



S. 50B & Capital Gains On Slump Transactions: A Comprehensive Analysis

By CA Ankit B. Agrawal

Mark Twain once said:

“Evolution is the law of policies: Darwin said it, Socrates endorsed it, Cuvier proved it and established it for all time in his paper on "The Survival of the Fittest". These are illustrious names, this is a mighty doctrine: nothing can ever remove it from its firm base, nothing dissolves it, but evolution.”

Mark Twain in substance said that ‘even the most settled things in this world may get unsettled later’. The things which are held today as absolute may become relative in future, like the belief that earth is flat got changed later or that atom is the most basic unit of matter got changed after the discovery that even it has further components.

This is even so true in the area of Law, especially, the Income Tax Law. On number of occasions, the most settled legal positions have been unsettled either by retrospective amendments by the Legislature to nullify the decisions of Courts or by the Courts themselves by reversing the law laid down in the earlier decisions. Certain examples where the settled positions have been changed by the Courts are:

- The law relating to existence of *mens rea* for imposition of penalty laid down by the Supreme Court in the case of Dilip N. Shroff V. JCIT (291 ITR 519) was subsequently changed by the larger bench of the Supreme Court in UOI V. Dharamendra Textile Processors (306 ITR 277);
- Similarly, the decision of the Supreme Court in Virtual Soft Systems Ltd. V. CIT (289 ITR 83) holding that penalty cannot be imposed in cases where both the returned and the assessed income were loss was subsequently changed by the Supreme Court in CIT V. Gold Coin Health Food (P.) Ltd. (304 ITR 308);
- Recently, the Supreme Court once again changed the law relating to obtaining the approval of Committee of Disputes for contesting an appeal by Public Sector Undertakings. The decisions of the Supreme Court in ONGC V. CCE (4 SCC (Supl.) 541), (6 SCC 437) and ONGC V. CIDCO (7 SCC 39) were recalled by the larger bench in Electronics Corporation of India V. UOI (Civil Appeal No. 1883 of 2011) and the whole mechanism of obtaining approval from Committee of Disputes was eradicated.

Interestingly, in the examples cited above, apart from the law relating to the Committee of Disputes the law has been changed within a short span of a year and a half.

The Law relating to Slump Sale has also seen dramatic changes as the above mentioned examples, although with a slight twist in the tale.



SLUMP SALE

THE CONCEPT

Slump Sale has been one of the widely used ways of business acquisition in India. The concept of Slump Sale is quite old one but it gained popularity after 1990s. The concept of Slump Sale was incorporated in the Income tax Act, 1961 ('the IT Act') by the Finance Act, 1999 when Section 2(42C) was inserted defining the term 'slump sale' as 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.

Prior to the insertion of Section 2(42C), Courts have held that slump sale is a sale of a business on a going concern basis where the lumpsum price cannot be attributed to individual assets or liabilities. In CIT V. Artex Manufacturing Co. (227 ITR 260), the Apex Court treated the sale of the business on a going concern for a lumpsum consideration as an itemised sale on the ground that the slump price was determined by the Valuer on the basis of itemised assets whereas in CIT V. Electric Control Gear Mfg. Co. (227 ITR 278) the sale of the business on a going concern was regarded as a slump sale since in that case, there was nothing to show that the slump price is attributable to any asset. Interestingly, the Judges of both the decisions were same.

TAXABILITY

As stated above, the concept of Slump Sale got its recognition in the IT Act by the Finance Act, 1999 when in order to tax slump sale, Section 2 (42C) (which defines the term 'slump sale') and Section 50B (which lays down a special computing mechanism for computing the gains therefrom) were inserted. The said section was inserted prospectively i.e. was made applicable from A.Y. 2000-01.¹ Thus, the taxability of slump sale can basically be categorised into two parts:

- i. Pre-insertion of Section 50B; and
- ii. Post-insertion of Section 50B.

Pre-insertion of Section 50B

The taxability of Slump Sale prior to insertion of Section 50B has been examined by various English and Indian Courts. At that time, there was no specific provision in the IT Act or the erstwhile Income tax Act, 1922 to tax the same.

The Supreme Court way back in 1965 in CIT V. Mugneeram Bangar & Co. (57 ITR 299) had the occasion to examine the taxability of transfer of all the assets and liabilities of the business on a going concern for a slump price in the hands of the transferor. In the said case, the assessing officer taxed the excess of the slump price over the book value (termed as goodwill in the sale agreement) as business income on the ground that the excess is the profit on transfer of the stock in trade. The Supreme Court, after considering an English decision in Doughty V. Taxes Commissioner (1927) AC 327 (PC) and the decision of the Supreme Court in CIT V. West Coast Chemicals and Industries Ltd. (46 ITR 135), held that once it is proved that the transaction is a slump transaction i.e. the business was sold as a going concern, the only question that remains is

¹ In PNB Finance V. CIT (175 Taxman 242) (SC), Industrial Machinery Associates v. CIT (81 ITD 482) (Ahd.) and Coromandel Fertilisers v. DCIT (90 ITD 344) (Hyd), Section 50B was held as prospective in nature.



as to whether any portion of the slump price is attributable to stock in trade. If based on the facts of the case, no portion of the slump price can be attributed to stock in trade, then the gain arising from such a transaction cannot be taxed as business income.

Slump Sale: Neither taxable u/s. 41 (2) nor section 45

In the past, tax payers have always contended that gain from slump sale is not chargeable under the IT Act and the tax exchequer contended that gain from a slump sale transaction is either taxable as 'business income' u/s. 41 (2) [as it stood at that time] or as 'Capital Gains' u/s. 45. The difference between the historical cost of a depreciable asset and its written down value subject to the maximum of the difference between the consideration accruing on its disposition and its written down value was taxable u/s. 41 (2) (commonly known as 'balancing charge') and Section 45 is the charging section for 'Capital Gains'.

The taxability of the slump sale transactions prior to insertion of Section 50B eventually got evolved with the help of Courts which held that slump sale is neither taxable as business income nor as capital gains. The Supreme Court in *PNB Finance Ltd. V. CIT* (175 Taxman 242) after considering Sections 41 (2), 45 and 50B held that gain from slump transactions is neither taxable as business income u/s. 41 (2) nor as Capital gains u/s. 45 of the Act. The Apex Court held that to attract section 41 (2), the subject matter should be depreciable assets and the consideration received should be capable of allocation between various assets. In case of a slump sale, there is an undertaking which gets transferred (including depreciable and non-depreciable assets) and it is not possible to allocate slump price to depreciable assets and therefore, the same cannot be taxed u/s. 41 (2). On the question of taxing the same as Capital gains, the Apex Court following the decision in *CIT V. B. C. Srinivasa Setty* (128 ITR 294) held that the charging section and the computation sections are integrated code and if one fails other fails. If the computation sections fail then even the charging section fails. In case of slump sale, there are bundle of assets (including intangible assets like goodwill) that are transferred and in absence of any specific provision like Section 50B, it is not possible to determine the cost of the said assets and thus, the computation mechanism fails and so does the charging section. Therefore, it was held that the gains from the transfer of a bundle of asset on a slump basis is not chargeable to capital gains also. Thus, the slump sale was held to be not chargeable to tax prior to insertion of Section 50B.

Post-insertion of Section 50B

After the insertion of Section 50B, the profits or gains arising from slump sale, as defined in Section 2(42C), became chargeable under the head "Capital Gains". Section 50B provides for the mechanism to compute 'Net Worth' which is deemed to be the cost of acquisition of the undertaking being transferred for the purposes of Sections 48 and 49 so as to enable the computation of capital gains. The benefit of indexation is not available in the case of slump sale and the profit or gain on slump sale is regarded as long-term or short-term depending upon the period of holding of the undertaking being transferred.

TWIST IN THE TALE

The controversy relating to the taxability of slump sale seemed to have settled down after the decision in *PNB Finance Ltd. V. CIT* (Supra) and insertion of Section 50B in statute. But, a twist in the tale was still left.



Section 50B applies to 'Slump Sale' as defined u/s. 2(42C). What happens if a slump transaction does not fall under the definition of 'Slump Sale' as defined in Section 2(42C)? Before, coming to that aspect, let us examine Section 2 (42C), which defines the term 'Slump Sale' and reads as under:

*"slump sale" means the 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.*

.....
....."

(Emphasis Supplied)

As would be observed from the above, only transfer of one or more undertakings as a result of sale is defined as a Slump Sale. The definition of 'Slump sale' is an exhaustive definition and covers only transfer of an undertaking as a result of sale. The word 'transfer' is a very wide term and has been inclusively defined u/s. 2(47) to include sale, exchange, relinquishment, extinguishment of rights, etc. However, the Legislature has chosen to include only transfer as a result of sale within the ambit of slump sale and has expressly not covered transfers by any other means. It means that for the purposes of the IT Act only a sale of an undertaking for a lump sum consideration can be regarded as a slump sale and in cases where there is no sale or there is an exchange, relinquishment, etc. , the same is not a 'Slump sale' within the meaning of the IT Act. Therefore, section 50B of the IT Act would not apply to such other slump transactions.

This gives birth to questions relating to the taxability of slump transactions which do not fall under the definition of 'Slump Sale'. It would be interesting to note that this is the same question that was before the Courts prior to the insertion of Section 50B. This reminds me of a small kid who was riding a bicycle and was cribbing as to why he was ending up at the same place where he started, until he realised that he was travelling 'in a circle'. Indeed, in the present case, the question on taxability of slump transactions has also travelled a full circle and again, the *question before us is somewhat similar to the one we started from, i.e. what would be the tax treatment in case of slump transactions which do not fall under the definition of the 'Slump Sale'*. In such cases, the ratio laid down by the PNB Finance Ltd. V. CIT (supra) would squarely apply and the profits or gains arising from the same would neither be taxable as 'business income' u/s. 41 (2) nor as 'capital gains' u/s. 45 for the same reasons discussed above.

SALE: WHAT DOES IT MEAN?

This leads us to a question that what does "sale" mean. The term 'Sale' is not defined in the IT Act and thus, its meaning must be taken in its legal sense or dictionary meaning or its popular or commercial sense.² The term 'Sale' is defined in the Sales of Goods Act, 1930 ('the SOGA'). Section 4 of the SOGA defines 'Sale' as a contract whereby the seller transfers the property in goods to a buyer for a price. The main elements of sale are as under:

1. There must be at least two parties, a buyer and a seller;
2. There must be a contract between the buyer and the seller;

² In State of Orissa v. Titaghur Paper Mills Co. Ltd. (1985 Tax LR 2948) (SC), CIT v. Raja Benoy Kumar Sahas Roy (32 ITR 466) (SC), CIT v. Nirlon Synthetic Fibres and Chemicals Ltd. (130 ITR 14 at 17) (SC), the Courts have held that words which are not specifically defined must be taken in their legal sense or dictionary meaning or their popular or commercial sense.



3. There must exist a subject matter of sale, i.e., a property;
4. There must be an act of transfer of such property;
5. The sale must be for a price, i.e., monetary consideration;

In absence of even one of the aforesaid elements, the transaction would not be regarded as 'Sale'.

CERTAIN ILLUSTRATIONS WHERE A SLUMP TRANSACTION IS NOT A 'SLUMP SALE':

Transfer pursuant to a Court order is not a 'Sale'

One of the essential elements of 'Sale' is a contract. 'Contract of Sale' is one of the essential conditions of Sale. Section 4 of the SOGA defines 'Contract of Sale' as a contract whereby the seller transfers the property in goods to a buyer for a price and the term 'Sale' is defined as the contract of sale under which the property in the goods is transferred from the seller to buyer.

Now, the question which arises is what would happen if the transfer of the property in goods is not pursuant to a contract but pursuant to a Court Order. The transfer of the property in goods pursuant to an order of a court cannot be regarded as 'Sale'. This is quite clear from the language of Section 4 of the SOGA itself that only the transfer under a contract is regarded as 'Sale' i.e. only contractual transfer is regarded as 'Sale' and thus, the statutory transfers or transfer effected by orders of the court or operation of law cannot be regarded as Sale.

This issue has been examined by the Hon'ble Bombay High Court in *Sadanand S. Varde and Others v. State of Maharashtra and Others* (247 ITR 609). Chapter XX-C of the IT Act gives the Government a pre-emptive right to purchase a property in case of transfer of certain specified properties. In the context of the said Chapter, a question arose before the Hon'ble Bombay High Court as to whether transfer of property pursuant to a Scheme of Amalgamation duly sanctioned by the Company Court u/s. 391 of the Companies Act, 1956 can be regarded as 'transfer'. For the purpose of Chapter XX-C, the expression 'transfer' was defined as including sale or exchange or lease for a term of not less than 12 years. A contention was raised before the Hon'ble Bombay High Court that when the amalgamation takes place pursuant to the Court's order, it is not a sale or exchange or lease as the assets are transferred by the force of the Company Court's order and/or by operation of law and it ceases to be a contractual or consensual transfer³. The Hon'ble Bombay High Court upheld the contention of the assessee and held that:

"a scheme of amalgamation has statutory operation when sanctioned by the Company Court under the relevant provisions of the Companies Act and is distinct and different from a mere agreement signed by the necessary parties. Even if the scheme is approved by all concerned parties by consensus, merely because it is so agreed upon, the court is not obliged to put its imprimatur on it. The court has the discretion and power to reject a scheme even if all the shareholders and creditors have agreed to it. But, once the scheme is scrutinised by the Company Court and sanctioned by an order made by it under section 391 of the

³Similar view taken in *Garner Motors Ltd., In re* [1937] 1 All ER 671, J.K. (Bombay) (P.) Ltd. v. *New Kaiser-I Hind Spg. and Wvg. Co. Ltd.* (40 Comp. 689) (Bom.), *Sailendra Kumar Ray v. Bank of Calcutta* [1948] (18 Comp. Cas. 1) (Cal.), *Sayayanidhi (Virudhunagar) Ltd. v. A.S.R. Subramanya Nadar* (20 Comp Cas 214) Mad (FB), etc.



Companies Act, it ceases to retain the character of contract and operates by force of the statute.”

Similarly, the Hon’ble Mumbai Tribunal in Oudh Sugar Mills Ltd. v. ITO (35 ITD 76) has held that transfer of asset of one company to another company in the scheme of arrangement approved by Hon’ble Bombay High Court cannot be considered as ‘sold’ for the purpose of Section 41 (2) of the IT Act.

In view of the foregoing decisions, it is clear that the transfer pursuant to a Company Court’s order and/or by operation of law is not ‘Sale’. Therefore, if an undertaking is transferred pursuant to an order of the Company Court u/s. 391 of the Companies Act, 1956 on slump basis then same cannot be treated as ‘Sale’ and thus, would not fall under definition of ‘Slump sale’ as defined u/s. 2 (42C) of the IT Act.

The Hon’ble Mumbai Tribunal in Avaya Global Connect Ltd. V. ACIT (26 SOT 397) had the occasion of examining the same issue and the Hon’ble Tribunal held that on reading the definition of ‘slump sale’ in section 2(42C), it is clear that it is only a transfer as a result of sale that can be construed as a slump sale. Therefore, any transfer of an undertaking otherwise than as a result of sale would not qualify as a ‘slump sale’. It was further held that in case the transfer is as a result of scheme of amalgamation which had been duly approved by the High Court it could not be said to be a sale of an undertaking by the assessee. Consequently, the transfer could not be said to be as a result of sale and, therefore, the provisions of section 2(42C) would not apply.

Exchange

Another essential elements of sale is ‘Price’ i.e. the seller must transfer the property in goods to a buyer for a price. The term ‘price’ is defined u/s. 2 (10) of the SOGA to mean the money consideration for a sale of goods. Thus, *the presence of money consideration is an essential element in a transaction of sale.*

Now, the question that arises is what if the property in the goods is transferred for a consideration other than ‘money consideration’. The transfer of the property in goods for other than ‘money consideration’ would be regarded as ‘Exchange’ and not ‘Sale’. Section 118 of the Transfer of Property Act, 1882 defines "exchange" as:

“when two persons mutually transfer the ownership of one thing for the ownership of another, neither thing or both things being money only, the transaction is called an 'exchange'.”

The terms ‘sale’ and ‘exchange’ are defined in the Cambridge International Dictionary of English as under:

- Sale: an act of exchanging something for money.
- Exchange: to change (something) for something else of a similar value or type.

The Supreme Court in CIT vs. R. R. Ramkrishna Pillai (66 ITR 725) have explained the distinction between ‘sale’ and ‘exchange’. In that case, the assessee was carrying on a business and the assessee had transferred the assets of the business to a company in consideration for the



allotment of shares of that company. The question arose as to whether gain or profit on transfer of the assets by the assessee to the company is taxable under section 10(2)(vii) of the erstwhile Income Tax Act, 1922 (corresponding to section 41(2) of the IT Act) as only the balancing charge of the assets 'sold' was taxable u/s. 10(2)(vii). The Supreme Court laying down the distinction between 'sale' and 'exchange' held that where the assets are transferred for a money consideration and the liability of consideration so determined is discharged by any mode whether money or other asset then the said transaction is sale. In that case, there are in truth two transactions, one a transaction of sale and the other a contract under which the shares are allotted in satisfaction of the liability to pay the price. However, where the assets are transferred for a consideration of another asset other than money then the said transaction is exchange. On the basis of said distinction, the Supreme Court held that the transfer of the assets of the business to a company in consideration for the allotment of shares of that company is an 'exchange' and not 'sale' and thus, not taxable u/s. 10(2)(vii) of the erstwhile Income Tax Act, 1922.

Similar view was taken by the Supreme Court in CIT vs. Motors & General Stores (P.) Ltd. (66 ITR 692), where the transfer of a cinema hall for certain number of cumulative preference shares were held to be 'exchange' and not 'sale'.

Now, if an undertaking is transferred on slump basis in exchange of any asset other than money then the same would be 'Exchange' and not 'Sale'. Thus, it would not fall under the definition of 'Slump sale' as defined u/s. 2(42C) of the IT Act and consequently would not be taxable under the IT Act. Such transaction could be regarded as 'Slump Exchange'.

The issue relating to the concept of 'Slump Exchange' and its taxability was dealt by Hon'ble Mumbai Tribunal in Bharat Bijlee Limited V. ACIT (ITA No. 6410/Mum/2008) (2011-TIOL-197-ITAT-MUM). In that case, the assessee had transferred its lift division on a going concern basis against allotment of certain number of preference shares and debentures of the transferee company. Such consideration was determined on a lump sum basis and was not allocable to any specific asset of the undertaking transferred. The assessee contended that the said transaction is in the nature of 'exchange' and not 'sale' and therefore, would not qualify as a 'slump sale' as defined u/s. 2(42C). Consequently, the provisions of Section 50B is not applicable to it and in absence of any specific computation provision, the mechanism for computing capital gains fails and following the ratio of PNB Finance Ltd. V. CIT (Supra), the gain on transfer of the lift division is not taxable. The Hon'ble Tribunal acceded to the contention of the assessee and held that the said transaction is 'exchange' and not 'sale' and any transfer of an undertaking otherwise than as a result of sale would not qualify as a 'slump sale'. Consequently, following the ratio of PNB Finance Ltd. V. CIT (Supra), the gain from such transfer was held to be not taxable.

No Consideration

As discussed earlier, one of the essential conditions of Sale is consideration. In other words, the asset should be sold against some consideration. If there is no consideration paid by the seller to the buyer then the same is not a 'Sale'. If an undertaking is transferred on a going concern basis without any consideration then the same would not be a 'Sale' and thus, not a 'Slump Sale' as defined in Section 2(42C) of the IT Act. In Avaya Global Connect Ltd. V. ACIT (Supra), the assessee had transferred the undertaking without any consideration as the amount of the liabilities exceeded the assets of the undertaking and on this aspect also, the Hon'ble Tribunal held that the said transaction is not 'slump sale' as defined in section 2(42C) of the IT Act.

Essentials of valid contract like free consent, etc.

Sale is a contract and thus, all the essentials of a valid contract like lawful consideration, competent to contract, free consent, etc. must be present in a contract to Sale. If any of the essential elements of the contract is not fulfilled, the transaction cannot be regarded as a 'contract' and consequently, as a 'Sale'. If such an element is missing in case of a slump transaction then the same would not fall under the definition of 'Slump Sale' and accordingly, the same would not be taxable. For instance, say Government of India compulsorily acquires an Undertaking against the will of the person then the same would not be 'Sale' as the condition of 'free consent' of the parties to contract would not be fulfilled and thus, the said transaction would not be regarded as 'Slump Sale'. In Calcutta Electric Supply Corporation Ltd. V. CIT (19 ITR 406), the Hon'ble Calcutta High Court held that compulsory acquisition cannot be regarded as Sale as sale is not a transaction against the will of one of the parties, who is deprived of his property, and who is compelled to accept for that property something which he regards as inadequate. Thus, though compulsory acquisition of the undertaking would be regarded as a 'transfer' as defined u/s. 2 (47) [which specifically covers compulsory acquisitions], but, it would not be regarded as Slump Sale.

CONCLUSION

The undertaking transferred on a going concern basis as a result of sale (for a lump sum consideration) would be regarded as 'Slump Sale' within the meaning of the IT Act and the gains from such transfer would be taxable as per Section 50B. However, any undertaking transferred on a slump basis otherwise than as a result of sale would not qualify as a 'slump sale' and would not be chargeable to tax.

At the end, it would not be out of context to adapt the words of a German Philosopher, Arthur Schopenhauer in the present context and to say that:

“Law is like pendulum if it passes the centre of gravity on one side, it must go a like distance on the other; and it is only after certain time that it finds the true point at which it can remain at rest.”

The law relating to Slump Sale has been like a pendulum. The pendulum which earlier got rested with the decision of the Supreme Court in PNB Finance Ltd. (Supra) and introduction of Section 50B has now again been set in motion.

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