

QUESTION 1**Question 1 (A)**

Mr. Bhargava, a leading advocate on corporate law, decided to reduce his practice and to accept briefs only for paying his taxes and making charities with the fees received on such briefs. In a particular case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with 5 lakhs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.

Question 1 (B)

XYZ Ltd. took over the running business of a sole-proprietor by a sale deed. As per the sale deed, XYZ Ltd. undertook to pay overriding charges of 15,000 p.a. to the wife of the sole-proprietor in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of XYZ Ltd., who had accepted that obligation as a condition of purchase of the going concern. Is the payment of overriding charges by XYZ Ltd. to the wife of the sole -proprietor in the nature of diversion of income or application of income? Discuss.

ANSWER TO QUESTION 1**Answer 1 (A)**

In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head "Profits and gains of business or profession".

Answer 1 (B)

This issue came up for consideration before the Allahabad High Court in *Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 267 ITR 370 (All)*. The Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e., the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

QUESTION 2

What are the rates of tax applicable to an Individual?

ANSWER TO QUESTION 2

With effect from Assessment Year 2021-22, every Individual or HUF have an option of following existing rates of tax or opting to be covered under section 115BAC. The rate of tax is as under:

(A) Existing rates of taxes:

- (i) Individual (other than those covered in (ii) or (iii) below) or HUF or every association of persons or body of individuals:

Total Income	Tax rate
Upto Rs. 2,50,000	Nil
Rs. 2,50,001 to Rs. 5,00,000	5 per cent
Rs. 5,00,001 to Rs. 10,00,000	20 per cent
Above Rs. 10,00,000	30 per cent

- (ii) Individual, being resident in India, who is of the age of 60 years or more but less than 80 years at any time during the year:

Total Income	Tax rate
Upto Rs. 3,00,000	Nil
Rs. 3,00,001 to Rs. 5,00,000	5 per cent
Rs. 5,00,001 to Rs. 10,00,000	20 per cent
Above Rs. 10,00,000	30 per cent

- (iii) Individual, being resident in India, who is of the age of 80 years or more at any time during the year:

Total Income	Tax rate
Upto Rs. 5,00,000	Nil
Rs. 5,00,001 to Rs. 10,00,000	20 per cent
Above Rs. 10,00,000	30 per cent

CBDT Circular No. 28 of 2016:

Clarification regarding attaining prescribed Age of 60 years / 80 years on 31st March itself, in case of Senior / Very Senior Citizens whose date of birth falls on 1st April, for purposes of Income-tax Act, 1961

1. Higher tax exemption limits have been prescribed under the past Finance Acts for resident senior citizen taxpayers who have attained the age of sixty years. Even in such cases, the exemption limit is still higher for very senior citizens who have attained the age of eighty years. A doubt has been raised about the attainment of the aforesaid qualifying ages for availing higher exemption in cases of the persons whose date of birth falls on 1st April of calendar year. In other words, the broader question under consideration is whether a person born on 1st April of a particular year can be said to have completed a particular age on 31st March, on the preceding day of his/her birthday, or on 1st April itself of that year.
2.the Hon'ble Supreme Court had an occasion to consider a similar issue in the case of Prabhu Dayal Sesma vs. State of Rajasthan & another 1986, AIR , 1948 wherein it observed that while counting the age of the person, whole of the day should be reckoned and it starts from 12 o'clock in the midnight and he attains the specified age on the preceding, the anniversary of his birthday.
3. In view of the aforesaid judgment, the Central Board of Direct Taxes , in exercise of powers under section 119 of the Act, hereby clarifies that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday. In particular, the question of attainment of age of eligibility for being considered a senior / very senior citizen would therefore be decided on the basis of above criteria.

(A) New rates of taxes: [Section 11BAC]

For every Individual or HUF

Total Income	Tax rate
Upto Rs. 2,50,000	Nil
From Rs. 2,50,001 to Rs. 5,00,000	5 per cent
From Rs. 5,00,001 to Rs. 7,50,000	10 per cent
From Rs. 7,50,001 to Rs. 10,00,000	15 per cent
From Rs. 10,00,001 to Rs. 12,50,000	20 per cent
From Rs. 12,50,001 to Rs. 15,00,000	25 per cent
Above Rs. 15,00,000	30 per cent

Conditions for availing new scheme under section 115BAC:

1. The option shall be exercised for every previous year where the individual or HUF has no business income and in other cases the option once exercised for a previous year shall be valid for that previous year and all subsequent years. The option must be exercised on or before due date of furnishing return of income under section 139(1) of the Act;
2. The option shall become invalid for a previous year or previous years, as the case may be, if the individual or HUF fails to satisfy the conditions and other provisions of the Act shall apply;
3. The total income shall be computed without allowing exemption of:

Sr. No	Section/ Rule	Deductions/Exemptions	Head of income
1.	10(5)	Leave Travel Allowance (LTA)	Salary
2.	10(13A)	House Rent Allowance (HRA)	
3.	10(14)	Allowances covered (for e.g. allowances to meet cost of living or to meet personal expenses etc.)	
4.	10(17)	Allowances to MPs/MLAs	
5.	16(ia)	Standard deduction of Rs.50,000	

6.	16(ii)	Entertainment allowance (to government employees)	
7.	16(iii)	Tax on employment (i.e. Professional Tax – PT)	
8.	Various	Any exemption/deduction for allowances / perquisite	
9.	24(b)	Interest on housing loan (Self occupied / Vacant Property – Sec. 23(2))	House Property
10.	57(iia)	Family Pension	Other Sources
11.	10(32)	Deduction for clubbing of income of minor Child	
12.	10AA	Units in SEZ	Business Income (PGBP)
13.	32(1)(iia)	Additional Depreciation	
14.	32AD	Investment in new plant or machinery in notified backward areas in certain States	
15.	33AB	Tea/Coffee/Rubber development account	
16.	33ABA	Site Restoration Fund	
17.	35(1)(ii)	Sum paid to research association or to a university/college/other institution to be used for scientific research	
18.	35(1)(iia)	Sum paid to a company for scientific research purpose	
19.	35(1)(iii)	Sum paid to research association or to a university/college/other institution to be used for social science or statistical research	
20.	35(2AA)	Sum paid to National laboratory/a university/an Indian Institute of Technology/specified person for scientific research part of approved programme	
21.	35AD	Capital expenditure on specified business	

22.	35CCC	Expenditure on agricultural extension Project	
23.	80C	LIC Premium, Children Tuition Fees, PF contribution, Principal component of housing loan etc.,	Chapter – VIA deductions (from Gross Total Income)
24.	80CCC	Contribution to certain pension funds	
25.	80CCD(1)	Employee's contribution to national pension Scheme	
26.	80D	Health Insurance Premium/Medical Expenditure / Preventive Health-check up	
27.	80DD	Maintenance/medical treatment of dependent disabled person	
28.	80DDB	Medical treatment of specified diseases	
29.	80E	Interest on loan taken for higher education	
30.	80EE	Interest on loan taken for residential house Property	
31.	80EEA	Interest on loan taken for residential house property (if not eligible to claim u/s 80EE)	
32.	80EEB	Interest on loan taken for purchase of electric vehicle	
33.	80G	Donation institutions to certain funds/charitable	
34.	80GG	Rent paid (if not eligible deduction u/s 10(13A)) to claim HRA	
35.	80GGA	Donations development for scientific research/rural	
36.	80GGC	Contributions to political parties	

37.	80-IA	Deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development	Chapter – VIA deductions (Having income from Business)
38.	80-IAB	Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ	
39.	80-IAC	Eligible Start-up	
40.	80-IB	Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings	
41.	80-IBA	Deductions in respect of profits and gains from housing projects	

Note 1:

However exemption in respect of following allowances notified under section 10(14) of the Act shall be allowed to the Individual or HUF exercising option under the proposed section 115BAC:

- A. Transport Allowance granted to a handicapped employee to meet expenditure for the purpose of commuting between place of residence and place of duty
- B. Conveyance Allowance granted to meet the expenditure on conveyance in performance of duties of an office
- C. Any Allowance granted to meet the cost of travel on tour or on transfer
- D. Daily Allowance to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty
- E. Eligible to claim deduction u/s 80JJAA in respect of additional employee cost

Note 2:

Income-tax Department has launched a mobile app to help assessee make an informed decision based on tax savings whether to opt for existing option or to switch over to section 115BAC;

Note 3:

Such assessee opting for S. 115BAC are not required to pay Alternate Minimum Tax (AMT) and are not eligible to carry forward and set off of AMT credit, if any

QUESTION 3

SURPLUS ON SALE OF SHARES AND SECURITIES -WHETHER TAXABLE AS CAPITAL GAINS OR BUSINESS INCOME? [CIRCULAR NO. 06/2016 DATED 29-2-2016]

ANSWER TO QUESTION 3

Section 2(14) defines the term "capital asset" to include property of any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets subject to certain exceptions. As regards shares and other securities, the same can be held either as capital assets or stock-in-trade/trading assets or both.

Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

Parameters laid down by CBDT and Courts to distinguish shares held as investments and shares held as stock in trade

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The CBDT has also, through instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007, summarized the said principles for guidance of the field formations.

Principles to determine whether gains on sale of listed shares and other securities would constitute capital gains or business income

Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principle in absolute terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), CBDT realizing that major part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs the Assessing Officers to take into account the following

while deciding whether the surplus generated from sale of listed shares or other securities would be treated as Capital Gain or Business Income—

- a) Where assessee opts to treat such shares and securities as stock-in-trade: Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,
- b) Listed shares and securities held for a period of more than 12 months: In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;
- c) Other cases: In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

Principles listed above not to apply in case of sham transactions

It is, however, clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long Term Capital Gain/Short Term Capital Loss or any other sham transactions.

Objective of formulation of principles: Reducing litigation and ensuring consistency

It is reiterated that the above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities. All the relevant provisions of the Act shall continue to apply on the transactions involving transfer of shares and securities.

QUESTION 4

Discuss newly inserted third proviso to section 48? What do you mean by Grandfathering clause?

ANSWER TO QUESTION 4

Provision:

“...**Provided** also that nothing contained in the first and second provisos shall apply to the capital gains arising from the transfer of a long-term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust referred to in section 112A...”

Analysis:

This proviso is attached when the following conditions are fulfilled:

- (i) Asset = LTCA
- (ii) Listed shares, unit of equity oriented MF, unit of business trust.
- (iii) Security transaction tax should be paid on such equity share, at the time of acquisition & transfer of such share.

If the above conditions are fulfilled then capital gain is computed as per 3rd proviso to sec 48.

As per this proviso, capital gain must be computed without giving benefit of indexation i.e.

Full value of consideration	XX
(-) cost of acquisition sec 55 (2) (ac)	XX
LTCG	XX

Computation of cost u/s 55(2) (ac)

cost = ↑ of A OR B

A → Actual cost

B → (i) FVOC

(ii) FMV as on 31.01.2018;

(i) Or (ii) whichever is lower;

Example: Compute capital gain under 3rd proviso to section 48 in the following 5 cases:

Particulars	1	2	3	4	5
Actual cost (A)	8,00,000	3,00,000	3,00,000	4,00,000	4,00,000
FVOC B ₁	3,00,000	8,00,000	2,00,000	6,00,000	2,00,000
FMV on 31.1.18 B ₂	2,00,000	2,00,000	8,00,000	5,00,000	1,00,000

(-) cost of acquisition 55(2) (ac) ↓ B ₁ or B ₂ & ↑ A	(800,000)	(300,000)	(300,000)	(500,000)	(400,000)
LTCG	(500,000)	500,000	(100,000)	100,000	(200,000)
Tax @ 10% or gain > 100000	-	40,000	-	-	-

- The entire loss of case 1, 3, 5 will be carried forward in future years as per sec 74.

Notification No. 60/2018

This condition of payment of STT at the time of acquisition of shares shall apply only if the share is acquired on or after 1.10.2004. Further, even for acquisition after this date, the condition for payment of STT at the time of acquisition i.e. applicable only to 3 types of transactions:-

- Preferential issue of shares which are categorized as less frequency traded.
- Acquisition of shares of a company which is already listed in recognized stock exchange.
- Acquisition of shares in a company at the time when the share is delisted.

Surcharge incase income includes LTCG u/s 112A or STCG u/s 111A : Extract of finance (No. 2) Act, 2019 read with Taxation law (Amendment) Act 2019 :

- If income of individual / HUF / AOP / BOI (including income referred in 112A & 111A) exceeds ₹ 50 lacs then rate of surcharge = 10%.
- If total income of individual / HUF / AOP / BOI (including income referred u/s 111A & 112 A) exceeds ₹ 1 Cr then rate of surcharge = 15%.
- If total income of individual / HUF / AOP / BOI (excluding income referred u/s 111A & 112 A) exceeds ₹ 2 Cr then rate of surcharge = 25%.
- If total income of individual / HUF / AOP / BOI (excluding income referred u/s 111A & 112A) exceeds 5 Cr then rate of surcharge = 37%.
- When in the above scenario 3 & 4 total income (Including income covered u/s 111A & 112 A) exceeds 2 Cr than surcharge is at the rate 15% on such LTCG & STCG. Provided that where surcharge of 25% or 37% is attracted the surcharge on LTCG u/s 112A or STCG u/s 111A shall in no case exceed 15%.

Example:

Salary	1,50,00,000	40,00,000	2,50,00,000
STCG u/s 111A	1,00,00,000	1,00,00,000	1,00,00,000
Total Income	2,50,00,000	1,40,00,000	3,50,00,000
Tax on STCG @15%	15,00,000	15,00,000	15,00,000
Tax on balance income	43,12,500	10,12,500	73,12,500
	58,12,500	25,12,500	88,12,500
Surcharge	871,875@15%	376,875@15%	18,28,125
			2,25,000
	66,84,375	28,89,375	1,08,63,625
(+) cess @4%	267,375	115,578	434,625
Total Tax	69,51,750	30,04,950	113,00,250

QUESTION 5

RUPEE DENOMINATED BOND [5th proviso to section 48]

ANSWER TO QUESTION 5**Provision:**

“...Provided also that, in case of an assessee being a non-resident any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of rupee denominated bond of an Indian company subscribed held by him shall be ignored for the purpose of computation of FVOC....”

Analysis

Rupee denominated bond (RDB) (Masala Bond) are denominated / expressed in INR although the actual investment & redemption may be in foreign currency. Redemption of RDB bond amounts to transfer and since the bonds are redeemable at par, logically the capital gain should be zero.

However, due to appreciation of rupee the following sceneries emerged. For the purpose of this example, let us assume that at the time of subscription ratio was

USD 1 = Rs. 70 and at the time of redemption USD 1 = Rs. 63. The investor invested USD equivalent to Rs. 70 lakhs and get redemption at par.

Particulars	INR	Working	USD
NOC	7000000	7000000/63	111111
(-) cost	7000000	7000000/70	(100000)
			11,111

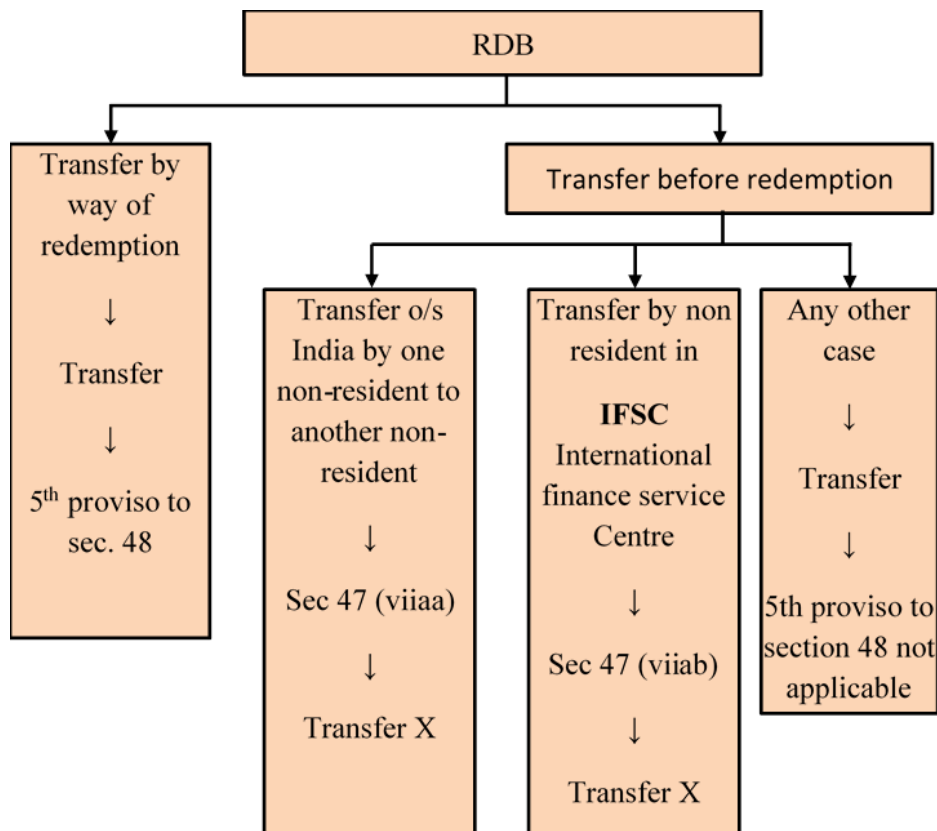
It is noticed above, that although redemption is at par a gain arises in computation which can be solely attributed on the appreciation of rupee.

To remedy this situation govt. inserted 5th proviso which states that such gain attributed to rupee appreciation needs to be ignored.

Subtotal as per above	11,111
(-) ignored as per 5th proviso	(11,111)
Capital Gain	Nil

Note:

1. The proviso mentions about “gain arising on rupee appreciation” if there is a loss due to rupee depreciation, the same is allowable i.e. need not be ignored.
2. 5th proviso applies when transfer is way of redemption of RDB. If transfer is before redemption is as under:



3. The benefit of 5th proviso to sec 48 is available not only the original subscriber, but any person who held the RDB at the time of redemption.

QUESTION 6

COST OF ACQUISITION IN CASE OF SEGREGATION OF MUTUAL FUND PORTFOLIO:
[AMENDMENT BY FINANCE ACT 2020]

ANSWER TO QUESTION 6

Introduction: The main objective of segregated portfolio is to handle defaulted bonds in the portfolio separately so that original scheme is not greatly affected and stop investor from buying at low price to take advantage price appreciation later when default dues are cleared. It also helps in fair treatment to all investors in case of a credit event and to deal with liquidity risks.

Relevant provisions:

49 (2AG) The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios.

49(2AH) The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under sub-section (2AG).

Explanation.— For the purposes of sub-section (2AG) and sub-section (2AH), the expressions “main portfolio”, “segregated portfolio” and “total portfolio” shall have the meanings respectively assigned to them in the circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160, dated the 28th December, 2018, issued by the Securities and Exchange Board of India under section 11 of the Securities and Exchange Board of India Act, 1992.’.

S.2(42A) Explanation 1:

“(hh) in the case of a capital asset, being a unit or units in a segregated portfolio referred to in sub-section (2AG) of section 49, there shall be included the period for which the original unit or units in the main portfolio were held by the assessee;”

Example: Mr. Arnab has invested in HSBC Global Fund on 01.04.2016. His total investment is Rs. 1 crore. On 01.04.2020 he receives a notice for segregation of portfolio owing to liquidity crisis emerging in the debt fund market on account of COVID – 19.

Pandemic. Accordingly, he gets 10,000 units in the segregated portfolio. You are required to calculate the capital gains if he sells both the portfolios for Rs. 80 lakhs and Rs. 30 lakhs respectively on 31.03.2021. Ignore Indexation.

Details of portfolio:

Net asset value of the asset transferred to the segregated portfolio	70 crores
net asset value of the total portfolio immediately before the segregation of portfolios	100 crores

Ans. Cost of acquisition in segregated portfolio = 1,00,00,000 70 / 100

= 70,00,000

Balance cost in the original portfolio

= 1 Crore 70 lakhs

= 30 lakhs

Computation of capital gains:

Particulars	Original	Segregated
Period of holding	01.04.2016 – 30.03.2020	01.04.2016 – 30.03.2020
Nature	LTCA	LTCA
Full Value of consideration	80	30
Less: Cost	70	30
Capital Gains	10	0

QUESTION 7

Whether receipt of higher compensation after notification of compulsory acquisition would change the character of transaction into a voluntary sale?

ANSWER TO QUESTION 7**Balakrishnan v. Union of India & Others (2017) 391 1TR 178 (SC)**

Facts of the case: The assessee owned vast area of agricultural land. The State Government acquired the property for development of a techno park. The assessee was awarded compensation of 214.37 lakhs. Aggrieved by the amount, the assessee initiated negotiations with the Collector, further to which compensation was increased to 238.42 lakhs. The assessee claimed exemption from capital gains under section 10(37)(iii) stating that the transfer of agricultural land was on account of

compulsory acquisition. The Revenue authorities contended that the exemption should be denied as it was not a compulsory acquisition but a voluntary sale.

Issue: Whether receipt of higher compensation on account of negotiations transforms the character of compulsory acquisition into a voluntary sale, so as to deny exemption under section 10(37)(iii)?

Supreme Court's Observations: The Supreme Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiations only for securing the market value of the land without having to go to the Court. Merely because the compensation amount is agreed upon during negotiations, the character of acquisition will not change from compulsory acquisition to a voluntary sale. The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

QUESTION 8

X Limited has transferred its Unit N to Y Limited by way of slump sale on November 30, 2019. The summarised Balance Sheet of X Limited as on that date is given below:

Liabilities	Rs.	Assets	Rs.
Paid up capital	1700	Fixed assets	
Reserves & Surplus	620	Unit L	150
Liabilities		Unit M	150
Unit L	40	Unit N	550
Unit M	110	Other assets:	
Unit N	90	Unit L	520
		Unit M	800
		Unit N	390
Total	2560	Total	2560

Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.

- (i) Lump sum consideration on transfer of Unit N is ₹ 880 lakhs.
- (ii) Fixed assets of Unit N include land which was purchased at ₹ 60 lakhs in August 2007 and revalued at ₹ 90 lakhs as on March 31, 2019.
- (iii) Other fixed assets are reflected at ₹ 460 lakhs (i.e. ₹ 550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 410 lakhs.
- (v) Cost inflation index for financial year 2007-08 and financial year 2019-20 are 129 and 289, respectively.

ANSWER TO QUESTION 8

Computation of capital gain on slump sale of Unit N under section 50B

Particulars	Rs.
Sale consideration for the slump sale of Unit N	880
Less: Net worth of Unit N (Refer Note 1 below)	770
Long term capital gain arising on slump sale	110

Computation of tax liability of X Ltd. on slump sale of Unit N

Particulars	Rs. In lakhs
Tax on capital gains @ 20%	22.00
Add: Surcharge @ 7%	1.54
	23.54
Add: Health & Education Cess @ 4%	0.94
Total tax liability on capital gain arising on slump sale of Unit N	24.48

Notes:

- The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	Rs. In lakhs
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	60
(ii) Other assets	390
(B) Written down value of depreciable assets under section 43(6)	410
Aggregate value of total assets	860
Less: Value of liabilities of Unit N	90
Net worth of Unit N	770

2. Since Unit N is held for more than 36 months, the capital gains of ₹ 110 lacs arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

QUESTION 9

The Balance sheet of JB Opticals Limited as on 31-03-2021 reads as under:

Paid up capital ₹ 2,52,00,000

	Unit A	Unit B
Fixed Assets	1,00,00,000	150,00,000
Debtors	1,00,00,000	75,00,000
Liabilities	28,00,000	50,00,000
Stock in Trade	50,00,000	25,00,000
Reserves		148,00,000
Share premium		22,00,000

The company acquired Unit B on 1.04.2018. They made certain capital additions in the form of Generator set and additional building etc., for ₹ 25 lacs during the year 2017-18. The members of the company have authorized the Board in their meeting held on 28.01.2021 to dispose of Unit 'B'. The company decides to sell Unit 'B' by way of slump sale for ₹ 225 lacs as consideration. The buyer is keen on buying the unit at the earliest, preferably before 31.3.2021. JB Opticals Ltd. has offered 4% discount if the buyer closes the sale and makes payment between 1.4.2021 and

30.4.2021, since the company would be able to avail benefit of concessional rate of tax on long-term capital gains. Accordingly, this discount would not be available if the sale is completed (and payment is made) before 31.03.2021. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is ₹ 120 lacs.

Would your answer change if the buyer is ready to accept discount of 3%, other facts remaining the same?

ANSWER TO QUESTION 9

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

Particulars	Rs.
Written down value of fixed assets	120
Debtors	75
Stock in Trade	25
	220
Less: Liabilities	50
Net Worth	170

Comparative calculation of chargeable capital gains

	Sale before 31.03.2021	Sale after 31.03.2021
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	0	9,00,000
Net sale consideration	2,25,00,000	2,16,00,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	55,00,000	NA
Long term capital gain	NA	46,00,000
Tax rate	31.20%	20.80%
Tax thereon	17,16,000	9,56,800

Computation of Net cash inflow:

	Sale before 31.03.2021	Sale after 31.03.2021
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	0	9,00,000
Net sale consideration	2,25,00,000	2,16,00,000
Less: Income tax	17,16,000	9,56,800
Net cash flow	2,07,84,000	2,06,43,200

Note:

The assessee is advised to effect slump sale before 31.03.2021 as the net cash flow arising from sale affected before 31.03.2021 is higher than the net cash flow arising from sale affected after 31.03.2021, inspite of the higher rate of tax on short-term capital gains.

Alternate Situation: If the buyer is ready to accept discount of 3% offered by J.B. Optical Ltd.

In this case, the capital gain tax and net cash flow would be as under:

Comparative calculation of chargeable capital gains

Particulars	Sale before 31.03.2021	Sale after 31.03.2021
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	0	6,75,000
Net sale consideration	2,25,00,000	2,18,25,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	55,00,000	NA
Long term capital gain	NA	48,25,000
Tax rate	31.20%	20.80%
Tax thereon	17,16,000	10,03,600

Computation of Net cash inflow

Particulars	Sale before 31.03.2021	Sale after 31.03.2021
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	0	6,75,000
Net sale consideration	2,25,00,000	2,18,25,000
Less: Income tax	17,16,000	10,03,600
Net cash flow	2,07,84,000	2,08,21,400

Note:

In case the buyer is ready to accept discount of 3%, the assessee can effect slump sale after 31.03.2021 as the net cash flow arising from sale effected after 31.03.2021 is higher than the net cash flow arising from sale effected before 31.03.2021.

QUESTION 10

PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for ₹ 385 lacs to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2021, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2021

Liabilities	Rs. In lakhs	Assets	Rs. In lakhs
Paid up capital	300	<u>Fixed assets</u>	
General Reserves	150	Hardware Unit	170
Share premium	50	Software Unit	200
Revaluation Reserves	120	<u>Debtors</u>	
<u>Current liabilities</u>		Hardware Unit	140
Hardware Unit	40	Software Unit	110
Software Unit	90	<u>Inventories</u>	
		Hardware Unit	95
		Software Unit	35
Total	750	Total	750

Following additional information are furnished by the management:

- (i) The Software unit is in existence since May, 2015.
- (ii) Fixed assets of software unit includes land which was purchased at ₹ 40 lacs in the year 2008 and revalued at ₹ 60 lacs as on March 31, 2021.
- (iii) Fixed assets of software unit mirrored at ₹ 140 lacs (₹ 200 lacs minus land value ₹ 60 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 90 lacs.
 - (a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.

- (b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

ANSWER TO QUESTION 10

- (a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of software unit

Particulars	Rs.
Sale consideration for the slump sale of Software unit	385
Less: Net worth of Software (Refer Note 1 below)	185
Long term capital gain arising on slump sale	200

Computation of tax liability of PQR Ltd. on slump sale of Unit Software :

Particulars	Rs. In lakhs
Tax on capital gains @ 20%	40.00
Add: Surcharge @ 7%	2.80
	42.80
Add: Health & Education Cess @ 4%	1.712
Total tax liability on capital gain arising on slump sale of Unit Software	44.512

Notes:

- The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	Rs. In lakhs
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	40
(ii) Debtors	110
(iii) Inventories	35
(B) Written down value of depreciable assets under section 43(6)	90
Aggregate value of total assets	275
Less: Value of liabilities of Unit Software	90
Net worth of Unit Software	185

Note: For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

(b) Tax advice

- (i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.
- (ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.