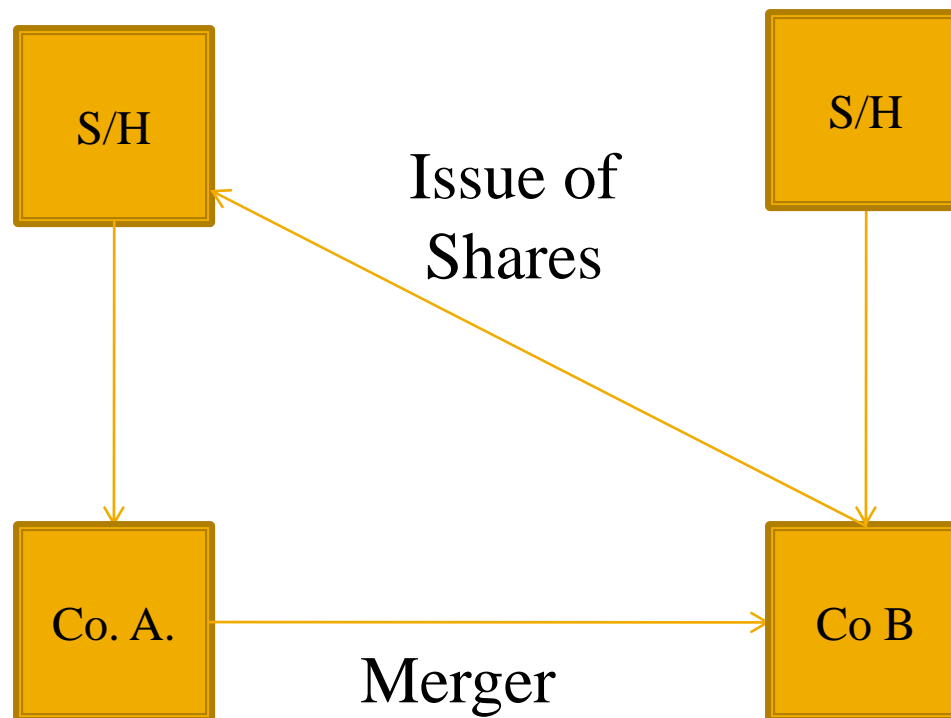


# Direct Tax Issues in Amalgamation

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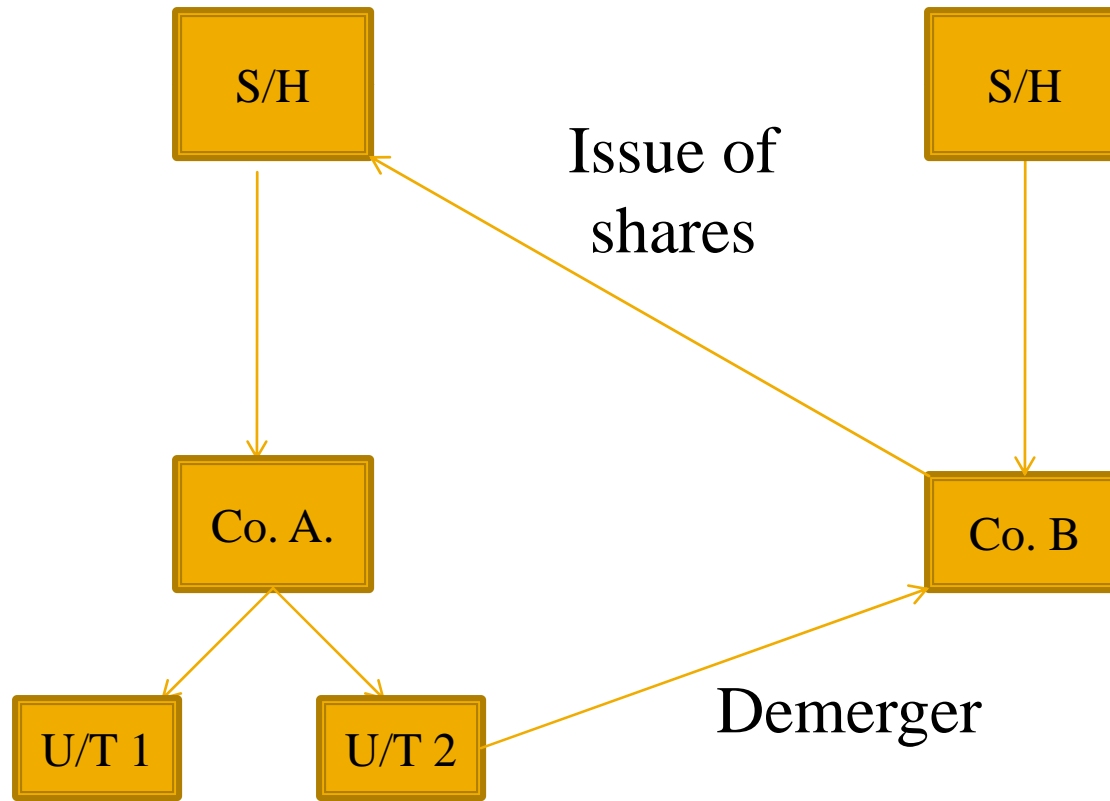
# Types of Transactions

## AMALGAMATION



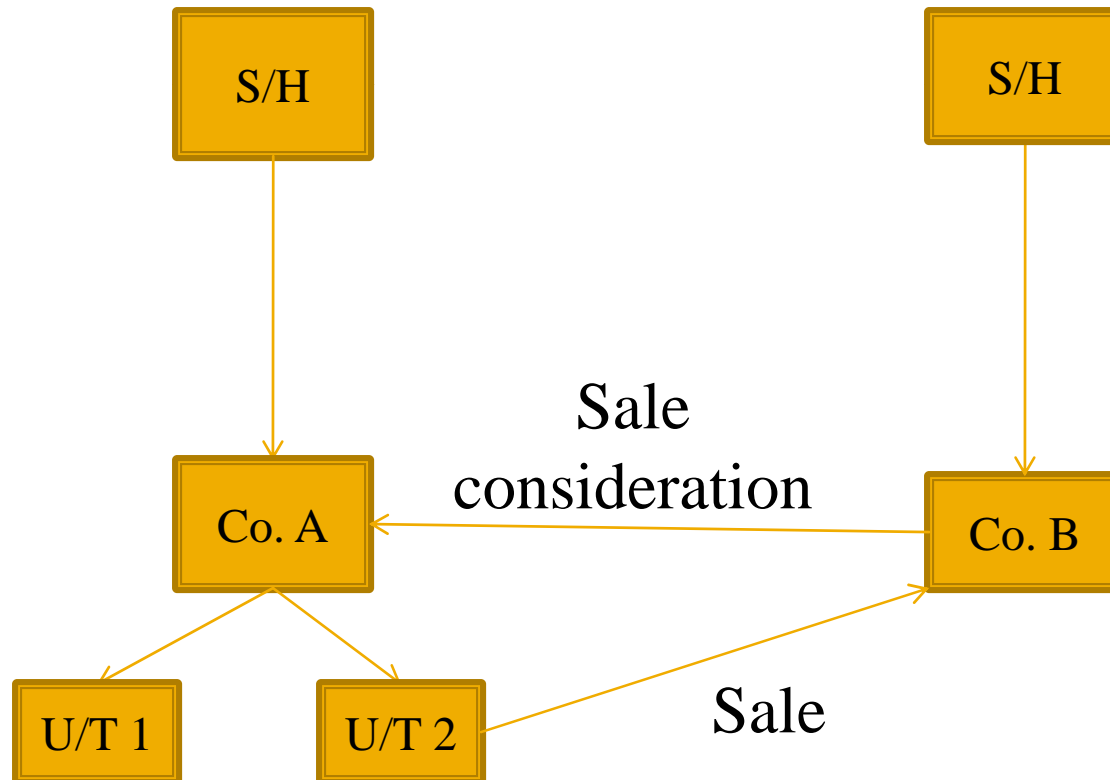
# Types of Transactions

## DEMERGER



# Types of Transactions

## SLUMP SALE / PURCHASE



# Significant provisions of the Income Tax Act, 1961

# Definition

- *Section 2(1B)* – “**Amalgamation**” means merger of one or more companies with another company or merger of two or more companies to form one company.
- Consequence –
  - Amalgamating Company loses its existence.
  - Amalgamated Company could be a new / existing company.

# Amalgamation - Key Conditions

- All the Properties / Liabilities of the amalgamating Company should be transferred.
- Shareholders holding not less than 75% of the value of shares in the transferor company [other than shares which are held by, or by a nominee for, the amalgamated company or its subsidiaries] become shareholders of the amalgamated company.

# Qualifying Amalgamation - Implications

- Tax Implications for:
  - Shareholders of the Amalgamating Company
  - Amalgamating (Transferor) Company
  - Amalgamated (Transferee) Company



# Shareholders of Amalgamating Company

- Receipt of new shares results in **extinguishment** of right in equity shares of the Transferor Company.
- *Section 47(vii)* – Extinguishment of right in equity shares not regarded as “Transfer”.
- Conditions:
  - Amalgamated Company is an Indian company
  - It is in consideration of allotment of shares in Amalgamated Company.

# Shareholders of Amalgamating Company (Contd.)

- ***Section 2(42A) - Period of Holding***
  - Include the period for which shares in Amalgamating Company were held by Shareholder [Explanation 1(i)(c)].
  - Cost Indexation – available accordingly.
- ***Section 49(2) – Cost of Acquisition***
  - Shall be deemed to be cost of shares in Amalgamating Company.

# Amalgamating Company

- *Section 47(vi)* - Transfer of capital assets in a Scheme of Amalgamation to an Indian company - not regarded as “Transfer”. Hence, no capital gain tax in the hands of the Amalgamating Company.
- *Section 47(via)* – transfer of a capital asset being shares held in an Indian company, by Amalgamating Foreign Company to Amalgamated Foreign Company, not regarded as transfer, if following conditions fulfilled:
  - 25 % or more of the shareholders of amalgamating foreign company continue to remain shareholders of amalgamated foreign company, and
  - Such transfer does not attract capital gain tax in country in which amalgamating company is incorporated.

# Amalgamated Company

## ■ Cost of Acquisition

- *Explanation 7 to Section 43(1)* - Actual Cost of transferred capital asset to be the same as it would have been if the amalgamating company had continued to hold the capital asset.
- *Explanation 2(b) to Section 43(6)* - Block of Assets – Actual Cost of block to be WDV as in the case of the amalgamating company for immediately preceding PY as reduced by the amount of depreciation actually allowed in PY.

# Section 32 - Depreciation

- Fifth *Proviso* to Section 32(1) :
  - The aggregate deduction of depreciation shall not exceed the depreciation as per prescribed rates.
  - Such deduction shall be apportioned between Amalgamating Company / and Amalgamated Company in ratio of number of days for which assets were used by them.

# Section 56(2)(viiia)

- *Section 2(24)(xv) read with Section 56(2)(viiia) - Income to include value of shares issued at Nil consideration / lower than FMV.*
- *Proviso to Section 56(2)(viiia) - However, where such shares are issued under amalgamation scheme - not to be regarded as “Income” .*

# Deduction of Certain Expenditure

Amalgamated Company can claim deduction in respect of expenditure on :

- Scientific Research - *Section 35(5)*
- Acquisition of Patent Rights / Copyrights - *Section 35A(6)*
- Know-How - *Section 35AB(3)*
- For obtaining license to operate telecommunications services - *Section 35ABB(6)*
- Amortisation of certain preliminary expenses - *Section 35D(5)*
- Amortisation (in 5 equal installments) of expenditure incurred for the Amalgamation - *Section 35DD*
- Amortisation of expenditure under VRS - *Section 35DDA(2),(5)*
- Prospecting for certain minerals - *Section 35E(7)*

# Tax Holiday Benefits

Amalgamated Company eligible for unexpired period of Tax Holidays as per following provisions:

- Newly established undertaking in FTZ – *Section 10A(7A)*
- Newly established undertaking in SEZ – *Section 10AA(5)*
- Newly established 100% Export Oriented Undertakings-  
*Section 10B(7A)*



# Profit Linked Benefits

Amalgamated Company eligible for following deduction provided Amalgamating Company and Amalgamated Company Indian Company:

- Deduction in respect of profits and gains by an undertaking or enterprise engaged in SEZ - *Section 80IAB(3)*
- Deduction in respect of profits and gains from certain industrial undertaking other than Infrastructure Development undertaking - *Section 80IB(13)*
- Special provisions in respect of certain undertakings or enterprises in certain special category states - *Section 80IAC(7)*
- Special provisions in respect of certain undertakings in North Eastern States - *Section 80IE(6)*

# Section 72A(1) - Carry Forward and Set Off of Accumulated Losses and Unabsorbed Depreciation

- Applicability
  - A company owning industrial undertaking or ship or hotel,
  - Banking company, and
  - Public sector company engaged in the business of operation of aircraft.
- Accumulated loss and unabsorbed depreciation of Amalgamating Company deemed to be loss / unabsorbed depreciation of Amalgamated Company for PY in which amalgamation effected.

# Section 72A(2) - Claim of Accumulated Losses and Unabsorbed Depreciation - Conditions

## ■ For Amalgamating Company

- has been engaged in the business for three or more years;
- has held continuously for two years prior to the date of amalgamation at least three-fourths of the book value of fixed assets.

## ■ For Amalgamated Company

- continues the same business for a minimum period of five years from the date of amalgamation;
- holds continuously for a period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets acquired;
- other conditions – *Rule 9C*.

# Other Conditions - Rule 9C

- Company owning industrial undertaking to achieve at least 50% level of production of the installed capacity before end of 4 years from the date of amalgamation and continue to maintain the said level till the end of 5 years from date of amalgamation:
  - Central Government may relax this condition in suitable cases.
- Company to furnish to AO - certificate in Form No.62, duly verified by an accountant from the year of achieving 50% level of production upto completion of 5 years from amalgamation.
  - This Certificate is not required to be attached with the Return of Income – *Rule 12(2)*.

# **Section 72A (3) - Implication of violation of conditions**

- The set off of loss or allowance of depreciation made in any PY in hands of Amalgamated Company deemed to be income of Amalgamated Company .
- Such deemed income chargeable in year in which conditions not complied with.

# Typical Issues

# Consideration for Amalgamation

- Whether issue of bonds / debentures alongwith shares conforms with the definition of “Amalgamation”?
- Gautam Sarabhai Trust (173 ITR 216) (Guj)

# Nature of Shareholding

- Shares held in the Amalgamating Company other wise than as “capital assets”:
  - Whether benefits of Section 47(vi) and other provisions of the Act available to the Amalgamating Company / Shareholders of the Amalgamating Company ?



# Amalgamation of foreign companies

- Section 47(via) of the Act recognizes such mergers for exemption from capital gains, subject to certain conditions being fulfilled.
- Should such foreign companies comply with definition in Section 2(1B) of the Act ?

# Amalgamation – 100% subsidiary

- Merger of company held fully by another company / its nominees with that (holding) company – whether conditions of Section 2(1B) satisfied ?
- Credit Suisse (International) Holding AG (349 ITR 161) (AAR)

# Return of Income

*How will the Return of Income be filed where Appointed Date does not coincide with the FY end (i.e. March 31) ?*

- Upon Scheme becoming effective, Transferee Company is vested with all income, assets, etc. of the Transferor from the Appointed Date (*Marshall Sons & Co. India Ltd. v/s ITO (89 Taxman 619 - SC)*).
- Therefore, Transferee Company to file return of income for period even prior to Effective Date in respect of income of Transferor.
- The assessment of such return will be in the hands of the Transferee Company.

# Indexation

*Whether the indexation benefit will be available from the date of acquisition of shares in amalgamating company or date of acquisition of shares in amalgamated company?*

- The period of holding of shares acquired in amalgamation includes period of holding of shares in Amalgamating Company [*Section 2(42A)*].
- Therefore, cost indexation at the time of sale of shares of Amalgamated Company would be computed, considering such period.
- *Kotak Mahindra Bank Ltd. Vs. ACIT (2009 TIOL 383 – ITAT – Mum)*
- *Manjula Shah (318 ITR 417)(Mum SB)*

# Book Profits - MAT

*Whether carry forward and set off of unabsorbed book losses / book depreciation of amalgamating company available for adjustment against book profits of amalgamated company for MAT purpose?*

- VST Tillers & Tractors (2009 TIOL 26) (Bang. ITAT)

# MAT Credit

*Whether in respect of the tax paid on deemed income u/s.115JA / 115JB by the amalgamating company, credit can be claimed by the amalgamated company?*

- SKOL Breweries – (2008 TIOL 741) (Mumbai ITAT)

# Benefit of Section 72A – “Industrial Undertaking”

- Section 72A applies inter alia to a company owning “industrial undertaking”?
  - Is this term defined in the Act ?
  - Can the scope be expanded to include service industry ?
  - Apollo Hospitals Enterprises Ltd. (300 ITR 167) (Mad) and other decisions.

# Profit linked benefits – Section 80IA(12) /(12A)

- These provisions suggest non availability of the benefits in case of transfers of enterprise/undertaking in an amalgamation after 1.4.2007.
  - Is “sun set” of the benefits intended ?



# Goodwill on Amalgamation – Depreciation

*Will the Goodwill arising on Amalgamation be eligible for depreciation?*

- *Section 32(1)(ii)* defines intangible assets as “know how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature”.
- Goodwill on amalgamation, whether or not already recognised by Amalgamating Company, should be of any specific category of intangibles or “any other business or commercial rights of similar nature”.
- Judicial pronouncements have held various business rights/ advantages as “any other business or commercial rights of similar nature”

# Goodwill on Amalgamation – Depreciation (Contd.)

- *Skyline Caterers P. Ltd v ITO (20 SOT 266) (Mum ITAT)*
- *B. Ravindran Pillai (237 ITR 80) (Ker.)*
- *Borkar Packaging (Panaji ITAT)*
- *R. G. Keswani (116 ITD 133 Mumbai ITAT)*
- *A. P. Paper Mills (128 TTJ) (Hyd)*
- *Hindustan Coca-Cola (331 ITR 192) (Del)*
- *Smifs Securities (348 ITR 302)(SC)*

# Goodwill on Amalgamation – Depreciation (Contd.)

- Goodwill acquired by amalgamating company and recognised by amalgamated company could involve such business or commercial rights.
- Goodwill arising upon amalgamation - whether involves business or commercial rights?

# Section 72A – Period available for set off to the Amalgamated Company

- Accumulated business loss and unabsorbed depreciation of the Amalgamating Company deemed to be loss/ depreciation allowance of the Amalgamated Company.
- Is the period exhausted by the Amalgamating Company to be considered for computing the period available for claim by the Amalgamated Company ?
- Supreme Industries Ltd. (17 SOT 476)(Mum)(2007)

# Section 72A vis-a-vis Section 79

## *Whether Section 72A will override Section 79?*

- *Section 79* – Non obstante clause – overriding other provisions of the Act.
- Proviso of *Section 79* – shall not apply in a situation where private company / company in which public are not substantially interested merges into another company.
- *Section 72A* specifically deals with amalgamations.
- Objective of enacting *Section 72A*.

# Amalgamation – Tax avoidance scheme

- Whether Amalgamation could be considered a design to avoid capital gains tax ?
  - Wood Polymer Limited and Bengal Hotels Pvt. Ltd. (109 ITR 177) (Guj)
  - Star Television Entertainment Ltd. (321 ITR 1) (AAR)

# Amalgamation – Sanction under SICA

- Scheme sanctioned by BIFR under SICA –
  - Whether SICA to have overriding effect with respect to Income Tax Act ?
  - JK Corporation Ltd. (331 ITR 303) (Cal)

# Reverse Merger

- A loss making company merges with a profit making company or a company with higher networth merges with a company with lower networth.
- Also used where a company has potential to improve and needs larger entity (including public listed company) with substantial means of finance.
- Conditions of Section 2(1B) to be complied with.
- Losses of Amalgamated Company will be adjusted against profits of Amalgamating Company.
- Other deductions / benefits protected.



# Amalgamation – DTC

- Important provisions in the Direct Tax Code

**Thank You**