

Business Restructuring

BY

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CHARTERED ACCOUNTANTS

Slump Sale

Slump Sale

50 B Capital Gain

Slump Exchange

Purchase price allocation

Depreciation on goodwill

Non-Compete fees

Conversion of firm into company

Conversion of company into LLP

Transfer of shares

Exemption from applicability

Property

Revised rule 11 UA

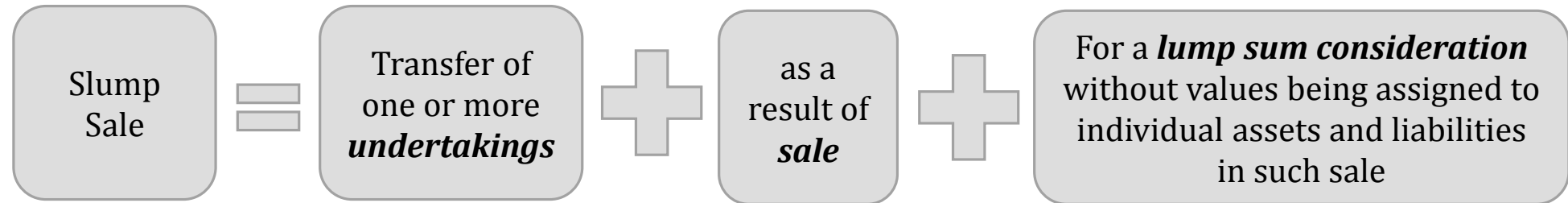
Buy back v/s dividend

Anti-Avoidance provision

Gift

Slump Sale

- Defined under section 2(42C) of the Income-Tax Act, 1961 (“the IT Act”)



- Undertaking shall have the meaning assigned under section 2(19AA) of the IT Act
- Attribution of value for purpose of payment of stamp duty not regarded as assignment of values for the purposes of Section 2(42C).

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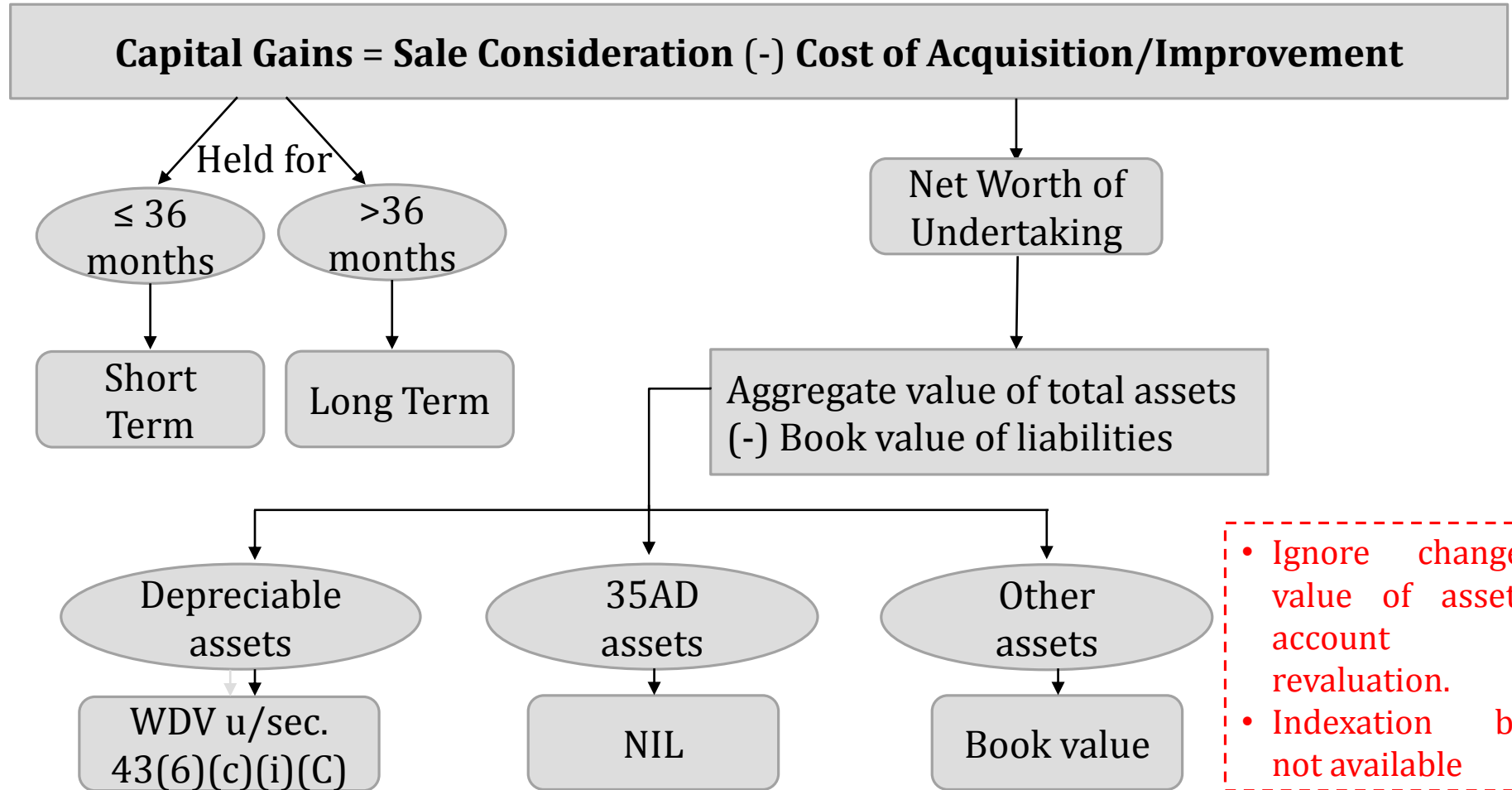
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Section 50B – Capital Gains



Compliance - Furnish report of an accountant certifying the computation of net worth.

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Case Study

A Limited proposes a slump sale of its Lift Undertaking to B Limited for INR 100 crores. However, certain bad assets to the tune of INR 1.5 Crores are not taken over by B Ltd.

Whether merely because certain bad assets are not transferred, the definition of Undertaking is not met with?

Whether such exclusion would result in denial of application of section 50B of the IT Act?

- ***Triune Projects (P.) Ltd v DCIT (Del. HC)***
- ***Rohan Software Pvt. Ltd. v. ITO (117 TTJ 490) (Mum)***

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Net worth of an undertaking includes negative net worth

- ***DCIT v Summit Securities Ltd (19 taxmann.com 102)(Mum.)(SB) [2012]***
- ***Zuari Industries Ltd. v ACIT (105 ITD 569) (Mum.) [2007]***
- ***PaperBase Co. Ltd. v. ACIT (19 SOT 163) (Delhi) [2008]***

Expense incurred as a precondition of slump sale – allowable under section 48

- ***PCIT v Nitrex Chemicals India Ltd (75 taxmann.com 282)(Del. HC) [2016]***

Whether the provisions of section 50C of the IT Act are attracted on transfer of an undertaking under slump sale?

- ***DCIT v Hyderabad Industries Ltd (ITA Nos. 917, 918 & 919/HYD/2009)***

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- Whether individual values can be assigned to assets in a slump sale
 - ***CIT v. Artex Manufacturing Co.(227 ITR 260) (SC) [1997]***
 - ***CIT V. Electric Control Gear (227 ITR 278) (SC) [1997]***
- Can Assets be transferred in slump sale without transfer of liabilities?
 - ***Mahindra Sintered Products Ltd. v. DCIT, (95 ITD 380)(Mum.) [2004]***
 - ***Weikfield Products Co. (I) (P.) Ltd. v. DCIT, (71 TTJ 518) (Pune) [2004]***

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Whether Slump Exchange Considered?

- *X Limited transferred an operating division to Y Limited, consideration for the same being the issue of preference shares. Whether the same could be regarded as slump sale under section 2(42C) thus resulting in computation of capital gains in accordance with section 50B?*
- ***CIT v Bharat Bijlee Limited (Bom. HC) [2014]***
- ***SREI Infrastructure Finance Limited v ITSC (251 CTR 129) (Del. HC) [2012]***

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Purchase Price Allocation

- *On acquisition of an undertaking by a Buyer, the buyer would have to carry out a purchase price allocation of the lump-sum consideration paid to record the assets and liabilities in the books of the Buyer*
- *Usually, a report of a Chartered Accountant is obtained for this purpose*
- *Intangible Assets acquired by virtue of the slump sale can also be recognized in the books of the Buyer*
- Depreciation available on intangible assets – know-how, patents, copyrights, trade-marks, licenses, franchises or any business or commercial right of similar nature

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Depreciation

- *Depreciation on Goodwill*

- ***Smifs Securities (348 ITR 302) (SC) [2012]***

- ***Areva T&D India Ltd v DCIT (345 ITR 421)(Del. HC) [2012]***

- ***Triune Energy Services (P) Ltd (237 Taxman 230) (Del. HC) [2016]***

- ***ACIT v Koch Chemical Technology Group (India) Ltd (174 TTJ 747) (Mum. Trib.) [2015]***

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Non-compete

- *Non-compete fees depreciation under section 32*
 - ***Pentasoftware Technologies Limited v. DCIT (264 CTR 187) (Madras HC) [2014]***
 - ***CIT v. Ingersoll Rand International Ind. Ltd (227 Taxman 176) (Karnataka HC) [2014]***
 - ***Sharp Business System v. CIT (211 Taxman 576) (Delhi HC) [2012]***
 - ***Global Home Products (P) Ltd. V. JCIT (18 SOT 194) (Mumbai Tribunal) [2007]***
- *Non-compete fees allowable under section 37(1)*
 - ***CIT v. Andhra Fuels (P.) Ltd. (240 Taxman 280) (AP HC) [2016]***
 - ***Sharp Business System v. CIT (211 Taxman 567) (Delhi HC) [2012]***

Conversion of firm/company

Conversion of Firm into Company

Conversion under Chapter XXI (Part I) of Companies Act, 2013

Sale Business to the Company

Takeover by Corporate partner on dissolution of firm

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Conversion in Compliance with Section 47 (xiii)

- **Conditions under Section 47(xiii)**
 - *All assets and liabilities related to the business are transferred*
 - *Shareholding in the same proportion of their Capital Account*
 - *No direct/indirect benefit other than allotment of shares to the Partners*
 - *Shareholding by the firm in the Company $\nless 50%$ of the total voting power for a period of 5 years*

- **Section 47A**

Where conditions specified are not complied with, the gains earlier not charged would be chargeable to tax in accordance with section 47A(3) in the previous year in which the non-compliance takes place.

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Conversion in Compliance with Section 47 (xiii)

- *What would be Actual Cost of fixed assets under section 43 (1) in the hands of the Company? Whether Company can claim depreciation on enhanced cost?*
- Unabsorbed depreciation and accumulated loss of the firm can be carried forward by the company – Section 72A(6) – 8 years from the date of conversion

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Conversion of a Company into LLP

- *Conditions under Section 47(xiii b)*
 - *All assets and liabilities related to the business are transferred*
 - *Profit Sharing Ratio and Capital proportion in the same ratio as the Shareholding in the Company*
 - *No direct/indirect benefit other than PSR and capital contribution to the Shareholders*
 - *Aggregate of PSR of the Shareholders in the firm \leq 50%*
 - *Total Sales/turnover/gross receipts \geq INR 60 lakhs in the preceding three years*
 - *Total assets \geq INR 5 crores in the preceding three years*
 - *No direct/indirect withdrawal of accumulated profit for a period of three years*

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Conversion in Compliance with Section 47 (xiiib)

- WDV of the Fixed Assets of the Company would be the actual cost of fixed assets to the LLP– Explanation 2C of section 43(6)
 - Unabsorbed depreciation and accumulated loss of the firm can be carried forward by the company – Section 72A(6) – 8 years from the date of conversion
- No MAT credit available on conversion under section 115JAA(7)
- Carry forward and set off of losses available to the company by the LLP
 - If conditions of section 47(xiiib) complied, section 72A permits carry forward and set off of losses to LLP ;
 - LLP Act provides all “assets , interest, rights, privileges” available with the company would vest in the LLP, therefore unabsorbed losses as well should vest in the LLP and be available for set off and carry forward ;
 - Akin to succession/inheritance

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Non-compliant Conversion

- Section 45(4) of the IT Act

The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other AOP or BOI (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, AOP or BOI, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

Transfer by way of distribution of capital asset

Transfer should be on dissolution of the firm or otherwise

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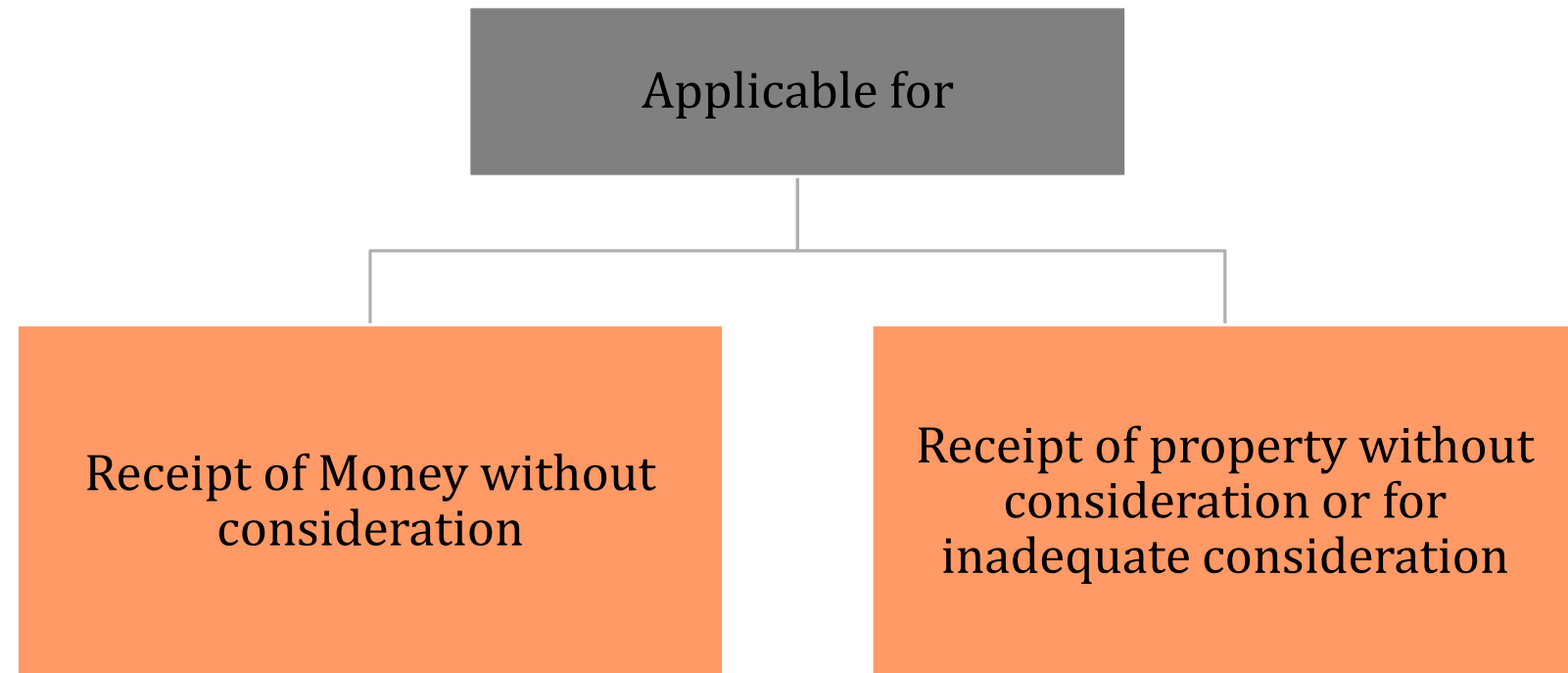
- Conversion under Chapter XXI (Part I) of Companies Act, 2013
 - ***CIT v Texspin Engg & Mfg Works (263 ITR 345) (Bom. HC) [2003]***
 - ***CADD Centre v ACIT (65 taxmann.com 291) (Mad. HC) [2016]***
- *Set-off of unabsorbed depreciation and accumulated loss of the Firm by the Company*
 - ***Amin Machinery P. Ltd. V. DCIT (114 ITD 413) (Ahmd. Tribunal) [2008] – against***

Transfer of Shares

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Section 56(2)(x)

Introduced by the Finance Act, 2017
The Section is Applicable to any person



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Exemptions from applicability

Section 56(2)(x) shall not apply to money or property received:

- From any relative
- Under will/inheritance
- From specified local authority
- From trust created solely for benefit of relative of an individual
- From the taxpayers mentioned under section 10(23C)
- By the taxpayer mentioned under section 10(23C)(iv),(v),(vi) and (via)
- By way of transaction not regarded as transfer under section 47:
 - Distribution of capital assets on total/partial partition of HUF
 - Tax neutral merger and demerger under section 47(vi), 47(via), 47(viaa), 47(vib), 47(vic), 47(vica), 47(vicb), 47(vid) or 47(vii)
- On occasion of marriage
- In contemplation of death
- Section 12A/12AA trust/institution

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Property

Immovable property, being land or building or both

Shares and securities

Jewellery, bullion

Archaeological collection, drawings, paintings, sculptures

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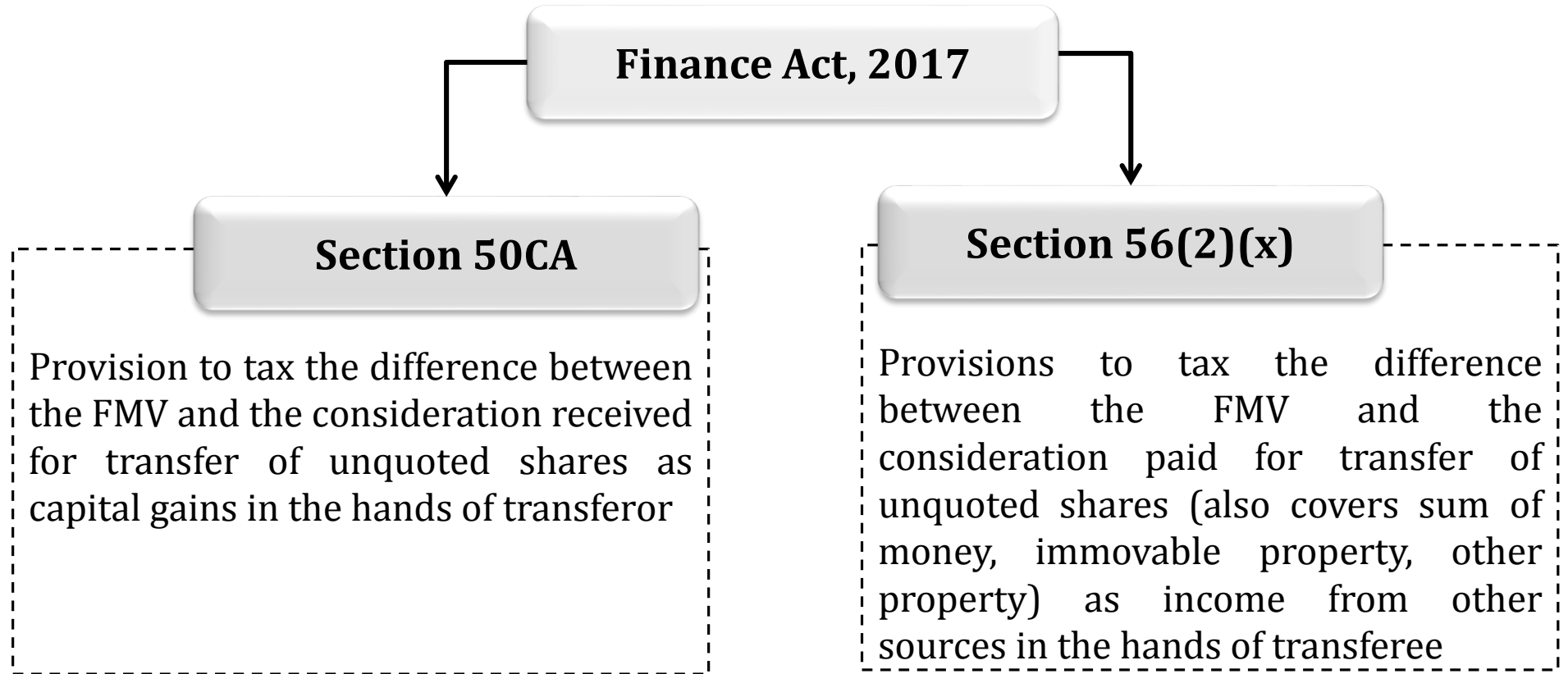
Valuation of property based on Rule 11UA
Notification 61/2017 dated July 12th, 2017
Applicable from April 1, 2018

$$\text{FMV of Unquoted Equity Share} = (A + B + C + D - L) \times (PV) / (PE)$$

- A : Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property)
- B : Price which the jewellery and artistic work would fetch if sold in the open market
- C : Fair market value of shares and securities
- D : Stamp duty value of the immovable property
- L : Book value of liabilities shown in the balance sheet
- PV : Paid up value of equity shares
- PE : Paid up equity share capital

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Interplay between sections 50CA and 56(2)(x)



Incidence of double taxation – Same amount taxed in the hands of transferor as well as transferee

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Interplay between sections 50CA and 56(2)(x)

Example

- Transferee/Buyer : A Ltd.
- Transferor/Seller : B Ltd.
- A Ltd. purchased 100 shares of a private company from B Ltd. for a price of INR 600 per shares; total consideration = INR 60,000
- B Ltd. had acquired such shares at INR 500 per share; gross amount paid = INR 50,000
- Say, the FMV of said shares on transfer date is INR 700

What would be the implications of provisions of section 50CA and 56(2)(x) under the mentioned circumstances ?

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Interplay between sections 50CA and 56(2)(x)

❑ Prior to amendment

Impact on Transferor – B Ltd.		Impact on Transferee – A Ltd.	
Sale consideration	60,000		
Less: Cost of acquisition	(50,000)	No Impact	
Capital gains	10,000		

❑ Post amendment

Impact of Sec. 50CA Transferor – B Ltd.		Impact of Sec. 56(2)(x) Transferee – A Ltd.	
Sale consideration	70,000	Sale consideration	70,000
Less: Cost of acquisition	(50,000)	Less: Cost of acquisition	(60,000)
Capital gains	20,000	Capital gains	10,000

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Buy-back Analysis

Buy-back

- Section 115QA @ 20%
- Section 10(34A)
- Not applicable to foreign companies and listed companies

Dividend

- Section 115 @ 20.92%
- Section 115BBDA >INR 10 Lakhs Dividend ~ 10%
- Section 10(34)
- Effectively ~ 31% tax

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Buy-back Analysis

Value of the company (Pre-Buyback)	1000		
Shareholder's Holding	A 200	B 500	C 300
(-)Amount bought Back	20	Nil	30
(-)Tax under section 115QA @20%	4	Nil	6
Value Post Buyback	176	500	264

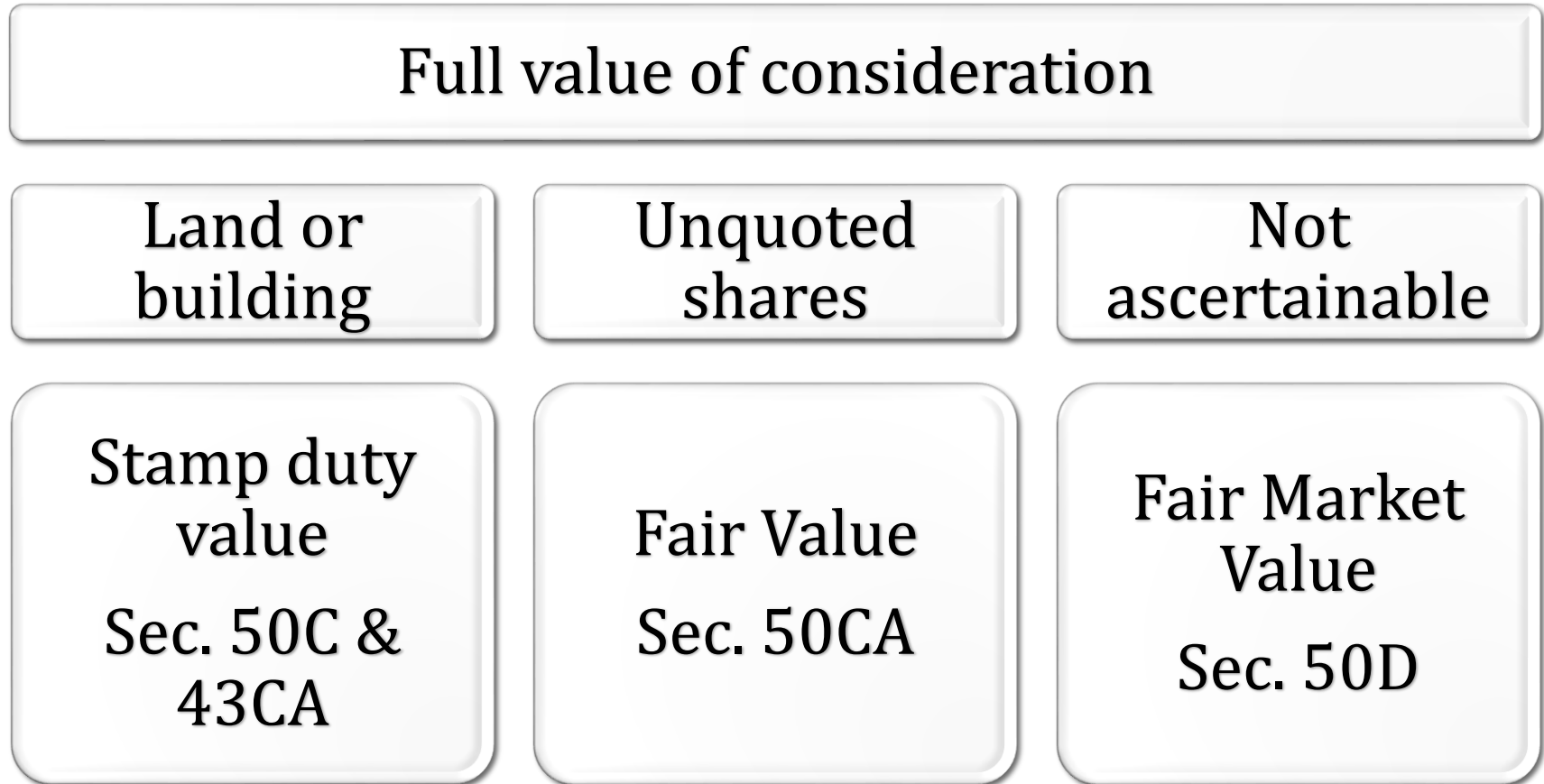
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Buy-back Analysis

Value of the company (Pre-Buyback)	1000		
Shareholder's Holding	A 200	B 500	C 300
(-)Amount bought Back	20	Nil	30
(-)Tax under section 115QA @20%	2	5	3
Value Post Buyback	178	495	267

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Certain Anti-avoidance provisions



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- Section 2(24)(iv)
Income includes :
 - value of benefit or perquisite obtained from a company by a director or a person having substantial interest in the company or by their relative; and
 - any payment by the company in respect of an obligation otherwise payable by such persons.
- Section 2(22)(e)
Dividend includes any payment by a company (in which public is not substantially interest):
 - by way of advance or loan to a shareholder holding more than or equal to 10% of voting rights or to any concern in which such shareholder is a member/partner and has substantial interest.
 - on behalf of, or for the benefit of such shareholder.
[to the extent of the company's accumulated profits]
- Section 28(iv)
Profits and gains of business or profession includes the value of any benefit or perquisite arising from business or exercise of profession

Thank You
