

Important issues relating to CAPITAL GAIN ISSUES IN BUSINESS RE-ORGANISATION

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**Seminar on Recent Updates and
Issues in Capital Gains**

WIRC of ICAI

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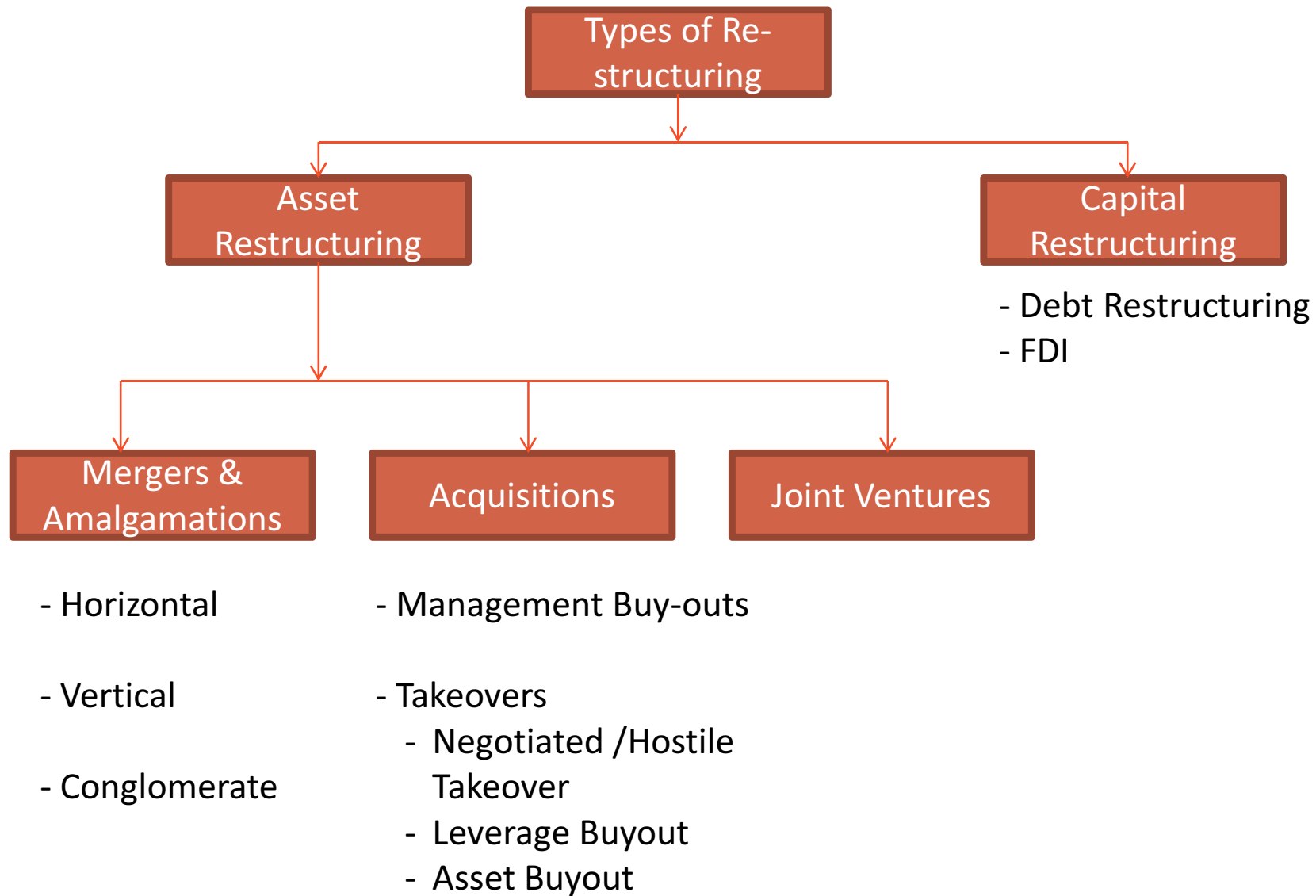
Restructure means to organise differently

Restructuring is the corporate management term for the act of reorganising the legal, ownership, operational, or other structures of an entity for the purpose of making it more profitable, or better organised for its present needs

Restructuring includes a change of ownership or ownership structure, demerger, or a response to a crisis or major change in the business such as bankruptcy, repositioning or buy-out

Restructuring may also be described as corporate restructuring, debt restructuring and financial restructuring

BUSINESS RESTRUCTURING - TYPES



BENEFITS

- Combination benefits
- Operational resource sharing
- Domain strengthening / Domain Exploring
- Acquiring capability / Acquiring Business Position
- More efficient economic activity
- Great deal of competition for business assets
- Create value for shareholders
- Capturing new opportunities in the evolving economies

TAX ISSUES IN BUSINESS RE-STRUCTURING

- The Income Tax Act contemplates and recognizes the following types of mergers & acquisition activities:-
 - Amalgamation (i.e a merger which satisfies the conditions satisfied)
 - Slump Sale/Asset Sale
 - Transfer of Shares
 - De-merger or Spin-off

Tax Issues

- Carry forward of losses
- Capital Gains on Corporates & Shareholders
- Expenditure/Income Allocation
- Valuation related issues
- Stamp Duty
- Indirect Taxes & Carry forward of Credits

TAXABILITY OF INDIRECT TRANSFER

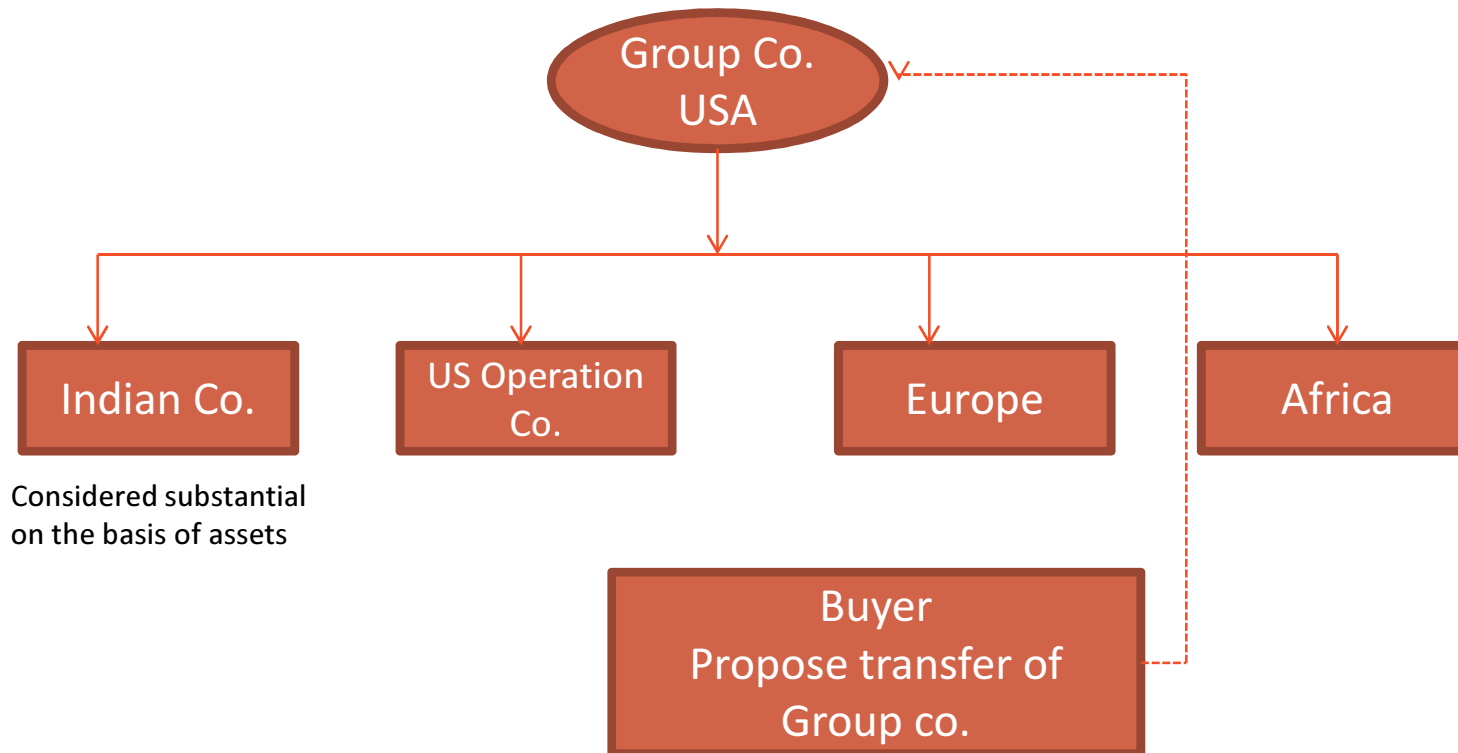
Definition expanded

- Amend Sec. 2(47) by adding Explanation 2 to clarify that “transfer” includes and shall be deemed to have always included disposing or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India

Shome Committee Recommendations

- For threshold test on substantiality and valuation at least 50% of the total value should be derived from assets located in India. Further, to this extent, the value of the Indian assets should be more than 50% of the global assets to determine whether the 50% test has been met
- Under DTC, indirect transfer of shares of Indian Company taxable if FMV of Indian assets exceeds 50% of FMV of all assets of foreign company, whose shares are transferred

INDIRECT TRANSFER



In the above hypothetical transaction if the proposed transaction happens on transfer of group company shares to the buyer then the tax implications of such transaction will attract Indian Tax Law, since Indian Company having substantial assets when compared to the group. The full value received by the Group Co. shareholders will be liable to tax in India

BUSINESS RE-STRUCTURING POSSIBILITIES

- Amalgamation
- Demerger
- Slump Sale
 - Capital Gains
 - Tax Base
 - Depreciation on the assets revalued based on technical valuer's report
- Conversion of Firm to Company
 - Capital Gain
 - Depreciation
 - Tax Base
- Conversion of Proprietorship to Company
 - Capital Gain
 - Depreciation
 - Tax Base
- Conversion of Company to LLP

ISSUES – AMALGAMATION

- Defined sec. 2(1B)
 - Companies not firms
 - All assets
 - All liabilities
 - 75% shareholders
- Tax neutrality
 - No capital Gains
 - ❖ Company
 - ❖ Shareholder
- Continuity of Tax Base
 - For Depreciation
 - ❖ Cost & WDV – Expl. 7 to sec. 43(1)
- Tax neutrality
 - For Capital Assets
 - ❖ Cost
 - ❖ Indexation
 - ❖ Period of Holding

ISSUES – AMALGAMATION (CONTD..)

- Depreciation
 - To be bifurcated – 5th proviso to sec. 32(1)
- Losses
 - Unabsorbed depreciation
 - Unabsorbed business loss
 - Other c/f. provisions (capital Losses, House Property, Speculation, Race Horses, Preliminary Expenses, etc.)
- Tax neutrality
 - MAT Credit
 - Sec. 72A
 - Special provision
 - Continuing conditions

- Definition
- “Undertaking” – *shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity*
Expl. 1 to Section 2(19AA)
- Transfer of Assets & Liability (identification of Liability)
- Capital Gains
- Tax Base
 - Depreciation
 - Capital Asset
- Losses & unabsorbed depreciation
- MAT Credit

ISSUES – CONVERSION OF FIRM INTO COMPANY

- Transfer
 - of Asset/Investment
 - Without Tax
 - Stamp Duty optimization
 - Depreciation – Section 32(1) proviso (v); Expl. 3 section 43(1)
 - Position of Stock-in-trade
 - ALA Firm [1991] 189 ITR 285 (SC)
 - Sec. 43C
 - Need to match asset / liability
 - Low Net Consideration
 - In shares / preference shares
 - Tax on redemption
 - Deemed dividend / capital gains

- Tax Neutrality
 - No “transfer” for transferor company
 - No “transfer” for the shareholders
- Conditions of sec. 47(xiiib) to be fulfilled
- Carry forward of losses and unabsorbed depreciation of Company - s. 72A(6A)
- Depreciation on assets to LLP as per WDV of Company - Expl. 2C to S. 43(6)
 - No step up in WDV – same WDV to continue
- Cost of other non depreciable assets – cost to previous owner – company – s. 49(iii)(e)
- Carry forward MAT credit of company will not transfer to LLP – S. 115 JAA(7)
- Violation of conditions - S. 47A(4)
 - Profit not charged to company – will become capital gains for LLP
 - Profit not charged to shareholder– will become income for partner
 - Provision similar to that for conversion of firm – S. 47(xiii) – additional coverage for shareholders

OTHER ISSUES

- Section 45(2) – Liability to pay the tax arises when ??
- Section 45(3) – Difference between the value of the capital asset and amount recorded in the books of the partnership firm shall be taxed in the hands of the transferee
- Section 45(4) – FMV on the date of distribution of capital assets on dissolution of firm is the consideration which ought to be taxed
- Section 56(2)(vii) – “where an individual or a Hindu undivided family receives from any person any property either without consideration or for in-adequate consideration
- Section 56(2)(viii)
 - Applicable where a company or a firm receives shares of another company from any person, either without consideration or for inadequate consideration
 - Aggregate value of sum of money received exceed Rs. 50,000 is the limit to attract chargeability
 - FMV of equity shares which are unquoted in stock exchange, in accordance with rule 11UA(1)(c)(b) (Net Asset Value method) $FMV = (A - L) * (PV) / (PE)$

OTHER ISSUES

- Section 56(2)(viib)
 - Applicable where a company receives any consideration receives any consideration for issue of shares that exceed the face value
 - FMV of equity shares which are unquoted in stock exchange, in accordance with rule 11 UA(2) at the option of the assessee.
 - Net Asset value method or Discounted Cash Flow method

THANK YOU!!