

BUSINESS RESTRUCTURING

Some key points

Prominent methods of business restructuring

- (a) Amalgamation and Merger [Section 2(1B)] : The exemption from capital gain is contained in sections 47(vi) and 47(vii). In the case of international restructuring, the condition for exemption is contained in section 47(via). Carry forward and set off of accumulated loss and unabsorbed depreciation is governed by section 72A of the Act. Subject to satisfaction of prescribed conditions, the following unabsorbed expenditures of the amalgamating company could be carried forward and set off by the amalgamating company.
 - (i) Capital expenditure on scientific research (section 35)
 - (ii) Expenditure in connection with amalgamation (section 35DD)
 - (iii) Expenditure for obtaining licence to operate telecommunication services (section 35ABB)
 - (iv) Preliminary expenses (section 35D)
 - (v) Deduction for expenditure on prospecting etc for minerals (section 35E)
- (b) Demerger [Section 2(19AA)]: It is applicable only in the case of corporate assessee. A demerger transaction is free from capital gains both with respect to transfer of assets as well as issue of shares to the shareholders. The accumulated loss and depreciation to the extent attributable to demerged unit is eligible for carry forward and set off by the resulting company.
- (c) Conversion of sole proprietary business into company [Section 47(xiv)] : Subject to certain conditions contained therein conversion of proprietary concern into a corporate entity is not liable for capital gains tax.
- (d) Conversion of firm into company [Section 47(xiii)]: Conversion firm into a company subject to certain conditions, is not chargeable to capital gains tax.
- (e) Conversion of company into LLP [Section 47(xiiib)]: The Finance Act, 2010 has inserted this clause to provide tax exemption in respect of capital gains on conversion of company into a LLP.

Direct Tax Laws

- (f) Slump sale of business [Section 2(42C)] : It is applicable on transfer of one or more undertakings for a lump sum consideration without assigning value to individual assets and liabilities. It is applicable to a non-corporate entities is also. If the undertaking was owned and held for more than 36 months the gain thereon is taxable as long term capital gain. Where the holding period is less than 36 months before transfer, it is taxable as short term capital gain.

Question 1

Your client, Ashavari Ltd. has two industrial undertakings-one engaged in production of audio music CDs and cassettes and the other engaged in production of video CDs. As a restructuring drive, the company has decided to sell its undertaking producing video CDs as a going concern by way of slump sale for Rs. 450 lakhs to a new company called Tori Ltd., in which it holds 75% equity shares. The balance sheet of Ashavari Ltd. as on 31st March, 2011 reads as follows:

	Rs. in lakhs	
	Audio Unit	Video Unit
Fixed Assets	150	225
Debtors	150	112.5
Inventories	75	37.5
Liabilities	42	75
Paid up share capital		Rs. 378 lakhs
General Reserve		Rs. 222 lakhs
Share premium		Rs. 33 lakhs
Revaluation Reserve		Rs. 140 lakhs

The company set up the video unit on 1st April, 2007. The written down value of the block of assets for tax purpose as on 31st March, 2011 is Rs.200 lakhs of which Rs.85 lakhs are attributable to video unit.

- (i) Determine the tax liability which would arise to Ashavari Ltd. from slump sale; (5 Marks)
- (ii) Suggest modification of the restructuring plan of Ashavari Ltd. without changing the amount of consideration so as to make it more tax efficient.

Answer

- (i) As per section 50B, any profits or gains arising from the slump sale in the previous year is chargeable to income tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer takes place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before such slump sale, the capital gain shall be deemed to be long-term capital gain.

Particulars	Rs.
Calculation of capital gains	
Slump sale consideration	4,50,00,000
Less: Cost of acquisition (net worth) [See Working Note below]	1,60,00,000
Long-term capital gain	2,90,00,000
Calculation of tax liability	
Income tax @ 20%	58,00,000
Surcharge @ 7.5%	4,35,000
	62,35,000
Education cess @ 3%	1,87,050
Total tax liability	64,22,050
Working Note:	
Net worth of Video unit	Rs
WDV of block of assets	85,00,000
Debtors	1,12,50,000
Inventories	37,50,000
	2,35,00,000
Less: Liabilities	75,00,000
Net worth	1,60,00,000

Note - Indexation benefit is not available in the case of slump sale as per section 50B(2)

- (ii) Transfer of any capital asset from a holding company to its 100% Indian subsidiary company is exempt from tax under section 47(iv). Therefore, if it is possible for Ashavari Ltd to acquire the entire shareholding of Tori Ltd and then make slump sale, in which case, the resultant capital gain shall not attract capital gains tax.

However, Ashavari Ltd should not transfer any shares in Tori Ltd for a period of 8 years from the date of such (slump) sale.