

Full Day Seminar on Direct Taxes

Restructuring of Firms, LLPs, Private Companies and Trust

June 29, 2019

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Reorganisation/ Resolution

Financial

Reorganisation of
Ownership and Capital
Structure



Relevant from direct tax
perspective

Operational

Reorganisation of
Management and mode of
doing business



Not relevant from direct tax
perspective

Methods of Financial Reorganisation/Restructuring for Firms and LLPs

General Methods

- General methods of financial reorganisation for Firm/LLP
 - Sale of Business (Slump Sale v. Itemised Sale)
 - Transfer of Interest in Firm/LLP
 - Transfer of interest by way of Admission/Retirement of Partner
 - Conversion of Firm into Company
 - Conversion of Firm into LLP
 - Succession of Sole Proprietor by Company/Firm/LLP
 - Merger/Demerger between Firm/LLP
 - Merger of Firm/LLP into Company

Slump Sale

- Definition – S. 2(42C)
 - Sale of “undertaking” – Contrast from itemised sale
 - Lump sum consideration - can be split for stamp duty purpose
 - Split by buyer –
 - For “cost” of capital asset
 - For depreciation

Slump Sale

- Allocation of consideration for slump sale & depreciation on the component of goodwill –
 - Areva T & D India Ltd. v. DCIT (345 ITR 421) (Delhi HC)
 - Triune Energy Services (P.) Ltd. v. DCIT (237 Taxman 230) (Delhi HC)
 - ACIT v. Koch Chemical Technology Group (India) Ltd. (174 TTJ 747) (Mum. Trib.)
- Whether slump exchange is covered?
 - SREI Infrastructure Finance Ltd. v. ITSC (251 CTR 129) (Delhi HC) – **Against**
 - CIT v. Bharat Bijlee Ltd. (365 ITR 258) (Bom HC)
 - ITO v. Datex Ohemda (India) Pvt. Ltd. (TS-320-ITAT-2018) (Kol. Trib)

Slump Sale

- Capital gain on sale of undertaking or part of the undertaking. - Sec. 50B is applicable even if certain assets are left out because they would cause inconvenience for the purchasing party - Triune Projects (P.) Ltd. v. DCIT (291 CTR 268) (Delhi HC)
- Cost of acquisition – Net worth of the undertaking – including the negative net worth – DCIT v. Summit Securities Ltd (15 ITR(T) 1) (Mum. Trib.) (SB)
- Sec 50C not applicable in case of slump sale - DCIT v. Summit Securities Ltd (15 ITR(T) 1) (Mum. Trib.) (SB)
- Deductions specific to undertaking shall continue as it is change of ownership and not reorganisation
 - E.g. Section 10AA and 10B – CBDT Circular 1/2013 dated January 17, 2013

Slump Sale

- If transfer of undertaking qualifies as succession u/s 47(xiii) or 47(xiiib) or 170 – 6th proviso to S. 32(1) applicable – depreciation allowed on proportionate basis. Itemised sale – depreciation based on cost of acquisition of individual asset.
- Slump sale - benefit of tax rate of long term capital gains on transfer of Depreciable Assets.
- S. 56(2)(x) –
 - In the hands of transferor – receipt of money for consideration – S. 56(2)(x) not applicable
 - Slump sale - in the hands of transferee – receipt of “undertaking” – not property referred to in S. 56(2)(x) – in any case receipt is for a consideration
- GST exemption on transfer of a going concern as a whole or independent part thereof (Assess transfer of underlying GST credit)

Itemised Sale of Asset

- In case of itemised sale of asset – independent taxation:
 - **Depreciable Assets forming part of block of assets:** Reduce sale proceeds from the Block of Assets – tax consequences only when the block cease to exist or consideration is higher than the carrying value of Block of Asset – Tax Rate?
 - **Non - Depreciable assets:** Benefit of Indexation
- STCG on depreciable asset can be set off against LTCL – CIT v. Parys (Eastern) (P.) Ltd. (384 ITR 264) (Bom. HC)
- 56(2)(x) – in the hands of transferee – receipt of specified property – 56(2)(x) may apply.
- Profit on transfer of Inventory taxable as business income
- GST applicable on Transfer of Individual Assets. Transfer of GST credit is not required.

Transfer of Interest in Firm/LLP

- Restriction on transfer of interest in LLP/Firm – S. 42 of the LLP Act and S. 29 of the Indian Partnership Act –
 - Transferee or assignee does not have the right to participate in the management or conduct of the activities of the LLP or access information concerning the transactions of the LLP.
 - Only the right to profit or loss in the firm/LLP is transferrable
- Taxation on transfer of interest in LLP
 - Cost of Acquisition?
 - Capital contribution; or
 - Not determinable
 - How to compute indexation ?
 - 56(2)(x) – interest in partnership marketable security ?

Transfer of Business by way of Admission/Retirement of Partner

- Admission of partner – Capital contribution
 - Cash – No tax consequences
 - Capital Asset – S. 45(3) – Book value –
 - LLP – Rule 23 of LLP Rules, 2009 – fair value ?
 - 50C will apply ?
 - DCIT v. M/s Amartara Pvt Ltd [2018] TIOL 125 (Mum T)
 - Stock in trade – S. 45(3) will apply ?
 - ITO v. Orchid Griha Nirman (P.) Ltd. [2016] 74 taxmann.com 187 (Kolkata - Trib.)
 - DLF Universal Ltd. v. DCIT [2010] 36 SOT 1 (Delhi Trib.) (SB) – **against**
- 56(2)(x) – consideration not determinable
 - Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC);
 - CIT v. Marudhar Hotel (P.) Ltd. [2004] 269 ITR 310 (Rajasthan HC)

Transfer of Business by way of Admission/Retirement of Partner

- Retirement of partner
 - Cash Payment
 - 45(4) – Not applicable – CIT v. Dynamic Enterprises [2013] 359 ITR 83 (Kar. HC) (FB); PCIT v. Electroplast Engineers [2019] 263 Taxman 120 (Bombay HC); **Savitri Kadur TS-257-ITAT-2019(Bang Trib) - against**
 - 56(2)(x) - Smt. Vasumati Prafullachand Sanghavi v. DCIT [2018] 168 ITD 585 (Pune - Trib.)
 - Transfer of Capital Asset
 - 45(4) – fair value of asset - CIT v. A. N. Naik Associates and Another [2004] 265 ITR 346 (Bom HC) – no reference to Rule 11UA. **Contrary view - National Company v. ACIT [2019] 263 Taxman 511 (Madras HC) – Correct ?**

Transfer of Business by way of Admission/Retirement of Partner

- Retirement of partner
- Goodwill paid to the retiring partner

Accounting by Firm

- Goodwill is recognised in books – Revalue the business of firm & give corresponding credit to partners capital.
- Goodwill is not recognised in books – goodwill payment is debited to continuing partners capital account or incoming partners capital account.
- Taxation
 - Amount received by retiring partner on retirement from firm on account of goodwill will not be subjected to tax as capital gains in his hands - PCIT v. R.F. Nanngani HUF [2018] 93 taxmann.com 302 (Bombay HC)

Transfer of Business by way of Admission/Retirement of Partner

- Admission of New Partners & Retirement of old partners
 - No tax consequences under normal tax provision - PCIT vs. Electroplast Engineers [2019] TS 168 (Bom HC)
 - GAAR ?
 - Main purpose to avoid tax ?
- Admission of New Partner & reduction in profit share of old partners to a nominal amount will help ?
- Simpliciter change in profit sharing ratio of existing partners – tax consequences ?

Conversion of Firm into Company

- Modes of Conversion

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956)
- Acquisition of business of the firm:
 - Sale of business to the Company
 - Takeover by Corporate Partner on dissolution of firm

Conversion of Firm into Company

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956) :
 - No statutory exemption under the Act
 - Statutory vesting – no transfer – no consideration – no capital gain in the hands of the Firm – not required to comply with S. 47(xiii)
 - CIT v. Texspin Engg. & Mfg. Works (263 ITR 345 (Bombay HC)
 - CIT v. Ravishankar R Singh [2018] TS 447 (SC) (SLP Dismissed)

Succession of Firm by a Company

- Section 47(xiii) – Exempts transfer of capital asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm.
- Conditions –
 - all the assets and liabilities of the firm before the succession become the assets and liabilities of the company;
 - all the partners of the firm becomes the shareholders of the company in the same proportion of their capital accounts;
 - the partners of the firm do not receive any consideration other than by way of allotment of shares in the company; and
 - aggregate shareholding of the partners in the company is not less than fifty per cent for a period of five years;

Conversion of Firm into LLP

- Permitted by S. 55 of the LLP Act
- No exemption under the Income-tax Act
- CBDT Circular No. 5/2010 dated June 3, 2010 on amendments made by Finance Act 2009 reads as under:

“As an LLP and a general partnership is being treated as equivalent (except for recovery purposes) in the Act, the *conversion from a general partnership firm to an LLP will have no tax implications* if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. If there is a violation of these conditions, the provisions of section 45 shall apply.”

- Time frame to continue with same rights and not to transfer any asset or liability?

Succession of Sole Proprietor by a Company

- Section 47 (xiv) exempts succession of a sole proprietary concern by a company in the business carried on by it. The succession can be pursuant to sale or otherwise transfers capital asset to the company.
- Conditions
 - **all the assets and liabilities** of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
 - the shareholding of the sole proprietor in the company is not less than **fifty per cent of the total voting power** in the company and his shareholding continues to remain as such for a period of **five years** from the date of the succession; and
 - the sole proprietor does **not receive any consideration** or benefit, directly or indirectly, in any form or manner, **other than by way of allotment of shares** in the company;

Succession of Sole Proprietor by Firm/LLP

- No statutory exemption under the Income-tax Act
 - **Option A:** Formation of Firm/LLP with nominal capital amount.
 - **Step 1** Formation of LLP/Firm
 - **Step 2** Declaration by the partner of contributing the business to the firm. The Firm will record the business undertaking at book value/agreed value/fair value(LLP) and credit the respective partner's capital.
 - **Step 3** Other partners bringing capital contribution (cash or otherwise)
 - **Option B:** Succession of Sole Proprietor into Company – Exemption under S. 47(xiv) and subsequently Conversion of Company into LLP – Exemption under S. 47(xiiib). GAAR ?

Merger / Demerger of LLPs

- S. 60 to 62 of the LLP Act permits merger/demerger amongst LLP, subject to NCLT approval. No similar provision under Indian Partnership Act
- No statutory exemption under the Income-tax Act
- Taxation of a non-qualifying demerger/merger:
 - Demerged/Amalgamating LLP
 - No consideration received – AAR ruling in the context of amalgamation of company – Banca Sella S.p.A., In re (72 taxmann.com 360) (AAR New Delhi) [2016]

Merger / Demerger of LLPs

- Partners of LLP –
 - Demerger
 - No transfer of capital assets; interest in demerged LLP continues
 - Amalgamation
 - CIT v. Grace Collis (248 ITR 323) (SC) [2001]?
 - CBDT Circular 5/2010 dated June 03, 2010?
- Resulting /Amalgamated LLP
 - Section 56(2)(x)
 - Inadequate consideration?
 - Specified Property?

Merger of Firm/LLP into Company

- No statutory exemption under the Income-tax Act
 - Tax consequences in the hands of partners of LLP ?
- LLP
 - No statutory provision under LLP Act permitting merger
 - NCLT has approved merger in following cases:
 - M/s. Real Image LLP with M/s. Qube Cinema Technologies Pvt. Ltd. (CP/123/CAA/2018) (Chennai NCLT)
 - Vertis Microsystems LLP with Forgeahead Solutions Private Limited (Petition No. 190 and 191 of 2017) (Mum. NCLT)

Merger of Firm/LLP into Company

▫ Partnership

- Favour – Kirtilal Kalidas Diamond Exports (148 Comp Case 607) (Bom. HC)
- Against – Kediya Ceramics, In re [2017] 86 taxmann.com 166 (NCLT - Ahd.)

▫ Tax consequences

- No statutory exemption
- Tax risk – same as merger of two LLPs

Trust

What is Trust

- Section 3 of the Indian Trust Act, 1882 (“Trust Act”) defines “trust” –
 - *“an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner”*
- The person who reposes or declares the confidence is called the “author of the Trust” (generally, known as settlor).
- The person who accepts the confidence is called the “Trustee”.
- The person for whose benefit the confidence is accepted is called the “beneficiary”.
- The “beneficial interest” or “interest” of the beneficiary is his right against the trustee as owner of the trust property.

Types of Private Trusts

- Based on the nature of beneficial interest
 - Determinate; or
 - Discretionary.
- In a determinate trust, the trustees have the powers to administer and manage the trust, and its finances; however, they do not have the discretion to decide the ratio in which the income and corpus of the Trust is to be distributed among the beneficiaries.
- The Trust would be determinate trust even if the Trust Deed only provides for manner of computation of beneficial interest of each beneficiary – CIT v. India Advantage Fund-VII [2017] 392 ITR 209 (Karnataka HC)

Types of Private Trusts

- In a discretionary Trust, the trustees may distribute the benefits
 - to a few beneficiaries (and exclude others); or
 - vary the proportion each year or
 - decide not to distribute the income at all in a given year (subject to the discretion being exercised reasonably and in good faith).
- A Single Trust may have characteristic of both determinate trust and discretionary trust
 - e.g. the Trust Deed specifies the share of each beneficiary for 40% of the Trust Property and for the remaining 60% of the Trust Property the Trust Deed gives the discretion to the Trustee.

Taxation on Settlement of Trust

- Settlor
 - Exemption u/s 47(iii) – settlement of irrevocable trust

- Trustee
 - Receives trust property coupled with obligation to use the property for the benefit of beneficiaries – cannot say the property is received without consideration or inadequate consideration.

 - Commissioner of Gift-tax v. G.G. Morarji [1965] 58 ITR 505 (Bombay HC) *The trustee has no power to transfer trust property for his benefit, nor can he enjoy the trust property for his benefit. He undoubtedly possesses the trust property, but the possession is for the benefit of others, the beneficiaries. The trust thus is merely a means or a vehicle by which a donor passes on his interest in the trust property to the beneficiaries.*

Taxation on Settlement of Trust

- Beneficiary
 - What do the beneficiaries receive on settlement of Trust ?
 - Determinate Trust –
 - W.O. Holdsworth vs. The State of Uttar Pradesh [1958] 33 ITR 472 (SC) – *the trustee is the owner of the trust property and the beneficiary only has a right against the trustee as owner of the trust property. The trustee is thus the legal owner of the trust property and the property vests in him as such. He no doubt holds the trust property for the benefit of the beneficiaries but he **does not hold it on their behalf**. The expressions "for the benefit of" and "on behalf of" are not synonymous with each other. They convey different meanings.*
 - *Right against trustee – not a specified property for Section 56(2)(x)*

Taxation on Settlement of Trust

- Discretionary Trust – No tax consequence
 - CWT v. Estate of HMM Vikramsinhji of Gondal [2014] 268 CTR 232 (SC) has held that *A discretionary trust is one which gives a beneficiary no right to any part of the income of the trust property, but vests in the trustees a discretionary power to pay him, or apply for his benefit, such part of the income as they think fit. . . . The beneficiary thus has no more than a hope that the discretion will be exercised in his favour.*
 - Commissioner of Wealth-tax v. Arvind Narottam [1988] 173 ITR 479 (SC) *a mere right to be considered for distribution of the income or of the corpus of the trust fund cannot be regarded as an 'interest' since it was **not capable of valuation.***
- 56(2)(x) – exemption – trust settled for relatives of settlor

Transfer of Interest in Trust

- Section 58 of Indian Trust Act – empowers a beneficiary to transfer beneficial interest.
- ‘right of beneficiary’ or beneficial interest in Trust property is not a specified property, Section 56(2)(x) may not apply even to transfer of an interest in Trust Property.
 - The above principles may not apply to a beneficial interest in a business trust (units of collective investment scheme and mutual fund scheme) in a form which is specifically included in the definition of Securities u/s 2(h) of the Securities Contracts (Regulation) Act, 1956 and therefore, constitutes specified property for purposes of Section 56(2)(x)
- Capital gains on transfer of interest in a determinate trust ?
- Admission of new beneficiary – taxation – equivalent to settlement of trust for that beneficiary

Modification of Trust Deed

- At the time of settlement of Trust, the property is transferred by the settlor/author to the Trustee.
- Generally, there is no transfer/receipt of any Property on modification of terms of the Trust Deed and consequently, the section is not triggered
 - Commissioner of Gift-tax v. Nandkishore Sakarlal (264 ITR 453) (Guj HC)
- There is a scope of transfer only when the modification results in a change in Trustee and/or change/modification in the interest of the beneficiary.

Distribution of Trust Property

- Trust income distributed to the beneficiary is a distribution of tax-paid income and, therefore, it cannot be taxed again in the hands of the beneficiary.
 - *CIT v. Smt. Kamalini Khatau* [1994] 209 ITR 101 (SC)
- The distribution of trust property to the beneficiaries is working out of pre-existing rights of the beneficiaries as per the trust deed.
- The amount received by a person as beneficiaries on the distribution of trust corpus of trust or otherwise cannot be termed to be an amount received 'without consideration'.
 - *Ashok C. Pratap v. ACIT* [2012] 139 ITD 533 (Mumbai Trib);
 - *Mrs. Sharon Nayak v. DCIT* [2016] 159 ITD 143 (Bangalore - Trib.)
- Transfer of Trust Property by the Trustee to the beneficiary cannot be said to be a transfer without consideration for levy of Gift Tax
 - *Commissioner of Gift-tax v. Trustees of H.E.H. the Nizam's Wedding Gift Trust* [1989] 175 ITR 266 (Andhra Pradesh)

Methods of Financial Reorganisation/Resolution for Companies

General Methods

- General methods of financial reorganisation for Company
 - Conversion of Company into LLP
 - Acquisition by transfer of shares (sale, exchange)
 - Buyback
 - Capital Reduction
 - Variation in the rights of the shareholders
 - Conversion of Preference shares to Equity shares or vice-versa
 - Fast track Merger/Demerger
 - IBC – Takeover
 - Amalgamation
 - Demerger

Conversion of Company into LLP

- Section 47(xiiib) exempts transfer of a capital asset by a private company or unlisted public company to a LLP and also transfer of shares held in the company by a shareholder
- Conditions –
 - **all the assets and liabilities** of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;
 - **all the shareholders** of the company become partner of the LLP and their capital contribution and profit sharing ratio in the LLP are in the **same proportion as their shareholding** in the company;
 - the **shareholders** of the company **do not receive any consideration** or benefit, **other than by way of share in profit** and capital contribution in the LLP;

Conversion of Company into LLP

- Conditions –
 - the **aggregate of the profit sharing ratio** of the shareholders of the company in the LLP shall not be less than **fifty per cent** at any time during the period of **five years** from the date of conversion;
 - the total sales, **turnover** or gross receipts in the business of the company in any of the **three previous years** preceding the previous year in which the conversion takes place does not exceed **sixty lakh rupees** and the **total value of the assets** as appearing in the books of account of the company in any of the **three previous years** preceding the previous year in which the conversion takes place does not exceed **five crore rupees**; and
 - **no amount is paid** to any partner out of balance of **accumulated profit** standing in the accounts of the company on the date of conversion for a period of **three years** from the date of conversion.

Conversion of Company into LLP

- Conversion in compliance with provisions of 47(xiiib) – Conditions –
 - All assets and liabilities are transferred
 - Same capital contribution and profit sharing ratio
 - If company has preference shares?
 - No consideration other than share in profit
 - Share of profit of shareholders is not less than 50% for five years from the date of conversion
 - Change of profit sharing ratio among the partners, shareholder having one share is entitled to 99% profit of LLP?

Conversion of Company into LLP

- Total sales in last 3 years < 60 lacs -
 - Sales which is taxable under the head 'PGBP' – CBDT Circular on Finance Act, 2010 (Circular No. 1 of 2011)

- Total asset in last 3 years < 5 crores
 - If the company is in existence for less than 3 years?

- No amount is paid to partners in next 3 years out of accumulated profits on the date of conversion
 - Bonus shares prior to conversion ?
 - Loan to partners ?
 - Remuneration?
 - Withdrawal of capital?
 - Negative Current Account?

Conversion of Company into LLP

- Merger/Demerger followed by conversion ?
 - GAAR ?
- Whether any capital gains in the hands of company or shareholder on non-compliant conversion ?
 - Aravali Polymers LLP v. JCIT [2014] 47 taxmann.com 335 (Kolkata - Trib.) – Capital Gain in the hands of company
 - ACIT v. Celerity Power LLP [2018] 174 ITD 433 (Mum Trib.)
 - Conversion of a company into a LLP, is differently placed as in comparison to succession of a partnership firm by a company under Part IX of the Companies Act, 1956. Conversion of the company into LLP involves transfer' of capital assets.
 - Book value of each individual asset was to be regarded as full value of consideration for purpose of capital gains. 56(2)(x), 50C, 50CA ?

Conversion of Company into LLP

- Depreciation – continuity of cost of fixed assets to the Company - Explanation 2C of S. 43(6) - ACIT v. Celerity Power LLP [2018] 174 ITD 433 (Mum Trib.)
- Depreciation on Goodwill ?
 - Explanation 2C of S. 43(6) and Explanation 2 of S. 43(6) are *pari materia*
- Continuity of unaborsbed depreciation and accumaltded loss (S. 72A(6A)) – 8 years from the year of conversion.
- No MAT credit – S. 115JAA(7)

Recent Developments

- Sale of shares of subsidiary is not an undertaking
 - PCIT v. UTV Software Communication Ltd [2019] TS 44 (Bom. HC). Rationale – Business Undertaking is owned by the subsidiary company and even after the transfer of shares, the business undertaking continues with the same company.
- Family Arrangement – Corporate Entity
 - B.A.Mohota Textiles Traders Pvt. Ltd. v. DCIT [2017] 82 taxmann.com 397 (Bombay HC) *While a family arrangement/settlement does not amount to a "transfer" u/s 2(47) as it only recognizes "pre-existing rights" between the parties, the same applies only to members of the families and **not to transfers made by corporate entities**. The corporate veil can never be lifted at the instance of the company itself because that would amount to its denying its own corporate existence. **The fact that the Company is wholly owned by the members of the family is irrelevant.***

Acquisition by transfer of shares

- Transfer of shares
 - In hands of transferor – Capital Gains (S. 50CA)
 - In the hands of transferee – S. 56(2)(x)
 - Rule 11UA
- Specific Exemption on transfer of shares held by foreign company
 - Shares of Indian Co. – S. 47(via) and S. 47(vic)
 - Shares of Foreign Co. deriving its value substantially from shares of Indian Co. – S. 47(viab) and S. 47 (vicc)

Transfer of shares

- DTAA benefit to Non-Resident Shareholders
- Cost of acquisition of encumbered shares not determinable - Bijal Investment Co. (P.) Ltd. v. ITO (72 taxmann.com 243) (Gujarat HC)
- Call option of 150 years - irrevocable power of attorney – is a transfer of capital asset - Praful Chandaria v. ADIT (73 taxmann.com 14 (Mum. Trib.)
- Compensation received against right to sue – due to fall in value of shares – Satyam case – is a capital receipt
 - Lead Counsel of Qualified Settlement Fund (QSF), In re (65 taxmann.com 197) (AAR - New Delhi)
 - Aberdeen Claims Administration Inc., In re (65 taxmann.com 246) (AAR - New Delhi)

Transfer of shares

- **S. 112A of the Income-tax Act**
 - Capital gains tax @ 10% on transfer of equity shares, units of equity oriented funds and units of business trust which were exempted as per provisions of section 10 (38)
 - COA shall be higher of the following:
 - The actual cost of acquisition, and
 - The lower of
 - the fair market value on January 31, 2018 of such assets; and
 - the full value of consideration

Transfer of shares

- Listed Companies - impact of grand fathering
 - To issue bonus shares or not ?
 - Impact of reverse merger ?
 - Merger of entity owning shares of listed entity ?

Buyback

- Buyback v. Dividend
 - 115QA – tax on domestic companies not listed on recognised stock exchange on distributed income on buy back – tax rate 20%
 - 10(34A) – exempts income in the hands of shareholders
 - Dividend – 115-O + 115BBDA – tax rate 30%
- Buy back price should represent true fair market price of shares - No dubious method to avoid tax (dividend) – Fidelity Business Services India Pvt. Ltd. v. ACIT (80 taxmann.com 230) (Bang. Trib.)

Buyback

- Realignment of shareholding
 - Companies Act – No restriction on minimum or maximum price for buy back of shares
 - S. 56(2)(x) – Not a capital asset
 - Commercial Tax Officer & Ors vs State Bank Of India [2016] 11 TMI 416 (SC);
 - Vora Financial Services P. Ltd. v. ACIT [2018] TS 346 (Mum Trib)
 - S. 50CA – 10(34A) exemption
 - GAAR - ?
 - Main purpose to avoid tax ?

Capital Reduction

- With consideration
 - Transfer chargeable to capital gains in hands of shareholders – Kartikeya V. Sarabhai v. CIT (228 ITR 163) (SC) [1997]
 - 50CA ?
 - Deemed Dividend u/s 2(22)(d) to the extent of accumulated profits
- Without consideration
 - No capital gains tax - Bennett Coleman & Co. Ltd. v. ACIT [2011] 12 ITR(T) 97 (Mumbai T SB)
 - 50CA may not apply
- 56(2)(x) – no receipt by the company

Variation in the rights of Shareholders

- Companies Act permits differential rights to shareholders - example
 - Differential right to dividend
 - Differential right to vote
- No distinction under Rule 11UA
- Variation of rights tantamount to transfer ?
 - Cost of acquisition of particular right
- 56(2)(x)
 - Scope of securities ?

Conversion of shares

- Conversion of equity shares to preference shares from one class to another
 - Transfer chargeable to capital gains –
 - ACIT v. Trustees of H.E.H. The Nizam's Second Supplementary Family Trust (102 ITR 248) (AP HC)[1976] – against
 - CIT v. Santosh L. Chowgule (234 ITR 787) (Bom HC) [1999] – against
 - Periar Trading Company (P.) Ltd. v. ITO [2018] 174 ITD 137 (Mum. Trib) – favour
 - Specific Exemption – S. 47
 - Conversion of preference shares into equity shares – S. 47(xb)
- Redemption of preference shares in accordance with S. 55 of Companies Act, 2013 – no deemed dividend
 - M/s Parle Biscuits Pvt Ltd v. ACIT (5318 & 5319 /Mum /2006) [2011]
 - Shri Uday K. Pradhan v. ITO(4669/Mum/2014) [2016]

Fast track Merger/Demerger

- S. 233 of the Companies Act, 2013 – Companies between which fast track merger scheme can be entered:
 - Two or more small companies
 - Paid-up Share capital does not exceed fifty lakh rupees ; and
 - Turnover as per its last P&L account does not exceed two crore rupees
 - Holding company and Wholly-owned Subsidiary company
- No mandatory approval of NCLT. Only approval of Regional Director is required

Fast track Merger/Demerger

- Major impediment – approval of 90% of creditors
- Income Tax
 - S. 2(1b) "amalgamation" *in relation to companies, means the merger of one or more companies with another company*
 - S. 2(19AA) "demerger" *in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394 of the Companies Act, 1956*
- Fast track Demerger – may not be eligible for income tax exemption
 - Notes to Clause Companies Bill, 2011 states that S. 233 of the Companies Act, 2013 is a new section whereas S. 230 to 232 corresponds to S. 391 to 394 of the Companies Act, 1956.

IBC - Takeover

- Possible ways for takeover
 - Purchase of Shares (original shares and shares (if any) allotted on conversion of liability into equity) of the target company
 - Subscribe to shares of target company and without consideration cancel (capital reduction) the original shares and shares (if any) allotted on conversion of liability into equity.
 - Purchase of undertaking (S. 170)/assets (S. 176) of the target company (along with agreed liabilities) and dissolution of the target company.

Restructuring - takeover in IBC

- Main income tax issues on waiver of loan –
 - S. 41(1) – cessation of trading liability
 - Waiver of loan taken for acquiring capital assets - Commissioner v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC) - not taxable u/s 41(1) – not taxable
 - Waiver of loan taken for trading activity – Solid Containers Ltd. v. DCIT (308 ITR 417) (Bombay HC) – taxable

Restructuring - takeover in IBC

- Main income tax issues on waiver of loan –
 - **MAT – waiver of loan - credit to Statement of Profit and Loss**
 - Amendment vide Finance Act, 2018 - the aggregate amount of unabsorbed depreciation and loss brought forward would be allowed (otherwise lesser of the two amounts is allowed)
 - B & B Infotech Ltd. V. ITO (155 ITD 1040) (Bang. - Trib.)(Against) (confirmed by Kar HC – (396 ITR 420)
 - M/s. JSW Steel Limited v. ACIT (TS-76-ITAT-2017) (Mum Trib) (Favour) (after considering Bangalore Tribunal)

Restructuring - takeover in IBC

- Options to mitigate tax implication –
 - Option 1 - Takeover of loan from the lenders by the acquirer for a nominal consideration and conversion of interest bearing loan into interest free loan – future DDT liability also reduced
 - Option 2 – Conversion of Loan into Equity Shares and purchase of equity shares by the acquirer at nominal consideration (subject to S. 56(2)(x))
 - Option 3 – SPV of the acquirer to takeover of loan & equity shares of the target company. Reverse merger of SPV into target company

Amalgamation

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graph TD; A[Amalgamation] --> B[Qualifying]; A --> C[Non-Qualifying]
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Qualifying

- Amalgamation of companies fulfilling conditions u/s 2(1B)

Non-Qualifying

- Amalgamation of companies not fulfilling conditions u/s 2(1B)
- Amalgamation of entities other than companies

Qualifying Amalgamation

- Inserted in 1967 – to facilitate merger of uneconomic company units with other financially sound Indian companies with tax neutrality
- S. 2(1B)
 - All the property & liabilities of the amalgamating company becomes property & liabilities of the amalgamated company
 - 3/4th of the shareholders (in value) of the amalgamating company becomes shareholders of the amalgamated company [other than shares already held therein by amalgamated co. or its subsidiary]

Qualifying Amalgamation

- Exemption from Capital Gains
 - ❖ S. 47(vi) – in the hands of amalgamating company

Additional Condition to claim exemption –

- Amalgamated company is Indian Company

(Merger of Foreign Company into Indian Company is permitted by S. 234 of the Companies Act r.w. Foreign Exchange Management (Cross Border Merger) Regulations, 2018)

S. 234 of the Companies Act, 2013 allows merger of Indian Co. into Foreign Co. – no exemption in case of such mergers

Qualifying Amalgamation

- Exemption from Capital Gains

- ❖ S. 47(vii) – in the hands of shareholders of amalgamating company

Additional Condition to claim exemption –

- Amalgamated company is an Indian Company
- Consideration is any share or shares of amalgamated company
- Preference share to equity shares?

In case consideration is other than shares then exemption in hands of shareholders – not available

- CIT v. Gautam Sarabhai Trust [1988] 173 ITR 216 (Gujarat HC) – **(Against)**
- CIT v. M. CT. M. Corpn. (P.) Ltd. [1996] 221 ITR 524 (Madras HC)

Qualifying Amalgamation

- Exemptions – S. 56(2)(x)
 - S. 56(2)(x) – not applicable to transactions covered under
 - S. 47(vi) – receipt by amalgamated company and;
 - S. 47(vii) – receipt by shareholders of amalgamating company
 - Out of abundant caution ?
 - Aamby Valley Ltd. v. ACIT [2019] 102 taxmann.com 385 (Delhi - Trib.)

Non-qualifying Amalgamation

- If, amalgamation is not exempt –
 - Shareholders of amalgamating co. – receiving shares of amalgamated company in lieu of shares of amalgamating co. (where shares of amalgamating co. constitute capital asset in India)– in principle taxable, CIT v. Grace Collis (248 ITR 323) (SC) [2001]
 - No capital gains on amalgamating company – as no consideration is received - Banca Sella S.p.A., In re (72 taxmann.com 360) (AAR New Delhi) [2016]

Amalgamation - Issues

- Goodwill – Arising/Recorded on Amalgamation
 - Depreciation can be claimed u/s 32 - CIT v. Smifs Securities Ltd. [2012] (348 ITR 302) (SC) – recently followed in PCIT v. Zydus Wellness Ltd. 87 taxmann.com 82 (Gujarat HC)
 - Cannot be claimed in the year of amalgamation to the extent it exceeds the total depreciation allowable as per 6th proviso (earlier 5th proviso) to S. 32 - United Breweries Ltd. (TS-553-ITAT-2016) (Bang. Trib.) [2016]

Other assets not recorded in the books of Transferor?

Amalgamation - Issues

- Carry forward and set off of accumulated loss
 - Business Losses – S 72 – c/fd allowed only in hands of the assessee incurring it
 - Eastern Dooars Tea Co. Ltd. V. ITO (7 ITD 820) (Cal. Trib) [1984]
 - C/fd of losses and unabsorbed depreciation allowed by Court approved Scheme – allowable even if beyond Income-tax Act provisions
 - Bharat Heavy Electricals Ltd. V. ITO (5 ITD 361) (Del. Trib) [1983]
 - Electrocast Sales India Ltd. V. DCIT (92 taxmann.com 85) (Kol ITAT) [2018]

Amalgamation - Issues

- S. 72A – conditions subject to which c/fd of unabsorbed depreciation and accumulated losses allowed in the hands of amalgamated company
- In case conditions of S. 72A not satisfied or in case of amalgamation of entities other than companies – c/fd not allowed
 - Rajasthan R.S.S. & Ginning Mills Fed. Ltd. (363 ITR 564) (SC) [2014]
- If S. 72A is not satisfied, WDV of block asset to be increased by unabsorbed depreciation ?
 - CIT v. Hindustan Petroleum Corpn. Ltd. (187 ITR 1) (Bombay HC) (1991)

Amalgamation - Issues

- If conditions are satisfied, fresh 8 years to set-off unabsorbed losses
- Losses other than business losses – not allowed
 - Clariant Chemicals (I) Ltd. V. ACIT (152 ITD 191) (Mum ITAT) [2015]
- MAT Credit of Amalgamating Company – allowed in hands of Amalgamated Company
 - Skol Breweries Ltd. V. ACIT (2008 TIOL 741)(Mum Trib.)
 - M/s Caplin Point Laboratories Ltd v. ACIT (2017 TIOL 435) (Mad. Trib.)

Amalgamation - Issues

- Computation of book profits –
 - Unabsorbed depreciation and b/fd losses as per books of Amalgamating Company – to be considered
 - ACIT v. Finolex Cables Ltd. (2011 (7) TMI 1153) (Pune Trib.)
 - M/s VST Tillers & Tractors Ltd v. CIT (2009 TIOL 26) (Bang. Trib.)
 - Quantum in case of companies under IBC
 - Amendment vide Finance Act, 2018 – unabsorbed depreciation + b/fd losses
 - Increased quantum - allowable even in hands of amalgamated company?

Amalgamation - Issues

- Computation of book profits –
 - Revaluation on merger –
 - Reserves created/increase in equity on merger – whether revaluation reserve?
 - Not to be ignored – in absence of specific provision unlike in cases of demerger [S. 115JB(2B)]
- Reverse merger
 - Ajanta Pharma (NCLT Mumbai)
 - NIIT Technologies Limited (NCLT Delhi)

Demerger

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graph TD; A[Demerger] --> B[Qualifying]; A --> C[Non-Qualifying]
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Qualifying

- Demerger of undertaking fulfilling conditions u/s 2(19AA)

Non-Qualifying

- Demerger not fulfilling conditions u/s 2(19AA)

Qualifying Demerger

- Definition – S. 2(19AA) –
 - S. 391 to 394 of Companies Act, 1956 (S. 230 to 232 of Companies Act, 2013) – whether to include demerger under IBC?
 - All the property of the undertaking is transferred to the resulting company.
 - All the relatable liabilities of the undertaking are transferred to the resulting company.
 - All property and liabilities are recorded at book value by the resulting company (except revaluation).

Qualifying Demerger

- Definition – S. 2(19AA) –
 - Resulting company issues shares to the shareholders of demerged company, on proportionate basis – consideration only in form of shares of resulting co.
 - 3/4th of the shareholders (in value) of the demerged company becomes shareholders of the resulting company.
 - Undertaking is transferred on going concern basis.

Qualifying Demerger

- Undertaking – Explanation 1 to S. 2(19AA) –
 - Whole or part – not individual asset
 - DCIT v. NOCIL Ltd. (165 ITD 138) (Mum. Trib.) [2017]
 - Shares of a operating subsidiary company is not an undertaking
 - PCIT v. UTV Software Communication Ltd [2019] TS 44 (Bom. HC)
 - Certain assets retained?
 - Triune Projects (P.) Ltd. v. DCIT (291 CTR 268) (Delhi HC)
 - Additional assets also transferred along with the undertaking – non-qualifying demerger?

Qualifying Demerger

- Resulting Company – S. 2(41A) –
 - Single company
 - Group of two or more companies (including WOS)
 - Includes –
 - Any authority or body or local authority
 - Public sector company
 - Company formed as a result of demerger

Qualifying Demerger

- Exemptions – Capital Gains
 - S. 47(vib) in the hands of demerged company
 - Additional condition – Resulting Company is an Indian Company
 - S. 47(vid) – transfer or issue of shares **by** resulting co. **to** shareholders of demerged co.
 - no capital gains in hands of resulting co. - irrelevant
 - Gains in hands of shareholders of demerged co. – not dealt with?

Qualifying Demerger

- Exemptions – S. 56(2)(x)
 - S. 56(2)(x) – not applicable to transactions covered under
 - S. 47(vib) – receipt by resulting company and;
 - S. 47(vid) – receipt by shareholders of demerged company

Out of abundant caution?

Demerger - Issues

- In case of qualifying demerger –
 - Position for shareholders of the demerged company ?
 - Transfer by way of Cancellation or Capital Reduction of shares of the demerged company – Allotment of shares by resulting co. and Transfer are two separate transactions ? – If so, transfer is without consideration.
 - No Cancellation/Capital Reduction of shares of the demerged company – Reduction in value of shares of demerged co. – whether results in relinquishment of rights ? – if yes, is the transfer exempt?
 - Receipt of shares of resulting co. – S. 56(2)(x) not applicable

Qualifying Demerger

- Carry forward and setoff of accumulated losses and unabsorbed depreciation
 - S. 72A(4) Computation –
 - Accumulated loss & unabsorbed depreciation directly related;
 - Accumulated loss & unabsorbed depreciation not directly related – Proportionate based on assets – (net assets or gross assets, book value or fair value)
 - Fresh 8 years for set-off ?
- Losses other than business losses – not allowed – Clariant Chemicals (I) Ltd. V. ACIT (152 ITD 191) (Mum ITAT) [2015]

Demerger - Issues

- In case of qualifying demerger –
 - Goodwill/Brand not in the books of demerged company to be considered ? Depreciation ?
 - Ind AS 103 – fair value accounting – compliant demerger?
 - MAT Credit of the demerged undertaking –allowed – Adani Gas Ltd. v. ACIT (2016 TIOL 146)(Ahm. Trib.) (No appeal by Department before High Court)

Demerger - Issues

- Computation of Book Profits u/s 115JB
 - Ind AS 103 – fair value accounting to be ignored for the purpose of MAT [S. 115JB(2B)]
 - Adjustment of debits/credits pursuant to demerger [Clause (c) and (d) of S. 115JB(2A)] – incorrect assumption as to applicability of Appendix A of the Ind AS 10?

Non-Qualifying Demerger

- Taxation of a non-qualifying demerger
 - Demerged company – No consideration received – AAR ruling in the context of amalgamation should apply
 - Company entitled to receive consideration on transfer of undertaking. Transfer of part of the consideration to the shareholders in the same scheme of arrangement – liable to be taxed in the hands of the company – CIT v. Salora International Ltd. (386 ITR 580) (Delhi HC) – SLP accepted (242 taxman 474) (SC)

Thank You

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