

Direct Tax Refresher Course

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Methods of Reorganisation

General Methods

- General methods of reorganisation
 - Amalgamation
 - Demerger
 - Slump sale

Amalgamation

- Exemption – S. 47(vi) amalgamating company & S. 47(vii) Shareholders of amalgamating company. Conditions –
 - Amalgamated company is Indian Company
 - All the property & liabilities of the amalgamating company becomes property & liabilities of the amalgamated company

Amalgamation

- Foreign company amalgamation/demerger with another foreign company – (no exemption to shareholders of foreign company) – Twin Condition –
 - 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

Amalgamation

- If, amalgamation is not exempt –
 - Shareholders of amalgamating company – receiving shares of amalgamated company – in principle taxable, CIT v. Grace Collis (248 ITR 323) (SC)
 - No capital gains on amalgamating company – as no consideration is received - Banca Sella S.p.A., In re (78 taxmann.com 260) (AAR New Delhi)

Amalgamation - Issues

- Goodwill – Arising/Recorded on Amalgamation
 - Depreciation can be claimed u/s 32 - CIT v. Smifs Securities Ltd. (348 ITR 302) (SC)
 - Cannot be claimed in the year of amalgamation – 5th proviso to section 32 - United Breweries Ltd. (TS-553-ITAT-2016) (Bang. Trib.)

Amalgamation - Issues

- Carry forward and set off of unabsorbed depreciation and accumulated loss. 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

Amalgamation - Issues

- Conditions specified in 72A – (Cont. . .)

- Amalgamated Company

- ☹ Continues to hold at least 3/4th of the fixed asset of amalgamating company for 5 years.

- ☹ Continues the business for five years.

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.

Amalgamation - Issues

- MAT Credit of Amalgamating Company –
 - Skol Breweries Ltd. V. ACIT (2008 TIOL 741) (Mum Trib.)
 - M/s Caplin Point Laboratories Ltd v. ACIT (2017 TIOL 435) (Mad. Trib.)
- Unabsorbed depreciation and unabsorbed loss as per books of Amalgamating Company –

Demerger

- Exemption – S. 47(vib) demerged company & S. 47(vii) resulting company. Conditions –
 - 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.

Demerger

- Conditions (Cont . . .) –
 - Resulting company issues shares to the shareholders of demerged company, on proportionate basis.
 - 3/4th of the shareholders (in value) of the demerged company becomes shareholders of the resulting company.

Demerger - Issues

- In case of compliant demerger –
 - Position for shareholders of the demerged company ?
 - What is an undertaking ? (Share of a operating subsidiary company is not an undertaking - UTV Software Communications Ltd. v. ACIT (157 ITD 71) (Mumbai - Trib.)

Demerger - Issues

- In case of compliant demerger –
 - Goodwill/Brand not in the books of demerged company to be considered ? Depreciation ?
 - Resulting Company – more than one ? (S. 2(41A))
 - MAT Credit of the demerged undertaking – Adani Gas Ltd. v. ACIT (2016 TIOI 146)(Ahm. Trib.)

Demerger - Issues

- In case of compliant demerger –
 - Ind AS 103 – fair value accounting – compliant demerger ?
 - Adjustment of debits/credits pursuant to demerger – applicability of Appendix A of the Ind AS 10 ? (S. 115JB(2A))

Demerger - Issues

- Carry forward and set off of unabsorbed depreciation and accumulated loss. (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)

Demerger - Issues

- Taxation of a non-compliant 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

Demerger - Issues

- Shareholders of the demerged company –
 - ☸ Transfer by way of Cancellation or Capital Reduction of shares of the demerged company – Allotment of shares by Resulting Company and Transfer are two separate transactions ? – If so, transfer is without consideration.
 - ☸ No Cancellation/Capital Reduction of shares of the

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.) (SP)

Slump Sale - Section 50B

- 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)
- Allocation of consideration for slump sale & depreciation on the component of goodwill –

Conversion of Firm into Company

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

Conversion of Firm into Company

- Conversion under Chapter XXI (Part I) of Companies Act, 2013 (Part IX of Companies Act, 1956) :
 - Statutory vesting - no transfer – no consideration - no capital gain in the hands of the Firm:

☞ CIT v. Texspin Engg. & Mfg. Works (263 ITR 345 (Bombay 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

Conversion of Firm into Company

- Conversion in compliance with provisions of 47(xiii) –
 - All assets and liabilities related to business are transferred
 - Same profit sharing ratio
 - 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 ?

Conversion of Firm into Company

- No specific explanation/provision for continuity of cost of fixed assets .
- Depreciation on cost to the company (fair value) – DCIT v. Suyash Laboratories Ltd. (65 taxmann.com 217) (Mumbai Trib.) – should also apply to goodwill.
- Continuity of unabosrbed depreciation and accumalted loss (S. 72A(6)) – 8 years from the year of conversion.

Conversion of Company into LLP

- Conversion in compliance with provisions of 47(xiii b) –
 - 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

Conversion of Company into LLP

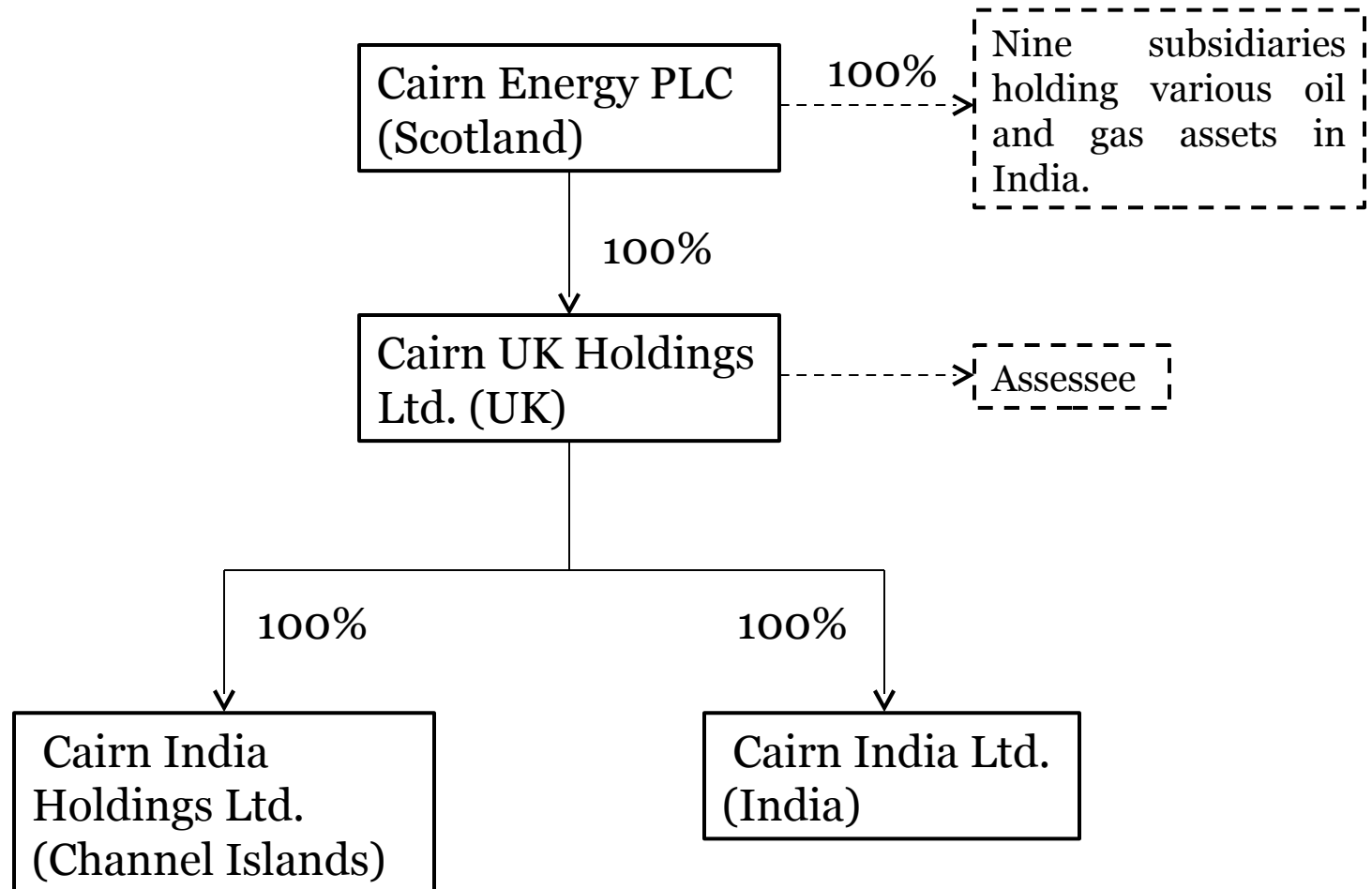
- Depreciation – continuity of cost of fixed assets to the Company - Explanation 2C of S. 43(6)
- Depreciation on Goodwill ?
 - Explanation 2C of S. 43(6) and Explanation 2 of S. 43(6) are pari materia
- Continuity of unabosrbed depreciation and accumalted loss (S 72A(6A)) – 8 years from the

Buyback of shares v. Dividend

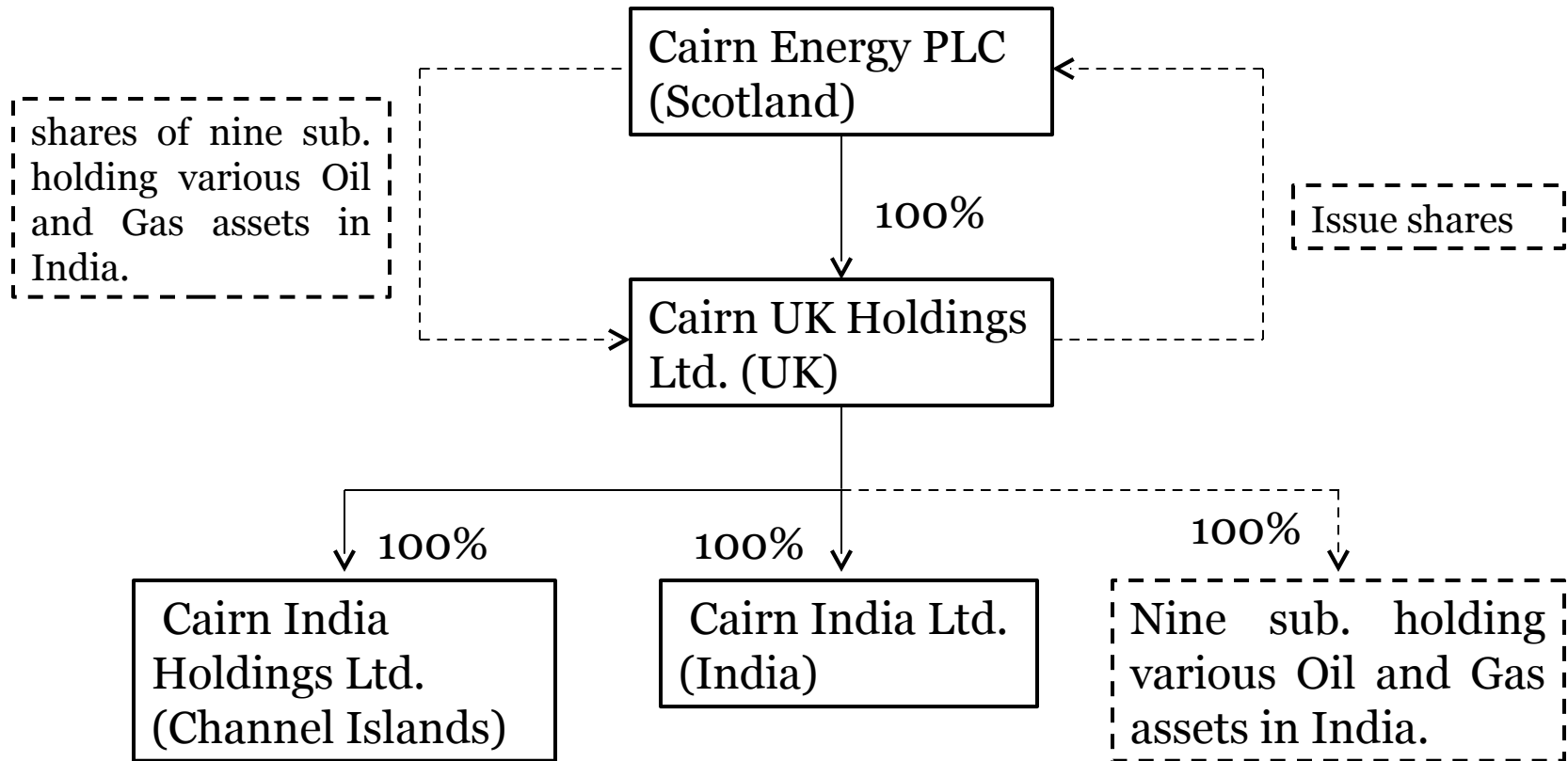
- 115QA – tax on domestic companies not listed on recognised stock exchange on distributed income on buy back – tax rate 20%
- Dividend – 115-O + 115BBDA – tax rate 30%
- Buy back price should represent true fair market price of shares - No dubious method to avoid tax
- Fidelity Business Services India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

Cairn Energy - A Case Study of Business Reorganisation

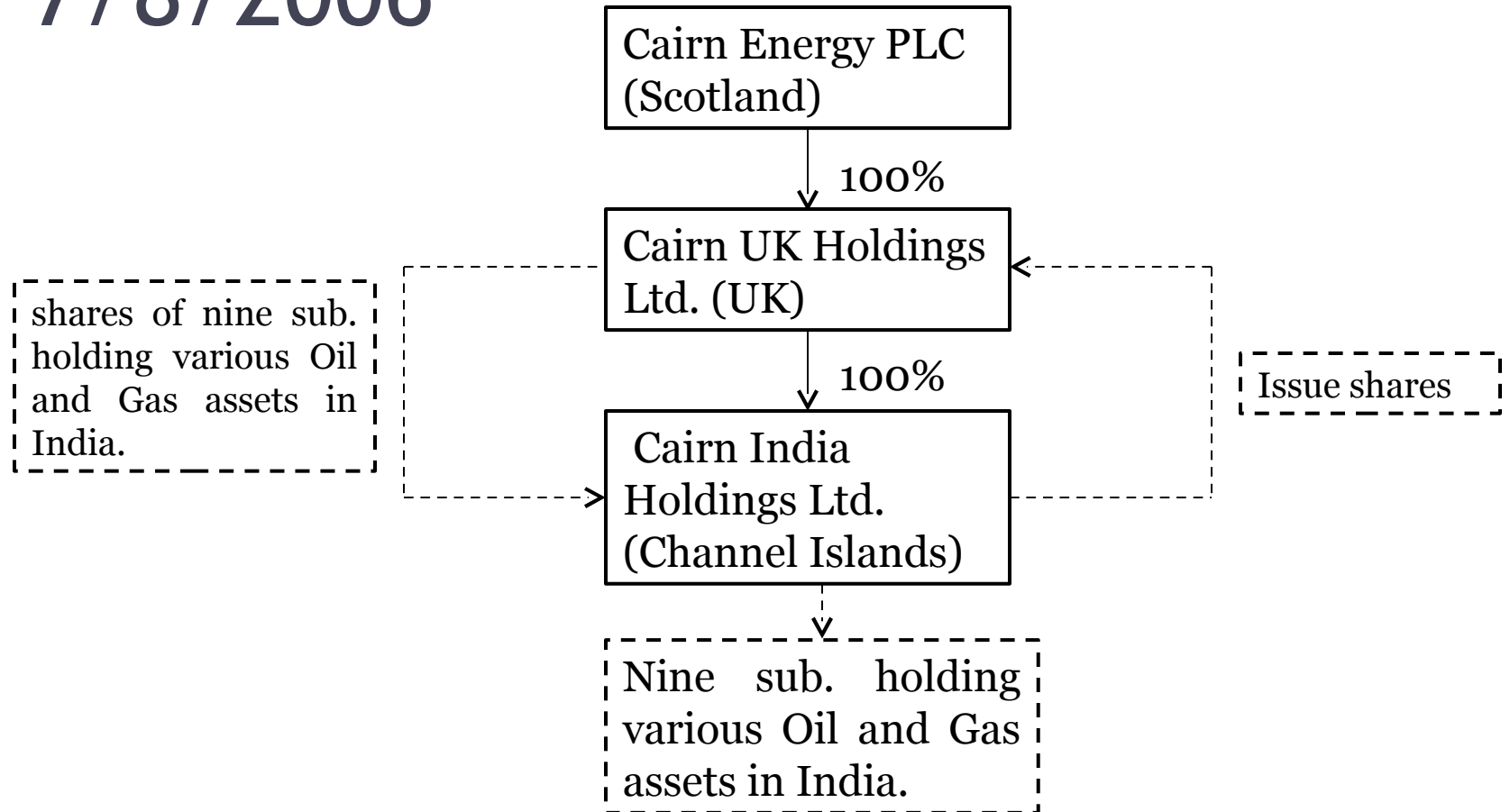
Structure at the Beginning



Transaction 1 - exchange - 30/6/2006

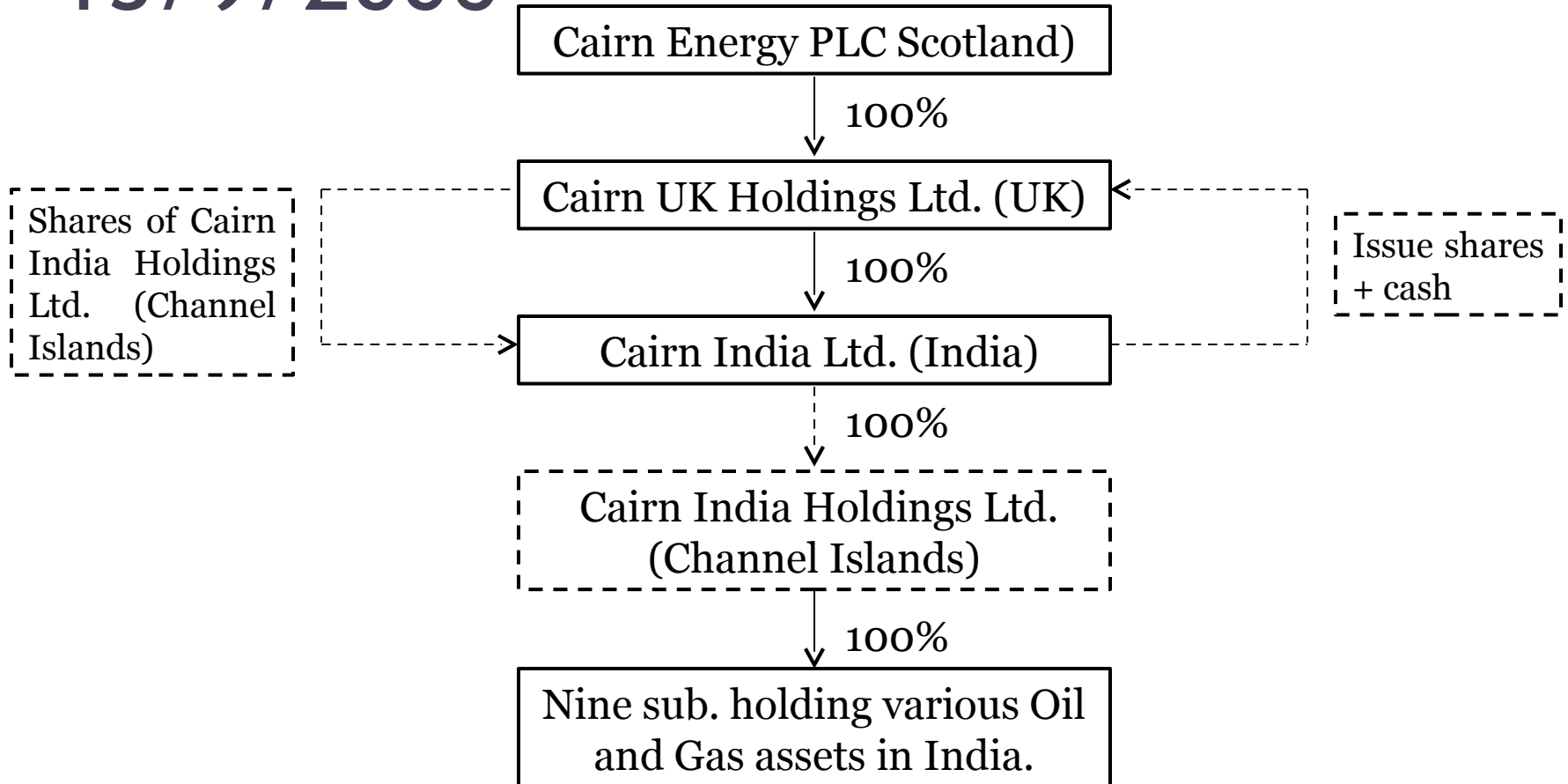


Transaction 2- exchange - 7/8/2006



Shares of Indian Operating Companies transferred from Cairn UK to Cairn India Holdings Ltd.

Transaction 3- exchange - 15/9/2006



Shares of Cairn India Holdings Ltd. transferred from Cairn UK to Cairn India.

Contention of the Assessing Officer

- Cairn UK Holdings Ltd. is liable to capital gains tax on transfer of shares of Cairn India Holdings Ltd. to Cairn India Ltd. (India). [Transaction 3]
- Arguments, not dealt with:
 - Shares to Cairn UK Holdings Ltd. were issued on transfer of oil & gas business in India. Therefore the cost of acquisition to Cairn UK Holdings Ltd. of shares of Cairn India Holdings Ltd. should be

Contention of the Assessing Officer

- How the cost of acquisition of shares (fair market value in case of exchange) to Cairn UK Holdings Ltd. acquired one month back (7/8/2006) be substantially different from consideration (fair market value) after one month (15/9/2006) ?
- Tribunal considered face value of shares issued (not their fair value) as cost to Cairn UK Holdings Ltd.

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**

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 (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;

Section 56(2)(x)

- Whether the definition of property includes –
 - Interest in Partnership/AOP/BOI
 - Actionable claims
 - Entitlement to right to subscribe to share

Section 56(2)(x)

- Valuation of property received - as per Rule 11UA
 - Rule 11UA change proposed by draft rule in valuation of unquoted equity shares
 - ☹ Earlier – book value of assets and liability
 - ☹ Now – fair value of shares, securities, immovable

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)

Section 56(2)(x) - Issues

- Rights issues & Bonus issue (reduction in value of existing shares)
- Transfer by 100% holding company to subsidiary company without consideration (the entire surplus belongs to holding company)
- Transfer by subsidiary company to 100% holding company without consideration (decrease in value of shares of subsidiary company)

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

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

Transfer of Shares

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)

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

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)

MAT and Ind - AS

MAT

- Capital receipts also liable to MAT if they aren't excluded by adjustments - B & B Infratech Ltd. v. ITO [2016] 76 taxmann.com 188 (Karnataka HC)
- MAT companies are also eligible for section 54EC relief – CIT v. Metal & Chromium Plater [2016] 76 taxmann.com 229 (Madras

MAT

- Gain on settlement of loan –

- ☸ 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)

- Share forefieture – DCIT v. M/s Binani Industries Ltd (TS-111-ITAT-2016) (Kol Trib)

IND - AS

- Compliance of Ind-AS mandatory in scheme of arrangement ?
 - S. 232 of Companies Act, 2013
 - Tata Advanced Materials Ltd (LSI-1109-HC-2016) (Kar HC)
- Ind AS – 103 Business Combination - Pooling of interest method compulsory for purchase business under common control. (eg holding subsidiary)

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

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 tax – without credit of stamp duty paid in another state – CCRA v. Reliance Industries Ltd. Mumbai (68 taxmann.com 140) (Bombay HC)

Thank You