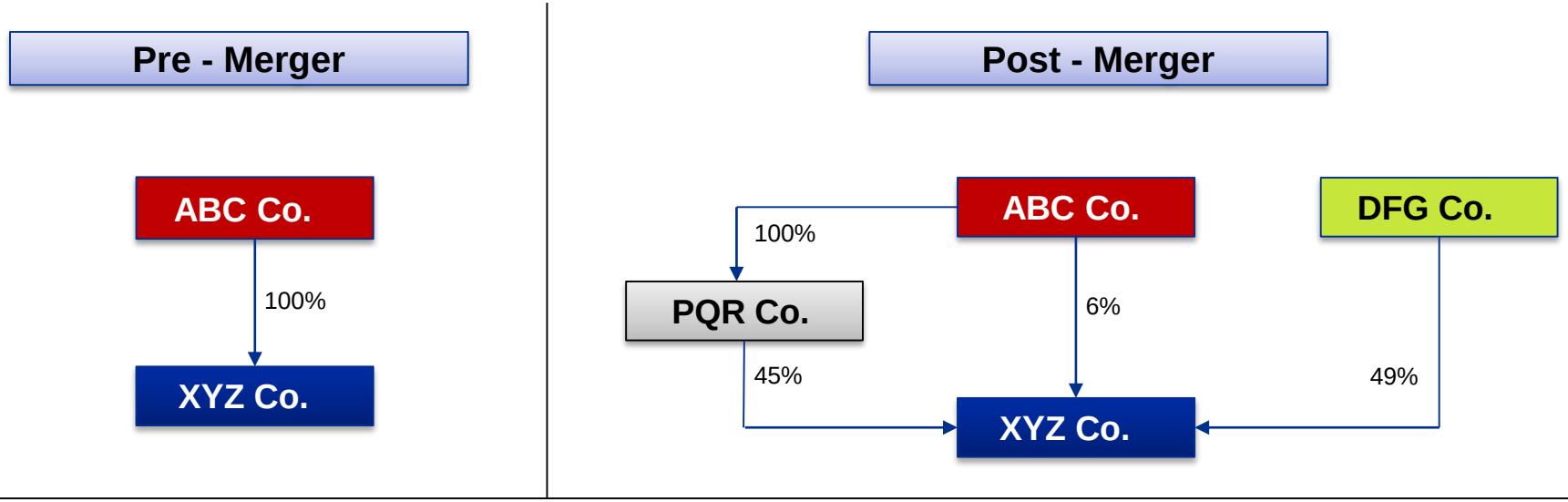
Facts of the case:

- The group decided to hold shares in Yum India through Yum Singapore and, therefore, the entire share holding in Yum India was transferred from one holding company, viz., Yum Asia to another immediate holding company, Yum Singapore, although the ultimate beneficial owner of the share holding in Yum India remained the holding company viz., Yum USA.
- Yum India filed its return of Income for AY 2009-10 declaring a loss of Rs. 18 crs
- Tribunal adjudicated the matter against the taxpayer and held that there was a change of 100% of the shareholding of Yum India
- ITAT Held that by virtue of Section 79 of the Act, since there had been a change of more than 51% of the share holding pattern of the voting powers of shares beneficially held in AY 2008-09 of Yum India, the carry forward and setting off of business losses could not be allowed

Delhi High Court Held that

- There was indeed a change of ownership of 100% shares of Yum India from Yum Asia to Yum Singapore, both of which were distinct entities

Case Study – Amco Power Systems Limited



Section 79:

Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless—

(a) on the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred.

Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift.

Provided further that nothing contained in this section shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

(b) [Omitted by the Finance Act, 1988, w.e.f. 1-4-1989.]

Yum Restaurants Pvt Ltd - Sec 79 – Dated 13 Jan 2016

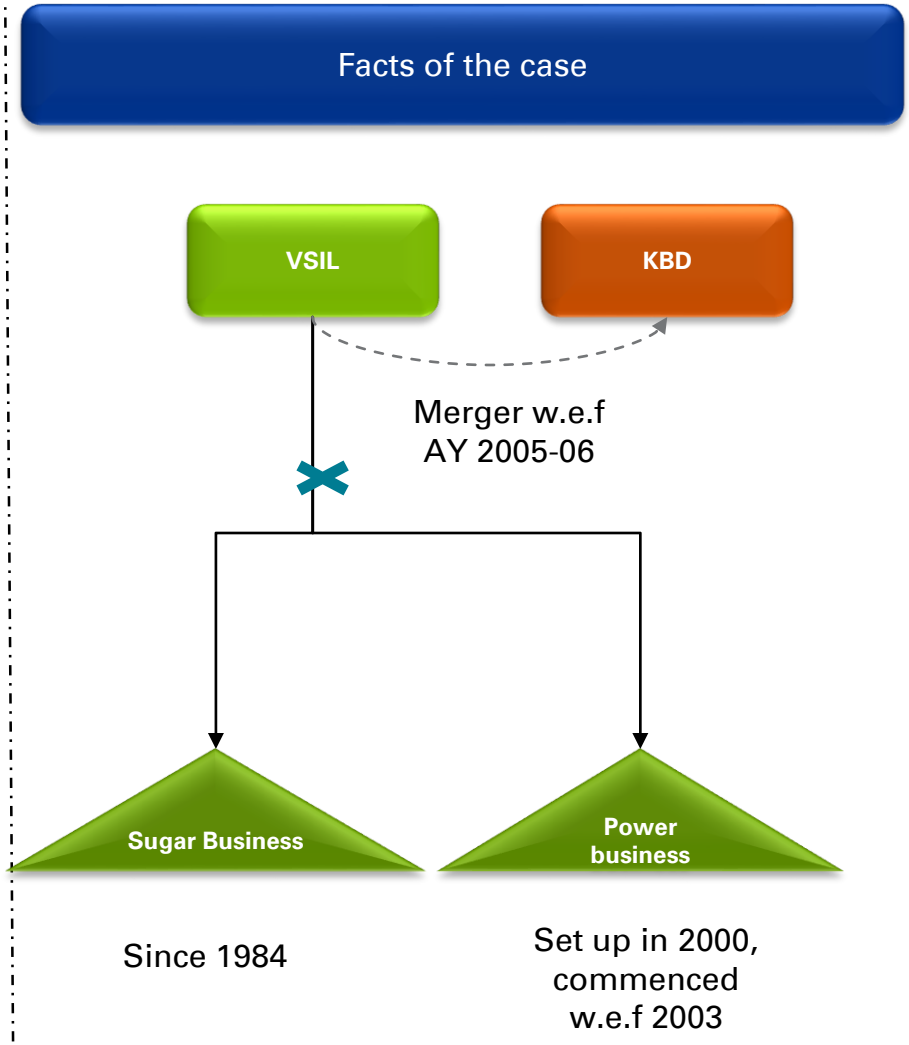
Order of High Court:

- AO did not accept the contention of Yum India that since the ultimate holding company remained Yum USA, it was the beneficial owner of the shares, notwithstanding that the shares in Yum India were held through a series of intermediary companies
- The parent company of Yum India on 31st March 2008 was the equitable owner of the shares but not as on 31st March 2009
- ITAT order analysed that there was a change of 100% of the shareholding of Yum India and consequently there was a change of the beneficial ownership of shares since the predecessor company (Yum Asia) and the successor company (Yum Singapore) were distinct entities.
- The fact that they were subsidiaries of the ultimate holding company, Yum USA, did not mean that there was no change in the beneficial ownership.
- Unless the Assessee was able to show that notwithstanding shares having been registered in the name of Yum Asia or Yum Singapore, the beneficial owner was Yum USA, there could not be a presumption in that behalf.
- HC finds that there was indeed a change of ownership of 100% shares of Yum India from Yum Asia to Yum Singapore, both of which were distinct entities.
- Although they might be AEs of Yum USA, there is nothing to show that there was any agreement or arrangement that the beneficial owner of such shares would be the holding company, Yum USA.

Unabsorbed losses of amalgamating Co. u/s 72A

KBD Sugar & Distilleries Ltd. – Sec 72A – Dated 16 Oct 2015

- KBD Sugars & Distelleries Limited (KBD) is engaged in business of manufacture of beer
- Vani Sugars and Industries Limited (VSIL) was engaged in following business
    - manufacturing and trading of sugar since 1984); and
    - generation of power (commenced business w.e.f. August 2003)
        - License for setting up of business of power generation, loans for the same, construction of building etc started from FY 2000
- Amalgamation of VSIL with KBD w.e.f. March 2005 i.e. AY 2005-06
- During AY 2005-06, KBD declared business income of INR 246.5 mn and brought forward losse of VSIL of INR 213.35 mn which was set off against above income
- AO disallowed brought forward losses amounting to INR 34.89 mn since the power unit had not commenced its production three years prior to amalgamation as required by the provisions of section 72A(2)(a) (i) of the Act.
- CIT(A) and ITAT held in favor of assessee



KBD Sugar & Distilleries Ltd. – Sec 72A – Dated 16 Oct 2015

Assessing Officers Contention:

- The assessing officer disallowed the business loss and unabsorbed depreciation from the power generation business which was brought forward and claimed as set off. The assessing officer was of the view that the amalgamating company was engaged in the power generation business for less than 3 years

Assessee's contention:

- The amalgamating company had started the work establishment of power generation in 2000 and had only commenced the operation of power generation from August 2003. Thus the amalgamating co. was engaged in the business for more than 3 years. Hence set off of the brought forward loss of the amalgamating co should be allowed.

High Court Ruling :

The Hon'ble High Court affirmed the order of ITAT with the findings as under:

i. Section 72A(2)(a)(i) of the Act uses the phrase **'engaged in business' and not 'commencement of business'** and since the assesse was engaged in activities such as obtaining licence, loans, construction of building and purchase of machinery from the year 2000 itself, it cannot be disputed that the assessee was engaged in the business of generation of power for more than three years.

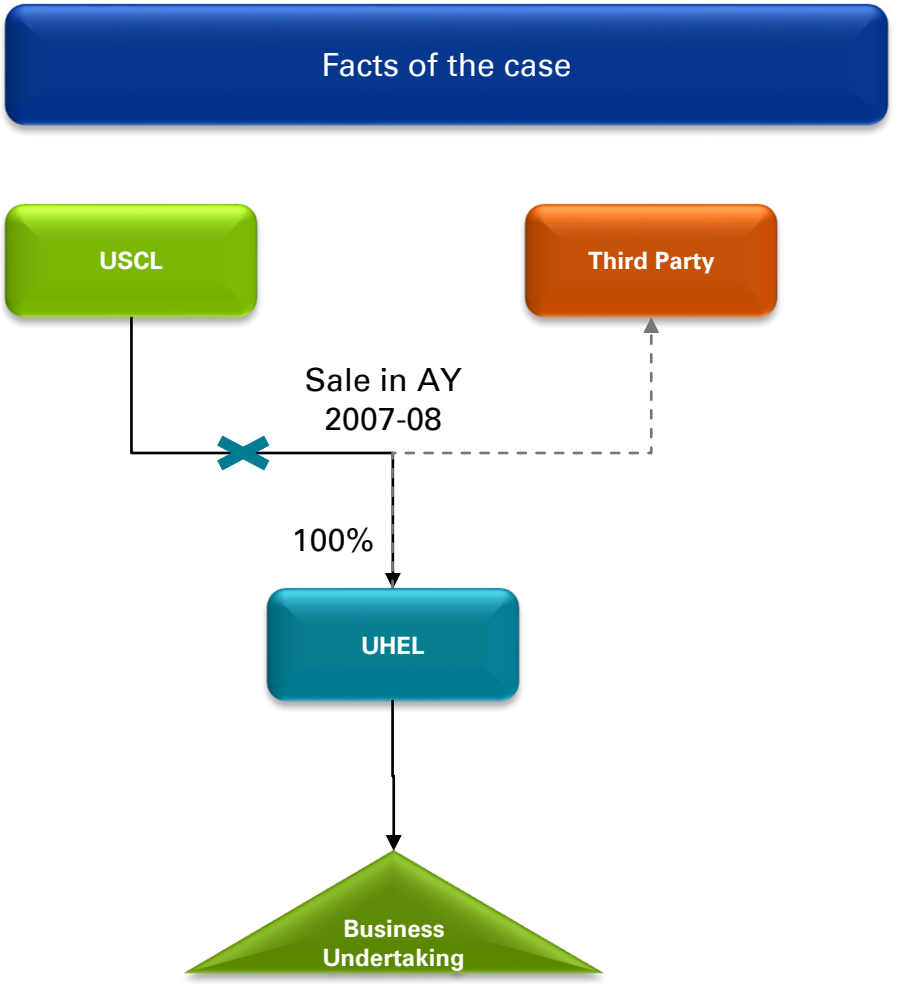
ii. Section 72A(2) of the Act states that it is the amalgamating company which should be in business for more than 3 years and not a particular unit or division. It is also stated that it is the loss of the amalgamating company as a whole, which is set off or carried forward, and not of a particular division or unit.

iii. Section 72A of the Act is a beneficial provision and thus it should be construed liberally. Therefore, when two view are possible, one in favor of assessee should be adopted.

Slump sale- Transfer of subsidiary's shares not 'slump-sale' of undertaking

UTV Software Communications Ltd. v. ACIT(I.T.A. No.3148/ 2013) (Mumbai ITAT)

- UTV Software Communications Limited (USCL) is engaged in business of Television Programs, Air Time sales, movie production
- United Home Entertaining Limited (UHEL) was a 100% subsidiary of USCL
- During AY 2007-08, USCL sold entire shareholding in UHEL to a third party resulting in LTCG of ~ INR 25 crs
- AO held that the transaction amounts to slump sale and computed u/s 50B r.w. s.2(42C) of the Act and recalculated the gain as short term capital gain of ~ INR 20.35 rs on the following ground:
  - 100% share of any company would lead to a change of ownership and management of the said company and same is the situation in the case of a slump sale



Relevant Sections

Section 50B

“(1)Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place :

Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than thirty-six months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer
of short-term capital assets.

(2) In relation to capital assets being an undertaking or division transferred by way of such sale, the "net worth" of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 and no regard shall be given to the provisions contained in the second proviso to section 48.

(3) Every assessee, in the case of slump sale, shall furnish in the prescribed form along with the return of income, a report of an accountant as defined in the Explanation below sub-section (2) of section 288 indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at in accordance with the provisions of this section.”

Section 2(42C)

”slump sale" means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales

Explanation — 1. For the purposes of this clause, "undertaking" shall have the meaning assigned to it in Explanation 1 to clause (19AA)

Mumbai ITAT Ruling

The Hon'ble ITAT held as under:

i. If the aforementioned sections are read in conjoint, we have no hesitation to hold that by any stretch of imagination, transfer of shares will not result into transfer of undertaking making it a slump sale for Sec. 50B of the Act.

ii. Assuming, yet not accepting this transaction to be a slump sale, the consideration should have been received by UHEL and not the assessee because it is UHEL which has been transferred and being a distinct legal entity is entitled for the sale consideration of its transfer. However, this is not the case since the shares were transferred by the assessee, assessee received the sale consideration.

Reliance placed on following case laws:

i. Supreme Court in case of Mrs. Bacha F. Guzdar (supra) –

The company is a juristic person and is distinct from the shareholders. It is the company which owns the property and not the shareholders.

ii. High Court of Karnataka in the case of Bhoruka Engineering Indus. Ltd (supra) –

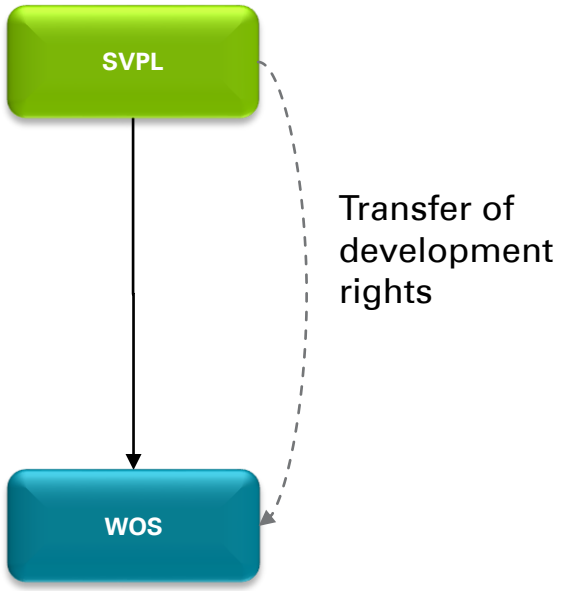
The language employed in section 10(38) of the Act is simple and unambiguous and it makes no distinction between the transfer of share of company with an immovable asset and movable asset, instead of executing a sale deed in respect of the immovable property by the company, which is owning the land. If the shareholder chooses to transfer the lands and part with the land to the purchaser of the shares, it would be a valid legal transaction in law and merely because they were able to avoid payment of tax, it cannot be said to be a colourable device or a sham transaction or an unreal transaction.

Exempt Capital Gains while computing book profits under provisions of MAT

Shivalik Venture Pvt. Ltd. v. DCIT – 19 September 2015

Facts:

- The Company (Shivalik Ventures) transferred a land parcel along with its development rights/ FSI to its WOS
  - ✓ The capital gains of Rs 300 crs arising thereon was exempt u/s 47(iv) of the IT Act
  - ✓ The Company did not include such gains while computing the "book profit" u/s 115JB of the IT Act by including a note in its Notes to Accounts to the effect that *'it is a capital receipt and a transaction is not regarded as a transfer under the Income-Tax Act, the company interprets that since it is not being in the nature of income it does not came within purview of Section 115JB'*



AO's objection

- AO did not agree with the contentions of the Company and included the above amount as part of "net profit" for the purpose of computing the "book profit" under the provisions of section 115JB of IT Act.
- CIT(A) upheld AO's order

Shivalik Venture Pvt. Ltd. v. DCIT - 19 September 2015

The Hon'ble ITAT observed as under:

- For the purpose of making adjustments, it is not necessary that those items should have been specified in Explanation 1 to Section 115JB of the Act, since net profit is itself is arrived at by adjusting the effects of notes given in notes to accounts
- The profit and loss account should be read along with notes to account and should be applied uniformly in all kinds of situations and hence due adjustments need to be done for the effect of items disclosed in notes to accounts
- The legislature, in its wisdom had decided not to tax income under section 10 (considered as 'income not included in total income'). The logic of this provision is that an item of receipt which falls under the definition of 'income' are excluded for purpose of computing book profits, since said receipts are exempt under section 10. Thus, legislature seeks to maintain parity between computation of total income and book profits, in respect of exempted category of income
- The facts in instant case are different from the case before special bench in case of Rain Commodities Limited. Vs DCIT, Hyd SB

Relevant Case Laws

Rain Commodities Limited. Vs DCIT, 40 SOT 265 (Hyd) SB: (Facts were similar to present case)

In the notes on accounts, it was nowhere mentioned and claimed that though the long-term capital gain was included in the profit and loss account but it was not to be includible in the net profit in terms of provisions of Part II and Part III of Schedule VI to the Companies Act or the accounting principles accepted under the Companies Act. Hence, it was held that it was not a case of the assessee that the long-term capital gain was not includible in the profit and loss account prepared in terms of Schedule VI to the Companies Act. In the absence of any provision for exclusion of capital gains exempted in the computation of book profits under the provisions contained in the Explanation to section 115JB, the assessee was not entitled to the exclusion thereof as claimed

Sain Processing & Weaving Mills (P) Ltd (Delhi HC)

The assessee therein issue did not charge depreciation to the Profit & Loss account, but disclosed the same in the Notes forming part of accounts. However, while computing book profit u/s 115J of the Act, Delhi HC allowed the amount of depreciation as deduction from the Net profit disclosed in the Profit and loss account

Hindustan Shipyard Ltd Vs. DCIT (6 ITR (Trib) 407)

In the case of assessee therein, it was noticed that the Government of India, by an order dated 24.3.99, had waived loan and interest accrued thereon to the tune of Rs.591.13 crores which was otherwise payable by that assessee. However, the said company did not incorporate the effect of such waiver in its books of accounts, though it disclosed the details of waiver in the notes to accounts. The ITAT held that the Assessing Officer is entitled to include the waiver benefit that was disclosed in the notes on accounts

Scheme does not comply with the definition of ‘demerger’ and ‘resulting company’ u/s 2(19AA) and 2(41A) read with section 2(19AAA) of the IT Act – Whether Valid

Thomas Cook Insurance Services (India) Limited – Dated 2 July 2015

Facts:

- Petitioner Companies filed a composite Scheme of Arrangement and Amalgamation between A ltd (Transferor Co) and B Ltd (Resulting Co 1) and C Ltd (Resulting Co 2).
  - ✓ A ltd is a listed company engaged in business of vacation ownership and leisure hospitality.
  - ✓ B Ltd and C Ltd are engaged in business of corporate agency for travel insurance and integrated travel and travel related services, respectively.
  - ✓ C Ltd is the parent of B Ltd
- **Scheme involved:**
  - ✓ Demerger of undertaking pertaining to time share and resort business from A Ltd into B Ltd
  - ✓ Amalgamation of A ltd (remaining business) with C Ltd
  - ✓ As consideration for demerger and merger envisaged above, C ltd to issue equity shares to the shareholders of A Ltd

RD's objection

- RD raised an objection with respect to discharge of consideration by C Ltd on demerger of time share and resort business from A ltd into B Ltd; B Ltd does not issue any shares as consideration on demerger which is not in accordance with Companies Act
- Further, Scheme does not comply with the definition of 'demerger' and 'resulting company' u/s 2(19AA) and 2(41A) read with section 2(19AAA) of the IT Act

Thomas Cook Insurance Services (India) Limited – Dated 2 July 2015

HC's ruling on non compliance under IT Act:

- If the scheme which is otherwise permissible both under Companies Act and IT Act, does not amount to demerger under IT Act, it may have certain tax implications, but there is no prohibition under IT Act to such a Scheme
- The scheme contains a provision that if any terms or provisions of the scheme are inconsistent with the provisions of Section 2(19AA) of IT Act, then provisions of Section 2(19AA) shall prevail and the scheme shall stand modified to the extent. Hence, framing of the Scheme and its sanction by the Court does not prejudice the application of section 2(19AA) of IT Act
- Sanction of the Scheme by the High Court does not:
  - ✓ Imply court's acceptance of Company's stance that the scheme complies with provisions of demerger u/s 2(19AA) of IT Act
  - ✓ Bind IT department to take any particular view as far as the tax implications are concerned

On non compliance under Companies Act:

- Provisions of clause 3941(i) to (vi) of Companies Act, are merely enabling provisions, which cannot be construed as compulsory in any sense. The said provisions are not in the nature of conditions for exercise of power of the Court u/s 394
- If a Scheme provides for discharge of consideration by transferee company by issue of shares, debentures, etc., then the Court while sanctioning the scheme may make appropriate provision in respect of such allotment or appropriation.
- It is not necessary in every case that the consideration must be in the form of allotment of shares of a transferee company. The consideration can be any legitimate consideration, which the transferor is entitled to accept for contract of transfer.
- Acceptance of any particular consideration will be based on the commercial wisdom of shareholders of transferor company. As long as such consideration is not against public interest or illegal or inappropriate, it is not for Court to accept or reject such consideration

Whether Assessment order issued to the Transferor Company pursuant to Scheme become effective is Void ?

CIT v. Dimension Apparels Pvt. Ltd. (Del) – 8 July 2014

Facts:

- Assessee was amalgamated with M/s B. S. Infratech Private Limited ('amalgamated company') vide Delhi High Court order dated December 7, 2009. Appointed date – April 1, 2008
- Search and seizure was conducted and assessment order was made on assessee on December 31, 2010 for AY 2003-04 to AY 2008-09
- Assessee appealed to CIT(A) on grounds that assessee ceased to exist on date of passing order
- **CIT(A) agreed with assesse's contention and held that assessment upon dissolved company is impermissible**
- **Tax department appealed to ITAT which upheld decision of CIT(A). Tax department further appealed to the High Court**

CIT v. Dimension Apparels Pvt. Ltd. (Del) – 8 July 2014

Tax department's contention:

- Assessment was justifiable u/s 170(1) and (2) as liabilities of amalgamating company accrued to amalgamated company
- Reliance was placed in case of Marshall Sons and Co for interpretation of appointed date and effective date in case of retrospective merger to determine date on which company can be considered as ceased to exist
- Mere omission to mention name of amalgamated company is procedural defect and same is rectifiable u/s 292B

Assessee's contention:

- Text of section 170(1) and (2) does not support tax department's argument
- Passing order on amalgamating company is jurisdictional defect and cannot be cured u/s 292B

CIT v. Dimension Apparels Pvt. Ltd. (Del) – 8 July 2014

High Court's Ruling

- Sections 170(2) makes it clear that assessment must be made on successor (i.e. amalgamated company)
- It is not possible to treat amalgamating company and amalgamated company as jointly liable in respect of assets and liabilities
- **Marshall Sons & Co deals with issue of effective date and not on issue whether assessment can be made on amalgamated company**
- Omission to substitute successor in place of predecessor is not procedural irregularity and same cannot be corrected by invoking provisions of Section 292B
- **High Court held that order on amalgamating company is invalid.**

Resulting Company entitled to pro-rata TDS and advance-tax & MAT credit post demerger ??

ITAT - Adani Gas Ltd Dated 18 January 2016

Background:

- Gas distribution undertaking was demerged from Adani Energy (AEL) to Adani Gas (AGL), appointed date being 1 Jan 2007
- As per Scheme of demerger, sanctioned by the Gujarat HC, there was generic clause on bifurcation of income and taxes pertaining to AEL
- Total amount of taxes paid was Rs. 2.11 crore and entire credit was transferred to AGL because the taxes resulted mainly from activities pertaining to AGL
- The above taxes had been paid prior to demerger and AGL claimed credit for the taxes which included TDS, advance tax and SA tax
- AEL revised return of income of Rs. 12.29 cr as Rs. 9.09 cr and AGL filed for Rs. 3.19 cr. Refund accordingly revised.
- The AO proceeded to determine demand for the relevant year u/s 143(3) for AGL without giving credit for above taxes.
- As per the office note, AO allowed credit in the hands of AEL since the demerger scheme did not speak of bifurcations of various tax credits.

Adani Gas Ltd Dated 18 January 2016

Held by the High Court:

- AO contended that demerger scheme did not speak of any bifurcation of taxes – this cannot be agreed withThe scheme covers all assets & properties of the gas distribution division.
- Clause also covers all possible benefits including deferred tax benefits
- The Transferor entity (AEL) is deemed to have carried on the business on behalf of the Transferee (AGL) – relied on **Marshall Sons & Co. (SC)**
- Entitlement of all benefits would be on pro rata basis qua those relating to the demerged undertaking
- **In case of Torrent (P) Ltd. (Guj HC),** DDT was paid on dividend declared by subsidiary co which was amalgamated with the holding co – writ petition was filed seeking refund of DDT of Rs. 5.92 cr which was allowed and when the Assessing Officer contended that there was no provision under which such refund can be claimed, it was held that Section 237 of the Act, provided that if any person satisfies the Assessing Officer that the amount of tax paid by him or on his behalf or treated as paid by him or on his behalf for any assessment year exceeds the amount with which he is properly chargeable under the Act for that year, he shall be entitled to a refund of the excess amount and the matter was adjudicated in favour of the assessee.
- There is no distinction in facts and law as compared to Torrent case
- **Once the demerged gas distribution undertaking no more exists w.e.f. 01-01-2007 coming to be the appointed day, the assessee-resulting company is entitled for all the pro rata adjustments of TDS, advance tax and MAT credits as per law; to be utilized in former's account.**

Thank You

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