

Taxation & Stamp Duty aspects of Corporate Restructuring

Lesson 7

KEY CONCEPTS

■ Capital Gain Tax ■ Conveyance ■ Stamp Duty ■ Slump Sale ■ Instrument ■ Demerger

Learning Objectives

To understand:

- Merger/ Demerger
- Slump Sale
- Carrying forward and set-off of accumulated business loss
- Unabsorbed Depreciation Allowance
- Capital Gains Tax
- Levy of stamp duty on
- Amalgamation and Mergers

Lesson Outline

- Taxation aspects of mergers and amalgamations
- Taxation aspects of slump sale
- Taxation aspects of demerger
- Deemed Dividend
- Constitutional background on levy of stamp duty
- Stamp duty payable on High Court order sanctioning amalgamation
- Amalgamation of holding and subsidiary companies – exemption from payment of stamp duty
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Companies Act, 2013
- Income Tax Act, 1961
- Indian Stamp Act, 1899

INTRODUCTION

In any merger or amalgamation, financial aspects of the transaction are of prime importance as the same are expected to accrue financial benefits. While framing a scheme of merger or amalgamation, a company has to fulfil the conditions prescribed under the Company Law as already discussed in previous lessons, but it has also to look after two very important aspects, i.e., taxation and stamp duty.

Tax considerations predominate and inevitably direct the manner in which the entire scheme has to be designed. Tax planning in cases of amalgamation of companies is perhaps the most vital aspect of decision-making involved in framing of the scheme of amalgamation. A company planning a merger or a takeover, need to do intensive tax planning before finalising the deal to get the maximum tax concession and benefits in the deal. In India, law provides for ample benefits in the form of various provisions to companies going in for amalgamation.

Since a merger or demerger inevitably entails some transfer of property, movable or immovable, it attracts the imposition of stamp duty which is essentially a form of revenue for the government arising out of taxation of various transactions governed under the Indian Stamp Act, 1899. The exposition of stamp duty is a vital aspect because it could substantially increase the costs of a merger deal.

In corporate restructuring through amalgamation and merger, stamp duty planning assumes a significant role and all efforts are made to pay as less a duty on such amalgamations as possible and yet proceed with the acquisitions through mergers and amalgamations. The incidence of stamp duty is an important consideration in the planning of any merger.

Since the stamp duty levied on amalgamations or mergers differ from one State to another, there is disadvantage of amalgamations in one State compared to another and therefore professional time and attention is devoted to work out the best method which can afford stamp duty savings on such amalgamations or mergers.

TAXATION ASPECTS OF MERGERS AND AMALGAMATIONS

The Companies Act, 2013 without strictly defining the term Amalgamation or Demerger, explains the concept. A 'merger' is a combination of two or more entities into one; the desired effect being not just the accumulation of assets and liabilities of the distinct entities, but organization of such entity into one business. Section 2(1B) of the Income Tax Act, 1961 defines the term 'amalgamation' as follows:

"Amalgamation" in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company), in such a manner that –

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourths in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation, otherwise than as a result of the acquisition

of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

Example:

Company “A” merges with another Company “B” in a scheme of amalgamation, and immediately before the amalgamation, company “B” held 20% of the shares in Company “A”, the abovementioned condition will be satisfied if shareholders holding not less than 3/4th in value of the remaining 80% of share in company “A” i.e. 60% thereof (3/4th of 80), become shareholders of company “B” by virtue of the amalgamation.

Thus, for a merger to be qualified as an ‘amalgamation’ for the purpose of the Income Tax Act, 1961, the above three conditions have to be satisfied.

CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION ALLOWANCE

Under Section 72A of Income Tax Act, 1961, a special provision is made which relaxes the provision relating to carrying forward and set-off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation.

(A) Amalgamation

- (1) Where there has been an amalgamation of—
- (a) a company owning an industrial undertaking or a ship or a hotel with another company; or
 - (b) a banking company referred to in clause (c) of section 5 of the Banking Regulation Act, 1949 with a specified bank; or
 - (c) one or more public sector company or companies with one or more public sector company or companies; or
 - (d) an erstwhile public sector company with one or more company or companies, if the share purchase agreement entered into under strategic disinvestment restricted immediate amalgamation of the said public sector company and the amalgamation is carried out within five years from the end of the previous year in which the restriction on amalgamation in the share purchase agreement ends,

then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:

Provided that the accumulated loss and the unabsorbed depreciation of the amalgamating company, in case of an amalgamation referred to in clause (d), which is deemed to be the loss or, as the case may be, the allowance for un-absorbed depreciation of the amalgamated company, shall not be more than the accumulated loss and unabsorbed depreciation of the public sector company as on the date on which the public sector company ceases to be a public sector company as a result of strategic disinvestment.

Explanation.— For the purposes of clause (d), —

- (i) “control” shall have the same meaning as assigned to in clause (27) of section 2 of the Companies Act, 2013;
- (ii) “erstwhile public sector company” means a company which was a public sector company in earlier previous years and ceases to be a public sector company by way of strategic disinvestment by the Government;

- (iii) "strategic disinvestment" means sale of shareholding by the Central Government or any State Government or a public sector company, in a public sector company or in a company, which results in—
 - (a) reduction of its shareholding to below fifty-one per cent; and
 - (b) transfer of control to the buyer:

Provided that the condition laid down in sub-clause (a) shall apply only in a case where shareholding of the Central Government or the State Government or the public sector company was above fifty-one per cent before such sale of shareholding:

Provided further that requirement of transfer of control referred to in sub-clause (b) may be carried out by the Central Government or the State Government or the public sector company or any two of them or all of them.

- (2) Notwithstanding anything contained in sub-section (1), the accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless—
 - (a) the amalgamating company—
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation.
 - (b) the amalgamated company—
 - (i) holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation.
 - (iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.
- (3) In a case where any of the conditions laid down in sub-section (2) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

(B) Demerger

- (4) Notwithstanding anything contained in any other provisions of this Act, in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall—
 - (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
 - (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to

be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

- (5) The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

(C) Reorganisation of Business

- (6) Where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in clause (xiii) of section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in clause (xiv) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:

Provided that if any of the conditions laid down in the proviso to clause (xiii) or the proviso to clause (xiv) to section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

Conversion of Company into LLP [Section 72A(6A)]

- (6A) Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly:

Provided that if any of the conditions laid down in the proviso to clause (xiiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

- (7) For the purposes of Section 72A—

(a) “accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

(aa) “industrial undertaking” means any undertaking which is engaged in—

- (i) the manufacture or processing of goods; or
- (ii) the manufacture of computer software; or
- (iii) the business of generation or distribution of electricity or any other form of power; or

- (iiia) the business of providing telecommunication services, whether basic or cellular, including radio paging, domestic satellite service, network of trunking, broadband network and internet services; or
 - (iv) mining; or
 - (v) the construction of ships, aircrafts or rail systems;
- (b) **“unabsorbed depreciation”** means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place;
- (c) **“specified bank”** means the State Bank of India constituted under the State Bank of India Act, 1955 or a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 or a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

CARRY FORWARD AND SET OFF OF ACCUMULATED BUSINESS LOSSES AND UNABSORBED DEPRECIATION IN A SCHEME OF AMALGAMATION IN CERTAIN CASES [SECTION 72AA]

- (1) Applicability: This section provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance where there has been an amalgamation of –
- (i) one or more banking company with—
 - (a) any other banking institution under a scheme sanctioned and brought into force by the Central Government under sub-section (7) of section 45 of the Banking Regulation Act, 1949; or
 - (b) any other banking institution or a company subsequent to a strategic disinvestment, wherein the amalgamation is carried out within a period of five years from the end of the previous year during which such strategic disinvestment is carried out; or
 - (ii) one or more corresponding new bank or banks with any other corresponding new bank under a scheme brought into force by the Central Government under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under section 9 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 or both, as the case may be; or
 - (iii) one or more Government company or companies with any other Government company under a scheme sanctioned and brought into force by the Central Government under section 16 of the General Insurance Business (Nationalisation) Act, 1972.
- (2) Allowability of carry forward and set-off of accumulated loss and unabsorbed depreciation in case of amalgamation:

The accumulated loss and the unabsorbed depreciation of such banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies shall be deemed to be the loss or, as the case may be, allowance for depreciation of such banking institution or company or amalgamated corresponding new bank or amalgamated Government company for the previous year in which the scheme of amalgamation was brought into force and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

For the purposes of Section 72AA —

- (i) “accumulated loss” means so much of the loss of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies, would have been entitled to carry forward and set off under the provisions of section 72, if the amalgamation had not taken place;
- (ii) “banking company” shall have the meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (iii) “banking institution” shall have the meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949;
- (iv) “corresponding new bank” shall have the meaning assigned to it in clause (d) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or, as the case may be, clause (b) of section 2 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980;
- (v) “general insurance business” shall have the meaning assigned to it in clause (g) of section 3 of the General Insurance Business (Nationalisation) Act, 1972;
- (vi) “Government company” means a Government company as defined in clause (45) of section 2 of the Companies Act, 2013, which is engaged in the general insurance business and which has come into existence by operation of section 4 or section 5 or section 16 of the General Insurance Business (Nationalisation) Act, 1972;
- (vii) “strategic disinvestment” shall have the meaning assigned to it in clause (iii) of the Explanation to clause (d) of sub-section (1) of section 72A;
- (viii) “unabsorbed depreciation” means so much of the allowance for depreciation of the amalgamating banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies which remains to be allowed and which would have been allowed to such banking company or companies or amalgamating corresponding new bank or banks or amalgamating Government company or companies, if the amalgamation had not taken place.

Capital Gains Tax

Capital gains tax is leviable if there arises capital gain due to transfer of capital assets. The word ‘transfer’ under section 2(47) of the Income Tax Act, 1961 includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law or in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment or any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 or any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring or enabling the enjoyment of any immovable property.

Capital gain arises only when a capital asset is transferred. If the asset transferred is not a capital asset, it will not be taxed as capital gain. Section 2(14) of the Income Tax Act, 1961 defines capital assets as below:

For the purposes of this subject, Capital asset means,

- (a) Property of any kind held by an assessee, whether or not connected with his business or profession.
- (b) Any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the regulations made under Securities and Exchange Board of India Act, 1992.

- (c) any unit linked insurance policy (ULIP) issued on or after 1.2.2021, to which exemption under section 10(10D) does not apply on account of –
 - (i) premium payable exceeding Rs. 2,50,000 for any of the previous years during the term of such policy; or
 - (ii) the aggregate amount of premium exceeding Rs. 2,50,000 in any of the previous years during the term of any such ULIP(s), in a case where premium is payable by a person for more than one ULIP issued on or after 1.2.2021.

But does not include the following:

1. Any stock in trade (Other than the securities referred to in sub-clause (b)), consumables stores or raw materials held for the purpose of his business or profession.
2. Personal effects (movable property including wearing apparel and furniture for personal use).
Exclusions: (a) jewellery; (b) archaeological collections; (c) drawings; (d) paintings; (e) sculptures; or (f) any work of art.
3. Rural Agricultural land in India, which is not an urban agricultural land. In other words, it must be rural agricultural land.

Explanation: For the removal of doubts, it is hereby clarified that “property” includes and shall be deemed to have always included any rights in or in relation to an Indian Company, including rights of management or control or any other rights whatsoever.

In an amalgamation, capital gain arises if there is a transfer of capital asset. However, section 47 of the Income Tax Act, 1961 treats certain transactions from amalgamation as not transfer and hence capital gains tax will not be applicable. They are as under:

- (vi) any transfer in a scheme of amalgamation of a capital asset by the amalgamating company to the amalgamated company, if the amalgamated company is an Indian company.
- (via) any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if–
 - (a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;
- (viaa) any transfer, in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under sub-section (7) of section 45 of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution.
Explanation: For the purposes of this clause:
 - (i) “banking company” shall have the same meaning assigned to it in clause (c) of section 5 of the Banking Regulation Act, 1949;
 - (ii) “banking institution” shall have the same meaning assigned to it in sub-section (15) of section 45 of the Banking Regulation Act, 1949.
- (viab) any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, if–
 - (A) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - (B) such transfer does not attract tax on capital gains in the country in which the amalgamating company is incorporated;
- (vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.

- (vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if–
 - (a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated:

Provided that the provisions of sections 230 to 232 of the Companies Act, 2013 shall not apply in case of demergers referred to in this clause.

- (vica) any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank or to the converted banking company;
- (vicb) any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank or to the converted banking company.

Explanation: For the purposes of clauses (vica) and (vicb), the expressions “business reorganisation”, “converted banking company”, “predecessor co-operative bank” and “successor co-operative bank” shall have the meanings respectively assigned to them in section 44DB.

- (vicc) any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in the Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company, if–
 - (a) the shareholders, holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated:

Provided that the provisions of sections 230 to 232 of the Companies Act, 2013 shall not apply in case of demergers referred to in this clause.

- (vid) any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking
- (vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if–
 - (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder himself is the amalgamated company, and
 - (b) the amalgamated company is an Indian company.

Even in the absence of Section 47(vii) of the Act, a shareholder is not liable to pay any capital gains tax since an amalgamation does not include exchange or relinquishment of the assets. Amalgamation does not involve an exchange or relinquishment of shares by amalgamating company as held in *CIT v. Rasik Lal Manek Lal (1975) 95I TR 656*. However, no benefit will be available under Section 47(vii) if the shareholders of amalgamating company are allotted something more than share in the amalgamated company viz. bonds or debentures [*CIT v. Gautam Sarabhai Trust (1988)173 ITR 216(Guj.)*].

When a proprietary concern is sold as a going concern for a consideration to a Company and the proprietor receives consideration as shares in the company and proprietor has held more than 51% shares for five years the capital gains will be exempt under section 47 (xiv) and is not liable to be taxed under section 50B of the Income Tax Act, 1961. ***ACIT v. Madan Mohan Chandak (2011)***.

For Example, Mr. "X" held 2000 shares in a company XYZ Ltd. This company amalgamated with another company during the previous year ending 31-3-2022. Under the scheme of amalgamation, Mr. "X" was allotted 1500 shares in the new company. The market value of shares allotted is higher by Rs. 150,000 than the value of holding in XYZ Ltd. The Assessing Officer proposes to treat the transaction as an exchange and to tax Rs. 1,50,000 as capital gain. Is he justified?

In the above case the transaction is squarely covered by the exemption under section 47(vii) and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

Amortisation of Preliminary Expenses

The benefit of amortization of preliminary expenses under section 35D of the Income-tax Act, 1961 are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled to the amortization is transferred to another Indian company in a scheme of amalgamation within the 5 years period of amortisation. In that event, the deduction in respect of previous year in which the amalgamation takes place and the following previous year within the 5 years period will be allowed to the amalgamated company and not to the amalgamating company.

Capital Expenditure on Scientific Research

In the case of an amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provision of section 35 of the Income-tax Act, 1961 would apply to the amalgamated company as they would have applied to amalgamating company if the latter had not transferred the asset.

Expenditure on Amalgamation

Section 35DD of the Income-tax Act, 1961 provides that where an assessee being an Indian company incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place.

Expenditure for obtaining Licence to Operate Telecommunication Services (Section 35 ABB)

The provisions of the section 35ABB of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining licence to operate communication services shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.

Expenditure for obtaining Spectrum (Section 35 ABA)

The provisions of the section 35ABA of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining spectrum to operate communication services shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the spectrum.

Deduction for expenditure on prospecting, etc., for certain minerals (Section 35E)

The provisions of section 35E of the Income Tax Act, 1961 relating to expenditure on prospecting, etc., for certain minerals shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company as if the amalgamation has not happened.

TAX ASPECTS ON SLUMP SALE

Section 180(1) of the Companies Act, 2013 empowers the Board of Directors of a company, after obtaining the consent of the company by a special resolution to sell, lease or otherwise dispose off the whole or substantially the whole of the undertaking(s) of a company.

Explanation-

- (i) “undertaking” shall mean an undertaking in which the investment of the company exceeds twenty per cent. of its net worth as per the audited balance sheet of the preceding financial year or an undertaking which generates twenty per cent of the total income of the company during the previous financial year;
- (ii) the expression “substantially the whole of the undertaking” in any financial year shall mean twenty per cent. or more of the value of the undertaking as per the audited balance sheet of the preceding financial year.

The transaction in this case, is normally of either of the following type:

- (a) Sale of a running concern.
- (b) Sale of a concern which is being wound-up.

(a) Sale of a Running Concern

This type of sale as a going concern provides for the continuation of the running of the undertaking without any interruption. But there is always a problem of fixing a value in the case of a running concern for all tangible and intangible assets including fixing a value for the infrastructure and other environmental facilities available. In view of all this, the seller normally fixes a lump sum price called ‘slump price’.

The noun ‘slump’ means ‘a gross amount, a lump’. Similarly, ‘slump sum’ means a ‘lump sum’ [Chambers Twentieth Century Dictionary, 1983 Edn., p1220]. A slump sale or a slump transaction would, therefore, mean a sale or a transaction which has a lump sum price for consideration.

(b) Sale of a concern which is being wound-up

On the other hand, a sale in the course of winding up, is nothing but a realization sale aimed at collecting the maximum price for distributing to the creditors and the balance to the contributories (the shareholders). By the very nature of the transaction, this is a piecemeal sale and not a slump sale. In this case, there will be liability to tax as per the various provisions of the Income Tax Act and the criteria which is applicable to a slump sale is not applicable here.

Normally, any sale of a capital asset will give rise to a capital receipt and any profit derived may give rise to capital gains in certain cases. This is true in the case of sale of an undertaking also.

Section 2(42C) of the Income Tax Act, 1961 defines slump sale as a means of transfer of one or more undertakings by *any means* for a lump sum consideration without values being assigned to the Individual assets and liabilities in such transfer.

The word any means now allows the transfer of a business undertaking not only ‘by way of sale’ but also ‘by way of an exchange’ or any other transfer structure defined in Section 2(47) of the Act to be included within its scope.

Determination of the value of an asset or liability (for sole purpose of payment of stamp duty, registration fees or other similar taxes or fee) shall not be regarded as assignment of values to individual assets or liabilities.

As per section 50B of the Income Tax Act, 1961 any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains from the transfer of long-term capital asset and shall be deemed to be the income of the previous year in which the transfer took place.

The gain or loss resulting out of a slump sale shall be a Capital Gain/Loss under the Income Tax Act. The computation has been prescribed as follows:

Particulars	Amount
Full Value of Consideration	XXXX
(-) Expenses in relation to transfer	XXXX
Net Consideration	Xxxx
Cost of Acquisition / net worth	Xxxx
Capital Gain or (Loss)	xxxx

Sale consideration to be calculated as per the Fair Market Value computation which includes monetary as well as non-monetary considerations.

The capital gain or loss as computed above will be either long term or short-term depending upon the period for which the undertaking is held.

If the undertaking is held for more than 36 months, the resulting capital gain or loss shall be long-term and if it is held for less than 36 months, the resulting capital gain or loss shall be short term.

Further, there will be no indexation benefit available in the computation of the capital gains.

In computing the net worth of the entity, the following points need to be considered:

1. The value of net worth should not take into account any change in the value of the asset or liability resulting from revaluation of such asset or liability.
2. In case of depreciable assets under the Income Tax Act, the Written Down Value of Block of assets as per the Act shall be considered.
3. In case of assets on which 100% deduction has been allowed u/s 35AD (specified business), the value of such assets will not be considered.
4. In case of any other asset, value as appearing in the books of accounts shall be considered.
5. After considering the above points, if the resulting net worth is negative, then the cost of acquisition shall be taken as nil for the purpose of computation of capital gains.
6. Value of goodwill while computing the 'net worth' of the undertaking while computing the 'net worth' of an undertaking which is then deemed 'cost of acquisition' under Section 50B, the insertion of Explanation 2(aa) of Section 50B clarifies that the value of any goodwill of business or profession (other than goodwill acquired by purchase from a previous owner) would need to be taken as NIL.

Tax rates: The rates of tax applicable to the capital gain in a slump sale are as follows:

Short Term Capital Gain: Normal Rates of taxation

Long Term Capital Gain: 20%

In **Doughty v. Commissioner of Taxes**, the Privy Council laid down the following principles: The sale of a whole concern engaged in production process, e.g. dairy farming or sheep rearing, does not give rise to a revenue profit. The same might be said of a manufacturing business which is sold with the lease holds and plant, even if there are added to the sale piece goods in stock and even if these piece goods form a very substantial part of the aggregate sold. Where, however, business consists entirely in buying and selling, it is difficult to distinguish for income tax purposes between an ordinary and realisation sale, the object in either case being to dispose of the goods at a profit. The fact that the stock is sold out in one sale does not render the profit obtained any different in kind from the profit obtained by a series of gradual and smaller sales. In the case of such a realization sale, if there is an item which can be traced as representing the stock-in-trade sold, the profit

obtained by the sale of the stock-in-trade, though it is in conjunction with the sale of the whole concern, may be treated as taxable income. But where there is a sale of the whole concern and a transfer of all the assets for a single unapportioned consideration, there cannot be said to be any revenue profit realised on the sale of the stock-in-trade which is sold with all the other assets, although the business of the concern may consist entirely in buying and selling.

The Supreme Court, based on the above decision held in the following two cases that the price received on the sale of industrial undertaking is a capital receipt.

CIT v. West Coast Chemicals and Industries Ltd.– 46 ITR135 – Where a slump price is paid and no portion is attributable to the stock-in-trade, it may not be possible to say that there is a profit other than what results from the appreciation of capital. The essence of the matter, however, is not that an extra amount has been gained by the selling out or the exchange but whether it can fairly be said that there was a trading, from which alone profit can arise in business.

CIT v. Mugneeram Bangur and Co. – 57 ITR 299 – In the case of a concern carrying on the business of buying land, developing it and then selling it, it is easy to distinguish a realization sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realization sale. The mere fact that in the schedule, the price of land was stated does not lead to the conclusion that part of the slump price is necessarily attributable to the land sold.

The same view was also reiterated by the Gujarat High Court in the following cases:

1. **Sarabhai M. Chemicals Pvt. Ltd. v. P.M. Mittal, Competent Authority–126 ITR1.**
2. **Artex Manufacturing Co. v. CIT–131 ITR 559.**

At the same time, the Gujarat High Court also recognized that when an undertaking as a whole is sold as a going concern there will be liability under the head Capital Gains. In 126 ITR 1 the Gujarat High Court stated as follows:

It is well settled that business is property and the undertaking of a business is a capital asset of the owner of the undertaking. When an undertaking as a whole is transferred as a going concern together with its goodwill and all other assets, what is sold is not the individual itemised property but what is sold is the capital asset consisting of the business of the undertaking and any tax that can be attracted to such a transaction for a slump price at book value would be merely capital gains tax and nothing else but capital gains tax. Plant or machinery or any fixture or furniture is not being sold as such. What is sold is the business of undertaking for a slump price. If the capital asset, namely, the business of the undertaking, has a greater value than its original cost of acquisition, then, capital gains may be attracted in the ordinary case of a sale of an undertaking.

The Bombay High Court also recognized that there will be a capital gains tax when a sale of business as a whole occurs (Refer **Killick Nixon and Co .v. CIT 49 ITR 244**).

Where assessee company had sold its entire running business with all assets and liabilities in one go, the Supreme Court held it was a slump sale of a long term capital asset and be taxed under section 50B and not under section 50(2). Section 50(2) applies to a case where any block of assets are transferred by assessee **CIT Vs Equinox solution (P) Ltd. 2017**.

TAX ASPECTS OF DEMERGER

Tax concession/incentives in case of demerger

Section 2(19AA) of the Income Tax Act, 1961 defines the term demerger as follows:

“demerger”, in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 231 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertakings to any resulting company in such a manner that–

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;

- (ii) all the liabilities relatable to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;
Provided that the provisions of this sub-clause shall not apply where the resulting company records the value of the property and the liabilities of the undertaking or undertakings at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger, in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015.
- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;
- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under sub-section (5) of section (viii) 72A by the Central Government in this behalf.

Explanation 1.—For the purposes of this clause, “undertaking” shall include any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.

Explanation 2.—For the purposes of this clause, the liabilities referred to in sub-clause (ii), shall include—

- (a) the liabilities which arise out of the activities or operations of the undertaking;
- (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and
- (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger.

Explanation 3.—For determining the value of the property referred to in sub-clause (iii), any change in the value of assets consequent to their revaluation shall be ignored.

Explanation 4.—For the purposes of this clause, the splitting up or the reconstruction of any authority or a body constituted or established under a Central, State or Provincial Act, or a local authority or a public sector company, into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified in the Official Gazette, by the Central Government.

Explanation 5.—For the purposes of this clause, the reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government in the Official Gazette.

Explanation 6. —For the purposes of this clause, the reconstruction or splitting up of a public sector company into separate companies shall be deemed to be a demerger, if such reconstruction or splitting up has been made to transfer any asset of the demerged company to the resulting company and the resulting company—

- (i) is a public sector company on the appointed day indicated in such scheme, as may be approved by the Central Government or any other body authorised under the provisions of the Companies Act, 2013 or any other law for the time being in force governing such public sector companies in this behalf; and
- (ii) fulfils such other conditions as may be notified by the Central Government in the Official Gazette in this behalf;

It should also be noted that in such cases, the reconstruction or splitting should, be made to transfer any asset of the demerged company to the resulting company and the resulting company is a public sector company on the appointed date indicated in such scheme as may be approved by the Central Government or any other authorised body and fulfils such other conditions as the Central Government may prescribe.

If any demerger takes place within the meaning of section 2(19AA) of the Income-tax Act, 1961 the tax concessions shall be available to:

1. Demerged company.
2. Shareholders of demerged company.
3. Resulting company.

These concessions are on similar lines as are available in case of amalgamation. However, some concessions available in case of amalgamation are not available in case of demerger.

1. Tax concession to demerged company

- (i) Capital gains tax not attracted [Section 47(vib)]

According to section 47(vib), where there is a transfer of any capital asset in case of a demerger by the demerged company to the resulting company, such transfer will not be regarded as a transfer for the purpose of capital gain provided the resulting company is an Indian company.

- (ii) Tax concession to a foreign demerged company [Section 47(vic)]

Where a foreign company holds any shares in an Indian company and transfers the same, in case of a demerger, to another resulting foreign company, such transaction will not be regarded as transfer for the purpose of capital gain under section 45 if the following conditions are satisfied:

- (a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- (b) such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated:

Provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) (Now Sections 230 to 232 of Companies Act, 2013) shall not apply in case of demergers referred to in this clause;

- (iii) any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, which derives directly or indirectly its values substantially from the share or shares of an Indian Company, held by the demerged foreign company to the resulting foreign company will not be regarded as transfer for the purpose of capital gains if the following conditions are satisfied: [Section 47(vicc)]
 - (a) Shareholders holding not less than three-fourths in value of the shares of the demerged foreign company, continue to remain shareholders of the resulting foreign company; and

- (b) Such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated.
- (iv) Reserves for shipping business: Where a ship acquired out of the reserve is transferred in a scheme of demerger, even within the period of eight years of acquisition there will be no deemed profits to the demerged company.

2. Tax concessions to the shareholders of the demerged company [Section 47(vid)]

Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company shall not be regarded as a transfer if the transfer or issue is made in consideration of demerger of the undertaking.

In the case of demerger, the existing shareholders of the demerged company will hold after demerger:

- (a) shares in resulting company; and
- (b) shares in demerged company.

And in case the shareholder transfers any of the above shares subsequent to the demerger, the cost of such shares shall be calculated as under: –

Cost of acquisition of shares in the resulting company [Section 49(2C)]

The cost of acquisition of the shares in the resulting company shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

Cost of acquisition of shares in the demerged company [Section 49(2D)]

The cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived at under sub-section (2C).

For the above purpose, net worth shall mean the aggregate of the paid-up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

Period of holding of shares of the resulting company [Section 2(42A)(g)]

In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.

3. Tax concessions to the resulting company

The resulting company shall be eligible for tax concessions only if the following two conditions are satisfied:

- (i) The demerger satisfies all the conditions laid down in section 2 (19AA); and
- (ii) The resulting company is an Indian company.

The following concessions are available to the resulting company pursuant to a scheme of demerger:

(a) Expenditure for obtaining licence to operate telecommunication services [Section 35ABB]

The provisions of the section 35ABB of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining licence to operate communication services shall, as far as may be, apply to the resulting company as they would have applied to the demerged company, if the latter had not transferred the licence.

(b) Expenditure for obtaining Spectrum to operate telecommunication services [Section 35ABA]

The provisions of the section 35ABA of the Income Tax Act, 1961 relating to deduction of expenditure, incurred for obtaining spectrum to operate communication services shall, as far as may be, apply to

the resulting company as they would have applied to the demerged company if the latter had not transferred the spectrum.

(c) Amortisation of certain preliminary expenses [Section 35D]

The benefit of amortization of preliminary expenses under section 35D of the Income-tax Act, 1961 are ordinarily available only to the assessee who incurred the expenditure. However, the benefit will not be lost in case the undertaking of an Indian company which is entitled to the amortization is transferred to another Indian company in a scheme of demerger within the 5 years period of amortisation. In that event the deduction in respect of previous year in which the demerger takes place and the following previous year within the 5 years period will be allowed to the resulting company and not to the demerged company.

(d) Treatment of expenditure on prospecting, etc. of certain minerals [Section 35E(7A)]

The provisions of section 35E of the Income Tax Act, 1961 relating to expenditure on prospecting, etc., for certain minerals shall, as far as may be, apply to the resulting company as they would have applied to the demerged company as if the demerger has not happened.

(e) Treatment of bad debts [Section 36(1)(vii)]

Where due to demerger, the debts of the demerged company have been taken over by the resulting company and subsequently by such debt or part of debt becomes bad such bad debt will be allowed as a deduction to the resulting company. This is based upon the decision of the Supreme Court in the case of **CIT v. Veerabhadra Rao (T.), K. Koteswara Rao & Co. (1985) 155 ITR 152 (SC)** which was decided in the case of amalgamation of companies.

Section 36(1) provides that the deductions provided in the clauses contained therein shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28. Clause (vii) provides that;

Subject to the provisions of sub-section (2), the amount of any bad debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year shall be allowed as deduction.

Provided that in the case of an assessee to which clause (vii) applies, the amount of the deduction relating to any such debt or part thereof shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause:

Provided further that where the amount of such debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof becomes irrecoverable or of an earlier previous year on the basis of income computation and disclosure standards notified under sub-section (2) of section 145 without recording the same in the accounts, then, such debt or part thereof shall be allowed in the previous year in which such debt or part thereof becomes irrecoverable and it shall be deemed that such debt or part thereof has been written off as irrecoverable in the accounts for the purposes of this clause.

Explanation 1.—For the purposes of this clause, any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee;

Explanation 2.—For the removal of doubts, it is hereby clarified that for the purposes of the proviso to clause (vii) of this sub-section and clause (v) of sub-section(2), the account referred to therein shall be only one account in respect of provision for bad and doubtful debts under clause (vii) and such account shall relate to all types of advances, including advances made by rural branches.

(f) Amortisation of expenditure in case of amalgamation or demerger [Section 35DD]

Where an assessee, being an Indian company, incurs any expenditure wholly and exclusively for the purposes of demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the demerger takes place.

(g) Carry forward and set off of business losses and unabsorbed depreciation of the demerged company [Section 72A (4)&(5)]

Section 72A(4): Notwithstanding anything contained in any other provisions of this Act, in the case of a demerger, the accumulated loss and the allowance for unabsorbed depreciation of the demerged company shall—

- (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;
- (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

Section 72A(5): The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

(h) Deduction available under section 80 - IA (12) or 80 - IB (12)

Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.:

Section 80-IA(12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

- (a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and
- (b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

However, nothing contained in sub-section (12) of sec 80IA shall apply to any enterprise or undertaking which is transferred in a scheme of amalgamation or demerger on or after the 1st day of April, 2007.

Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings:

Section 80-IB(12): Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger—

- (a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and
- (b) the provisions of this section shall, as far as may be, apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Dividend & Deemed Dividend

Section 2(22) of the Income Tax Act, 1961 defines the term dividend. Dividend includes—

- (a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

- (b) any distribution to its shareholders by a company of debentures, debenture-stock, or deposit certificates in any form, whether with or without interest, and any distribution to its preference shareholders of shares by way of bonus, to the extent to which the company possesses accumulated profits, whether capitalised or not;
- (c) any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalised or not;
- (d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not;
- (e) any payment by a company, not being a company in which the public are substantially interested, of any sum (whether as representing a part of the assets of the company or otherwise) made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereafter in this clause referred to as the said concern) or any payment by any such company on behalf, or for the individual benefit, of any such shareholder, to the extent to which the company in either case possesses accumulated profits ;

but “dividend” does not include—

- (i) a distribution made in accordance with sub-clause (c) or sub-clause (d) in respect of any share issued for full cash consideration, where the holder of the share is not entitled in the event of liquidation to participate in the surplus assets;
- (ia) a distribution made in accordance with sub-clause (c) or sub-clause (d) in so far as such distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after the 31st day of March, 1964, and before the 1st day of April, 1965;
- (ii) any advance or loan made to a shareholder or the said concern by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company;
- (iii) any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend within the meaning of sub-clause (e), to the extent to which it is so set off;
- (iv) any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of the Companies Act,;
- (v) any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

Explanation 1.—The expression “accumulated profits”, wherever it occurs in this clause, shall not include capital gains arising before the 1st day of April, 1946, or after the 31st day of March, 1948, and before the 1st day of April, 1956.

Explanation 2.—The expression “accumulated profits” in sub-clauses (a), (b), (d) and (e), shall include all profits of the company up to the date of distribution or payment referred to in those sub-clauses, and in sub-clause (c) shall include all profits of the company up to the date of liquidation, but shall not, where the liquidation is consequent on the compulsory acquisition of its undertaking by the Government or a corporation owned or controlled by the Government under any law for the time being in force, include any profits of the company prior to three successive previous years immediately preceding the previous year in which such acquisition took place.

Explanation 2A.—In the case of an amalgamated company, the accumulated profits, whether capitalised or not, or loss, as the case may be, shall be increased by the accumulated profits, whether capitalised or not, of the amalgamating company on the date of amalgamation.

Explanation 3. —For the purposes of this clause, —

- (a) “concern” means a Hindu undivided family, or a firm or an association of persons or a body of individuals or a company;
- (b) a person shall be deemed to have a substantial interest in a concern, other than a company, if he is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the income of such concern.

Taxability

Finance Act, 2018 has brought the deemed dividend within the ambit of dividend distribution tax under section 115-O, at the rate of 30% in the hands of the closely held companies.

As per the provisions of Section 10(34), dividend income under section 2(24)(e) is 100% exempt in the hands of the shareholders as it is charged to Dividend Distribution Tax under section 115-O of the Income Tax Act, 1961.

In Budget 2021, the burden of paying tax on dividend is transferred to the shareholders. Now the companies are not liable to pay Dividend Distribution Tax (DDT) while distributing dividends to the shareholders, i.e. DDT is abolished. These amendment has put all this to rest.

STAMP DUTY ASPECTS OF MERGER AND AMALGAMATIONS

The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.

CONSTITUTIONAL BACKGROUND ON LEVY OF STAMP DUTY ON AMALGAMATION AND MERGERS

Article 265

Article 265 of the Constitution prohibits levy or collection of tax except by authority of law.

Article 246, read with the Seventh Schedule of the Constitution provides legislative powers to be exercised by the Parliament and the State Legislatures.

The Seventh Schedule consists of three lists viz., List I-Union List, List II-State List and List III-Concurrent List. List I is the exclusive domain of the Parliament to make laws in relation to that matter and it becomes a prohibited field for the State Legislature. List II is within the exclusive competence of the State Legislature and Parliament is prohibited to make any law with regard to the same except in certain circumstances. In List III, both Parliament and State Legislature can make laws subject to certain conditions. Matters not mentioned in any of the three lists fall within the exclusive domain of the Parliament.

Article 372

All the laws in force immediately before the commencement of the Constitution continue to be in force until altered or repealed or amended by a competent Legislature or other competent authority. Accordingly, the Indian Stamp Act, 1899 is continuing to this extent.

The relevant entries in the Seventh Schedule regarding stamp duty are as follows:

List I Entry 91

“91. Rates of stamp duty in respect of bills of exchange, cheques, promissory notes, bills of lading, letters of credit, policies of insurance, transfer of shares, debentures, proxies and receipts.”

List II Entry 63

“63. Rates of stamp duty in respect of documents other than those specified in the provisions of List I with regard to rates of stamp duty.”

List III Entry 44

“44. Stamp duties other than duties or fees collected by means of judicial stamps, but not including rates of stamp duty.”

In exercise of power conferred by Entry 63, List II, the State Legislature can make amendment in the Indian Stamp Act, 1899 under article 372, in regard to the rates of stamp duty in respect of documents other than those specified in provisions of List I.

Stamp duty is levied in India on almost all, except a few documents, by the States and hence the rate and incidence of stamp in different states vary. The State Legislature has jurisdiction to levy stamp duty under entry 44, List III of the Seventh Schedule of the Constitution of India and prescribe rates of stamp duty under entry 63, List II.

Under the provisions of the Companies Act, 1956 it has been decided that by sanctioning of amalgamation scheme, the property including the liabilities are transferred as provided in sub-section (2) of section 394 of the Companies Act and on that transfer instrument, stamp duty is levied.

Therefore, it cannot be said that the State Legislature has no jurisdiction to levy such duty on an order of the High Court sanctioning a scheme of compromise or arrangement under section 394 of the Companies Act, 1956. [*Li Taka Pharmaceuticals Ltd. and another v. State of Maharashtra and others* *ibid*].

Stamp Duty Payable on a Tribunal Order Sanctioning Amalgamation

Section 232 of the Companies Act, 2013 is the corresponding section to the Section 394 of the Companies Act, 1956 and for understanding the payment of Stamp duty on Tribunal Order sanctioning Amalgamation, it is necessary to take reference of the judicial pronouncement under the Companies Act, 1956, which is as under:

1. In amalgamation the undertaking comprising property, assets and liabilities, of one (or more) company (amalgamating or Transferor Company) are absorbed by the transferee company and transferor company merges into or integrates with the Transferee Company. The former loses its entity and is dissolved (without winding-up).
2. The transfer and vesting of Transferor Company's property, assets, etc. into Transferee Company takes place “by virtue of” the High Court's order [Section 394(2)]. Thus, the vesting of the property occurs on the strength of the order of the High Court sanctioning the scheme of amalgamation, without any further document or deed. Property includes every kind of property, rights and powers of every description [Section 394(4)(d)].
3. For the purpose of conveying to the transferee company the title to the immovable property of the transferor company, necessary registration in the lands records in the concerned office of the State in which the property is situated, will be done on the basis of the High Court order sanctioning the amalgamation. If any stamp duty is payable under the Stamp Act of the State in which the property is situated, it will be paid on the copy of the High Court order.
4. An order of the High Court under section 394 is founded and based on the compromise or arrangement between the two companies for transferring assets and liabilities of the transferor company to the transferee company and that order is an instrument as defined in Section 2(1) of the Bombay Stamp Act, 1958 which included every document by which any right or liability is transferred [*Li Taka Pharmaceuticals Ltd. v. State of Maharashtra* (1996)22 CLA154: AIR 1997 Bom 7].
5. Thus, an order of the High Court sanctioning a scheme of amalgamation under Section 394 of the companies Act, 1956 is liable to stamp duty only in those States where the states stamp law provides.

In ***Hindustan Lever Ltd. v. State of Maharashtra (2003) 117 Comp Cas SC 758*** the Supreme Court considered this issue. Tata Oil Mills Company Ltd. (TOMCO) was merged with the *Hindustan Lever Ltd (HLL)*. The State imposed stamp duty on the order sanctioning the scheme of merger. The demand was challenged by the company on two grounds that State Legislature is not competent to impose stamp duty on the order of amalgamation passed by a court and such order of the court is neither instrument nor document (transferring properties from transferor company to transferee company) liable to stamp duty.

The Supreme Court dismissed the appeal of the company on following reasons:

Transfer of property has been defined to mean an act by which a living person conveys property, in present or in future, to one or more living persons. Companies or associations or bodies of individuals, whether incorporated or not, have been included amongst living persons. It clearly brings out that a company can affect transfer of property. The word *inter vivos* in the context of section 394 of the Companies Act, 1956 would include, within its meaning, also a transfer between two juristic persons or a transfer to which a juristic person is one of the parties. The company would be a juristic person created artificially in the eyes of law capable of owning and transferring the property. The method of transfer is provided in law. One of the methods prescribed is dissolution of the transferee company along with all its assets and liabilities. Where any property passes by conveyance, the transaction is said to be *inter vivos* as distinguished from a case of succession..

The State Legislature would have the jurisdiction to levy stamp duty under Entry 44 List III of the Seventh Schedule of the constitution and prescribes rate of stamp duty under Entry 63, List II. It does not in any way impinge upon any Entry in List I. Entry 44 of List III empowers the State Legislature to prescribe rates of stamp duty in respect of documents other than those specified in List I. By sanctioning a scheme of amalgamation, the property including the liabilities are transferred as provided in Section 394 of the Companies Act, 1956 and on that transfer instrument, stamp duty is levied. Therefore, it cannot be said that the State Legislature has no jurisdiction to levy such duty. Under the scheme of amalgamation, the whole or any part of the undertaking, properties or liability of any company concerned in the scheme are to be transferred to the other company. The intended transfer is a voluntary act of the contracting parties. The transfer has all trappings of a sale. While exercising its power in sanctioning a scheme of arrangement, the court has to examine as to whether the provisions of the statute have been complied with. Once the court finds that the parameters set out in section 394 of the Companies Act, 1956 have been met then the court would have no further jurisdiction to sit in appeal over the commercial wisdom of the class of persons who with their eyes open give their approval, even if, in the view of the court a better scheme could have been framed. Two broad principles underlying a scheme of amalgamation are that the order passed by the court amalgamating the company is based on a compromise or arrangement arrived at between the parties; and that the jurisdiction of the company court while sanctioning the scheme is supervisory only. Both these principles indicate that there is no adjudication by the court on merits as such.

The order of the court under sub-section (2) of section 391 has to be presented before the Registrar of Companies within 30 days for registration and shall not have effect till a certified copy of the order has been filed with the Registrar and the Registrar of Companies certifies that the transferor company stands amalgamated with the transferee company along with all its assets and liabilities. Thus, the amalgamation scheme sanctioned by the court would be an instrument within the meaning of section 2(i) of the Bombay Stamp Act, 1958. By the said instrument, the properties are transferred from the transferor company to the transferee company, the basis of which is the compromise or arrangement arrived at between the two companies. A document creating or transferring a right is an instrument. An order effectuating the transfer is also a document.

6. The company will provide to the Collector of Stamps—
 - application for adjudication of the High Court order for determination of stamp duty payable;
 - proof of the market value of equity shares of the transferor company (Stock Exchange quotation or a certificate from Stock Exchange) as of the appointed day;

- certificate from an approved valuer or valuation of the immovable property being transferred to the transferee company.
7. The Collector thereafter will adjudicate the order and determine stamp duty.
 8. The stamp duty will be paid in the manner prescribed under the Stamp Rules. The duty-paid Order will be registered with the Sub-Registrar of Assurances where the lands and buildings are located.

Incidence of Levy of Stamp Duty

Stamp duty is levied on “Instruments”. Section 3 of the Bombay Stamp Act, 1958 specifies the following essentials for the levy of stamp duty:

1. There must be an instrument
2. Such instrument is one of the instruments specified in Schedule I
3. Such instrument must be executed
4. Such instrument must have either–
 - (a) not having been previously executed by any person in the ‘State’ or
 - (b) having been executed outside the State, relates to any property situated in the State or any matter or thing done or to be done in the State and is received in the State.

Instrument

The term ‘instrument’ is defined in Section 2(i) of the Bombay Stamp Act, 1958 as follows:

“Instrument” includes every document by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded but does not include a bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, debentures, proxy and receipt.”

An award is an instrument within the meaning of the Stamp Act and the same is required to be stamped as was decided in the case ***Hindustan Steel Ltd. v. Dilip Construction Co., AIR 1969 SC 1238.***

The scheme of amalgamation sanctioned by the court would be an instrument within the meaning of Section 2(1) whereby the properties are transferred from the transferor company to the transferee company based on compromise arrived at between the two companies. The State legislature would have the jurisdiction to levy stamp duty under Entry 44, List II of the Seventh Schedule of the Constitution on the order of the court sanctioning scheme of amalgamation vide the case of ***Hindustan Lever v. State of Maharashtra, AIR 2004.***

This definition is an inclusive definition and includes any document which purports to transfer assets or liabilities considered as an instrument.

Order of Court under Section 394 of Companies Act, 1956 - A Transfer

It was earlier held that when transfer takes place by virtue of a court order to a scheme of amalgamation, stamp duty is leviable. By virtue of Section 2(g), the order of the Court ordering the transfer of assets and liabilities of the transferor company to the transferee company is deemed to be a conveyance. The definition of conveyance is given below:

As per Section 2(g) of the Bombay Stamp Act, 1958, “Conveyance” includes–

- (i) a conveyance on sale,
- (ii) every instrument,

- (iii) every decree or final order of any Civil Court,
- (iv) every order made by the High Court under Section 394 of the Companies Act, 1956 in respect of amalgamation of companies;

By which property, whether moveable or immovable, or any estate or interest in any property is transferred to, or vested in, any other person, *inter vivos*, and which is not otherwise specifically provided for by Schedule I.

The amended definition of term 'conveyance' under section 2(g) of the Bombay Stamp Act, 1958 (amended in 1985) *inter-alia* includes every order made by the High Court under section 394 of the Companies Act, 1956 in respect of amalgamation of companies by which property, whether moveable or immovable, or any estate or interest in any property of transferor is transferred to, or vested in the transferee company.

Transfer of the property of a partnership firm to a limited company on its conversion was held to be treated as a conveyance and, hence, chargeable to stamp duty, irrespective of the fact that the partners of the firm were the shareholders of the Company [In re **The Kandoli Tea Company 13 Cal 43; Foster v. Commissioners, (1894)1QB516**].

The landmark decision of Bombay High Court in [**Li Taka Pharmaceuticals v. State of Maharashtra (1996) 8 SC 102 (Bom.)**] has serious implications for mergers covered not just by the Bombay Stamp Act, 1958 but also mergers covered by Acts of other States. The following are the major conclusions of the Court:

1. An amalgamation under an order of Court under Section 394 of the Companies Act, 1956 is an instrument under the Bombay Stamp Act, 1958.
2. States are well within their jurisdiction when they levy stamp duty on instrument of amalgamation.
3. Stamp duty would be levied not on the gross assets transferred but on the "undertaking", when the transfer is on a going concern basis, i.e. on the assets less liabilities. The value for this purpose would thus be the value of shares allotted. This decision has been accepted in the Act and now stamp duty is leviable on the value of shares allotted plus other consideration paid.

The Calcutta High Court in the case of *Emami Biotech Ltd. (2012)* held that a Court order sanctioning a scheme of amalgamation or demerger under section 391 to 394 of the Companies Act, 1956 is an instrument and conveyance within the meaning of the Stamp Act applicable to the State of West Bengal and is accordingly, subject to stamp duty.

This case is related to a scheme sanctioned by the Calcutta High Court in West Bengal.

Stamp Duty on Other Documents

Usually, in a merger, several other documents, agreements, indemnity bonds, etc. are executed, depending on the facts of each case and requirements of the parties. Stamp duty would also be leviable as per the nature of the instrument and its contents.

Amalgamation between Holding and Subsidiary Companies—Exemption from payment of Stamp Duty

The Central Government has exempted the payment of stamp duty on instrument evidencing transfer of property between companies limited by shares as defined in the Indian Companies Act, 1913, in a case:

- (i) where at least 90 percent of the issued share capital of the transferee company is in the beneficial ownership of the transferor company, or
- (ii) where the transfer takes place between a parent company and a subsidiary company one of which is the beneficial owner of not less than 90 percent of the issued share capital of the other, or

- (iii) where the transfer takes place between two subsidiary companies each of which having not less than 90 percent of the share capital is in the beneficial ownership of a common parent company:

Provided that in each case a certificate is obtained by the parties from the officer appointed in this behalf by the local Government concerned that the conditions above prescribed are fulfilled.

Therefore, if property is transferred by way of order of the High Court in respect of the Scheme of Arrangement/ Amalgamation between companies which fulfil any of the above mentioned three conditions, then no stamp duty would be levied provided a certificate certifying the relation between companies is obtained from the officer appointed in this behalf by the local Government (generally this officer is the Registrar of Companies).

A circular was issued in the year 1937 vide which exemption was granted on payment of Stamp Duty when there is an amalgamation/merger between holding and subsidiary company. Delhi High Court in the case of **Delhi Towers Ltd. Vs. GNCT of Delhi** made reference to this circular.

However, stamp duty being a state subject, the above would only be applicable in those States where the State Government follows the above stated notification of the Central Government otherwise stamp duty would be applicable irrespective of the relations mentioned in the said notification.

LESSON ROUND-UP

- Financial aspects of mergers denote financial benefits in terms of stamp duty and taxation related aspects.
- Under Section 72A, a special provision is made which relaxes the provision relating to carrying forward and set-off of accumulated business loss and unabsorbed depreciation allowance in certain cases of amalgamation.
- Capital gains tax is leviable if there arises capital gain due to transfer of capital assets.
- The incidence of stamp duty is an important consideration in the planning of any merger. In fact, in some cases, the whole form in which the merger is sought to take place is selected taking into account the savings in stamp duty. The incidence of stamp duty, more particularly on transfer of immovable property is fairly high to merit serious consideration. The fact that, in India, stamp duty is substantially levied by the States has given considerable scope for savings in stamp duty.
- Usually, in a merger, several other documents, agreements, indemnity bonds, etc. are executed, depending on the facts of each case and requirements of the parties. Stamp duty would also be leviable as per the nature of the instrument and its contents.

GLOSSARY

Deemed Dividend: Deemed dividend is the amount paid in such a manner and to such persons as specified in section 2(22)(e) of the Income Tax Act, 1961.

Slump Sale: Slump sale means of 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.

Stamp duty: Stamp duty is levied in India on almost all, except a few documents, by the States. The State Legislature has jurisdiction to levy stamp duty under Entry 44, List III of the Seventh Schedule of the Constitution of India. Hence, the rate of duty varies from one state to another state. Under the provisions of the Companies Act, by sanctioning of amalgamation scheme, the property including the liabilities is transferred and on that transfer instrument, stamp duty is levied.

Conveyance: Conveyance means a conveyance on sale, every instrument, every decree or final order of any civil court, every order made by the High Court in respect of amalgamation of companies by which property, whether moveable or immovable or any estate or interest in any property is transferred to or vested in, any other person.

Instrument: Instrument includes every document by which any right or liability is or purports to be created, transferred, limited, extended, extinguished or recorded but does not include a bill of exchange, cheque, promissory note, bill of lading, letter of credit, policy of insurance, transfer of shares, debentures, proxy and receipt.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Describe the financial benefits that would arise out of merger.
2. What are the tax advantages of mergers? Discuss provisions related to capital gains.
3. Discuss the taxation aspects of slump sale.
4. What are provisions related to taxation aspects of demerger?
5. What is deemed dividend under section 2(22)(e) of the Income-tax Act, 1961? Discuss its taxability.
6. Explain the constitutional background of Indian Stamp Act, 1899 with respect to merger.
7. Is the order of Tribunal an instrument? Is stamp duty compulsory on the Tribunal order?

LIST OF FURTHER READINGS

- Master Guide to Mergers and Acquisition in India – Tax and Regulatory, 4th Edition, CCH
- Income Tax Act, 1961
- Indian Stamp Act, 1899
- State Stamp Acts