

SLUMP SALE- A BEGINNING OF NEW ERA



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(i) Introduction

With the advent of globalisation, business transfer arrangements have become an essential element. There are various ways of transferring a business such merger, amalgamations, reverse mergers, demergers, hive off, slump sale etc. It is generally said that “how you acquire” is equally important as “what you acquire”. The mode of acquisition of business is equally crucial in a jurisdiction like India wherein both the buyer and seller may have to examine implications under various regulations.

Typically, business acquisition transactions revolve around acquisition of entire business undertaking as a going concern or cherry picking of assets. The concept of acquiring the entire business undertaking as a going concern can be termed as “slump sale”. We have discussed tax and regulatory aspects relating to slump sale in below paragraphs.

The terms, 'business transfer' and 'slump sale' are used interchangeably in the Indian context and both refer to transfer and sale of an entire business undertaking of the seller on a going concern basis for a lump-sum consideration. The Companies Act 2013 does not define the term “slump sale”. Accordingly, a reference can be drawn from the provisions of Income Tax Act 1961 ('Act'). Section 2(42C) of the Act defines slump sale as:

“the transfer of one or more [undertaking, by any means,] for a lump sum consideration without values being assigned to the individual assets and liabilities in such [transfer].”

The Indian judicial authorities have analysed the above definition on several occasions and have laid down the fundamental requirements in order to qualify a business transaction as slump sale:

1. Transfer by any means
2. Transfer of an Undertaking
3. Transfer for lumpsum consideration
4. Transfer as a going concern

Let's understand each of the above items in greater details:

1. Transfer by any means

The erstwhile definition of slump sale under the Act was such that transfer of undertaking without a monetary consideration would not fall within its purview. There was some ambiguity on whether consideration in kind would affect the nature of a slump sale transaction. In the past, transactions were structured in a way that transfer of undertaking would be in exchange of assets or in kind.

In relation to above, the Hon'ble Supreme Court in case of **R.R. Ramakrishna Pillai**¹ has held that a transfer of an asset for consideration other than monetary consideration is an exchange and not sale. Also, the Hon'ble Bombay High Court in case of **Bharat Bijlee Ltd**². held that transfer of business as a going concern in return of shares and bonds is an exchange and not a sale.

Accordingly, taking a cue from above, the Finance Act 2021 amended the definition of slump sale thereby replacing the words “**undertaking as a result of sale**” with “**undertaking, by any means**”. The amendment broadens the scope of slump sale to include transfer (as defined under section 2(47) of the Act) of one or more undertakings by any means and effectively overturning the decision of Hon'ble Bombay High Court in case of Bharat Bijlee Ltd.

2. Transfer of an Undertaking

The term undertaking has been defined under the Act as:

'Undertaking 'shall include any part of an undertaking or a unit or a 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.'

The transferred undertaking should represent an identifiable stand-alone business activity and should contain all the assets and liabilities including employees, contracts and licenses that are required for conducting such business. The transferred undertaking should have the inherent ability and potential to run the business, which is being transferred and also, generate revenues independently without having to rely on any external support.

In an ideal scenario, all the assets and liabilities forming part of the business under consideration need to be transferred to the buyer in a slump sale but in case of Premier Automobiles Ltd³ exclusion of certain assets and liabilities were permitted so long as the assets and liabilities transferred as part of the undertaking are sufficient for conducting the business and generating sustainable revenue on its own on a standalone basis. This is important when assets and liabilities are shared by multiple departments. However, the seller on retaining certain assets can ensure that the same is substituted by certain other assets to the buyer.

3. Transfer for lumpsum consideration

The consideration for the slump sale has to be a lump-sum figure without attributing individual values to the assets and liabilities forming part of the transferred undertaking. It is not individual assets that the buyer is buying but a stand-alone business in entirety. Therefore, the business has to be valued as a whole and an aggregate consideration for the business has to be arrived at. However, it is clarified that the determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities. It is also observed that in certain cases an adjustment to working capital may also be required for the interim period (i.e. date of Business Transfer Agreement to date of actual transfer).

In a general parlance, lumpsum consideration in slump sale refer to single payment at a given time however at times it may not be possible for the same. There are arrangements wherein payments are made in instalments, it can still be said that the condition of lumpsum consideration is met as values are not assigned to individual assets or liabilities.

¹1967 66 ITR 725 SC.

²TS-270-HC-2014(BOM)

³Premier Automobiles Ltd. v. ITO (2003) 264 ITR 193 (Bom)

4. Transfer as a going concern

The most important element of a slump sale is that the undertaking is transferred as a 'going concern'. There should be no break or cessation in the operations of the transferred undertaking. The transfer of the undertaking from the seller and the vesting of the undertaking in the buyer together with all the assets and liabilities should be simultaneous and it should not stop, hinder or break the conduct of the business. Hence, it is important for the buyer to ensure that the buyer has all the requisite infrastructure, licenses and preparedness to start running the business simultaneously with the consummation of the slump sale.

(ii) Direct Tax Implications

Lets understand the implications under the Act on in case of a slump sale transaction both in the hands of the seller as well as buyer.

A. Section 50B of the Act

The transfer of business undertaking as a slump sale shall be subject to capital gains tax in the hands of the seller as per the provisions of section 50B of the Act. For purposes of computing capital gains from a slump sale transaction, the net worth of the undertaking is deemed to be the cost of acquisition. Further, where the undertaking is held for more than 36 months any gains arising from the transfer of such an undertaking shall be categorised as long term capital gains in the hands of the seller and subject to tax at the rate of 20% (plus applicable surcharge and 4% cess) without any indexation benefit. The same has been depicted in

Particulars	Amount (INR)
Full value of consideration (refer details below)	XXX
Less :- Expenditure in relation to transfer	(XXX)
Less :- Net worth** of the undertaking being the cost of acquisition and improvement	(XXX)
Capital Gain/loss... A	XXX
Long Term Capital Gain (LTCG)	20% of A (plus applicable surcharge and 4% cess)
Short Term Capital Gain (STCG)	Tax per Income slabs and legal status of taxpayer (plus applicable surcharge and 4% cess)

**Computation of Net Worth

Particulars	Amount (INR)
Aggregate value of total assets of the undertaking or division:	
In case of depreciable assets	WDV of block
In case of capital assets in respect of which whole expenditure claimed u/s 35AD	Nil
In case of other assets	Book value of assets
Less :- Value of liabilities of such undertaking or division	Book value
Net worth of the undertaking	XXX

**If net worth comes negative, then cost of acquisition shall be NIL

Prior to the Finance Act, 2021, there was no stipulation regarding the determination of the full value of consideration ("FVC") for computing capital gains in case of slump sale. However, the Finance Act 2021 brought about an amendment in this regard which provides that the FVC shall be deemed to be the fair market value ("FMV") of the undertaking to be determined as per prescribed rules.

In this regard, the Central Board of Direct Taxes ("CBDT") has prescribed valuation rules for determination of FVC for slump sale under Rule 11UAE of the Income-tax Rules, 1962 ("Valuation Rules"). The Valuation Rules provide two methods for determining the FVC as on the date of slump sale and the **higher** of the two shall be considered to be the FVC.

a. Book value-based formula:

Broadly under this method, the FVC is a function of the book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) as reduced by the book value of all the liabilities;

b. Actual consideration received:

This should be a sum of the monetary and non-monetary consideration received or accrued as a result of the slump sale. The Valuation Rules also prescribe the method for computing value of the non-monetary consideration received on account of slump sale.

Rule 11UAE provides that FMV of the undertaking on the date of slump sale, transferred by way of slump sale, for purpose of capital gains computation, shall be **higher** of:

- (I) **FMV1** – FMV of the capital assets transferred by way of slump sale determined as per formula prescribed; or
- (ii) **FMV2** – FMV of the consideration received or accruing as a result of transfer by way of slump sale determined as per formula prescribed.

(i) COMPUTATION OF FMV1- FMV OF CAPITAL ASSETS TRANSFERRED BY WAY OF SLUMP SALE

Formula: $FMV1 = A+B+C+D-L$

Constituents	Assets/Liabilities	Valuation
A	All Assets (other than jewellery, artistic work, shares, securities and immovable property)	Book value of all assets (other than jewellery, artistic work, shares, securities and immovable property), as appearing in the books of account of undertaking transferred, as reduced by the following amount which relate to such undertaking: (a) Any amount of income tax paid, as reduced by the amount of tax refund claimed under the ITL, if any; (b) Any amount shown as an asset including the unamortized amount of deferred expenditure which does not represent the value of any asset.
B	Jewellery and Artistic work	Price it would fetch on sale in open market and It should be basis valuation report from a registered valuer
C	Shares and Securities	FMV as determined in the manner provided in sub-rule (1) of rule 11UA
D	Immovable Property	The value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty
L	Liabilities	Book value of liabilities as appearing in the books of accounts of the undertaking, but not including the following amounts which relates to such undertaking or division, namely: i. Paid-up capital in respect of equity shares; ii. Amount set apart for payment of dividends on preference shares and equity shares, where such dividends have not been declared before the date of transfer at a general body meeting of the company; iii. Reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart toward depreciation; iv. Amount representing provision for taxation other v. than the amount of income tax paid, if any, less the amount of income tax claimed as refund, if any, to the extent of excess over tax payable with reference to the book profits, in accordance with the tax law applicable thereto; vi. Amount representing provisions made for liabilities other than ascertained liabilities; vii. Amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares.

(ii) COMPUTATION OF FMV2- FMV OF CONSIDERATION RECEIVED OR ACCRUING AS A RESULT OF TRANSFER BYWAY OF SLUMP SALE

Formula: FMV2 = E+F+G+H

Constituents	Monetary/Non Monetary Consideration	Valuation
E	Monetary	Value received or accruing as a result of transfer
F	Non-Monetary - (jewellery, artistic work, shares and securities)	<ul style="list-style-type: none"> • FMV as determined under Rule 11UA (1) • Refer annexure for valuation methodology prescribed in Rule 11UA (1)
G	Non-Monetary - (any other property)	<ul style="list-style-type: none"> • Price such property would fetch on sale in open market • It should be basis valuation report from a
H	Non-Monetary (Immovable Property)	<ul style="list-style-type: none"> • Stamp duty value adopted or assessed or assessable by any authority of Government, for purpose of payment of stamp duty.

The CBDT circular does not explicitly specify the effective date of applicability of the valuation rules specified in Rule 11UAE. Accordingly, it may be said that circular may be effective from the date when the notification is published in the official gazette i.e. May 24, 2021. This interpretation however raises issue for applicability of the new rule for past transactions undertaken in the interim period between 1 April 2020 and 23 May 2021.

B. Section 56 of the Act

As per the provisions of section 56(2)(x) of the Act, where any person, receives any property from any person without consideration or at a consideration which is less than the FMV of such property, the difference between the consideration and the FMV of such property is taxable under head 'income from other sources' in the hands of transferee. Section 56(2)(x) of the Act, being an anti-abuse provision, aims at preventing the taxpayers from selling the assets for inadequate considerations thereby avoiding the tax net. It would be essential to highlight that there is an ambiguity on the applicability of the provisions of section 56(2)(x) of the Act to slump sale transactions. The term 'property' under section 56(2)(x) of the Act does not cover undertaking within its ambit. While, the definition of property does not explicitly include an undertaking, in case any of the specified assets mentioned in the definition of property are transferred as a part of the undertaking in slump sale, possibility of income-tax authorities arguing applicability of Section 56(2)(x) of the Act based on the purchase price allocation cannot be ruled out. This can defeat the whole concept of slump sale where values are not assigned to individual assets.

C. Set off and Carry Forward of losses

Accumulated business loss and unabsorbed depreciation of the undertaking shall be carried forward by the buyer.

D. Reporting

The seller shall furnish a report by a chartered account in Form No 3CEA computing the net worth of an undertaking before the specified date.

E. Key Challenges

- The first component of FMV1 looks at the value of undertaking based on the existing valuation rules for certain anti abuse provisions and adopts a partial “look through” approach where values of certain assets and liabilities are adopted as per books of account and certain specified assets are valued as per fair valuation criteria (like stamp duty ready reckoner value for immovable property or listed shares are valued based on stock exchange quotation). This sets a floor value for computation of consideration even if the actual consideration is lower. This may pose a challenge where the undertaking is bonafide transferred at its true commercial value.
- The FMV1 component requires adoption of book values from books of account of the “undertaking” or “division” which is transferred. This raises issue where no separate books are maintained for the transferred “undertaking” or “division”. The exclusion of certain entity level items like equity/preference share capital, reserves and surplus, provision for taxation, etc. can also possibly raise issues for interpretation.
- The FMV2, looks at monetary and non-monetary consideration received for transfer of the undertaking. The consideration in the form of unlisted shares is to be valued as per partial “look through” approach as applicable for other anti-abuse provisions. It may not necessarily align with and can, in fact, be lower or higher than the commercially negotiated value of such shares.

Further, immovable property is to be valued at stamp duty ready reckoner value which can also deviate from commercially negotiated value.

- The new rule requires valuation to be made on date of slump sale. This can possibly pose a challenge where there is time interregnum between business transfer agreement entered between the parties and final closing of the transaction. It may also pose challenges where part or whole of the consideration is deferred and becomes payable at a future date.

(iii) Conclusion

The decision to opt for purchase of the entire company or purchase of relevant assets or undertaking of the target company has always been a subject of debate. In the recent times, various global corporations have been keen to inherit clean and transparent businesses without getting involved in any tax litigation through any structuring where it jeopardises the interest of the transferor or transferee. Having said that, slump sale involves its own respective sets of merits and challenges. Whilst we have tried to set out certain commercial and practical challenges, the strategy for acquisition needs to be considered carefully in the light of the amendments in past few years.

