

Direct Tax Refresher Course

Reorganisation of entities and tax liability thereon

June 23, 2018

Presentation by:
Gautam Doshi

Reorganisation / Resolution

```
graph TD; A[Reorganisation / Resolution] --> B[Financial]; A --> C[Operational]; B --> D[Reorganisation of Ownership and Capital Structure]; C --> E[Reorganisation of Management and mode of doing business]; D --> F[Relevant from direct tax perspective]; E --> G[Not relevant from direct tax perspective];
```

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/ Resolution

General Methods

- General methods of financial reorganisation
 - Amalgamation
 - Demerger
 - Slump sale
 - Conversion of firm/LLP into company or vice versa
 - Acquisition by transfer of shares (sale, exchange)
 - Restructuring (capital/debt/both)

Amalgamation

- Blending of two or more existing undertakings into one
- Income-tax Act recognizes only amalgamation of companies – with qualifying conditions
- Thus, from tax prospective amalgamations may be divided into:

Amalgamation

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

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
 - $3/4^{\text{th}}$ 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

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 Indian Company
- Consideration is any share or shares of amalgamated company

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)
- 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?

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. [2017] 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 section 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 unabsorbed depreciation
 - Unabsorbed depreciation – S. 32(2) – c/fd allowed only in hands of the assessee incurring it
 - Indian Iron & Steel Co. Ltd. V. CIT (11 ITR 328) (PC) [1943]
 - Anand & Company v. ACIT (89 ITD 125) (Kol ITAT) [2004]
 - 6th Proviso to S. 32(1) – total depreciation allowable if no amalgamation had not taken place – to include unabsorbed depreciation of amalgamating company

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 ITAT) [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) (Delhi ITAT) [1983]
 - Electrocast Sales India Ltd. V. DCIT (92taxmann.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

- Conditions specified in 72A –
 - Amalgamating Company
 - Owns an industrial undertaking or ship or hotel or it is a banking company or a public sector company
 - Engaged in the business (in which loss has occurred) for more than three years
 - Fixed asset on the date of amalgamation $> 3/4^{\text{th}}$ of the fixed assets held before two years (Comparison based on book value)

Amalgamation - Issues

- Conditions specified in 72A – (Cont. . .)
 - Amalgamated Company
 - Continues to hold at least $3/4^{\text{th}}$ of the fixed asset of amalgamating company for 5 years.
 - Continues the business for five years.
 - Achieve the level of production of at least 50% of the installed capacity of the undertaking (of the amalgamating company) before the end of 4th year from the date of amalgamation and continue to maintain the minimum level of production till the end of 5th year.

Amalgamation - Issues

- If conditions are satisfied, fresh 8 years to set-off unabsorbed losses
- If conditions not capable of being satisfied consider reverse-merger ?
 - Ensure compliance with Section 79.
- Losses other than business losses – not allowed – Clariant Chemicals (I) Ltd. V. ACIT (152 ITD 191) (Mum ITAT) [2015]

Amalgamation - Issues

- 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)]

Demerger

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

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 ITAT) [2017]
 - Shares of a operating subsidiary company is not an undertaking - UTV Software Communications Ltd. v. ACIT (157 ITD 71) (Mumbai - Trib.)
 - 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.)

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)

Other Provisions

- Other provisions applicable to qualifying amalgamation and demerger – to achieve tax neutrality
 - Continuity of various deduction under Sections 30 to 37 (eg. 32AD, 32AC, 35, 35D etc.)
 - S. 36(1)(vii) – CIT v. T. Veerbhadra Rao (155 ITR 152) (SC)
 - Principle laid down by SC can be extended to deductions disallowed u/s 43B and 40(a)(ia)
 - S. 41(1) – cessation of trading liability – successor to include amalgamated/resulting co.
 - Exemptions under Sections 10A, 10AA, 10B
 - Deductions under Part C of Chapter VIA (80-IB, 80-IAB, 80-IC and 80-IE)

Slump Sale - Section 50B

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

Slump Sale - Section 50B

- 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)
 - CIT v. Bharat Bijlee Ltd. (365 ITR 258) (Bom HC)
 - Bennett Coleman & Co. Ltd. v. ACIT (168 ITD 631) (Mum ITAT) [2018]

Slump Sale - Section 50B

- 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)
- Expense incurred as a precondition of slump sale – allowable u/s 48 – PCIT v. Nitrex Chemicals India Ltd. (75 taxmann.com 282) (Delhi HC)
- Deductions specific to undertaking shall continue as it is change of ownership and not reorganisation – ACIT v. Spray Engineering Devices Ltd. (23 taxmann.com 267) (Chd ITAT)

Slump Sale - Section 50B

- Sec 50C not applicable in case of slump sale - DCIT v. Summit Securities Ltd (15 ITR(T) 1) (Mum. Trib.) (SB)
- If transfer of undertaking qualifies as succession u/s 170 – 6th proviso to S. 32(1) applicable – depreciation allowed on proportionate basis
- S. 56(2)(x) –
 - In the hands of transferor – receipt of money for consideration – S. 56(2)(x) not applicable
 - 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

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 Specific provisions under the Income-tax Act
 - Statutory vesting – no transfer – no consideration – no capital gain in the hands of the Firm – unnecessary to comply with S. 47(xiii)
 - CIT v. Texspin Engg. & Mfg. Works (263 ITR 345 (Bombay HC))
 - CADD Centre v. ACIT (65 taxmann.com 291) (Mad. HC)

Conversion of Firm into Company

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956) :
 - Continuity of cost of fixed assets to the Firm ?
 - Depreciation on goodwill ?
 - Set off unabsorbed depreciation and accumulated loss – Amin Machinery P. Ltd. v. DCIT (298 ITR 140)(Ahmd Trib.) – Against

Acquisition/succession of business of a firm by a company

- Acquisition/ succession in compliance with provisions of 47(xiii) –
 - All assets and liabilities related to business are transferred
 - All partners become shareholders
 - Shares allotted in ratio of capital
 - No consideration other than allotment of shares
 - Shareholding of partners of the firm is not less than 50% for a period of five years from the date of succession.
- Position of partners ?

Acquisition/succession of business of a sole proprietor by a company

- Acquisition/ succession in compliance with provisions of 47(xiv) –
 - All assets and liabilities related to business are transferred
 - No consideration other than allotment of shares
 - Shareholding of sole proprietor is not less than 50% for a period of five years from the date of succession.
- The sole proprietor and business are same – S. 47(xiv) applicable in hands of sole proprietor

Acquisition/succession of business of a firm/sole proprietor by a company

- No specific explanation/provision for continuity of cost of fixed assets [S. 43(1) and S. 43(6)] – no condition relating to accounting by company
- Depreciation on cost to the company (fair value) – DCIT v. Suyash Laboratories Ltd. (65 taxmann.com 217) (Mumbai Trib.) – should also apply to goodwill.
- Proportionate depreciation – 6th proviso to S. 32(1) applicable
- Continuity of unaborsbed depreciation and accumalted loss (S. 72A(6)) – 8 years from the year of conversion.
- AMT credit avilable ?

Conversion of Company into LLP

- Conversion in compliance with provisions of 47(xiiib) –
 - All assets and liabilities are transferred
 - Same capital contribution and profit sharing ratio
 - 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.
 - Total sales in last 3 years < 60 lacs
 - Total asset in last 3 years < 5 crores
 - No amount is paid to partners in next 3 years
- Demerger followed by conversion ?
- 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

Conversion of Company into LLP

- Depreciation – continuity of cost of fixed assets to the Company - Explanation 2C of S. 43(6)
- Depreciation on Goodwill ?
 - Explanation 2C of S. 43(6) and Explanation 2 of S. 43(6) are pari materia
- Continuity of unabosrbed depreciation and accumaltd loss (S. 72A(6A)) – 8 years from the year of conversion.
- No MAT credit – S. 115JAA(7)

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)
- 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 - Exemption

- Transfer of shares of an Indian Co. by a Foreign Co.
 - Transfer pursuant to amalgamation/demerger of foreign co. – exempt in hands of foreign co. [S. 47(via) and 47(vic)]
 - At least 25% of the shareholders (in value) in case of amalgamation & 75% of the shareholders (in value) in case of a demerger, of the amalgamating/demerged company, continue to remain shareholders of the amalgamated/resulting company;
 - The transfer does not attract capital gains tax in the country in which amalgamating/demerged foreign company is incorporated.
 - No exemption to shareholders of amalgamating/ demerged foreign co – may attract capital gains pursuant to Explanation 5 to S. 9(1)(i)

Transfer of shares - Exemption

- Transfer of shares of a Foreign Co. (A) deriving its value substantially from shares of an Indian Co. , by a Foreign Co. (B)
 - Transfer pursuant to amalgamation/demerger of foreign co. (B) – exempt in hands of amalgamating/ demerged foreign co. [S. 47(viab) and 47(vicc)]
 - At least 25% of the shareholders (in value) in case of amalgamation & 75% of the shareholders (in value) in case of a demerger, of the amalgamating/demerged company, continue to remain shareholders of the amalgamated/resulting company;
 - The transfer does not attract capital gains tax in the country in which amalgamating/demerged foreign company is incorporated.

Transfer of shares - Exemption

- Transfer of shares of a Foreign Co. (A) deriving its value substantially from shares of an Indian Co. , by a Foreign Co. (B)
 - No exemption available to shareholders of Foreign Co. (B) – may attract capital gains pursuant to Explanation 5 of S. 9(1)(i)
- Transfer of shares of a Foreign Co. (A) covered under Explanation 5 to S. 9(1)(i) other than referred above, by a Foreign Co. (B) – No exemption available

Transfer of shares - Non Compete

- Non-Compete clause part of the transfer agreement
 - No consideration allocable to non-compete - Mrs. Hami Aspi Balsara v. ACIT (126 ITD 100) (Mum. Trib)
 - Entire consideration taxable u/s 28(va) - Sumeet Taneja v. CIT (261 CTR 494) (P&H HC)
 - Entire consideration to be treated in lieu of shares – CIT v. Shiv Raj Gupta (372 ITR 337) (Delhi HC)
 - Non-compete fees to be taxable u/s 28(va) - HM Publishers Holdings Ltd., In re (94 taxmann.com 193) (AAR – New Delhi) (2018)

Transfer of shares - Non Compete

- **Non-Compete fees allowable u/s 37(1)**
 - CIT v. Andhra Fuels (P.) Ltd. (240 Taxman 280) (AP HC) - favour
 - Sharp Business System v. CIT (211 Taxman 576 (Delhi HC) – against
- **Non-Compete fees depreciation u/s 32**
 - CIT v. Ingersoll Rand International Ind. Ltd. (227 Taxman 176) (Karnataka HC) – favour
 - Sharp Business System v. CIT (211 Taxman 576 (Delhi HC) – against

Transfer of shares

- 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.)

Transfer of shares

- 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)

Re-structuring

Restructuring - takeover in IBC

- 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)
 - 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

Restructuring through Buyback

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

Restructuring through conversion of shares

- Conversion of 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]
 - CIT v. Santosh L. Chowgule (234 ITR 787) (Bom HC) [1999]
 - Specific Exemption – S. 47
 - Conversion of preference shares into equity shares – S. 47(xb)
 - Conversion of equity shares into preference shares?

Restructuring through Capital Reduction

- Transfer chargeable to capital gains in hands of shareholders – *Kartikeya V. Sarabhai v. CIT* (228 ITR 163) (SC) [1997]
- Deemed Dividend u/s 2(22)(d) to the extent of accumulated profits
- 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]

Gift

Section 56(2)(x)

- Introduced by Finance Act, 2017
- Applicable to –
 - Any person
- Applicable for –
 - Receipt of money without consideration
 - Receipt of property without consideration or **for inadequate consideration**

Section 56(2)(x)

- Exemption includes – money or property received by way of transaction not regarded as transfer u/s 47
 - clause (i) total or partial partition of HUF
 - clause (iv) and (v) transfer by holding to wholly owned subsidiary and vice versa
 - clause (vi), (via), (viaa), (vii) amalgamation
 - clause (vib), (vic), (vid) demerger
 - clause (vica), (vicb) – business reorganisation of co-operative bank

Section 56(2)(x)

- Property is defined to mean following capital asset –
 - immovable property being land or building or both;
 - shares and securities;
 - jewellery, bullion;
 - archaeological collections, drawings, paintings, sculptures and any work of art.

Section 56(2)(x)

- Whether the definition of property includes –
 - Interest in Partnership/AOP/BOI
 - Actionable claims
 - Entitlement to right to subscribe to share
 - Rights in land or building
 - Atul G. Puranik v. ITO (11 ITR(T) 120) (Mum. Trib.) (leasehold rights)
 - Voltas Ltd. v. ITO (161 ITD 199) (Mum. – Trib.) (development rights)
 - Rajesh Gupta HUF v. PCIT (2018 TIOL 826) (Delhi HC) (occupancy rights) - Against

Section 56(2)(x)

- Valuation of property received - as per Rule 11UA
 - Rule 11UA amended w.r.t. valuation of unquoted equity shares
 - Earlier – book value of assets and liability
 - Now – fair value of shares, securities, immovable property, jewellery and artistic work. Others book value.

Section 56(2)(x) - Issues

- No method prescribed for valuation of non-monetary consideration paid for acquisition.
Example –
 - Contribution to partnership firm in cash or kind (participation in share of profit)
 - CIT v. A.C. Raghava Menon (243 ITR 167) (Kerala HC)
 - CIT v. Marudhar Hotel (P.) Ltd. (269 ITR 310) (Rajasthan HC)

Section 56(2)(x) - Issues

- Case laws
 - Notional reduction in value is a consideration
 - Rights issue - Sudhir Menon HUF v. ACIT (162 TTJ 425) (Mum. Trib.)
 - Bonus issue - DCIT v. Dr. Rajan Pai, (TS-299-ITAT-2016) (Bang. Trib.)

Specific Anti-Avoidance Provisions

- 50C & 43CA – stamp duty value of land or building transferred is deemed to be the full value of consideration
- 50CA – fair value of shares of a company other than quoted shares is deemed to be the full value of consideration
- 50D – if the consideration as a result of the transfer of a capital asset is not ascertainable, then the fair market value of the asset transferred shall be deemed to be the full value of the consideration. - Dana Corporation, In re (321 ITR 178) (AAR)

Gift - Other Provisions

- 2(24)(iv) – benefit or perquisite from the company
- 2(22)(e) – deemed dividend
- 28(iv) – benefit or perquisite arising from business
- 95 – 102 – General Anti-Avoidance Rule

Other Issues

Other issues - Set off of losses

- Section 79 – Change in more than 50% of beneficial ownership shares - No setoff
- S. 79 N.A. – transfer of shares from H. Co. to S. Co. – CIT v. AMCO Power Systems Ltd. (62 taxmann.com 350) (Kar. HC)
- S. 79 Applicable – transfer of shares from 100% subsidiary to another subsidiary - Yum Restaurants (India) (P.) Ltd. V. ITO (380 ITR 637 (Delhi HC)

Other issues - Set off of losses

- S. 79 N.A. – transfer of shares from S. Co. to H. Co. – pursuant to merger CIT v. Select Holiday Resorts (P.) Ltd. (217 Taxman 110) (Del. HC)
- Short term capital gain on transfer of depreciable asset - setoff against long term capital loss – CIT v. Parrys (Eastern) (P.) Ltd.(384 ITR 264) (Bombay HC)

Other issues - Stamp duty

- Scheme of arrangement to be approved by different high courts – stamp duty levied in both the States – without credit of stamp duty paid in another State – CCRA v. Reliance Industries Ltd. Mumbai (68 taxmann.com 140) (Bombay HC)

Thank You