

Business Re-organisation

Presentation before
Chartered Accountants Association, Ahmedabad

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Meaning of BR

- Altering the organizational structure of an entity;
- Business reorganization or restructuring means fundamental and substantial modifications to the debt, operations or structure of the business. Reorganisation or restructuring is resorted to for rapid growth or solving financial or operational problems of significant nature. Through reorganisation or restructuring, various objects of ultimate growth or revival is achieved.

Why BR

- Growth
- Survival
- Competitive Position
- Core Competence
- Economies of Scale

Contd...

- Fund Raising
- Cash
- Tax Planning & Reducing Costs
- Takeovers
- Diversification
- Family Arrangements

Types of BR

- Conversion of proprietary business into partnership firm;
- Conversion of proprietary business into a limited company;
- Conversion of partnership business into a limited company;
- Conversion of closely held company into a Limited Liability Partnership;
- Amalgamation of companies; and
- Demerger or halving of a division from an existing company.

Conversion of Proprietary business into Partnership Firm

- Prior to 01/04/1988 - Sunil Siddharthbhai V. CIT (156 ITR 509). Now S 45(3).
- Transfer of Assets from Proprietor to Firm
- S. 45(3) – consideration equals to amount recorded in the books of the Firm
- Same cannot be taken at market value (S. 52 since deleted) In any case, K. P. Varghese v. ITO (131 ITR 597).

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- Gift Tax abolished so no Deemed gift either.
- Issues:
 - Precautions as to value of assets between the block and book
 - Intangible assets
 - Stock in Trade (189 ITR 285 (SC) vs. 250 ITR 871 (SC))

Conversion of Proprietary business into limited company

- Provisions of Section 47(xiv) of the Act:
 - Transfer of all the assets and liabilities
 - Shareholding of the sole proprietor must not fall below 50%
 - Consideration has to be only in the form of issue of shares

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- 47A(3) – Breach of any of the conditions would make the whole gain chargeable to tax as income for the year of breach in the hands of the successor company .

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- S. 72A(4)/(5) - transferee limited company can carry forward accumulated loss or unabsorbed depreciation of the transferor proprietary concern and more importantly transferee limited company gets extension in so far as right to carry forward loss and depreciation are concerned.
- Breach would make the transferee company liable to pay taxes in the year of breach.

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- Transfer of assets at the book price to limited company – Consequences
- S. 50B
 - Capital gains on slump sale – Net worth is the const of acquisition.
 - If undertaking is owned and held for more than 36 months, long term capital gains would be levied. No benefit of indexation.

Conversion of Partnership Business into Limited Company

- Provision of Section 47(xiii) of the Act are broadly same as S.47(xiv) of the Act. However, there are certain issues which need consideration:
 - That all the partners of the firm immediately before the succession must become shareholders of the company; and

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- That the same should happen in the same proportion in which their capital accounts stood in the books of the firm on the date of succession.
- The requirement here is that aggregate of the shareholding in the company of the partners to be not less than 50% of the total voting power of the company.

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- Exemption under section 47(xiii) and (xiv) of the Act is from the obligation to pay capital gains tax under Section 45 of the Act. There is no exemption as regards levy of tax on the business income, if any, which might be earned on transfer of a business.

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- Right to claim depreciation
- Explanation (7) to Section 43(1) of the Act
- Fourth proviso to Section 32(i) of the Act
- Chitra Publicity (127 TTJ 1)(Ahd)(TM)

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- Conversion under Part IX of the Companies Act:
 - Part IX consists of sections 565 to 581 of the Companies Act;
 - By virtue of section 579, sub-section (4) a Partnership firm registered under the Partnership Act, having seven or more partners, is a JSC and it can register as a Limited company, governed by the Companies Act under Part IX of the Companies Act.

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- Deed of Settlement for the purpose of section 579 of the Companies Act includes any instrument constituting or regulating the companies, it may even be a partnership deed.
- No need for Deed of Conveyance transferring the properties of the erstwhile Firm in favour of the newly registered company.
- No occasion for applicability of Indian Stamp Act or Bombay Stamp Act.

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- S. 3 of the Bombay Stamp Act, 1958 which states that subject to the provisions of Act and the exemptions contained in Schedule-1, instrument listed in the section shall be chargeable with duty of the amount indicated in schedule-1. The term “instrument” is defined by S. 2(1) of the said Act. Since there is no instrument, no stamp duty.
- Vali Pattabhirama rao v. Sri Ramanuja Ginning and Rice Factory (P) Ltd. (AIR 1984 AP 176) = 60 Company Cases 568.

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- No income tax liability arises to the firm also as there is no transfer. (CIT V/s Texspin Engg. & Mfr. Works (263 ITR 345) (Bom), Well Pack Packaging vs. DCIT (78 TTJ 448 (Ahd)).
- Claim of various exemption / deductions. Tech Books Electronics Services (P.) Ltd. v. Addl. CIT [2006] 100 ITD 125 (Del)

Conversion of closely held company into a Limited Liability Partnership

- S. 47(iii) of the Act
 - Clauses (a) to (d) are similar to S. 47(xiii);
 - Sales, Turnover or gross receipts of the company should not exceed Rs.60 lacs in any of the 3 years prior to the conversion; and
 - No amount should be paid to the partners from accumulated profits of the company for a period of 3 years from the date of conversion.

Amalgamation of Companies

- **Halsbury's Laws (4th Edition) Para 1539 – Meaning of Amalgamation.**
- “Amalgamation is a blending of two or more existing undertakings into one undertaking, the shareholders of each blending company becoming substantially the shareholders in the company which is to carry on the blended undertakings.

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- **Meaning of 'merger' from Black's Law Dictionary.**
“As amalgamation of two corporation pursuant to statutory provision in which one of the corporation survives and the other disappears. The absorption of one company by another, the former losing its legal identity, and latter retaining its own name and identity and acquiring assets, liabilities, franchises, and powers of former, and absorbed company ceasing to exist as separate business entity.

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- **Definition of 'Amalgamation' under AS-14:**

“Amalgamation means an amalgamation pursuant to the provisions of the Companies Act, 1956 or any other statute which may be applicable to companies.

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- **Definition of Amalgamation u/s 2(1B) of the IT Act:**
“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 –

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(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.

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(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.

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otherwise than as a result of 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.”

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- **Tax impact in the hands of the:**
 - Transferor Company
 - Transferee Company
 - Shareholders of the transferor company
 - Shareholders of the transferee company

Transferor Company

- On amalgamation the transferor company shall be dissolved without winding up.
- Treatment of the following claims of the transferor company :
 - Carried forward unabsorbed losses
 - Carried forward unabsorbed depreciation
 - Investment allowances including carried forward unabsorbed investment allowance.

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- Unabsorbed Depreciation and Carried forward losses - S. 72A r.w. Rule 9C of the IT Rules.
 - Fresh lease of life for Losses
 - Reverse Merger - Bihari Mills Ltd. (56 Company Cases 6)
- Investment Allowance - Section 32A(6) of the Act.

Transferee Company

- Actual cost of the Assets of Transferor company - Explanation (7) to sub-section (1) of Section 43 of the Act.
- Fourth proviso to Section 32(i) of the Act - Proportionate depreciation in the year of Amalgamation.

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- Under the provisions of S. 79 for the purpose of carrying forward and setting off unabsorbed business losses it is necessary that not less than 51% of the shareholders holding share on the last day of the previous year in which losses were incurred continue to hold not less than 51% of the shares on the last day of the year in which loss is sought to be set off.

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- Exception to Section 79 of the Act:
 - company in which public are substantially interested.
 - Does not to carried forward unabsorbed depreciation which would be available even if there is a complete change in the shareholding pattern (CIT v. Kalpaka Enterprise Pvt. Ltd. 157 ITR 658 (Ker), CIT v. Subhalaxmi Mills Ltd. 148 ITR 863 (Guj), CIT v. Concord Industries 119 ITR 458 (Mad)).

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- Treatment of expenditure / losses, bad debts etc of the transferor company - CIT v. Veer Bhadrarao Koteswararao and Company (158 ITR 152)
- Effect of S. 43C

Shareholders of the transferor company

- On amalgamation, shareholders of the transferor company would receive, against their investment in the shares of the transferor company, shares and/or debentures and/or cash from the transferee company.

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- Section 47(vii) r.w.s. Section 49(2) r.w.s. Explanation (i)(c) of Section 2(42A) of the Act clarify that amalgamation is a tax neutral event.

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- Some issues:
 - whether amalgamation is at all a transfer so as to render a shareholder of the transferor company liable to pay capital gains tax on the transaction? (CIT v. Rasiklal Maneklal (177 ITR 198)(SC), Vania Silk Mills Pvt. Ltd. v. CIT (191 ITR 647)(SC), CIT v R. M. Amin (106 ITR 368) (SC), CIT v. Master Raghuvir Trust (151 ITR 368 (Karnataka)).

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- If shareholders of the transferor company get debenture and/or cash of transferee company, exemption under Section 47(vii) of the Act would be available to the assessee? (CIT v. Gautam Sarabhai (173 ITR 216) (GUJ))
- What would be the position if the shares are held by the shareholders of the transferor company not as a capital asset or investment, but as a stock in trade? (91 ITR 8 (SC))

Shareholders of the transferee company

- No Impact

Demerger or halving off a division from an existing company

- **Definition of Demerger – Section 2(19AA):**

Demerger means the transfer of one or more undertakings to any resulting company pursuant to a scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956, in such a manner that –

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- All the properties and liabilities of the demerged undertaking become the properties and liabilities of the resulting company.
- All the properties and liabilities are transferred at book value (excluding increase in value due to revaluation).
- The resulting company issues shares to the shareholders of demerged company on a proportionate basis.

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- Shareholders holding minimum 75% of the value of shares of the demerged company (other than shares which are held by, or by a nominee for, the resulting company or its subsidiaries) become shareholders of the resulting company.
- The transfer of the undertaking is on a going concern basis.
- The demerger is in accordance with the conditions notified under Section 72A(5). No conditions have been notified till date by the Central Government.

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- **'Undertaking'** for the purpose of demerger includes any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but excludes individual assets or liabilities not constituting a business activity [Explanation 1 to section 2(19AA)].

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- **Taxability in the hands of Shareholders in case of demerger :**
 - The transfer of shares by the shareholders of the transferor company in lieu of shares of the transferee company on demerger is not regarded as transfer and hence gains arising from the same are not chargeable to tax in the hands of the shareholders of the transferee company. [Section 47(vid)]
 - Distribution of shares of the transferee company to the shareholders of the transferor company on demerger will not be treated as deemed dividend [Clause (v) of section 2(22)].

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- In case of demerger, cost of acquisition of shares of the transferee/resulting company will be the amount which bears to the cost of acquisition of shares of the transferor/demerged company, the same proportion as the net book value of assets transferred bears to the net worth of the demerged company immediately before demerger [section 49(2C)]:

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Cost of Acquisition
of shares of resulting X
company

Net book value
of assets Trfd.
to demerged Co.

Net Worth of the
demerged company

Contd...

- wherein Net worth is equal to Paid-up Share Capital + General Reserve as per books of the demerged company immediately before demerger.
- The cost of acquisition of shares of the demerged company will be the original cost of shares of demerged company after reducing the cost of shares of the resulting company as computed above. [Section 49(2D)].

Some Issues

- Stamp Duty – Entry 20(d) of Schedule I to Bombay Stamp Duty Act, 1958 as applicable to the State of Gujarat.
- Labour Laws – Jitendra Sukhadia vs. Alembic Chemicals Co. Ltd. (64 Company Cases 206)
- Formalities prescribed under S. 391 to 394 of the Companies Act, 1956.
- Tenancy Rights - General Light Appliance Co. Ltd. v. M.A. Kadar (60 Company Cases 1013).

Thank You