



ICAI - WESTERN INDIA REGIONAL COUNCIL

Direct Tax Refresher Course, 2013

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Taxation of Business Reorganisation

(including LLPs)

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Forms of Reorganisation

- ▶ Amalgamation
- ▶ Demerger
- ▶ Slump Sale
- ▶ Conversion of Firm to Company
- ▶ Conversion of Sole Proprietorship to Company
- ▶ Conversion of Company to LLP
- ▶ Conversion of Firm to LLP

NOT EXHAUSTIVE

Amalgamation...

- ▶ Defined – 2(1B)
 - ▶ Companies – not firms [Rasiklal Maneklal – Transfer(?)]-**when used by Firms**
 - ▶ 1 or > 1:1 (Existing) or 2 or > 2:1 (New – Formed)
 - ▶ All Assets
 - ▶ All Liabilities
 - ▶ 75% Shareholders
 - ▶ Other than holding Company + nominees
 - ▶ Not Acquisition
 - ▶ Not Winding Up

...Amalgamation...

- ▶ Tax Neutrality - **Mergers**
 - ▶ No Capital Gains
 - ▶ Company – Sec. 47(vi)
 - ▶ Shareholder – Sec. 47(vii)
 - ▶ **No** Business Income (?)
 - ▶ Principle of ALA Firm's Case (189 ITR 285) – Not applicable – 43C
 - ▶ Also applicable to Capital Asset becoming SIT – 43C
 - ▶ **No** Other Income (?)

...Amalgamation...

▶ Continuity of Tax Base

▶ For Depreciation

- Cost and WDV – Exp 7 – Sec. 43(1) & Exp 2 – Sec. 43(6)

- CIT vs. Hindustan Petroleum Corporation Ltd. (187 ITR 1)

...Amalgamation...

▶ Tax Neutrality

▶ For Capital Assets

▶ Cost – 49(1)(iii)(e)

- Indexation – 48 (Explanation) – CIT vs. Manjula J. Shah (204 Taxmann 691)

▶ Period of Holding – 2(42A) – Explanation (1)(i)(b)

▶ For SIT becoming Capital Asset – (?)

▶ Depreciation

▶ To be bifurcated – 5th Proviso Sec. 32(1)

...Amalgamation...

- ▶ Losses

- ▶ Unabsorbed Depreciation
- ▶ Unabsorbed Business Loss - Lapses
- ▶ Other c/f. provisions (Capital Losses, House Property, Speculation, Race Horses, Preliminary Expenses, etc.)

...Amalgamation

▶ Tax Neutrality

- ▶ Mat Credit – Available – SKOL Breweries Ltd. vs. ACIT (28 ITAT 998) (Mum)
- ▶ Sec 72 A
 - ▶ Special Provision
 - ▶ Applicability – Industrial Undertaking - 3 years history - Fixed Assets held for two years
 - ▶ Continuing conditions – Business continued – 5 years – 50% capacity utilisation – continued holding of assets.
- ▶ Other Provisions
- ▶ Appointed Date vs. Date of Order – Marshall Sons (223 ITR 809)

Demerger...

- ▶ Definition – 2 (19 AA) – Section 391 to 394 of Companies Act
- ▶ Undertaking
 - Whole or Part – Not Individual Asset – Explanation 1 to 2 (19AA)
- ▶ Continuity – going concern
- ▶ Transfer of Asset and Liability (Identification of Liability)
- ▶ At Book Value (Except Revaluation) (?)
- ▶ Pro rata allotment to shareholders – 75 % become shareholders

...Demerger...

- ▶ Provisions relating to Demerger
 - ▶ Deemed Dividend – only shares – Redeemable (?)
 - ▶ Capital Gains – Company – 47(vib)
 - Shareholder – 47(vid) – Exp 1(i)(g) to Sec. 2 (42A)
 - ▶ Tax Base
 - Depreciation – Exp 7A to 43(1) & Exp 2B to 43(6)
 - Capital Asset – Not covered in Sec 49(1) – (?)

...Demerger

- ▶ Losses and Unabsorbed Depreciation - 72A(4) -
No specific / eligibility or continuity conditions
- ▶ MAT Credit (?)
- ▶ Non Qualifying Demergers

Slump Sale

- ▶ Definition
 - ▶ Contrast from itemised sale
- ▶ Lump sum consideration
 - ▶ Can be split for stamp duty
 - ▶ Can be arrived at by aggregating (?)
 - ▶ Can be formula based
- ▶ Split by Buyer
 - ▶ For “cost” of capital asset (?)
 - ▶ For “depreciation” (?)
 - ▶ For determination of Business Profit (?)
- ▶ Capital Gain
 - ▶ Cost to Vendor

Conversion of Firm into Company...

- ▶ Part IX – Change of Status – Continuity for Tax

(CIT vs. Texspin Engg. & Mfg. Works – 263 ITR 345)

- ▶ Sale Route – Sec. 47(xiii) – only “Business”

- ▶ Capital Gain

- Exempt – Slump and/or Itemised Sale

- Conditions – All Assets & Liabilities

- Partners : Shareholders (Proportion of Capital Accounts)

- Partners > 51% - 5 Years

- Consideration – only shares

...Conversion of Firm into Company

- ▶ Business Income – ALA Firm (?)

- ▶ Tax Base
 - Depreciation – Enhanced Value
 - Value adopted for Newly Recognised Assets

 - S-I-T – Enhanced Value

 - Losses / UAD – Continuity – 72A(6)

Conversion of Proprietorship to Company

- ▶ Sec.47(xiv)
- ▶ Mutatis Mutandis – Firm to Company

Conversion of Company to LLP

- ▶ Capital Gains
 - Vesting by Law
 - Is it a Transfer – 47(xiiiib) – Restrictive conditions
- ▶ Business Income – ALA Firm principle(?)
- ▶ Tax Base
 - ▶ Depreciation
 - Continuity –Exp 2C to Sec. 43(6)
 - Pro rata in year of conversion – 5th proviso to Sec. 32
 - ▶ SIT – Continuity – Rule 23 (?)
 - ▶ Losses / UAD – Continuity – 72A (6A)

Conversion of Firm to LLP

- ▶ Capital Gains
 - Vesting by Law
 - Is it a Transfer – No statutory provision
- ▶ Business Income – ALA Firm principle(?)
- ▶ Tax Base
 - ▶ Depreciation - Continuity / Fair Market Value (?)
 - ▶ SIT - Continuity / Fair Market Value
 - ▶ Losses / UAD – Lapse – Sec. 78(2)

Uses and Issues...

▶ Accounting

▶ Revaluation

- ▶ Investments } Assets
- ▶ Other }

▶ Amounts to Purchase

▶ Credit

- Share Capital
- Securities Premium
- Capital Reserve
- General Reserve

Mode of Accounting

▶ MAT

- No revaluation reserve
- No Withdrawal

...Uses and Issues...

- ▶ Not recognised / Permitted
 - Companies Act – Net Worth
 - SEBI - Promoter's Contribution

- ▶ Plain Vanilla Accounting Scheme
 - ▶ Merger
 - ▶ Demerger – Non Tax
- } Type of Scheme

- ▶ Devaluation / Writeoff
 - ▶ Directly in Transferee
 - ▶ Avoids debit to Profit and Loss Account

...Uses and Issues...

- ▶ Is Loss Allowable
 - ▶ Transferor
 - ▶ Does not exist
 - ▶ No carry forward
 - 72A
 - ▶ Transferee
 - Is it part of Purchase Consideration
 - ▶ Bad Debts
 - Condition – profit and Loss Account (?)
 - ▶ Fixed Assets – “Block”
 - ▶ Investments – Need for “Transfer”
- ▶ More Accounting than Tax

...Uses and Issues...

- ▶ Write Off of cancelled Asset
 - ▶ Route through Profit and Loss
 - Permitted
 - ▶ Withdrawal from Reserve
 - if necessary
 - ▶ Helps in MAT
 - ▶ Debit of Demerger
 - In Profit and Loss Account
 - ▶ Credit of Assets Received on Merger / Demerger
 - MAT Impact – Direct to Reserve
 - ▶ Dual Treatment – Inconsistent(?)

...Uses and Issues...

▶ Transfer

- ▶ Of asset / Investment
 - ▶ Without tax
 - ▶ Stamp Duty optimisation
- ▶ Corollary – Does not increase tax base?
 - Exception – Conversion of Firm / Proprietorship (?)
- ▶ Position of Stock – in – Trade (?)
 - ▶ ALA Firm
 - ▶ Sec 43C – ignores for tax
 - Eligible for MAT
- ▶ Need to match asset / liability
 - ▶ Low Net Consideration
 - ▶ In Shares / Preference Shares (?)
 - ▶ Tax on Redemption
 - ▶ Deemed Dividend / Capital Gain

...Uses and Issues

- ▶ Recognition of Intangibles
 - ▶ Requirement of Purchase Method
 - ▶ Not recognised in Indian GAAP
 - ▶ Self Generated
 - ▶ But, no prohibition to such recognition (?)
 - ▶ SC in Smifs
 - ▶ Goodwill
 - ▶ Can it apply to all Intangibles
 - ▶ Sec. 43 impact
 - ▶ Non existent Block
 - ▶ Is each intangible asset a “Block” by itself?

Anti Avoidance Provisions

- ▶ Cost to Previous Owner
- ▶ Sec. 47A
 - ▶ Continuity – 5 years – 50% - [47(xiii), 47(xiiib), 47(xiv)]
 - Distribution of Dividend
- ▶ Sec. 56(2) (viiia)
 - ▶ Receipt below fair value – shares
- ▶ Sec. 50D
 - ▶ Consideration Unascertainable

Examples

- ▶ Marshall Sons
 - ▶ Retrospective Appointed Date
 - ▶ Set Off against Losses
- ▶ Wood Polymer
 - ▶ Transfer of Plot for Hotel
- ▶ Vodafone Essar Gujarat
 - ▶ Transfer of “Towers”
- ▶ Star
 - ▶ Transfer of Regional Language Programs
- ▶ Gifts
 - ▶ From US to Singapore (Treaty Country)

...Examples

- ▶ Buy Back vs. Dividend
 - ▶ Shome Committee
- ▶ Reverse Mergers
 - ▶ RIL – Mynylon
- ▶ Is “loss” broking an Industry?
- ▶ GAAR – implications – Court Oder (?)

Other Provisions

- ▶ Gift

- ▶ Of exhausted block (Notional WDV)

- ▶ Succession

- ▶ Where predecessor cannot be found
 - ▶ Uses – vis – a – vis litigation

Thank You

