Walker Chandiok & Co LLP

Due Diligence – Indirect Taxes

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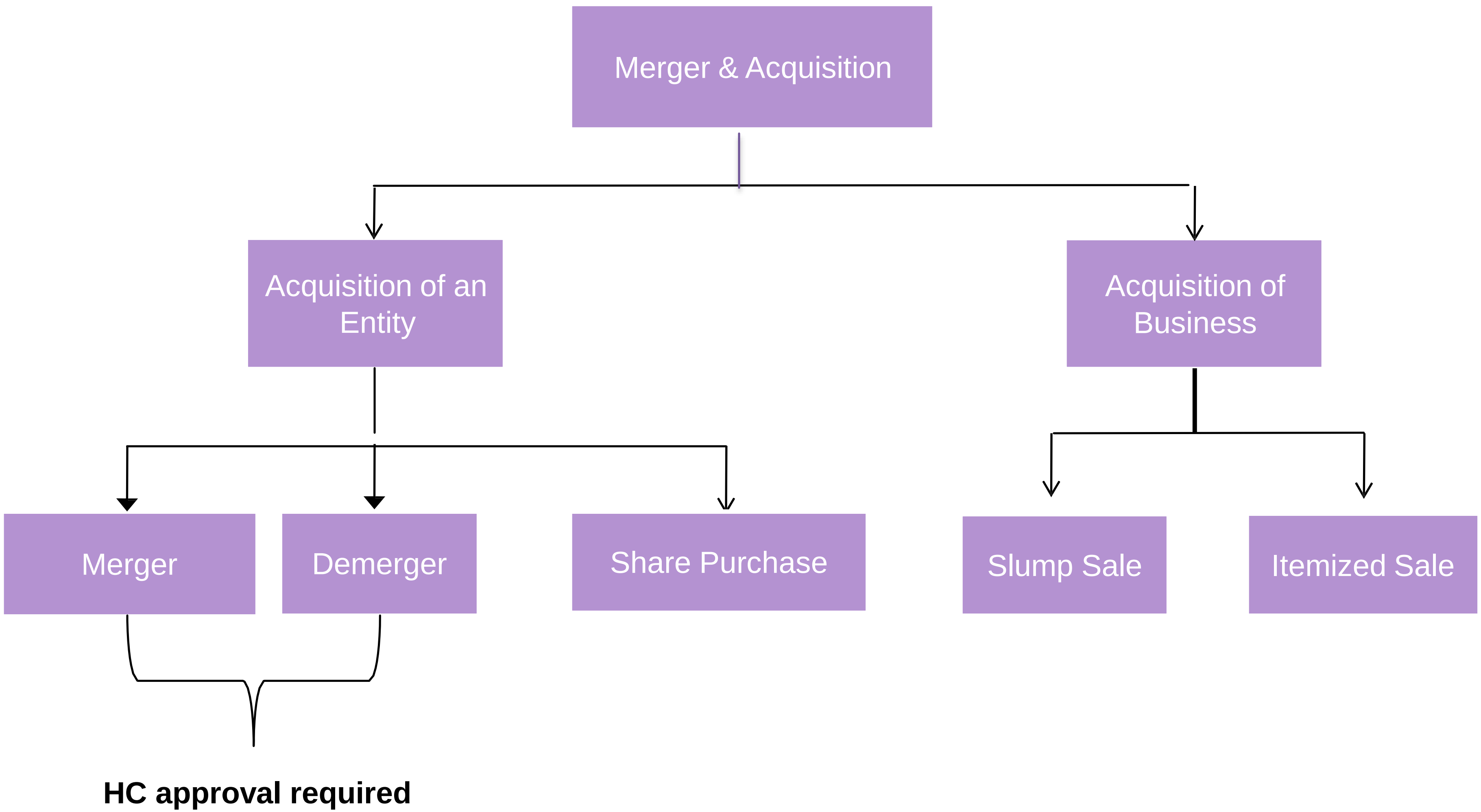
Modes of merger/ demerger & acquisition



Tax implications on Slump Sale and Itemized Sale Pre / Post GST

Transaction	Meaning	Pre GST	Post GST
Slump sale	As per Section 2(42C) of the Income Tax Act, 1961, ***"Slump sale" means transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.***	Exempted from service tax under Noti.25/2012-ST dt. 20/6/2012, ***"Services by way of transfer of a going concern, as a whole or an independent part thereof."*** No VAT / CST levy, as sale of Business as going concern cannot be termed as "Good"	As per Schedule II read with Sec. 7/ 8 of the Central GST Act, 2017 ***Business as going concern neither Goods nor service – No GST levy.***
Itemized sale	It means sale of assets and liabilities where the value of each item is known along with the value of goodwill and liquid cash etc.	VAT / CST / Central Excise would be levied on sale / transfer of each of assets and liabilities as in the case of sale / transfer of each assets / liabilities	GST would be levied / Credit to be reversed on sale of individual assets and liabilities

Tax implications on Share purchase Pre /Post GST

Transaction	Meaning	Pre GST	Post GST
Share acquisition	It means acquisition of Equity share capital of the company in which the target business is vested	No VAT implication since securities is excluded from definition of Goods u/s 2(12) of MVAT Act No Service tax implication since, securities excluded from the definition of service under Sec 2(44) of the Finance Act, 1994	No GST implication in respect of sale / transfer as excluded from the definition of Goods under Sec. 2(52) and service under Sec. 2(102) read with Section 7 of the Central GST Act, 2017

Case laws with respect to slump sale

Coromandal Fertilizers Limited vs. The State of A.P. [112-STC-1 A.P.]

It was observed that sale of cement division on going concern basis for lump sum consideration was not liable to sales tax since what was intended to be sold was not goods or stock, but the concern in its entirety

Shri Ram Sahai vs. The Commissioner of Sales Tax [1963-14-STC-275-All]

It was observed that amount of the sales proceeds of the business sold was not to be included in the turnover since business is not a movable property and hence it cannot be termed as goods under Sales Tax Act

Deputy Commissioner vs. K. Behnan Thomas [1977-39-STC-324-Mad]

It was observed that sale of Ooty branch for lump sum consideration was not liable to sales tax since it was regarded as transfer of independent business which is neither considered as transfer of goods nor transfer of service

Collect key details of the client

Key managerial personnel, their contact details

Manufacturing locations/ Warehouses/ offices – whether rented / owned

Key products / inputs/ manufacturing process

Procurement model – Import / domestic – local / outside state

Sales/ marketing model/ strategy- incentive schemes/ discount/ gifts /sales return policy

Material sent for Job work / received for job work

Key Vendors / Customers

Statutory Auditors / Cost Auditor / Internal Auditor / Tax Auditor

Captive consumption of goods – semi finished/ finished

Procurement / Disposal of Capital goods / other Capital expenditure incurred

Key incentives availed under Foreign Trade Policy / Backward area scheme, if any

Documents for review

- Audited Financial statements for past 3-5 years
- Trial balance thereafter up to the period of due diligence
- Business & product/service profile
- Tax audit report
- VAT audit reports
- Statement of Contingent liability
- Trial Balance (grouped)
- Returns & Payment Challan with workings & reconciliations
- Tax exemption documents (PSI, SSI, Area based exemptions)
- List of open assessments and litigations
- EA-2000 / CERA or Business audit reports
- Notices, letters of tax authority seeking details/ raising questions

Determining period of Tax Due Diligence

Period of Tax due diligence is determined basis the period upto which assessment / audit / adjudication may be conducted by the tax authority.

The period, however would be extended for any open assessment, enquiries, tax dispute etc..

Legislation	Period of review
Customs/ Central Excise / Service tax	5 years
VAT/ CST/ Entry Tax	4-8 years
GST	7 years 9 months

A shorter period may be selected as it gives necessary insights about the compliance level and the risk profile of the target and specific observations may be looked into for periods not covered under the review.

Due diligence – Indirect taxes

Careful & methodological investigation of financial and tax records

Highlighting ambiguities in compliances of tax legislations

Examining appropriateness of the tax positions taken by the target.

Identify potential exposures due to aggressive / inaccurate tax positions

Reviewer must have in-depth knowledge and practical exposure of indirect tax compliance process

Critical to examine

- All ledger accounts related to indirect taxes
- Contingent liabilities reported in financials
- Unutilised incentive scrips received under different schemes of FTP
- Year wise tax refunds reported in tax returns
- Admissibility and quantification of VAT refund filed or yet to be filed
- Input tax credits/ CENVAT Credits appearing in the financial records viz.a viz. report in returns/ Audit reports
- Unclaimed backward area incentives – admissibility to the buyer/ new entity
- Amendments required in different registrations viz. GST / IEC /PT/S&E

Due diligence – Indirect taxes

Identification of lapses in tax compliances, if any, and quantification of tax exposure

Analysis of tax positions taken by the target and assessing their impact going forward

Analysis of risk profile of ongoing litigations of the target company

Identifying underreported tax liabilities and ascertaining provisions requirements

Validating representation made by the seller at the time of pre-deal negotiation

Ascertaining representations, warranties and indemnities to be sought and adjustments to be made in the enterprise value on account of findings during tax due diligence

Challenges

Time-bound assignment leaves limited room for research or contemplate alternatives, dependency on different experts creates unwarranted pressure

Difficult to manage cost, since lot of time is wasted in collection of relevant information and seeking clarification.

Difficulty in resource planning – uneven work pressure.

Incomplete information – data or details, delay in providing relevant details, target may hide vital information relevant to reach conclusion

Use of information available in public domain may lead to errors / wrong conclusions

Resorting to test check may lead to failure in identifying vital exposures.

Key areas to be verified

To verify	Customs	Central Excise	Service tax	VAT/ CST	Entry Tax	Octroi /LBT	GST
Taxable event	Y	Y	Y	Y	Y	Y	Y
Classification	Y	Y	Y	Y	Y	Y	Y
Valuation	Y	Y	Y	Y	Y	Y	Y
Inclusions/ Exclusions in value	Y	Y	Y	Y	Y	Y	Y
Point of Tax/ Time of Supply	N	Y	Y	Y	Y	Y	Y
Place of provision /Supply	N	Y	Y	Y	Y	Y	Y
Exemption	Y	Y	Y	Y	Y	Y	Y
CENVAT / Input Tax Credit	N	Y	Y	Y	Y	Y	Y
Adjustment of tax on goods return	N	Y	N	Y	Y	Y	Y
Adjustment for deficiency in service	N	N	Y	N	N	N	Y

Key Processes

- **Sale/ supply/ receipt of goods/services**

Valuation method applied

Terms of sale / Discount policies/ Schemes/ Incentives

Verify exemptions claimed and fulfilment of conditions of such exemptions

Tax adjustments – goods return/ non provision of service

Tax adjustments – Deficient quality / quantity

Place of removal / delivery

- **Purchases/ returns/ loss/ write off**

Recording of purchase of RM / CG, Services and claiming eligible credits

Adjustment of credit on purchase returns

Reversal of credit on loss of RM, SFG, FG, CG,write off/ disposal, gift, sale, non business use

- **Tax Compliance / Tax Accounting**

Have a walk through of compliance process followed, Verify key returns under each of the tax legislation

Verify tax liabilities and ITC reported in the returns match with financial statement

Tax disputes and potential exposure

Common Tax disputes -For industry / segment / area

Status of audits / assessments by tax authorities

Status of enquiries initiated/ SCN issued / SCN adjudicated

Contingent liabilities reported and developments since last audited financials

Merit in tax disputes and requirement of provision if any

Provision made, if any against the tax demand, whether provision adequate or not

Subsequent legal pronouncements having bearing on tax disputes/ tax positions

Potential exposure / adequate provisions on account of

- non receipt of declarations such as Form C,E, F, H, I
- Non fulfilment of conditions of incentives under FTP/ Backward area schemes

Pre- deposits/ tax refunds / ITC / CENVAT credit balance identified and supported by documents and duly reconciled

Claims lapsed/ time barred / not maintainable/ doubtful / unsupported/ subject to principle of unjust enrichment

Other Key aspects

Status of registrations under different tax laws – renewal / updation thereof

Location of records, accessibility, easy retrieval, safety, adequacy for facing assessments/ audit /defending during tax disputes / enquiries.

Persons responsible for tax compliance, their qualification, experience on the job, no. of years with the company, expertise and updated knowledge

Indirect tax specialists to be part of initial kick-off meeting

Review internal controls in respect of indirect tax process

Quantify observations - Where quantification not possible, provide basis to quantify

Challenge by Target company -Be prepared to have each observation challenged

Consistency of language, philosophy on positions taken, manner of estimation, etc. is crucial

Regulatory changes and Credit admissibility

Goods and services Tax (GST) came into force from 1st July, 2017. Before introduction of GST, multiple taxes, viz. Service tax, VAT, CST, Entry Tax, Octroi, Central Excise duty were applicable. All the above taxes were subsumed in GST

Find out whether or not appropriate taxes discharged on transactions undertaken during pre- GST era

Input Tax / CENVAT Credit availability to Manufacturer, Service provider and Trader prior to introduction of GST:

Tax	Manufacturer	Service provider	Trader
Central Excise	Yes	Yes	No
Service tax	Yes	Yes	No
Basic custom duty	No	No	No
CVD u/s 3(1)	Yes	Yes	No
SAD u/s 3(5)	Yes	No	Refund
SBC	No	No	No
KKC	No	Yes	No
GST	Yes	Yes	Yes

Implications of IDT in respect of Capital Goods

Capital goods	Purchase and sale under pre GST era	Purchase pre GST era and sale Post GST era	Purchase and sale Post GST era
Land and building	• No VAT / CST / service tax as Land Buildings are immovable property.	• No VAT / CST/ service tax / GST as Land Buildings are immovable properties.	• No GST, not a "supply" - Schedule III of the Central GST Act, 2017
Plant & machinery	• VAT/CST will be applicable on sale of plant and machinery • ITC available if purchase within state • CENVAT Credit reversal can be availed as per Rule2(a) of CCR 2004	• Unavailed VAT/CENVAT credit can be availed as transition credit under GST • GST will be applicable on sale since sale of P&M is covered in definition of supply	• GST will be applicable on sale as per Schedule I read with section 7 of CGST Act • ITC in respect of purchase can be availed

Implications of IDT in respect of Capital Goods

Capital goods	Purchase and sale prior to introduction of GST	Purchase pre GST era and sale Post GST era	Purchase and sale Post GST era
Office equipment	• VAT / CST applicable on sale of asset. • ITC available after deduction of 3% in case within state sale • CENVAT Credit reversal, if availed earlier. ITC available.	• GST applicable on transaction value • ITC available to buyer	• GST applicable on transaction value. • ITC available to buyer
Software	• Charges for assignment of rights for balance period subject to Service tax • CENVAT Credit available	• Charges for assignment of rights for balance period subject to GST • ITC available	• Charges for assignment of rights for balance period subject to GST • ITC available

Credit reversal in case of Capital goods

Transaction	Pre GST	Post GST
Credit reversal (in case capital goods are removed after being used)	Cenvat credit taken reduced by % points per quarter as per SLM OR Transaction value*duty leviable, whichever is higher	Input tax credit taken reduced by 5% points per quarter as per SLM OR Transaction value* GST rate, whichever is higher Sec. 18(6) of CGST Act

Transfer of business with tax liability - impact on valuation

Transferee is responsible for all Indirect Tax liabilities even for past periods for ongoing business as per business agreement

It's important to factor probability of tax liability for past transactions due to aggressive tax positions, insufficient documentation/ details, non receipt of statutory forms, pending WCT TDS certificates etc.

The probable liability for past transactions has a bearing on the valuation of the business to be transferred

Pending tax assessments- appropriate documents and details should be available and provided to the transferee

Contingent liability and other enquiries/ notices from tax authorities to be disclosed, so as to factor the future tax liabilities in respect of past transactions

Past transactions – Joint and several liability under MVAT and GST

Business Transfer – Merger/Amalgamation/De-merger/Slump sale:

As per Section 44(4) of the MVAT Act, joint and several liability of tax, interest and penalty on the transferor and transferee and the person succeeding up to the time of such transfer, disposal or change

In view of the above, the liability to pay historical VAT liabilities up to the date of transfer would be jointly and severally on the transferor and transferee

As per Section 85(1) of CGST Act, joint and several liability of tax, interest and penalty would arise on the transferor and transferee up to the time of such transfer

In view of the above, the liability to pay historical GST liabilities up to the date of transfer would be jointly and severally on the transferor and transferee

Transfer of tax registrations

Business Transfer – Merger/Amalgamation/De-merger/Slump sale:

As per Section 22(4) of CGST Act, in case of merger, demerger, amalgamation pursuant to High court or tribunal order, transferee is liable to be registered from the date on which ROC issues a Certificate of Incorporation to the new entity

Practically, in case of transfer of business requiring surrender of old registration and obtaining a new registration, the authorities typically insist on an undertaking from the buyer that he undertakes the liability to pay any tax, interest or penalty that may arise in future for past transactions

Right to re-course available: Right of "attachment and sale" extended to various articles which are in custody of transferee

Business re-organization – Indirect Tax implications

Tax credits – Central Excise, GST and Service Tax

As per Rule 10 of the CENVAT Credit Rules, 2004,

if a factory is transferred on account of sale, merger, amalgamation, lease, the unutilized balance of CENVAT credit can be transferred to the new entity provided liabilities of such factory is also transferred to the new Company

the CENVAT credit in respect of inputs and capital goods would be allowed to be transferred only if the inputs as such, semi FG and CG are also transferred to the new entity

Position post introduction of GST

As per Section 18(1) of CGST Act, when there is change in constitution of a registered person on account of sale, merger, demerger or amalgamation, the said registered person will be allowed to transfer the ITC which remains unutilized in his ECL to such sold, merged, amalgamated company

Business re-organization – Indirect Tax implications

Tax credits –VAT/CST

As per Section 55(7) of the MVAT Act, where a dealer transfers or otherwise disposes of his business in whole or in part or effects any change in the ownership thereof, in consequence of which he is succeeded in the business or part thereof, by any other person

In view of the above, transfer of input tax credit should be permitted in case of whole or part transfer of business or change in ownership

Input tax credit cannot be transferred in case of itemized sale of assets

GST implications in case of Mergers and Acquisitions

As per Section 18(3) of CGST Act, when there is change in constitution of a registered person on account of sale, merger, demerger or amalgamation with the specific provision for transfer of liabilities, the said registered person shall be allowed to transfer unutilized ITC from his Electronic credit ledger (ECL) to transferee company

As per rule 41(1) of CGST Rules, the transferor shall furnish details of merger, amalgamation, de-merger in FORM GST ITC-02 along with request for transfer of unutilized ITC lying in his Electronic credit ledger to the transferee

Also to furnish certificate from by practicing CA or Cost accountant that sale, merger, demerger has been done with specific provision for transfer of liabilities

In case of demerger, ITC shall be distributed in ratio of value of assets of new units

Thank You