Corporate Restructuring -Amalgamation & Demerger- PART II

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Quiz

- Dutch banking group _____ is planning to return to India by buying a controlling stake in the state owned lender IDBI Bank
- ING;
- UBS
- Balclays
- Wells Fargo

- Which of the airlines will be merged with Tata-Air India in 2024?
- GoFirst
- Spicejet
- Vistara;
- Indigo

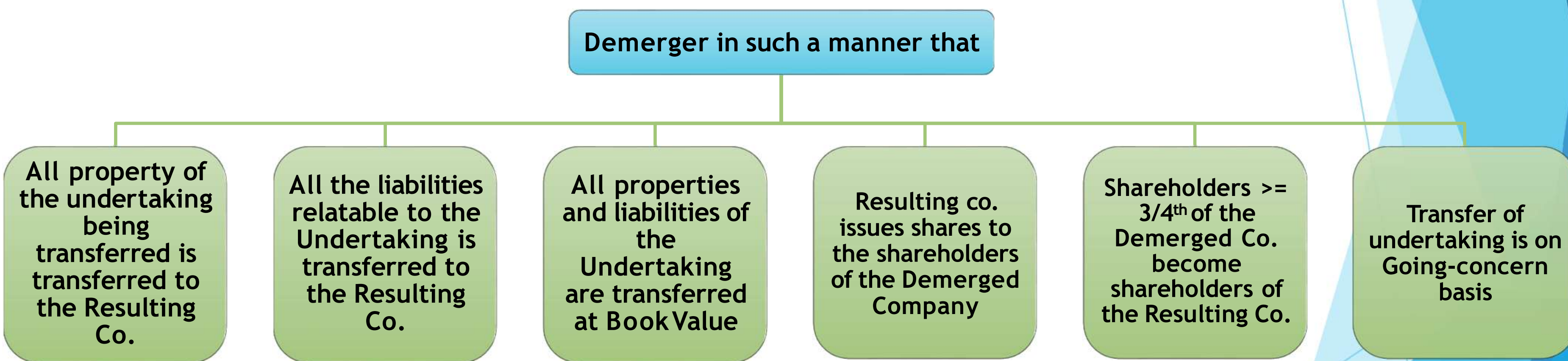
- Which of the following acquired Oziva and Wellbeing nutrition in December 2022?
- HUL;
- Britannia
- ITC
- P&G

- With which bank have Dena Bank and Vijaya Bank merged?
- Corporation Bank
- Bank of Baroda;
- PNB
- United Bank of India

Tax Implications on Demergers

Definition of Demerger (1/2)

- As per Section 2(19AA) of the Income Tax Act, 1961 "demerger", in relation to **companies**, means the transfer by a demerged company of its one or more undertakings to any resulting company



- ***Demerged Co. [Sec. 2(19AAA)]-*** *company whose undertaking is transferred, pursuant to a demerger, to a resulting company*
- ***Resulting Co. [Sec. 2(41A)]-*** *company (including a WoS) to which the undertaking of the Demerged Co. is transferred in a demerger and, the Resulting Co. in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company*

Definition of Demerger (2/2)

Points to note-

- The definition is only applicable in case of de-merger of **companies;**
- Revaluation, if any, of the properties and liabilities being transferred, **shall be ignored;**
- Shares to be allotted to the shareholders of the Demerged Co., must be **on proportional basis;**
- W.r.t. the shareholding condition- Shares already held by the Resulting Co. or its nominees, in the Demerged Co. **shall not be included;**
- The shares allotted to shareholders of Demerged Co. is **not** subject to any lock-in;
  - A share-swap agreement either pursuant to the Scheme, or otherwise is a common transaction;
- It is not mandatory that the shareholders of Demerged Co. constitute the same % of holding in the Resulting Co.
  - For eg: if shareholders holding 80% in Demerged Co. become shareholders of Resulting Co.- it is not mandatory that they constitute 80% in Resulting Co. also.
- Conditions u/s 2(19AA) are only to ascertain tax neutrality
  - non-compliance of the same does not in any manner result in the arrangement not being regarded as a 'demerger' under Cos. Act.

Meaning of “Undertaking” (1/2)

- **Explanation 1- Meaning of “Undertaking”-** It includes
  - 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.

- **Key Considerations**
  - Can assets and liabilities be cherry picked?
  - What does “going-concern” mean?
  - What is business activity?

Meaning of "Undertaking" (2/2)

Cherry-picking of Assets & Liabilities

- The Hon'ble Delhi High Court *vide* its judgement in *Indo Rama Textile Ltd* [Co. Petition No. 4 of 2003, Co. Appl. No 762 of 2009, July 23, 2012], held that-

  "in a demerger, transfer of all common assets and/or liabilities relatable to undertaking being demerged is not required ***so long as the assets and liabilities transferred, by themselves, constitutes a running business and the business can be carried on uninterruptedly with such assets and liabilities alone****"*

- The Delhi High Court further held that-
  - To ensure that the undertaking has been transferred as a going concern or not, while sanctioning a scheme of arrangement, **the Court can examine whether essential and integral assets like plant, machinery and manpower without which it would not be able to run as an independent unit have been transferred to the resulting company**

Meaning of “Liabilities”

- **Explanation 2- Meaning of Liabilities-** it shall include-
  - the liabilities which arise out of the activities or operations of the undertaking (**identifiable to an Undertaking)**
  - the specific loans or borrowings (including debentures)- w.r.t. the Undertaking
  - **Other than above, general liabilities & borrowings in the same proportion to assets being transferred.**

Taxation in Demerger - Key Aspects

- Tax Neutrality- No capital gain implications for the company [sec 47 (vib)] or shareholders and 47 (vic and vid)]
- Cost of acquisition of the shares of demerged co, for shareholders proportionate to the net book values [49 (2C)/(2D)]
- Carry forward of losses and accumulated depreciation [sec 72A (4) and (5)]
- Demerger Expenses [35DD] and Bad Debts
- Apportionment of Depreciation [sec 32(1); 43 (1); 43 (6)]
- Other Aspects
- Important Case Laws

Tax Neutrality in case of Demerger (1/2)

Transfer of any capital asset is subject to capital gains tax in India; However, de-merger enjoys tax-neutrality with respect to tax on transfer.

Tax neutrality u/s 47 for Demerged Co. and Resulting Co.

- (vib) if the Resulting Co. is an Indian Co.
- (vic) shares in an Indian Co. by a foreign Demerged Co. to a foreign Resulting Co, such that
  - (a) At least 25% of Foreign DC become shareholders of foreign RC
  - (b) such transfer does not attract tax on capital gains in the country, in which the RC is incorporated
- (vicc) transfer by demerger of a foreign DC (which derives its value substantially from shares of an Indian Co.) to a foreign RC such that
  - (a) At least 25% of Foreign DC become shareholders of foreign RC
  - (b) such transfer does not attract tax on capital gains in the country, in which the RC is incorporated

Tax Neutrality in case of Demerger (2/2)

Taxability in the hands of shareholder – Sec 47 (vid)

- any transfer or issue of shares by RC, to the shareholders of the DC if the transfer or issue is made in consideration of demerger of the undertaking
- In case of a demerger, the existing shareholders of the DC will hold:
  - (a) Shares in the resulting Co.; and
  - (b) Shares in the demerged co.

- **Cost of acquisition will be computed as under-**

  By virtue of Section 49(2D) the COA of shares in the Demerged Company shall be:

  - COA of original shares in the demerged company

    Less: COA of shares in the resulting company as calculated in section 49(2C)

- Cost u/s 49 (2C)=

  CoA f the shares held, in the same proportion as the

  Net Book Value : Net Worth of the DC

Carry Forward of Losses and Unabsorbed Depreciation- Sec 72 (A)(4)

- **Losses and unabsorbed depreciation of the Demerged Co, shall be carried forward-**
  - **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
  - **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

Apportionment of Depreciation

For apportionment of depreciation b/w the Demerged Co. and Resulting Co., following steps should be followed [proviso to S. 32(5)]

- Assume that there has been no demerger; and compute depreciation for the Demerged Co.
- Once computed, the depreciation amount shall be:
  - Apportioned b/w the Demerged Co. and Resulting Co.
  - In the ratio of the number of days for which the assets were used by them

Demerger Expenses and Bad Debts

Amortisation of demerger expenses [sec. 35DD]

- Where an **Indian Co.;**
- Incurs any expenditure **wholly or exclusively for the purpose of amalgamation;**
- Deduction = 1/5th of such expenditure
  - For each of the 5 successive years
  - Beginning in the prev. year in which amalgamation was done
- Shall be given to the Resulting Co.
- If any proportion of such expense has been considered by the Demerged Co.; the Resulting Co. shall amortize the remaining portion only.

Treatment of Bad-debts [sec. 36 (1) (vii)

- Where the debts of the Demerged Co. transferred to the Resulting Co. becomes bad;
- Such bad debts will be allowed as a deduction to the Resulting Co.

[CIT v. T. Veerabhadra Rao, K. Koteswara Roa & Co. (1985) 155 ITR 152 (SC)]

Demerger with Nil Consideration

ITAT, **Mumbai in Aditya Birla Telecom Limited** {TS-608-ITAT-2016} Mum ITAT

- held that no capital gain tax to be levied in absence of consideration received/ accrued to the taxpayer for transfer of undertaking under a scheme of demerger.
- The Tribunal observed that, in absence of nexus between transfer of the undertaking and the revaluation of investment, the same can neither be considered as arising on account of such demerger nor considered as the full value of consideration.

The ITAT held:

- Since no consideration accrues or is received by the assessee, no capital gains would arise in the hands of the assessee;
- Business Restructuring Reserve created in the books of the assessee was merely an accounting entry passed on account of revaluation of its investment and could not be deemed value of sale consideration for calculating capital gain;
- Wherever considered appropriate, the legislature has inserted specific provisions for determination of sale consideration for transfer of assets in specified cases

Other Aspects

- By virtue of Section 2(22)(v) there will be no dividend in the hands of shareholders on distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company.
- By virtue of amendment in section 2(42A), for calculating the period for which the shares are received upon demerger are held, the period for which shares were held in the demerged company shall also be considered.
- The Resulting Company must record the cost of assets transferred pursuant to the demerger, as equal to the cost that would have been recorded in the books of the Demerged Co., i.e. **the actual cost:**
  - **However, exception made for companies which have adopted IndAS**

Applicability of GAAR on a merger / demerger

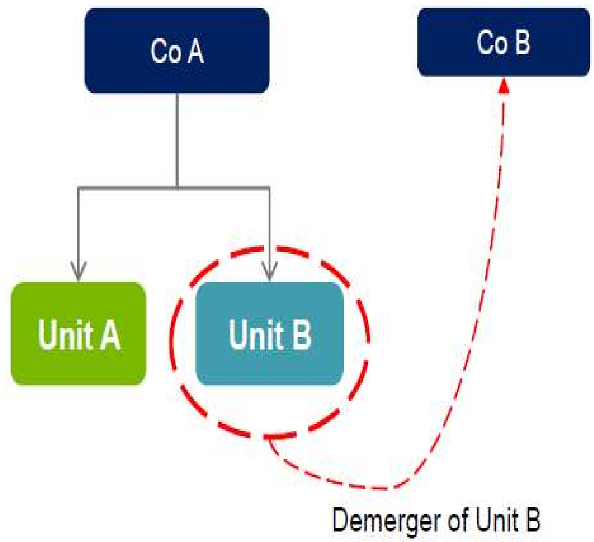
- General Anti Avoidance Rules ('GAAR') introduced w.e.f. 1 April 2017 is a tool for checking aggressive tax planning, especially transactions or business arrangements, which are entered into with the object of avoiding taxes. GAAR provisions come into effect if the revenue authorities are able toestablish that the main purpose of the arrangement is to obtain a tax benefit. **GAAR provisions grant wide powers to the revenue authorities inter-alia to disregard or even recharacterize the transactions. Invocation of GAAR may lead to wide ramifications including denial of treaty benefits.**A plausible issue is on applicability of GAAR provisions to a transaction of merger / demerger.
- CBDT in a circular [71] has indicated that where NCLT has explicitly and adequately considered the tax implications while sanctioning the arrangement, then GAAR provisions will not apply to such arrangement.
- However, it may be noted that GAAR provisions have recently been implemented and there are no judicial precedents or explanatory guidelines to infer meaning of the term 'explicitly' and 'adequately'. There may be practical challenges on when it can be regarded that NCLT has explicitly and adequately considered the tax implications while sanctioning the arrangement. In absence of clarity on the issue it is important to review judicial developments on the subject when matter is being evaluated.

Facts:

- Net worth of Unit B on the Appointed date is negative
- No consideration issued by Co B to either Co A or the shareholders of Co A

Issues:

- Whether the said transfer qualifies as a “demerger” u/s 2(19AA)?
- If not, can the said transfer be considered as Slump sale?
- Whether the said transfer is taxable in the hands of Co A?



Case Studies

Case Study-1-Demerger

Larsen & Toubro Limited

L&T was established in 1942. Within a span of fifty years L&T became a leading manufacturer and engineer in turnkey projects having diversified activities in electrical and electronics; construction projects; cement manufacturing; medical equipment; shipping; earthmoving equipment; heavy engineering and information technology. From the year 2000, the company was planning to restructure some of its business divisions through demerger and consolidation in order to concentrate more on infrastructure and turnkey businesses.

Why Demerger

Grasim Industries Ltd. (GIL) a flagship company of Aditya Birla Group was trying to take over control in L&T management by purchasing shares of L&T from the open market. The company first acquired 15 percent stake in L&T and also made an open offer to L&T shareholders to increase its stake which does not succeed.

In the year 2004, shareholders approved the demerger of L&T's cement division with a resulting entity named UltraTech CemCo Ltd. (UCL).

Case Study-1-Demerger

- It was decided that in the first phase L&T would spin off the cement business into a new company, UltraTech CemCo Ltd. (UCL), where L&T would hold 20 percent and the balance of 80 percent would be held by existing shareholders of L&T.

- In the second phase, GIL would buy 8.5 percent of UCL from L&T @ ` 342.60 per share and make an open offer to other shareholders of another 30 percent at the same price. It would take GIL's stake to 51 percent in UCL, if this offer was fully subscribed, and on the sale of its stake in UCL, L&T would realize ` 3.62 billion.

- In the third phase, L&T Employee Welfare Foundation would acquire the GILs 15.3 percent stake in the residual engineering company. Hence, after the demerger, GIL gave an open offer to UCL shareholders and purchased the shares to cover a 51 percent hold in UCL. Immediately after the acquisition, GIL finally changed the name from UltraTech CemCo Ltd. to UltraTech Cement Ltd.

As per the demerger ratio, for every 2 shares (of face value ` 10) held in L&T, the shareholder was given 1 share (face value ` 2) in the New L&T.

At the same time for every 5 shares held in L&T, the shareholder was given 2 shares in the demerged cement company – Ultra Tech CemCo.

Case Study-1-Demerger

Benefits of Demerger to L&T

— Lead to immediate realization of value from cement business;

— Create two distinct listed entities for (a) engineering and (b) cement;

— Enable L&T to become focussed Engineering, Construction and Technology Company

Benefits of Demerger to Grasim

— Economies of scale and overall competitiveness

— Multi-functional synergies in the areas of procurement, marketing, logistics and cost reductions

— Combined resource pool

— Cross leverage financial strengths to access domestic and international markets

— Increased Capacity.

Case Study-2-Merger

MERGER OF ICICI WITH ICICI BANK

ICICI Limited

- ICICI Limited was basically a Development Financial Institution providing medium-term or long-term project finance to industries in India. It was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian industry. Initially it focused on project finance, and providing long-term funds to a variety of industrial projects. Subsequently, it diversified into venture capital financing, commercial banking asset management and management of mutual funds brokering and marketing, internet stock trading, housing finance etc.

ICICI Bank

- ICICI Bank was originally promoted in 1994 by ICICI Limited, an Indian financial institution, and was its wholly-owned subsidiary. ICICI's shareholding in ICICI Bank was reduced to 46% through a public offering of shares in India in fiscal 1998, and an equity offering in the form of ADRs listed on the NYSE in fiscal 2000,

RBI Announcement

- The RBI announced in April, 2001 that it would consider proposals from Development Financial Institutions wishing to transform themselves into banks.

Case Study-2-Merger

- After consideration of various corporate structuring alternatives in the context of the emerging competitive scenario in the Indian banking industry, and the move towards universal banking, the managements of ICICI and ICICI Bank formed the view that the merger of ICICI with ICICI Bank would be the optimal strategic alternative for both entities, and would create the optimal legal structure for the ICICI group's universal banking strategy.
- The merger would enhance value for ICICI shareholders through the merged entity's access to low-cost deposits, greater opportunities for earning fee-based income and the ability to participate in the payments system and provide transaction-banking services.
- The merger would enhance value for ICICI Bank shareholders through a large capital base and scale of operations, seamless access to ICICI's strong corporate relationships built up over five decades, entry into new business segments, higher market share in various business segments, particularly fee-based services, and access to the vast talent pool of ICICI and its subsidiaries

Case Study-2-Merger

- In October 2001, the Board of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly-owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank.

- The merger was approved by shareholders of ICICI and ICICI Bank in January 2002, by the High Court of Gujarat at Ahmedabad in March 2002, and by the High Court of Judicature at Mumbai and the Reserve Bank of India in April 2002.

- Consequent to the merger, the ICICI group's financing and banking operations, both wholesale and retail, have been integrated in a single entity.

Case Studies

Acquirer	Target Company	Deal Size	Comments
Flipkart	Myntra	USD300mn	Acquisition led to scripting of largest ecommerce stories
Asian Paints	Ess Ess bathroom products	undisclosed	to be onestop provider in home décor space
RIL	Network 18 Media & Investments	Rs4000cr	78% percent shares were taken over by RIL
Merck	Sigma	USD17bn	Acquisition to boost lab supply business of Merck
Sun Pharma	Ranbaxy	USD4bn	increase presence in global and domestic markets
TCS	CMC		merger to consolidate IT business
Tata Power	PT Arutmin Indonesia	Rs 47.4bn	Purchased 30% stake
Groupe Lactalis	Tirumala Milk	USD275mn	lactalis entry into India
CSP CX	Aditya Birla Minacs	USD260mn	Aditya Birla's exit from IT industry
Thomas Cook	Sterling India	Rs 870cr	Entry into hospitality business
Yahoo	Bookpad	USD15mn	First acquisition made by Yahoo
Kotak Bank	ING Vysya	USD2.4bn	All share deal
Ola cabs	Taxi for sure	USD200mn	Acquisition of competition

Tax Implications on Slump Sale

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Introduction to Slump Sale

- **Provisions**
- As per Section 2(42C) slump sale means transfer of business **undertaking** as a going concern for lump sum consideration without values being assigned to individual assets and liabilities.
- As per Section 50B transferor company is liable to short/long term capital gains (holding period 36 months)
  - – Capital gains computed by deducting 'net worth' from the sale consideration
- ***Undertaking** has same meaning as under Explanation 1 to Sec 2(19AA)*
- Computation of WDV as per sec.43 (6)

- **Whether Undertaking is a capital asset?**

  The Supreme Court in the case of *R.C. Cooper V. UOI : AIR 1970 SC 564 (610)* held that

  "the undertaking is distinct from the various assets which comprise the undertaking"

- **Undertaking must be a business activity as a whole**
- **Whether in a slump sale some of the assets could be retained by the transferor?**

  If some assets are retained by the transferor / liabilities not taken over by the transferee, the same does not militate against the concept of slump sale.

  [CIT v F.X. Periera and Sons Pvt. Ltd.: 184 ITR 461 (Ker.) ; Premier Automobiles Ltd. v. ITO: 264 ITR 193 (Mum.); ACIT v. Raka Food Products Ltd.]

Key Aspects

- Consideration is paid to the Transferor Company, not its shareholders
- Capital gains = Full value of consideration – Net worth of undertaking
  - Net worth = Aggregate value of WDV of the block of assets and book value of other assets of the undertaking – Value of liabilities of undertaking
  - Change in value of assets on revaluation be ignored for computing net worth
- If values of individual assets are considered while computing the lumpsum value, or where it is possible to attribute prices to individual assets, the transaction may not amount to slump sale – *CIT vs Artex Manufacturing*, 227 ITR 260 (SC)
- If the net worth of the undertaking is negative, the entire sale consideration is capital gain – *Zuari Industries v CIT* (2006) SOT 563 (Mum.)
- Any business loss/ accumulated depreciation stays with the transferor.
- Slump sale provisions do not provide tax treatment for the purchaser. Hence, purchaser may split the actual consideration paid for the going concern and treat the assets/liabilities accordingly as if acquired in normal course of business
  - In DE Nora India Limited vs CIT (2015) 370 ITR 391 (Del), the transferee's right to allocate values based on valuations was also upheld

Difference Demerger/Slump Sale

Particulars	Demerger	Slump Sale
NCLT Approval	Yes	No
Tax	No u/2 2(19AA)	Attracts long term or short term capital gains tax

Tax Implications on Buy Back of Shares

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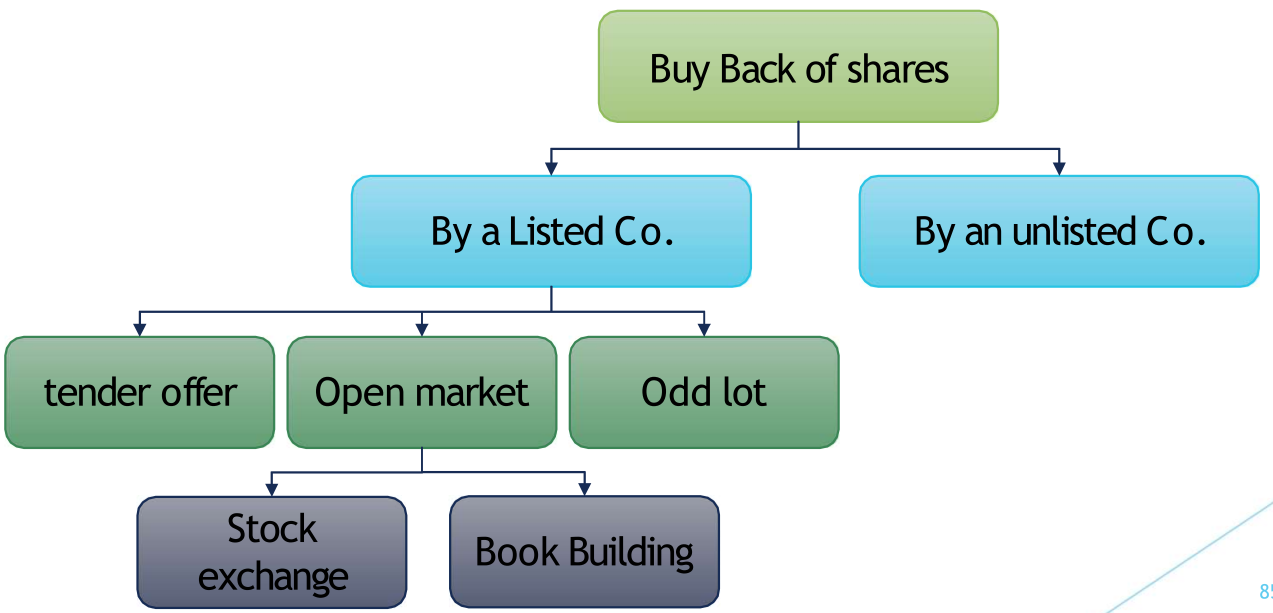
Buy Back of Shares- Introduction

Buy Back, also referred to as "**share repurchase**" is when a company buys its own shares from the shareholders, to reduce the number of shares available in the open market



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Taxation Aspects

- Finance Act, 2013 inserted sec 115QA, which provides for
  - levy of tax on buy back at an effective rate of 23.296%
    - 20% + 12% SC + 4 % H&EC
  - Sec 115QA was made applicable on domestic unlisted cos.
  - The shareholders was exempt from tax incidence in case of buy-back of shares
- **Later on, Finance Act, 2019 extended the scope of sec. 115QA included listed co. within its ambit (w.e.f. 05-07-2019)**

- The tax on distributed income (i.e. buy-back) is payable by the company even if such company is not liable/ required to pay income tax.
- As per **Section 10(34A)** of IT Act, the tax on buy-back of shares is levied at the level of company and the consequential income arising in the hands of shareholders is exempt from tax.

Taxation Aspects

Will section 56 (2) (x) be applicable on the Company ?

- 56 (2) (x) provides for "Income from Other Sources", where any person **receives** any **property**
- As per section 2 (56) (vii), "property" includes shares;
- However, **in case of buy-back, shares get extinguished**- hence, nothing is received by the co.
  - Thus, shares recd. in buy back- not a property
- **Therefore, sec. 56 (2) (x) is not applicable in case of buy back**

[See** Vora Financial Services P.Ltd.* ***[2018] 171 ITD 646 (Mum), ITAT]

Tax Implications on Other Modes of Restructuring

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Conversion of Company into LLP (1/4)

- The LLP Act permits conversion of
  - Private co. into LLP (sec 56); and
  - Unlisted public co. into LLP (sec 57)
- Subject to the following conditions-
  - There is no security interest* in its assets (at the time of application); and
  - **All** the shareholders of the co. become the partners of the LLP
- **The following companies cannot convert into LLP-**
  - Companies in Banking, finance and insurance;
  - Companies have secured loans, securities on assets;
  - Companies having ECBs;
  - Companies having FDI under approval route;
  - Companies engaged in business governed by sector specific regulators which does do not recognize LLPs

Conversion of Company into LLP (2/4)

- Conversion of Co. into LLP shall be tax neutral, subject to fulfilment of following conditions laid down u/s 47 (xiiib)-

Conditions for tax neutrality u/s 47 (xiiib)

- all A/L of the Co. become A/L of the LLP
- all shareholders of the co. become partners of LLP
  - capital contribution & profit sharing ratio in the LLP = shareholding in the Co.
- the shareholders of the co. do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the LLP
- the aggregate of the profit sharing ratio of the shareholders of the Co. in the LLP >= 50% at any time during the period of 5 yrs from the date of conversion
- the **total sales**, turnover or gross receipts in the business of the Co. **in any of the 3 prev. yrs.** preceding the prev. yr. in which the conversion takes place **=< Rs. 60 lakhs**
- the **total value of the assets** as appearing in the books of account of the company **in any of the 3 prev. yrs.** preceding the prev. yr. in which the conversion takes place **=< Rs. 5 crore**
- no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion

Conversion of Company into LLP (3/4)

Consequences if conditions u/s 47 (xiiib) are violated-

- **Transfer of Capital Assets-** the transfer of capital asset is to be done at the market rate and accordingly capital gain is to be calculated.
- **Transfer of Other Assets-** The other assets like, stock in trade, current asset etc is also transferred at the market value and the applicable taxes is to be paid.
- **Impact on shareholders-**
  - The shares in the hands of the shareholders of the private limited company will be converted as capital of the LLP;
  - The shareholder has to pay tax on the capital gain arising from such transfer.
  - The Value of capital is the consideration for the transfer of shares. The cost of share is the amount paid by such share holder at the time of purchase of shares

- In the case of *Domino Printing Services (AAR No. 1290 of 2012), the Authority for Advance Tax Rulings held that*
  - *Conversion of co. into LLP amount to transfer u/s 2 (47); and*
  - *Shareholders shall be subject to capital gains tax*
- *In another case, the ITAT Mumbai held that*
  - Conversion of a co. into a LLP results in “transfer” of capital assets and is subject to capital gains tax in India in the hands of Co.
    - unless covered by the specific exemption under the Income-tax Act

Conversion of Company into LLP (4/4)

- **Other Aspects-**
- **Carry forward of loss and unabsorbed depreciation [sec 72A (6A)]**
  - Where there has been reorganization of business whereby a Pvt. Co./ Unlisted Pub Co. is succeeded by a LLP
  - fulfilling the conditions laid down in 47 (xiiib)
  - then, 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 LLP**
  - for the purpose of the previous year in which business reorganisation was effected (fresh carry forward for 8 years)
- **Cost of acquisition & improvement [sec 49 (1) (e)]**
  - Cost of acquisition of the asset : Shall be deemed to be the cost of acquisition of company
  - Cost of Improvement : Any cost incurred on improvement of the assets by predecessor company and LLP shall be the cost of improvement.
- **Period of holding of asset**
  - As per Section 2(42A)(b), for the purpose of determining period of holding of capital asset for determining nature of capital gain, period for which the asset was held by predecessor company shall be included.

Conversion of Firm into Company (1/3)

- Conversion of a LLP/ Partnership into company is governed by sec 366 of Cos Act, 2013

Conditions for tax neutrality u/s 47 (xiii)

- **all A/L of the firm** or of the association of persons or body of individuals relating to the business **becomes the A/L of the company**
- all the partners of the firm immediately become the shareholders of the company
  - in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession
- the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
- the aggregate of the shareholding in the company of the partners of the firm >= 50% of the total voting power in the company and it continues for 5 yrs from succession
- the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme approved by SEBI

Conversion of Firm into Company(2/3)

Consequences if conditions u/s 47 (xiii) are violated-

- The Bombay High Court (HC) in *CIT v. Umicore Finance, W.P. No.510 of 2010* held that
  - As capital gains were not chargeable at the time of conversion of firm into company,
  - The same cannot be charged to income tax u/s 47A, **notwithstanding compliance u/s 47 (xiii)(d)**
- 47 (xiii) (d) lays down the 50% shareholding condition

- **Withdrawal of Exemption from tax implications [sec. 47(A)(3)]**
  - Where any of the conditions laid down 47 (xiii) are not complied with,
  - the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45
  - shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements u/s 47 (xiii), are not complied with.

Conversion of Firm into Company (3/3)

Other Aspects-

- **Carry forward of loss and unabsorbed depreciation [sec 72A (6)]**
  - Where a firm is succeeded by a company fulfilling the conditions laid down in sec 47 (xiii),
  - the accumulated loss and the unabsorbed depreciation of the predecessor firm,
  - 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

- **Cost of acquisition & improvement [sec 49 (1) (e)]**
  - Cost of acquisition of the asset : Shall be deemed to be the cost of acquisition of company
  - Cost of Improvement : Any cost incurred on improvement of the assets by predecessor company and LLP shall be the cost of improvement.

Conversion of Proprietorship into Company (1/3)

Conditions for tax neutrality u/s 47 (xiv)

- **all A/L of the proprietorship** relating to the business **becomes the A/L of the company**
- the shareholding of the sole proprietor in the company >= 50% of the total voting power in the company; and his shareholding continues to remain as such for a period of 5 yrs from succession
- the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company

Conversion of Proprietorship into Company (2/3)

Other Aspects-

- **Carry forward of loss and unabsorbed depreciation [sec 72A (6)]**
  - Where a proprietorship is succeeded by a company fulfilling the conditions laid down in sec 47 (xiv),
  - the accumulated loss and the unabsorbed depreciation of the predecessor firm,
  - 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

- **Cost of acquisition & improvement [sec 49 (1) (e)]**
  - Cost of acquisition of the asset : Shall be deemed to be the cost of acquisition of company
  - Cost of Improvement : Any cost incurred on improvement of the assets by predecessor company and LLP shall be the cost of improvement.

Conversion of Proprietorship into Company (3/3)

- **Withdrawal of Exemption from tax implications [sec. 47(A)(3)]**
  - Where any of the conditions laid down 47 (xiv) are not complied with,
  - the amount of profits or gains arising from the transfer of such capital asset or intangible asset not charged under section 45
  - shall be deemed to be the profits and gains chargeable to tax of the successor company for the previous year in which the requirements u/s 47 (xiv), are not complied with.

Thank you!!

Any Questions?

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