

GST IMPLICATION ON BUSINESS RESTRUCTURING



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In today's business dynamics, we commonly come across businesses resorting to restructuring activities. The business restructuring could be in response to market / economic forces and trends, changes in ownership, changes in corporate strategy, to bring synergy, to increase cash flow and so on. While there are several modes of restructuring, they can be bucketed into the following categories for the purpose of understanding GST implications:

- Transfer of Business vide Business Transfer Agreement (slump sale) or Mergers & Acquisitions (merger, demerger, amalgamation)
- Itemized or Piecemeal sale of Assets
- Transfer of Business as sale or transfer of Securities

I. GST Implications on Transfer of Business

- 1.1 In order to determine GST implications on transfer of business, let us first understand the GST provisions. The charging section 9(1) of the CGST Act, 2017 ('*GST Act*'), levies tax on "supply" of goods and services. As per section 7(1) of the GST Act, '*supply includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business....*'
- 1.2 Therefore, the important elements for an activity to fall within the folds of the 'supply' definition are:
 - (i) There should be supply of 'goods' or 'services'
 - (ii) There should be 'consideration'
 - (iii) The same should be done in the course of furtherance of 'business'
- 1.3 The term 'goods' has been defined in section 2(52) of the GST Act to mean '*every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply*'.
- 1.4 In terms of section 2(102) of the GST Act, 'services' means '*anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged*'.

1.5 Further, Clause 4(c) of Schedule II of the GST Act states that:

“(c) where any person ceases to be a taxable person, any goods forming part of the assets of any business carried on by him shall be deemed to be supplied by him in the course or furtherance of his business immediately before he ceases to be a taxable person, unless –

- (i) the business is transferred as a going concern to another person; or
- (ii) the business is carried on by a personal representative who is deemed to be a taxable person.”

1.6 Schedule II of the CGST Act prescribes the list of activities to be treated as a supply of goods or supply of service, whereas in Clause 4(c), transfer of business assets has been considered as supply of goods. The 'transfer of business as a going concern' does not constitute as supply of goods as per the clause 4(c). Hence, it would be important to delve into the aspect whether transfer of business constitutes supply of a 'service'.

1.7 As seen from the definition of 'service', it is defined very widely to mean 'anything other than goods'. Hence, on a strict reading, it appears that transfer of business would fall within the ambit of 'service'. And more so when an exemption has been provided in entry No. 2 of Notification No. 12/2017-Central Tax (Rate) dated 28th June 2017, 'Services by way of *transfer of a going concern*, as a whole or an independent part thereof'. Accordingly, the GST law recognizes that (i) transfer of business is a service and (2) further exempts the same by way of an exemption notification.

1.8 However, the question that merits consideration is whether there is existence of a 'supply' at all. When the transfer of business includes transfer of assets (goods), liabilities, contractual obligations, employees, technology, cash equivalents etc. can it be said that the same amounts to supply of 'service'? A layman understanding of the phrase 'transfer of business', would definitely result into a negative answer. Section 2 which defines service, starts with “unless the context otherwise requires” and it has also been held by various judicial precedents that a literal adoption of the term which results in absurd interpretation should be avoided. Further, section 7 requires supply to be in the 'course or furtherance of business'. When the business per-se is being transferred, can it be said to be in the course or furtherance of business. Under erstwhile VAT laws, Courts have in many instances, held that the dealer cannot be said to be engaged in the 'business' of 'transfer of business'. The activity of transfer of business cannot be said to be incidental or ancillary to trade, commerce, adventure or concern. Reference in this regard is made to the decisions of *Monsanto Chemicals of India (P.) Ltd. v. State of Tamil Nadu* [1982 51 STC 278 Mad HC] and *Deputy Commissioner (C.T.), Coimbatore v. Behanan Thomas* [1977 39 STC 325 Mad HC], *Coromandal Fertilisers Limited v. State of A.P.* [1999 112 STC 1 AP HC] and *Paradise Food Court v. state of Telangana* [Writ Petition No. 2167 of 2017 on 18-04-2017].

1.9 As regards the exemption notification which exempts the 'service' of transfer of business, it is a settled law that an exemption notification cannot levy tax on a transaction and subsequently exempt the same. Accordingly, if there is no supply per se, the question of making the same exempt does not arise.

1.10 Hence, the authors are of the view that there is no supply in case of transfer of business. Nevertheless, the same would be exempt from GST even if considered otherwise. Many GST Advance Rulings have held that transfer of business amounts to supply of service and the same is exempt from GST in lieu of the exemption entries. Reliance in this regard, is placed on *Rajashri Foods Pvt Ltd* [2019 (22) GSTL 293 (AAR GST)], *Rajeev Bansal & Sudershan Mittal* [2020 (35) GSTL 510 (AAR - GST - UK)], *Innovative Textiles Ltd* [2019 (24) GSTL 480 (AAR - GST)] and *Shilpa Medicare Ltd* [2020 (39) GSTL 34 (AAR - GST - AP)].

What is 'Going concern' and whether transfer of a Unit (part of business) can be considered as 'Transfer of a going concern'?

1.11 As per NN 12/2017, in order to qualify for the exemption, the following conditions ought to be satisfied:

- Transfer of business shall be a transfer of going concern
- Business which is transferred shall be as a whole or an independent part

1.12 Reference is drawn to the AAR-Karnataka in the case of *Rajashri Foods (P.) Ltd.* [2018 (13) G.S.T.L. 221 (A.A.R. - GST)] whereby the applicant intended to sell one of their animal feed manufacturing units and undertake a transaction envisaging transfer of all assets and liabilities to the buyer. The AAR held that the unit sought to be sold is a fully functional unit and the transaction contemplates the transfer of the entire business to a new person, who would not only enjoy a right over the assets but shall also take over the liabilities. Hence, treating the transaction as transfer of Business and not solely transfer of Business Assets. The court held that: *“9.A going concern is a concept of accounting and applies to the business of the company as a whole. Transfer of a going concern means transfer of a running business which is capable of being carried on by the purchaser as an independent business. Such transfer of business as a whole will comprise comprehensive transfer of immovable property, goods and transfer of unexecuted orders, employees, goodwill, etc”.*

1.13 Further, in the Ruling of **Rajeev Bansal & Sudershan Mittal (supra)** and **Innovative Textiles (supra)**, it was held that:

“In terms of financial transaction 'going concern' has the meaning that at the point, in time to which the description applies, the business is live or operating and has all parts and features necessary to keep it in operation. We further find that internationally accepted guidelines (applicable to the case in hand) issued by His Majesty's Revenue & Customs (HRMC) to treat transfer of business as a going concern are as under :

- (a) *The assets must be sold as part of a 'business' as a 'going concern'*
- (b) *The purchaser intends to use the assets to carry on the same kind of business as the seller*
- (c) *Where only part of a business is sold it must be capable of separate operation.*
- (d) *There must not be a series of immediately consecutive transfers*

1.14 Hence, it can be seen that if a running business is sold to the seller who intends to run the said business, the same would qualify as a going concern. Even if a unit or a vertical from the entire business is transferred to a buyer, the same will qualify as transfer of a going concern, provided all the assets and liabilities pertaining to the said unit are transferred.

Transfer of Input Tax Credit

1.15 Section 18(3) of the GST Act allows transfer the input tax credit which remains unutilized in his electronic credit ledger to the sold, merged, demerged, amalgamated, leased or transferred business. Rule 41 of CGST Rules, 2017 ('*GST Rules*') provides that the registered person shall request for transfer of unutilized ITC in Form ITC-02 electronically on the common portal.

- 1.16 In case of demerger, ITC shall be apportioned in the ratio of the value of assets, irrespective of whether ITC on the same is availed or not, of the new units as specified in the scheme of demerger. CBIC vide *Circular No.133 03/2020-GST dated 23rd March, 2020* has clarified on some issues pertaining to the transfer of ITC. It has been clarified that transfer of unutilized ITC is optional and not mandatory.

Whether Reversal of ITC is required?

- 1.17 If transfer of business as a going concern is considered as an 'exempt' service, then it appears ITC reversal under Section 17(2) read with Rule 42 is required to be made. However, if it is contended that transfer of business is not a supply per se (as mentioned in para 1.8 to 1.10), then there is no question of ITC reversal.
- 1.18 Further, section 18(3) of GST Act read with Rule 41 of GST Rules specifically provide for transfer of unutilized ITC. Hence, there is a contention that when a specific provision has been prescribed (to transfer the unutilized ITC), then the same could prevail over the general provision (to reverse ITC due to exempt turnover). In few Advance Rulings, even though transfer of business has been held as exempt service, transfer of unutilized ITC has been permitted. Reference is placed on *Shilpa Medicate Ltd [2020 (39) GSTL 34 (AAR - GST - AP)]* and *B.M. Industries [2019 (22) G.S.T.L. 293 (A.A.R. - GST)]*.

Can ITC be claimed by the merged entity (transferee company) in case where old invoice has been raised in the name of the transferor company

- 1.19 There may be a scenario wherein the invoice pertaining to the transferor company is received post-transfer by the transferee company. In the context of Excise law, Hon'ble Hyderabad Tribunal in the case of *Farmax India Ltd. vs Commr. OF Cus., C. EX. & S.T., Hyderabad-IV [2020 (43) G.S.T.L. 526 (Tri. - Hyd.)]* has held that in case of merger, all the assets and liabilities of the transferor companies are transferred to the transferee and therefore there is no reason or requirement for the transferee to take permission from the Tax Authorities for availment of credit on the invoices raised on the transferor companies by the transferee company. Similar decision was also held in the case of *Lanco Industries Ltd vs. CCE [2008 (223) E.L.T. 550 (Tri. - Bang.)]*.
- 1.20 The said rationale may also be applied in the GST regime to allow ITC. However, there would be practical difficulties as the amounts would not appear in GSTR-2A/2B of the transferee company and the taxpayers may have to litigate to avail such ITC.

Liability and Registration in case of transfer of business

- 1.21 The taxable person and the person to whom the business is so transferred are jointly and severally liable either wholly or to the extent of such transfer to pay the tax, interest or any penalty due from the taxable person upto the time of such transfer irrespective of whether such tax, interest or penalty has been determined before such transfer and has remained unpaid or is determined there after. Where the transferee of a business carries on such business, he shall be liable to pay tax on the supply of goods or services effected by him with effect from the date of such transfer.
- 1.22 Accordingly, it is from such date of transfer that the transferor company can apply for cancellation of registration and the transferee company would be required to obtain new registration / amend its existing registration.

Liability and Registration in case of Amalgamation or Merger of companies

- 1.23 When two or more companies are amalgamated or merged pursuant to a court or Tribunal order and the order is to take effect from a date earlier to the date of the order and any two or more of such companies have supplied or received any goods or services to or from each other during the intervening period (commencing on the date from which the order takes effect till the date of the order), then such transactions of supply and receipt shall be included in the turnover of supply or receipt of the respective companies and they shall be liable to pay tax accordingly. The said two or more companies shall be treated as distinct companies for the period up to the date of the said order.
- 1.24 As per section 87(2) of GST Act, the registration certificates of the said companies shall be cancelled with effect from the date of the said order.
- 1.25 Further, in terms of section 22(4), the transferee shall be liable to be registered with effect from the date on which the Registrar of Companies issues a certificate of incorporation giving effect to such order of the High Court or Tribunal.
- 1.26 It can be seen that there is a dichotomy between the above provisions – the date of cancellation of Transferor Company is date of court order and date of new registration of transferor company is date on which ROC issues incorporation certificate. There could be an intervening period between the court order and date of ROC certificate.
- 1.27 However, there could be practical issues in surrendering the GST registration when Form GSTR-9 (Annual Return) and Form-9C (reconciliation statement) have not been filed, as the portal would get inactive after cancellation of registration. Accordingly, taxpayers may choose to file GSTR-9/9C first and then opt of cancellation of registration and lastly filing of Final return.

Liability of Directors/Partners

- 1.28 Where any tax, interest or penalty due from a private company in respect of any supply of goods or services for any period cannot be recovered, then every person who was a director of the private company during such period shall be liable, jointly and severally unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company. The above provision will not be applicable in case of conversion of private limited company to public limited company.
- 1.29 Where any firm is liable to pay any tax, interest or penalty, the firm and each of the partners of the firm shall, jointly and severally, be liable for such payment. Where any partner retires from the firm, he or the firm, shall intimate the date of retirement of the said partner to the Commissioner by a notice in that behalf in writing and such partner shall be liable to pay tax, interest or penalty due up to the date of his retirement whether determined or not, on that date. If no such intimation is given within one month from the date of retirement, the liability of such partner shall continue until the date on which such intimation is received by the Commissioner. This underlines the importance of timely communication to the Department regarding changes in constitution of the entities.

II. GST IMPLICATIONS ON ITEMIZED/PIECEMEAL SALE

- 2.1 Where assets and liabilities of a business are transferred by way of assigning the value to each item, it is known as an itemized sale. This means the sale by the way of transfer of specific assets of a business after assigning a value to these assets. Transaction of itemized assets is considered as supply under the ambit of GST and tax will be applicable in case of Itemized/piecemeal sale at the rate applicable to respective individual items.
- 2.2 However, if piecemeal assets are sold for a lumpsum consideration, then the same may qualify as 'mixed supply' as defined under section 2(74) of the GST Act. Accordingly, the highest rate of GST applicable to any individual items would be applicable to the entire lumpsum consideration.

III. GST IMPLICATIONS ON THE SALE/TRANSFER OF SECURITIES

- 3.1 Another method of acquisition of a business is share acquisition. The definition of both goods as well as services specifically excludes 'securities'. Hence, shares of a company are neither treated as goods nor services under the GST law, and accordingly, there is no GST liability on sale or transfer of securities.

Based on the above, the following points should be considered from a GST perspective while business restructuring or drafting a business transfer agreement:

- Transfer of business as a going concern or not
- Transfer of all the assets and liabilities of the said unit / business vis-à-vis itemized transfer
- Manner of determining consideration – lumpsum vis-à-vis individual amounts
- Treatment of Input tax credit – Reversal as well as Transfer of unutilized ITC
- In case of amalgamation or merger or demerger - Transactions between the two entities, disclosure of turnover / ITC and authorized signatory for compliance / litigation during the intervening period
- Liability of the transferor and transferee company
- Amendment, cancellation and new registrations pursuant to the restructuring activity

