NALSAR University of Law
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Income-tax Perspective- Amalgamation & Demerger

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PART A – Amalgamation

What is Amalgamation?

Amalgamation

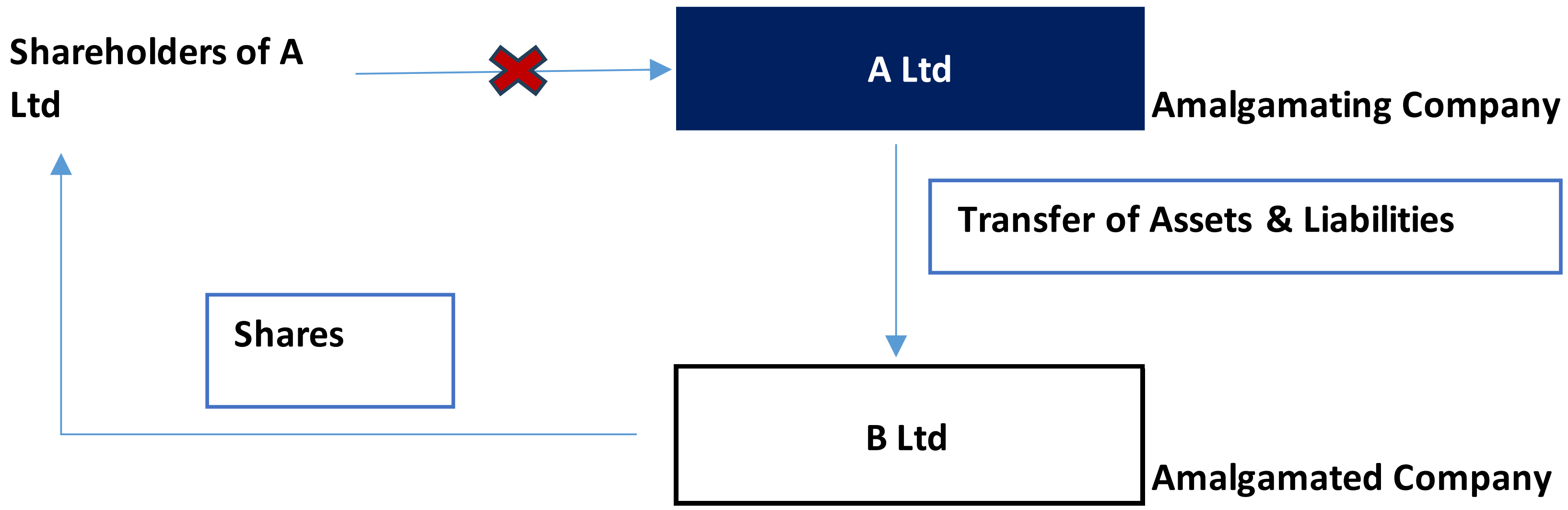


Fig. Amalgamation

Why entities do Amalgamation?

Advantages Disadvantages of Amalgamation

Advantages

- Synergy and Economies of Scale
- Diversification of Risk
- Increased Market Share
- Enhanced Competitive Advantage
- Access to New Markets and Customers
- Cost Reduction and Efficiency Gains
- Expansion of Product or Service Offering
- Strengthened Financial Position
- Access to New Technologies or Resources
- Greater Bargaining Power with Suppliers

Real Life Examples :-
Vodafone Idea Merger
HDFC Bank- HDFC Merger
Adani – NDTV
Tata Motors- Land Rover, Jaguar
Infosys- Axon

Disadvantages

- Integration Challenges
- Cultural Differences
- Employee Uncertainty and Resistance
- Legal and Regulatory Hurdles
- Overpayment for Acquired Assets
- Financial Risks
- Loss of Key Talent and Expertise
- Dilution of Shareholder Value
- Negative Impact on Company Reputation
- Potential for Strategic Misalignment

Practical Insights:-
Tata Motors- Jaguar, Land Rover
HUL – GSK Consumer Healthcare

Amalgamation – Income-tax Perspective

2(1B) Amalgamation

"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**;

Evaluating Taxability in the hands of shareholders of Amalgamating Co

1. ***Whether on Amalgamation there is a transfer of shares by shareholders of Amalgamating Company***

Definition of Transfer

Provisions of S. 12 B of Income-tax Act, 1922
"Capital gains.—
The tax shall be payable by an assessee under the head 'Capital gains' in respect of any profits or gains arising from the ***sale, exchange, relinquishment or transfer of a capital asset*** effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place."

Provisions of Income-tax Act, 1961:
Section 2(47): "'transfer', in relation to a capital asset, includes the ***sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law;"***
Section 45: "Capital gains .— Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53 and 54, be chargeable to income-tax under the head 'Capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

Relevant Decisions

01

CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198 (SC)

02

Vania Silk Mills (P.) Ltd. v. CIT [1991] 191 ITR 647 (SC)

03

CIT v. Grace Collis [2001] 248 ITR 323 (SC)

CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198 (SC)

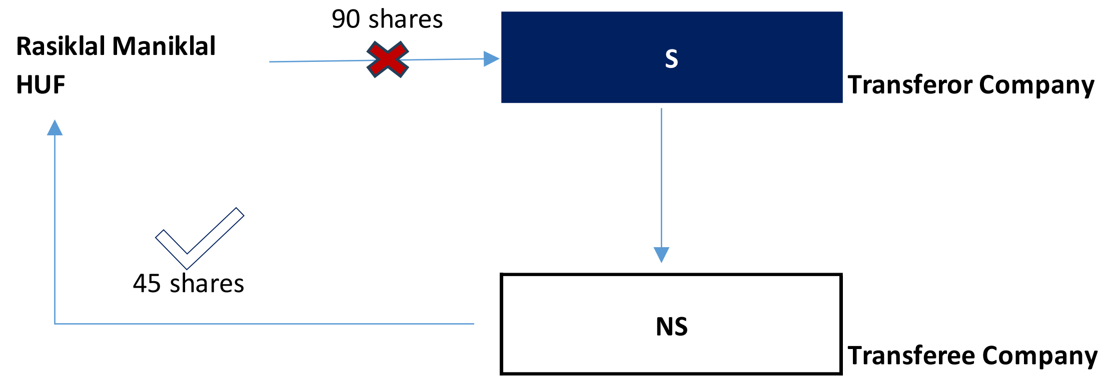


Fig. 177 ITR198 (SC)

Facts :
The assessee owned 90 shares in company 'S' which amalgamated with 'NS' under a scheme, resulting in the transfer of assets and liabilities to 'NS' and the allotment of 45 shares in 'NS' to the assessee.

Question before SC :
Whether the allotment of shares in 'NS' to the assessee, following the amalgamation of 'S' with 'NS', constitutes a taxable event under section 12B of the Indian Income-tax Act, 1922.

Relevant Provisions:
S. 12B of 1922 Act
"Capital gains.—The tax shall be payable by an assessee under the head 'Capital gains' in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place."

Views of the audience?

Decision of Supreme Court

Exchange	Relinquishment
"An exchange involves the transfer of property by one person to another and reciprocally the transfer of property by that other to the first person.“ "There must be a mutual transfer of ownership of one thing for the ownership of another."	"A relinquishment takes place when the owner withdraws himself from the property and abandons his rights thereto.“ "It presupposes that the property continues to exist after the relinquishment."

An exchange involves the ***transfer of property by one person to another and reciprocally the transfer of property by that other to the first person.*** *There must be a mutual transfer of ownership of one thing for the ownership of another. In the present case, the assessee could not be said to have transferred any property to any one. When he was allotted the shares of the NS, he was entitled to such allotment because of his holding the 90 shares of S. The holding of the 90 shares in S was merely a qualifying condition entitling the assessee to the allotment of the 45 shares of NS. The dissolution of S deprived the holding of the 90 shares of that company of all value. Accordingly, no exchange was involved in the transaction in question. Further, a relinquishment takes place when the owner withdraws himself from the property and abandons his rights thereto. It presumes that the property continues to exist after the relinquishment. Upon amalgamation, the shares of S lost all value as that company stood Unsolved. Hence, there was no relinquishment. The High Court was, therefore, justified*

Vania Silk Mills (P.) Ltd. v. CIT [1991] 191 ITR 647 (SC)

Facts :

- The assessee-company, engaged in manufacturing and selling art-silk cloth, had purchased machinery in 1957 and leased it to another company.
- A fire in 1966 damaged the machinery beyond repair, and the **insurance company compensated** the lessee, who in turn paid the assessee a sum for the destruction of the machinery

Question before SC :
Whether the amount received on insurance claim constitutes a transfer of capital asset under section 45 of the Income-tax Act, 1961?

Relevant Provisions (1961 Act) :
Section 2(47): "'transfer', in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law;"
Section 45: "Capital gains .— Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53 and 54, be chargeable to income-tax under the head 'Capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

Vania Silk Mills (P.) Ltd. v. CIT [1991] 191 ITR 647 (SC)

It is true that the definition of 'transfer' in section 2(47)is inclusive, and therefore, extends to events and transactions which may not otherwise be 'transfer' according to its ordinary, popular and natural sense. It is this aspect of the definition which has weighed with the High Court and. therefore, the High Court has argued that if the words 'extinguishment of any rights therein' are substituted for the word 'transfer' in section 45, the claim or compensation received from the insurance company would be attracted by the said section. The High Court has, however, missed the fact that the definition also mentions such transactions as sale, exchange etc., to which the word 'transfer' would properly apply in its popular and natural import Since those associated words and expressions imply the existence of the asset and of the transferee, ***according to the rule of noscitur a sociis,*** the expression ***'extinguishment of any rights therein' would take colour from the said associated words and expressions and will have to be restricted to the sense analogous to them***. If the Legislature intended to extend the definition to any extinguishment of right, it would not have included the obvious instances of transfer, viz., sale, exchange, etc. Hence, the expression 'extinguishment of any rights therein' will have to be confined to the extinguishment of rights on account of transfer and cannot be extended to mean any extinguishment of right independent of or otherwise than on account of transfer.- Reproduced from Para 6

CIT v. Grace Collis [2001] 248 ITR 323 (SC)

Facts :

- Assessees were shareholders of Ambassador Steamship Pvt. Ltd.
- Kerala High Court sanctioned a Scheme of Arrangement for amalgamation with Collis Line Pvt. Ltd.
- Under the scheme, shareholders received shares in Collis Line Pvt. Ltd. in exchange for shares in Ambassador Steamship Pvt. Ltd.
- Assessees sold their shares in Collis Line Pvt. Ltd. to B.K. Chatterji and associates.
- Tax authorities levied capital gains tax on the sale.

Question before SC :
Whether the transfer of shares in Ambassador Steamship Pvt. Ltd. to Collis Line Pvt. Ltd. constitutes a transfer attracting capital gains tax?

Relevant Provisions (1961 Act) :
Section 2(47): "'transfer', in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law;"
Section 45: "Capital gains .— Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections 53 and 54, be chargeable to income-tax under the head 'Capital gains', and shall be deemed to be the income of the previous year in which the transfer took place."

CIT v. Grace Collis [2001] 248 ITR 323 (SC)

15. We have given careful thought to the definition of 'transfer' in section 2(47) and to the decision of this Court in Vania Silk Mills (P.) Ltd.'s case (supra) . In our view, the definition clearly contemplates the extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof.

We do not approve, respectfully, of the limitation of the expression 'extinguishment of any rights therein' to such extinguishment on account of transfers or to the view that the expression 'extinguishment of any rights therein' cannot be extended to mean the extinguishment of rights independent of or otherwise than on account of transfer. **To so read, the expression is to render it ineffective and its use meaningless***. As we read it, therefore, the expression does include the extinguishment of rights in a capital asset independent of and otherwise than on account of transfer.*

Taxability in the hands of shareholders of Amalgamating Co

Whether there is a consideration being received on transfer of shares when there is Amalgamation of Subsidiary Co. with Holding Co., since no new shares are issued

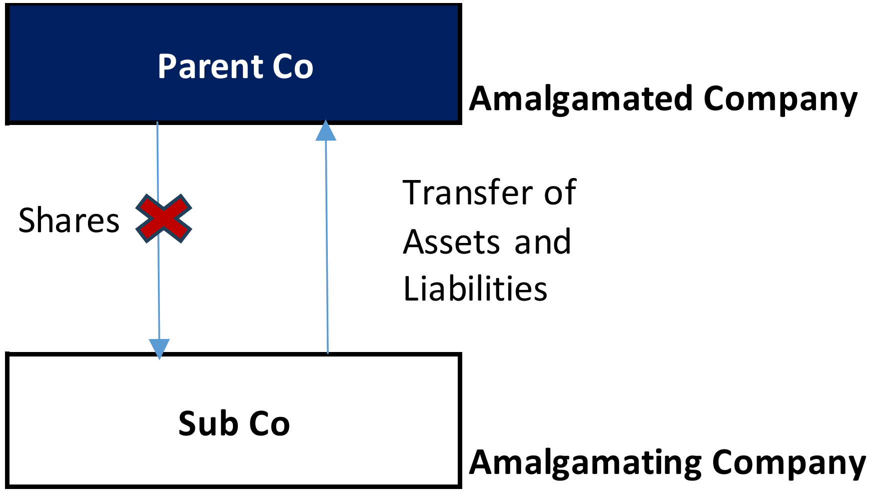


Fig. Merger of Sub Co. with Parent Co.

Evaluation:-

1. Whether any consideration is received by shareholders of Amalgamating Co.?

Relevant Decisions :

- Bana Sella SpA, In re 387 ITR 358
- Hoechst Gmbh, in re, 289 ITR 358

Taxability in the hands of Amalgamating Company

Whether on Amalgamation, transfer of Capital assets taxable ?

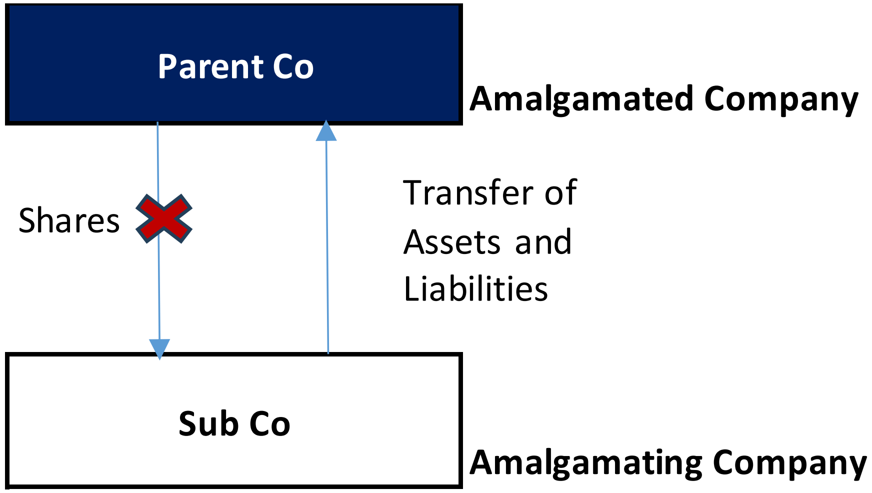


Fig. Merger of Sub Co. with Parent Co.

Evaluation:-
Whether any consideration is received by the Amalgamating Company

Relevant Decisions :

- Shaw Wallace & Co. Ltd. v. CIT [1979] 119 ITR 399(Cal.)
- Bana Sella SpA, In re 387 ITR 358
- Hoechst Gmbh, in re, 289 ITR 358

Taxability in the hands of Amalgamating Company

Capital gain or loss could occur only on the transfer of a capital asset for consideration, involving more than one party. When the assets of the amalgamating companies were transferred it was covered within the provisions of section 47(vi)*. On subsequent dissolution of these companies, the rights of the assessee-company in the shares were extinguished, involving no other party and without consideration and as such there was no element of transfer. The net effect of the scheme was transfer of entire capital assets of the subsidiary companies to the holding company which held the entire share capital of the subsidiary companies. Such a transfer would fall within section 47*(vi) *and would be excluded from the operation of section 45. Besides, the assessee-company being the owner of all the shares of the subsidiaries, the scheme was a mere rearrangement of the capital base so that there could be no element of profit or loss and as a result of the amalgamation, there was no extinguishment of the rights of the assessee. Hence, the loss claimed by the assessee-company was not allowable.*

- Reproduced from Shaw Wallace & Co. Ltd. v. CIT (1979] 1 Taxman 551 (Calcutta)

Transactions not regarded as "Transfer" by virtue of S. 47

S. 47(vi)-

Transferor Company (where Amalgamated Co is Indian Co)

S. 47(vii)- Shareholders of Transferor Company (where Amalgamated Co is Indian Co)

S. 47(via)-

Transferor Co (Foreign) – Transfer of Ind Co shares

S. 47(viab) – Transferor Co. (Foreign) – Indirect transfer of Ind Co. shares

S. 47(vi) & (vii)- Amalgamation of Indian Co with Indian Co.

Section	Relief to	Extract of Section
S. 47(vi)	Transferor Co	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**
S. 47(vii)	Shareholders of Transferor Co	**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 itself is the amalgamated company, **and** (b)the amalgamated company is an **Indian company**

Case Study – 47(vii)

Scenario : 1

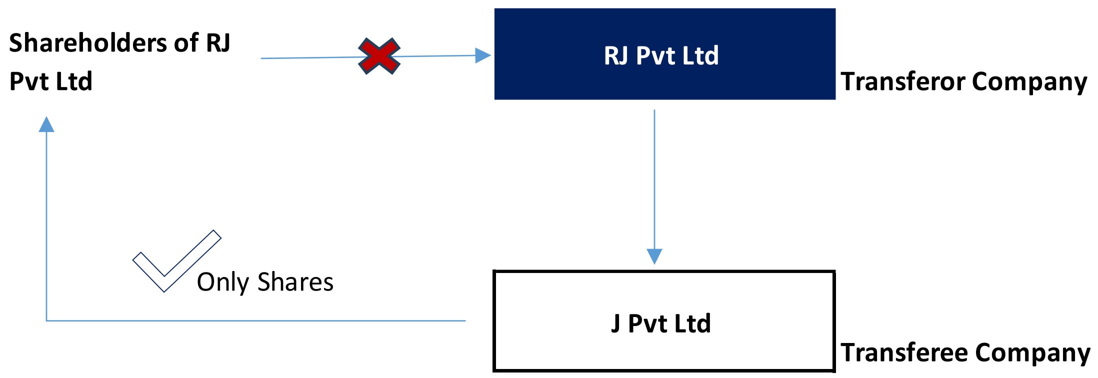


Fig. S. 47(vi) & 47(viii)

Scenario : 2

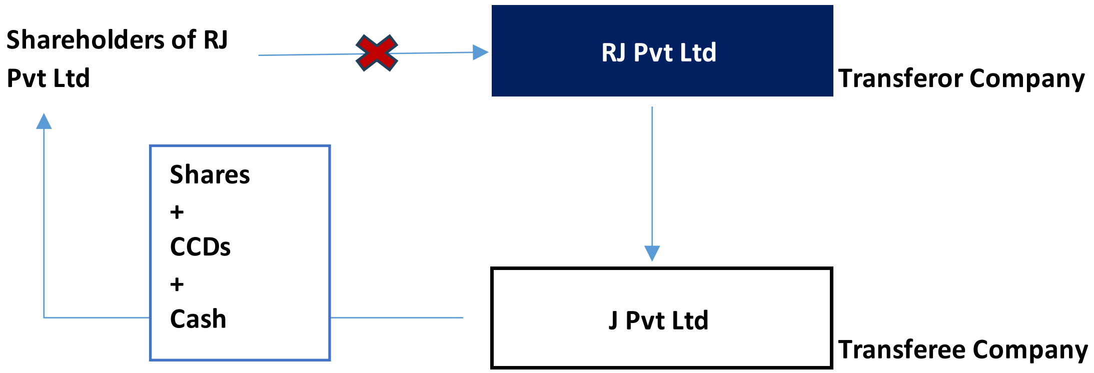


Fig. S. 47(vi) & 47(viii)

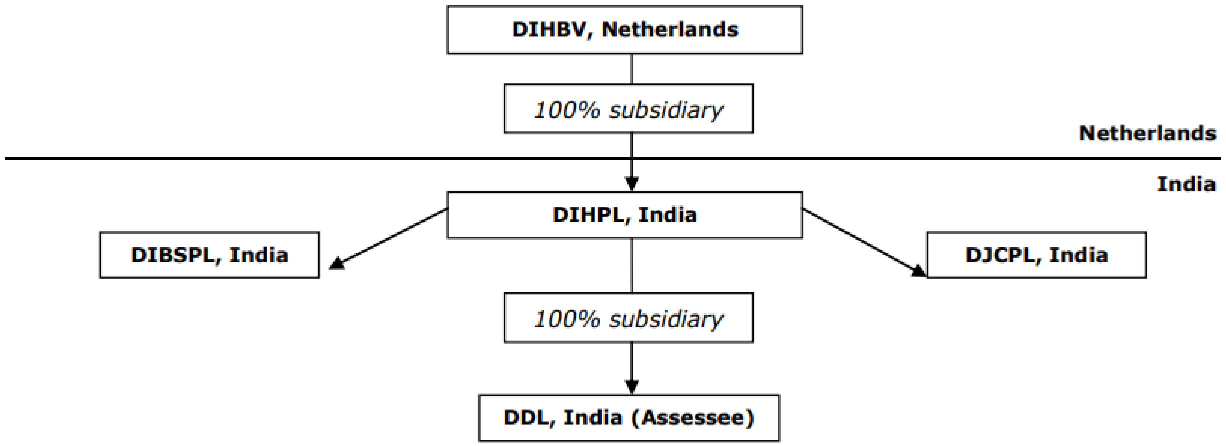
any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if—
(a) the transfer is made **in consideration** of the allotment to him of **any share or shares** in the amalgamated company **except where the shareholder itself is the amalgamated company**, and
(b)the amalgamated company is an Indian company

Whether Entire Consideration Should be in the form of Shares? Or

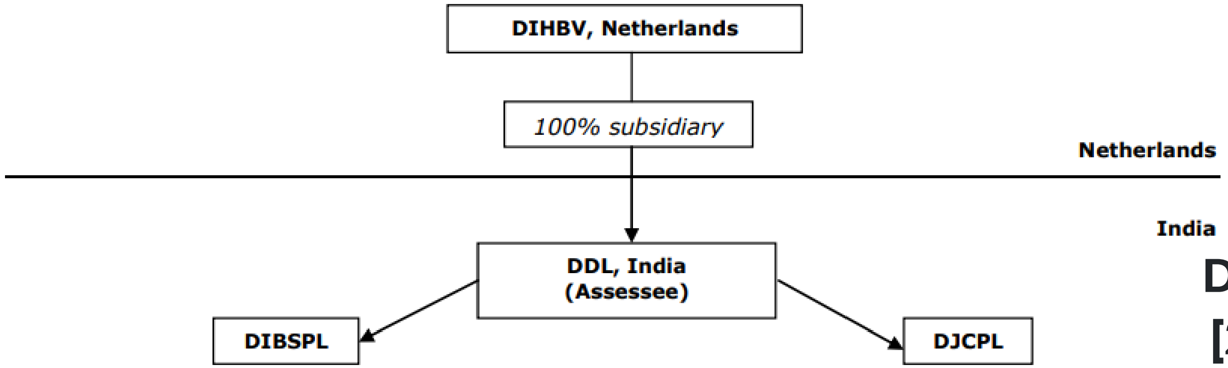
Can it partly be through Shares and partly in the form of other securities/ cash.

Case Study – 47(vii)

(i) Pre-merger



(ii) Post-merger



Issue of equity shares	*Rs. 3,35,33,120*
Issue of CCDs	*Rs. 85,00,00,000*
Cash	*Rs. 100,00,00,000*
Total	*Rs. 188,35,33,120*

Dimexon Diamonds Ltd. v. ACIT [2024] 159 taxmann.com 118 (Mumbai - Trib.)[

S. 47(via) & (viab)- Amalgamation of Foreign Co.

Section	Extract of Section
S. 47(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;
S. 47(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;

These are relief for Transferor Co.

What about amalgamation of Foreign Co with Indian Co?

What about relief to shareholders of foreign co?

Any views?

S.46(via) Merger Of F Co. with F Co.

India - Netherlands - Article 13 - Capital Gains of Comprehe...

ARTICLE 13

CAPITAL GAINS

1. Gains derived by a resident of one of the States from the alienation of immovable property referred to in Article 6 and situated in the other State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of one of the States has in the other State or of movable property pertaining to a fixed base available to a resident of one of the States in the other State for the purpose of performing independent personal services, including such gains from the alienation of such permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft, shall be taxable only in the State in which the place of effective management of the enterprise is situated. For the purposes of this paragraph, the provisions of paragraph 3 of Article 8A shall apply.

4. Gains derived by a resident of one of the States from the alienation of shares (other than shares quoted on an approved stock exchange) forming part of a substantial interest in the capital stock of a company which is a resident of the other State, the value of which shares is derived principally from immovable property situated in that other State other than property in which the business of the company was carried on, may be taxed in that other State. A substantial interest exists when the resident owns 25 per cent or more of the shares of the capital stock of a company.

5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in the State of which the alienator is a resident.

However, gains from the alienation of shares issued by a company resident in the other State which shares form part of at least a 10 per cent interest in the capital stock of that company, may be taxed in that other State if the alienation takes place to a resident of that other State. However, such gains shall remain taxable only in the State of which the alienator is a resident if such gains are realised in the course of a corporate organisation, reorganization, amalgamation, division or similar transaction, and the buyer or the seller owns at least 10 per cent of the capital of the other.

6. The provisions of paragraph 3 shall not affect the right of each of the States to levy according to its own law at tax on gains from the alienation of shares or 'jouissance' rights in a company, the capital of which is wholly or partly divided into shares and which under the laws of that State is a resident of that State, derived by an individual who is a resident of the other State and has been a resident of the first-mentioned State in the course of the last five years preceding the alienation of the shares or 'jouissance' rights.

Controversial Issues | I Co merges with F Co.

Amalgamation of Indian Co with Foreign Parent Co?
Indian Subsidiary Co. amalgamates with Foreign Holding Company

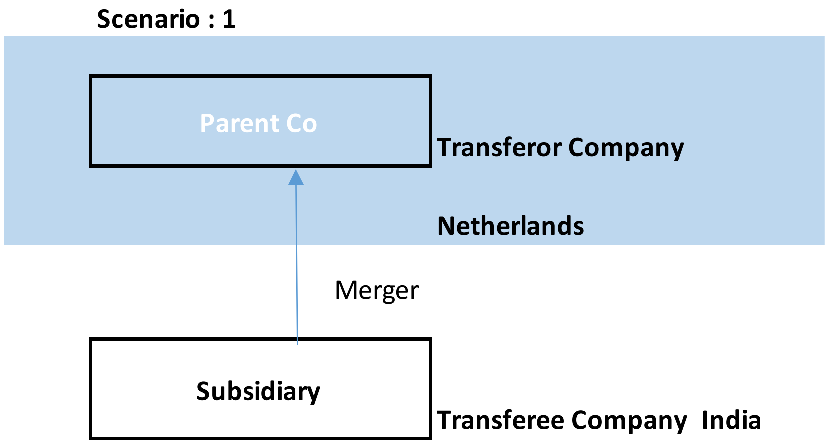


Fig. Merger of Ind Co. with Foreign Parent Co.

Issue :
a) S. 47(vi) & (vii) applies where amalgamated co. is Indian Co.
b) S. 47(via) & (vib) applies where both cos are Foreign Co's

Evaluation of Tax Implications in the hands of Subsidiary(Transferor Company) & Shareholder :-

- No specific exemption u/s 47
- Argument based on first principles (already discussed)

[No Consideration received; S. 45 will not apply]

Relevant Decisions :

- Bana Sella SpA, In re 387 ITR 358
- Hoechst Gmbh, in re, 289 ITR 358

Controversial Issues| F Co. to F Co.

Foreign Subsidiary Co. amalgamates with Foreign Parent Company

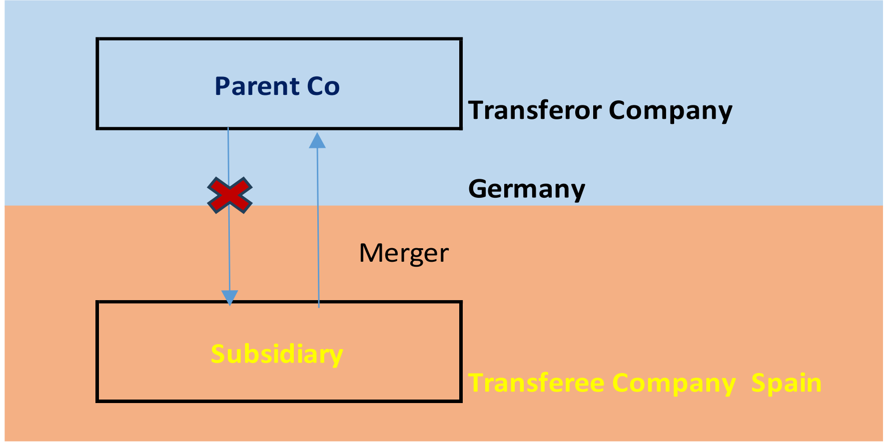


Fig. Merger of Foreign Parent Co. with Foreign Subsidiary Co.

Evaluation of Tax Implications in the hands of Subsidiary(Transferor Company) :-

- Impossibility of performance
- Non-Discrimination (Extract in Next Page)

Posers : Whether any consideration is received by Indian Subsidiary Co?

Discussed in earlier slides

or is it in satisfaction or realisation of rights as a shareholder

Relevant Decisions :

- Bana Sella SpA, In re 387 ITR 358
- Hoechst Gmbh, in re, 289 ITR 358

Controversial Issues| F Co. to F Co.

ARTICLE 24

NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances and under the same conditions are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

****

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State ***to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.***

Other Aspects

Period of Holding of Shares of Amalgamated Indian Company [49(2)]

Cost of Acquisition of Shares in respect of shares of Indian Amalgamated Co [2(42A)]

Expenditure on Scientific Research [Sec. 35(5)] – Unabsorbed Depreciation will be allowed, If Sold, till cost – PGBP, Above Cost – CG.

Amortization of Expenditure in Case of Amalgamation [Sec. 35DD] – 20% for 5 years

Treatment of Preliminary Expenses [Sec. 35D(5)]- in the same manner as it should have been allowed to the Amalgamating Company ($)

Expenditure for Obtaining a License to Operate Telecommunication Services [Sec. 35ABB(6)] $

Treatment of Capital Expenditure on Family Planning [Sec. 36(1)(ix)] $

Treatment of Bad Debts [Sec. 36(1)(vii)]

Depreciation Claim on Goodwill Acquired on Amalgamation – Amendment vide Finance Act, 2021. For other Intangibles recognised pursuant to Ind AS 103 - Controversial

Source: OECD

Quick Recap

- General
- Definition
- Taxability in the hands of Shareholder of Amalgamating Co.
- Taxability in the hands of Amalgamating Co.
- Relaxations by S. 47
- Gap
- Controversies
- Other Miscellaneous

PART B – Demerger

What is Demerger?

Demerger

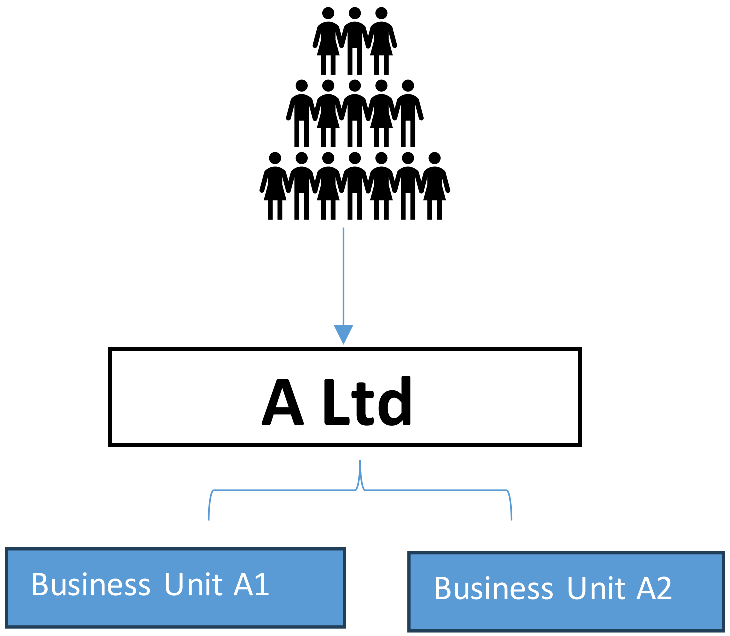


Fig. Before Demerger

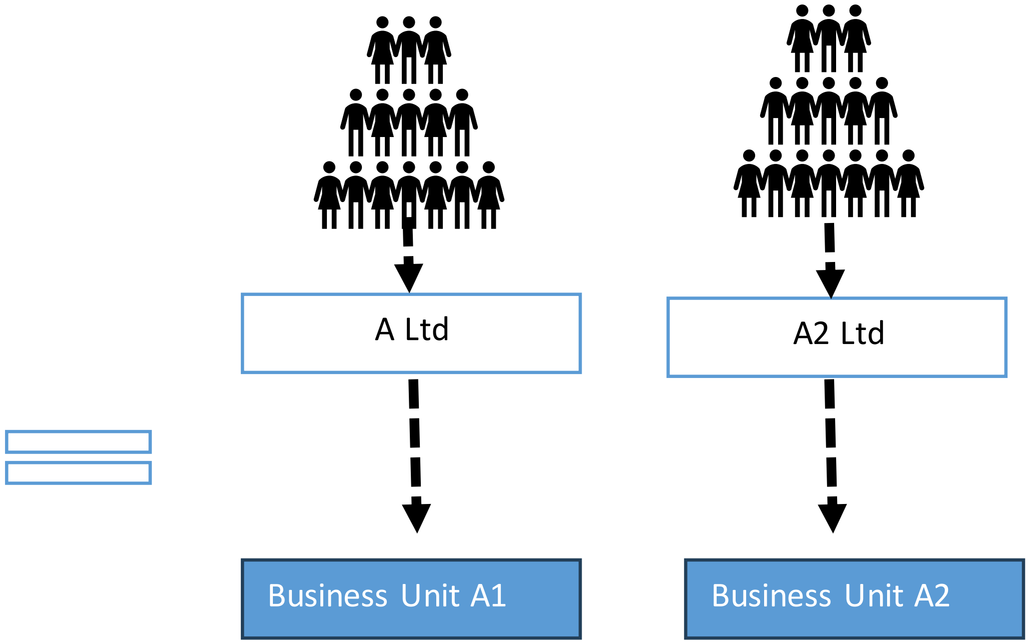


Fig. After Demerger

Why Demerger?	Entity B has approached Entity A for Business Unit A1. They have approached you for suggesting options available to them

Demerger – Income-tax Perspective

2(19AA) Demerger

"demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 391 to 394[9] of the Companies Act, 1956 (1 of 1956), 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; **[EXAMPLE OF PHARMA CO- FORMULATIONS & CONTRACT MANUFACTURING]**

(*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: **[REVALUATION TO BE IGNORED]**

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 72A by the Central Government in this behalf.

2(19AA) – Demerger| Key Terms

A) "undertaking" shall include :

any part of an undertaking, or

a unit or division of an undertaking or

a business activity taken as a whole, ***<u>but does not include individual assets or liabilities or any combination thereof not constituting a business activity</u>***

B) The liabilities referred to in sub-clause (ii), shall include—

(a) the liabilities which arise out of ***the activities or operations of the undertaking****;*

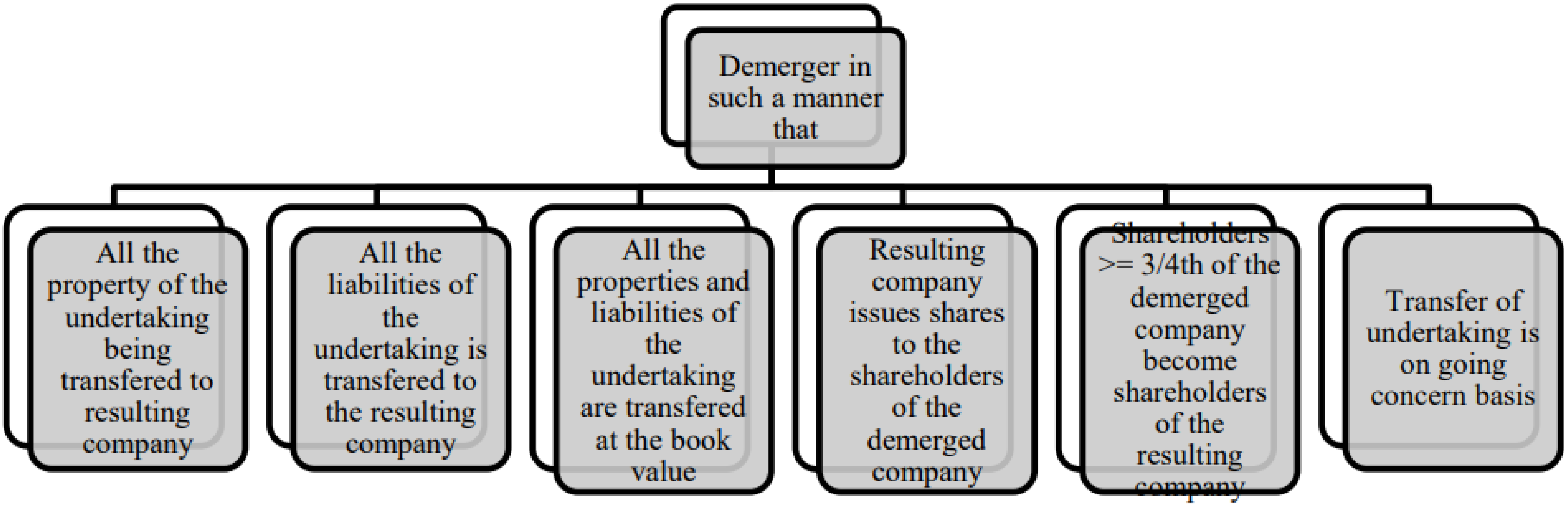
(b) the ***specific loans or borrowings (including debentures)*** *raised, incurred and utilised solely for the activities or operations of the undertaking; and*

(c) in cases, other than those referred to in clause (a) or clause (b), so much of the ***amounts of general or multipurpose borrowings, i****f 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.*

2(19AA) – Demerger| Key Terms

"resulting company" means one or more companies (including a wholly owned subsidiary thereof) ***to which the undertaking of the demerged company is transferred in a demerger*** and, the resulting company in consideration of such transfer of undertaking, ***issues shares to the shareholders of the demerged company*** and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.

2(19AA) Demerger



Transactions not regarded as “Transfer” by virtue of S. 47- Demerger

S. 47(vib)- Demerged Entity , where resultant company is Indian Company

S. 47(vid)- To the shareholders of Demerged Entity , where resultant company is Indian Company

S. 47(vic)- Demerged Co.(F Co. to F Co.) – Transfer of Ind Co shares

S. 47(vicc) – Demerged Co.(F Co. to F Co.) – Indirect transfer of Ind Co. shares

S. 47(vib) & (vid)- Amalgamation of Indian Co with Indian Co.

Section	Relief to	Extract of Section
S. 47(vib)	Demerged Co	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;**
S. 47(vic)	Shareholders of Demerged Co	**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;

S. 47(vic) & (vicc)- Demerger of Foreign Co.

Section	Extract of Section
S. 47(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 391 to 39488 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;
S. 47(vicc)	(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 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

S. 47(vi cc) Example

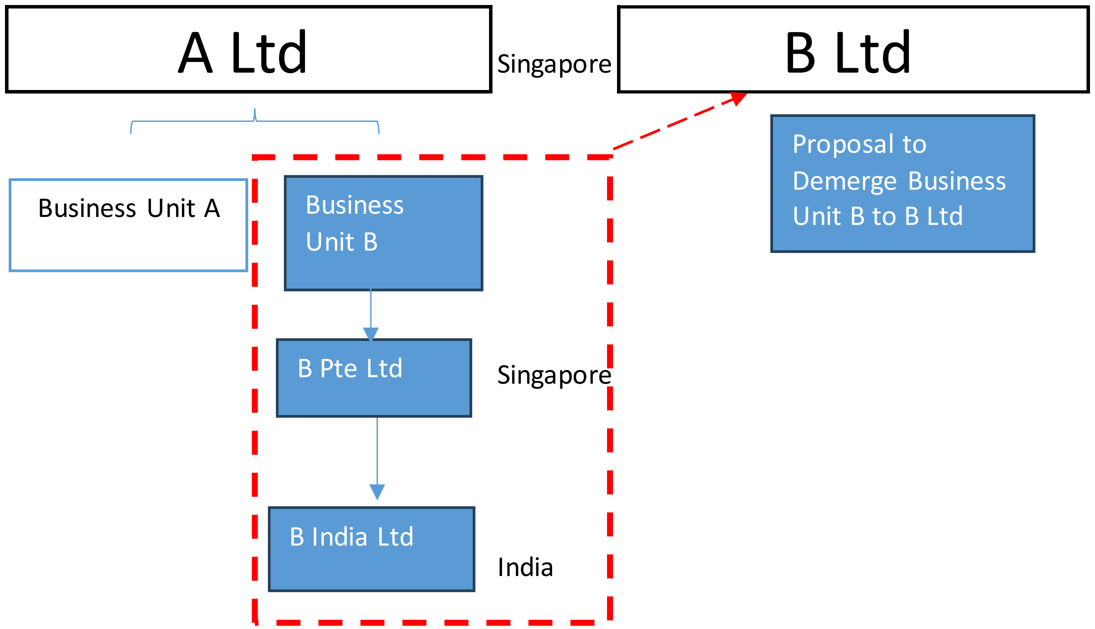


Fig : Demerger of F Co.

(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 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demergers referred to in this clause;

Discussion on S. 90- Application of Beneficial Provisions DTAA : India- Singapore DTAA - Article 13(5)

Case Study – 47(vi cc)| Extract of Article 13 India-Singapore DTAA

1. Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.

2. Gains from the **alienation of movable property forming** part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from **the alienation of ships or aircraft** operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.

[2]**[***4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.*

4B. Gains from the ***alienation of shares acquired*** *on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.*

4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.

5. Gains from the alienation of ***any property other than that referred to in paragraphs 1, 2, 3, 4A and 4B of this Article shall be taxable only in the Contracting State of which the alienator is a resident*****.]**

Controversial Issues | Reference to S. 391 to 394

Whether Fast Track Mergers/ Demergers u/s 233 Tax Neutral?

Comparative

Companies Act, 1956	Title	Companies Act, 2013	Title
Section 391	Power to compromise or make arrangements with creditors and members	Section 230	Power to compromise or make arrangements with members or creditors
Section 392	Power of High Court to enforce compromise or arrangement	Section 231	Power to enforce compromise or arrangement
Section 393	Information as to compromises or arrangements with creditors and members	Section 232	Merger and amalgamation of companies
Section 394	Provisions for facilitating reconstruction and amalgamation of companies	Section 233A	Merger or amalgamation of certain companies
NA	NA	Section 233	Merger or amalgamation of certain companies and Limited Liability Partnerships (LLPs) through **Fast Track Merger Scheme**

Controversial Issue | Demerger Conditions Not Satisfied

In the hands of	Controversy
a) Demerged Company	Slump Sale? - Refer Decision on Next Slide
b) Shareholders of the Demerged Company	Dividend?
	Whether 56(2)(x) will trigger

Controversial Issue | Demerger Conditions Not Satisfied

With regard to other ingredient required for levy of capital gains, namely, profits or gains arising from the transfer of the undertaking, no part of consideration was indicated against different and definite items, having regard to their valuation on the date of transfer.

There was no basis for even apportioning any consideration for various assets comprised in the transfer. Since individual items of capital assets had not been transferred, the aggregate of individual assets in the form of an undertaking was a capital asset which was had been transferred.

The transfer being one of the going concern, it was not possible to ascertain the profit or gain from transfer of undertaking. ***Cost of acquisition and the cost of improvement of the undertaking could not be ascertained.***
It, therefore, became difficult to apply computation under provisions of section 48. A business undertaking ***as a going concern includes all rights, assets, contingent or definite, corporeal and incorporeal and all interests in advantage, present or future****. It also includes the management, executive employees and anything which goes as part of an organization, including the potentiality of the organization to grow. It contains a variety of elements, both tangible and intangible. It remains substantial in form and nebulous in character. A going concern is a dynamic concept characterized by perennial change influenced by socio-economic ecology. A going concern is essentially a functioning, living organism, possessing attributes of vitality, growth and evolution. Obviously, it would not be possible to conceptualize the cost of acquisition of such a going concern as well as date of acquisition thereof. If the cost of acquisition and/or the date of acquisition of the asset cannot be determined, then it cannot be brought within the purview of section 45 for levy and computation of capital gains. Looking to the nature and character of the capital asset, being the going concern, consideration realized by the assessee would be outside the purview of capital gains under section 45*

- Avaya Global Connect Ltd. v. ACIT [2008] 26 SOT 397 (Mumbai)

Other Aspects

Shares of an Indian Company which are given in consideration of Demerger [2(42A)]

Cost of Acquisition of Shares of Resulting Company [49 (2C)) – Refer Example on Next page

Expenditure on Scientific Research [Sec. 35(5)] – Unabsorbed Depreciation will be allowed, If Sold, till cost – PGBP, Above Cost – CG.

Amortization of Expenditure in Case of Demerger [Sec. 35DD] – 20% for 5 years

Treatment of Preliminary Expenses [Sec. 35D(5)]- in the same manner as it should have been allowed to the Demerged Company ($)

Expenditure for Obtaining a License to Operate Telecommunication Services [Sec. 35ABB(6)] $

Treatment of Capital Expenditure on Family Planning [Sec. 36(1)(ix)] $

Treatment of Bad Debts [Sec. 36(1)(vii)]

Depreciation Claim on Goodwill Acquired on Demerger – Amendment vide Finance Act, 2021. For other Intangibles recognised pursuant to Ind AS 103 - Controversial

Source: OECD

Cost of Acquisition of shares of Resulting Company

Parameter	Calculation	Amount (Rs.)
Assets transferred (Company B)	Rs. 1,00,00,000	Rs. 1,00,00,000
Net worth of demerged company (Company A)	Rs. 5,00,00,000	Rs. 5,00,00,000
Proportion of assets transferred	Assets transferred / Net worth of Company A	20%
Cost of shares in Company A held by investor	Rs. 50,000	Rs. 50,000
Cost of acquisition of shares in Company B	Proportion * Cost of shares in Company A	Rs. 10,000

ITC
DEMERGER
EXAMPLE

Source: OECD

Set off & Carry Forward of Loss

S. 72A Carry Forward of Loss | Amalgamation

72A. (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

***

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:

"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 system

S. 72A Carry Forward of Loss | Conditions

- **Consequences of Non Compliance:**

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.***

Condition	Description
Amalgamating Company's Conditions	Must have been engaged in the business with losses occurred or depreciation remain unabsorbed for 3+ years.
	Must continuously hold 3/4 of the book value of fixed assets 2 years prior to amalgamation.
Amalgamated Company's Conditions	Must hold 3/4 of the book value of fixed assets acquired from the amalgamating company for 5 years.
	Must continue the business of the amalgamating company for 5 years.
	Must achieve 50% of the installed capacity of the industrial undertaking of the amalgamating company within 4 years from the date of amalgamation and maintain this level of production for 5 years. Amalgamated company may apply to the Central Government for relaxation of conditions based on genuine efforts and circumstances preventing achievement. Furnish Form 62

S. 72A Carry Forward of Loss | Demerger

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.

S. 79 Carry forward & Set off in certain cases | Foreign Co

Section 79 of the Income Tax Act (ITA) addresses the requirement of beneficial ownership for claiming loss carry-forward and set-off.

Shareholder Requirement: It mandates that 51% beneficial ownership of voting power is required for loss carry-forward and set-off during the assessment year.

Exemptions: Amalgamation/ Demerger of Foreign Company

Any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company;

Demerger vs Amalgamation

- A tech company is experiencing significant losses, and a potential buyer has approached you with an attractive offer for a buyout. You are being asked for advice on restructuring to allow the buyer to utilize these losses while minimizing potential risks.

Quick Recap

PART A - Amalgamation

- General
- Definition – Discussed definition of S. 2(1B) [asset, liability, 3/4th shareholder]
- Taxability in the hands of Shareholder of Amalgamating Co. [Transfer – 1922 Act and 1961 with SC Case laws, Consideration]
- Taxability in the hands of Amalgamating Co. [Transfer – Consideration ? Decision of Wallace Pharma]
- Relaxations by S. 47 [Amalgamated Indian Co, Foreign Co to Foreign Co Amalgamation- Non Discrimination]
- Gap/ Controversies - [I Co to F Co, Shareholder taxation of F Co. to F Co.]
- Other Miscellaneous- Period of holding, Cost of holding, Other expenditure, Claim of dep,for Intangibles on Demerger(other than goodwill)
- Set off & Carry forward of Losses – Industrial Undertaking, Conditions of Amalgamating Co/ Amalgamated Co.

PART B – Demerger

- General
- Definition
- Key terms of Definition – [Undertaking – Pharma (Formulation & Manufacturing example)
- Relaxations by S. 47 - [Resulting Indian Co, Foreign Co to Foreign Co]
- Controversial topics [Fast Track merger, Taxability of Non-Qualifying Demergers]
- Other Miscellaneous- Period of holding, Cost of holding (ITC Example), Other expenditure, Claim of dep,for Intangibles on Demerger(other than goodwill)
- Set off & Carry forward of Losses – On pro-rata basis

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Thank you!

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