Direct Tax Issues in Amalgamation

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Types of Transactions

AMALGAMATION

S/H → Issue of Shares → Co. A. → Merger → Co B → S/H
Types of Transactions

DEMERGER

Co. A.  \(\rightarrow\)  S/H  \(\rightarrow\)  Co. B

U/T 1  \(\rightarrow\)  Demerger  \(\rightarrow\)  U/T 2

Issue of shares
Types of Transactions

SLUMP SALE / PURCHASE

S/H

Co. A

U/T 1

Sale consideration

U/T 2

S/H

Co. B

Sale

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**Definition**

- *Section 2(1B)* – “Amalgamation” means merger of one or more companies with another company or merger of two or more companies to form one company.

- **Consequence** –
  - Amalgamating Company loses its existence.
  - Amalgamated Company could be a new / existing company.
Amalgamation - Key Conditions

- All the Properties / Liabilities of the amalgamating Company should be transferred.

- Shareholders holding not less than 75% of the value of shares in the transferor company [other than shares which are held by, or by a nominee for, the amalgamated company or its subsidiaries] become shareholders of the amalgamated company.
Tax Implications for:

- Shareholders of the Amalgamating Company
- Amalgamating (Transferor) Company
- Amalgamated (Transferee) Company
Receipt of new shares results in **extinguishment** of right in equity shares of the Transferor Company.

*Section 47(vii)* – Extinguishment of right in equity shares not regarded as “Transfer”.

**Conditions:**
- Amalgamated Company is an Indian company
- It is in consideration of allotment of shares in Amalgamated Company.
Section 2(42A) - Period of Holding

- Include the period for which shares in Amalgamating Company were held by Shareholder [Explanation 1(i)(c)].
- Cost Indexation – available accordingly.

Section 49(2) – Cost of Acquisition

- Shall be deemed to be cost of shares in Amalgamating Company.
Section 47(vi) - Transfer of capital assets in a Scheme of Amalgamation to an Indian company - not regarded as “Transfer”. Hence, no capital gain tax in the hands of the Amalgamating Company.

Section 47(via) – transfer of a capital asset being shares held in an Indian company, by Amalgamating Foreign Company to Amalgamated Foreign Company, not regarded as transfer, if following conditions fulfilled:

- 25 % or more of the shareholders of amalgamating foreign company continue to remain shareholders of amalgamated foreign company, and
- Such transfer does not attract capital gain tax in country in which amalgamating company is incorporated.
Cost of Acquisition

- *Explanation 7 to Section 43(1)* - Actual Cost of transferred capital asset to be the same as it would have been if the amalgamating company had continued to hold the capital asset.

- *Explanation 2(b) to Section 43(6)* - Block of Assets – Actual Cost of block to be WDV as in the case of the amalgamating company for immediately preceding PY as reduced by the amount of depreciation actually allowed in PY.
Fifth *Proviso* to Section 32(1):

- The aggregate deduction of depreciation shall not exceed the depreciation as per prescribed rates.

- Such deduction shall be apportioned between Amalgamating Company / and Amalgamated Company in ratio of number of days for which assets were used by them.
Section 56(2)(viiia)

- *Section 2(24)(xv) read with Section 56(2)(viiia)* - Income to include value of shares issued at Nil consideration / lower than FMV.

- *Proviso to Section 56(2)(viiia)* - However, where such shares are issued under amalgamation scheme - not to be regarded as “Income”.
Deduction of Certain Expenditure

Amalgamated Company can claim deduction in respect of expenditure on:

- Scientific Research - *Section 35(5)*
- Acquisition of Patent Rights / Copyrights - *Section 35A(6)*
- Know-How - *Section 35AB(3)*
- For obtaining license to operate telecommunications services - *Section 35ABB(6)*
- Amortisation of certain preliminary expenses - *Section 35D(5)*
- Amortisation (in 5 equal installments) of expenditure incurred for the Amalgamation - *Section 35DD*
- Amortisation of expenditure under VRS - *Section 35DDA(2),(5)*
- Prospecting for certain minerals - *Section 35E(7)*

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Amalgamated Company eligible for unexpired period of Tax Holidays as per following provisions:

- Newly established undertaking in FTZ – *Section 10A(7A)*
- Newly established undertaking in SEZ – *Section 10AA(5)*
- Newly established 100% Export Oriented Undertakings - *Section 10B(7A)*
Profit Linked Benefits

Amalgamated Company eligible for following deduction provided Amalgamating Company and Amalgamated Company Indian Company:

- Deduction in respect of profits and gains by an undertaking or enterprise engaged in SEZ - *Section 80IAB(3)*
- Deduction in respect of profits and gains from certain industrial undertaking other than Infrastructure Development undertaking - *Section 80IB(13)*
- Special provisions in respect of certain undertakings or enterprises in certain special category states - *Section 80IAC(7)*
- Special provisions in respect of certain undertakings in North Eastern States - *Section 80IE(6)*
Applicability

- A company owning industrial undertaking or ship or hotel,
- Banking company, and
- Public sector company engaged in the business of operation of aircraft.

Accumulated loss and unabsorbed depreciation of Amalgamating Company deemed to be loss / unabsorbed depreciation of Amalgamated Company for PY in which amalgamation effected.
Section 72A(2) - Claim of Accumulated Losses and Unabsorbed Depreciation - Conditions

- For Amalgamating Company
  - has been engaged in the business for three or more years;
  - has held continuously for two years prior to the date of amalgamation at least three-fourths of the book value of fixed assets.

- For Amalgamated Company
  - continues the same business for a minimum period of five years from the date of amalgamation;
  - holds continuously for a period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets acquired;
  - other conditions – Rule 9C.
Other Conditions - Rule 9C

- Company owning industrial undertaking to achieve at least 50% level of production of the installed capacity before end of 4 years from the date of amalgamation and continue to maintain the said level till the end of 5 years from date of amalgamation:
  - Central Government may relax this condition in suitable cases.

- Company to furnish to AO - certificate in Form No.62, duly verified by an accountant from the year of achieving 50% level of production upto completion of 5 years from amalgamation.
  - This Certificate is not required to be attached with the Return of Income – Rule 12(2).
Section 72A (3) - Implication of violation of conditions

- The set off of loss or allowance of depreciation made in any PY in hands of Amalgamated Company deemed to be income of Amalgamated Company.

- Such deemed income chargeable in year in which conditions not complied with.
Typical Issues
Consideration for Amalgamation

- Whether issue of bonds / debentures alongwith shares conforms with the definition of “Amalgamation”?

- Gautam Sarabhai Trust (173 ITR 216) (Guj)
Nature of Shareholding

- Shares held in the Amalgamating Company otherwise than as “capital assets”:
  - Whether benefits of Section 47(vi) and other provisions of the Act available to the Amalgamating Company / Shareholders of the Amalgamating Company?
Section 47(via) of the Act recognizes such mergers for exemption from capital gains, subject to certain conditions being fulfilled.

Should such foreign companies comply with definition in Section 2(1B) of the Act?
Amalgamation – 100% subsidiary

- Merger of company held fully by another company / its nominees with that (holding) company – whether conditions of Section 2(1B) satisfied?
  - Credit Suisse (International) Holding AG (349 ITR 161) (AAR)
How will the Return of Income be filed where Appointed Date does not coincide with the FY end (i.e. March 31)?

- Upon Scheme becoming effective, Transferee Company is vested with all income, assets, etc. of the Transferor from the Appointed Date (Marshall Sons & Co. India Ltd. v/s ITO (89 Taxman 619 - SC).
- Therefore, Transferee Company to file return of income for period even prior to Effective Date in respect of income of Transferor.
- The assessment of such return will be in the hands of the Transferee Company.
Indexation

Whether the indexation benefit will be available from the date of acquisition of shares in amalgamating company or date of acquisition of shares in amalgamated company?

- The period of holding of shares acquired in amalgamation includes period of holding of shares in Amalgamating Company [Section 2(42A)].
- Therefore, cost indexation at the time of sale of shares of Amalgamated Company would be computed, considering such period.
- Kotak Mahindra Bank Ltd. Vs. ACIT (2009 TIOL 383 – ITAT – Mum)
- Manjula Shah (318 ITR 417)(Mum SB)
Whether carry forward and set off of unabsorbed book losses / book depreciation of amalgamating company available for adjustment against book profits of amalgamated company for MAT purpose?

- VST Tillers & Tractors (2009 TIOL 26) (Bang. ITAT)
Whether in respect of the tax paid on deemed income u/s.115JA / 115JB by the amalgamating company, credit can be claimed by the amalgamated company?

- SKOL Breweries – (2008 TIOL 741) (Mumbai ITAT)
Section 72A applies inter alia to a company owning “industrial undertaking”?  
- Is this term defined in the Act?  
- Can the scope be expanded to include service industry?  
- Apollo Hospitals Enterprises Ltd. (300 ITR 167) (Mad) and other decisions.
These provisions suggest non availability of the benefits in case of transfers of enterprise/undertaking in an amalgamation after 1.4.2007.

- Is “sun set” of the benefits intended?
Goodwill on Amalgamation – Depreciation

Will the Goodwill arising on Amalgamation be eligible for depreciation?

- *Section 32(1)(ii)* defines intangible assets as “know how, patents, copyrights, trademarks, licenses, franchises or any other business or commercial rights of similar nature”.

- Goodwill on amalgamation, whether or not already recognised by Amalgamating Company, should be of any specific category of intangibles or “any other business or commercial rights of similar nature”.

- Judicial pronouncements have held various business rights/ advantages as “any other business or commercial rights of similar nature”
Goodwill on Amalgamation – Depreciation (Contd.)

- Skyline Caterers P. Ltd v ITO (20 SOT 266) (Mum ITAT)
- B. Ravindran Pillai (237 ITR 80) (Ker.)
- Borkar Packaging (Panaji ITAT)
- R. G. Keswani (116 ITD 133 Mumbai ITAT)
- A. P. Paper Mills (128 TTJ) (Hyd)
- Hindustan Coca-Cola (331 ITR 192) (Del)
- Smifs Securities (348 ITR 302)(SC)
Goodwill on Amalgamation – Depreciation (Contd.)

- Goodwill acquired by amalgamating company and recognised by amalgamated company could involve such business or commercial rights.

- Goodwill arising upon amalgamation - whether involves business or commercial rights?
Accumulated business loss and unabsorbed depreciation of the Amalgamating Company deemed to be loss/depreciation allowance of the Amalgamated Company.

- Is the period exhausted by the Amalgamating Company to be considered for computing the period available for claim by the Amalgamated Company?
- Supreme Industries Ltd. (17 SOT 476)(Mum)(2007)
**Section 72A vis-a-vis Section 79**

**Whether Section 72A will override Section 79?**

- *Section 79* – Non obstante clause – overriding other provisions of the Act.
- Proviso of *Section 79* – shall not apply in a situation where private company / company in which public are not substantially interested merges into another company.
- *Section 72A* specifically deals with amalgamations.
- Objective of enacting *Section 72A*. 
Amalgamation – Tax avoidance scheme

- Whether Amalgamation could be considered a design to avoid capital gains tax?
  - Wood Polymer Limited and Bengal Hotels Pvt. Ltd. (109 ITR 177) (Guj)
  - Star Television Entertainment Ltd. (321 ITR 1) (AAR)
Amalgamation – Sanction under SICA

- Scheme sanctioned by BIFR under SICA –
  - Whether SICA to have overriding effect with respect to Income Tax Act?
  - JK Corporation Ltd. (331 ITR 303) (Cal)
Reverse Merger

- A loss making company merges with a profit making company or a company with higher networth merges with a company with lower networth.
- Also used where a company has potential to improve and needs larger entity (including public listed company) with substantial means of finance.
- Conditions of Section 2(1B) to be complied with.
- Losses of Amalgamated Company will be adjusted against profits of Amalgamating Company.
- Other deductions / benefits protected.
Amalgamation – DTC

- Important provisions in the Direct Tax Code
Thank You