Unit I: Introduction to Tax Management

Tax Management

Just as everyone knows you can count on death and taxes, you know that you can count on one thing in managing taxes: change. A changing constituent base, changing ownership of properties, changing regulations, changing reporting requirements.

OpenRDA’s Tax Management system is designed to manage change. You define codes, classifications and other data types to match your needs. Use the import/export capabilities to accept updated appraisals and send data to reporting agencies.

The Tax Management Modules (Real Property and Personal Property) give you the tools you need for recording, tracking and calculating taxes. Seamless integration with Financial Management, Bank Reconciliation, Collections, and Budget Preparation keeps your financials up-to-date and ensures data consistency. User-defined tables, expressions, and formulas process supplements, unique taxes, or charges. A powerful editor that simplifies the task of editing individual records when needed.

Features:

- Powerful on-line editor updates taxpayer, property and assessed value data on-line
- Print detail and summary reports on demand
- User-defined codes and classifications simplify data management
- Land books and property books supported
- Automatically computes tax levies, late payment penalties and simple interest due
- Interface with 3rd party assessors packages to import/export data
- Information accessed via property ID, owner name or property location or other user-defined criteria
- Creates and maintains detailed records for each transaction including:
  - Property ID
  - Owner
  - Transaction Date
  - Tax/Charge Amount
  - Payment Charge
- Master files contain the following information, and more:
  - District
  - Exempt Amount
  - Market Value
  - Taxable Value
  - Class Code
  - Digest Reference Number
  - Tax Relief Code
  - Description
  - Bill Number
- Tracks unlimited number of information years
- Prior year information is secure and available for review and analysis
Tax planning is a broad term that is used to describe the processes utilized by individuals and businesses to pay the taxes due to local, state, and federal tax agencies. The process includes such elements as managing tax implications, understanding what type of expenses are tax deductible under current regulations, and in general planning for taxes in a manner that ensures the amount of tax due will be paid in a timely manner.

One of the main focuses of tax planning is to apply current tax laws to the revenue that is received during a given tax period. The revenue may come from any revenue producing mechanism that is currently in operation for the entity concerned. For individuals, this can mean income sources such as interest accrued on bank accounts, salaries, wages and tips, bonuses, investment profits, and other sources of income as currently defined by law. Businesses will consider revenue generated from sales to customers, stock and bond issues, interest bearing bank accounts, and any other income source that is currently considered taxable by the appropriate tax agencies.

Tax avoidance

**Tax avoidance** is the legal usage of the tax regime to one's own advantage, to reduce the amount of tax that is payable by means that are within the law. **Tax sheltering** is very similar, and **tax havens** are jurisdictions which facilitate reduced taxes. The term tax mitigation is sometimes used; its original use was by tax advisers as an alternative to the pejorative term tax evasion. "Tax aggressive" strategies fall into the grey area between commonplace and well-accepted tax avoidance (such as purchasing municipal bonds in the United States) and evasion. However, the uses of these terms vary.[1]

Laws known as a General Anti-Avoidance Rule (GAAR) statutes which prohibit "tax aggressive" avoidance have been passed in several developed countries including the United States (since 2010),[2] Canada, Australia, New Zealand, South Africa, Norway and Hong Kong. In addition, judicial doctrines have accomplished the similar purpose, notably in the United States through the "business purpose" and "economic substance" doctrines established in *Gregory v. Helvering* and in the UK through the *Ramsay* case. Though the specifics may vary according to jurisdiction, these rules invalidate tax avoidance which is technically legal but not for a business purpose or in violation of the spirit of the tax code.[4] Related terms for tax avoidance include tax planning and **tax sheltering**.

The term avoidance has also been used in the tax regulations of some jurisdictions to distinguish tax avoidance foreseen by the legislators from tax avoidance which exploits **loopholes** in the law such as **like-kind exchanges**. The United States Supreme Court has stated that "The legal right of an individual to decrease the amount of what would otherwise be his taxes or altogether avoid them, by means which the law permits, cannot be doubted."**Tax evasion**, on the other hand, is the general term for efforts by individuals, **corporations**, **trusts** and other entities to evade taxes by illegal means. Both tax and
Tax evasion

Tax evasion is the illegal evasion of taxes by individuals, corporations and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions. Tax evasion is an activity commonly associated with the informal economy. One measure of the extent of tax evasion (the "tax gap") is the amount of unreported income, which is the difference between the amount of income that should be reported to the tax authorities and the actual amount reported.

In contrast, tax avoidance is the legal use of tax laws to reduce one's tax burden. Both tax evasion and avoidance can be viewed as forms of tax noncompliance, as they describe a range of activities that intend to subvert a state's tax system, although such classification of tax avoidance is not indisputable, given that avoidance is lawful, within self-creating systems.[4]

Economics of tax evasion

In 1968, Nobel laureate economist Gary Becker first theorized the economics of crime,[3] on the basis of which authors M.G. Allingham and A. Sandmo produced, in 1972, an economic model of tax evasion. This model deals with the evasion of income tax, the main source of tax revenue in the developed countries. According to the authors, the level of evasion of income tax depends on the level of punishment provided by law.[4]

The literature's theoretical models are elegant in their effort to identify the variables likely to affect non-compliance. Alternative specifications, however, yield conflicting results concerning both the signs and magnitudes of variables believed to affect tax evasion. Empirical work is required to resolve the theoretical ambiguities. Income tax evasion appears to be positively influenced by the tax rate, the unemployment rate, the level of income and dissatisfaction with government.[5] The U.S. Tax Reform Act of 1986 appears to have reduced tax evasion in the United States.[citation needed]

Evasion of customs duty

Customs duties are an important source of revenue in developing countries. Importers purport to evade customs duty by (a) under-invoicing and (b) misdeclaration of quantity and product-description. When there is ad valorem import duty, the tax base can be reduced through under invoicing. Misdeclaration of quantity is more relevant for products with specific duty. Production description is changed match a H. S. Code commensurate with a lower rate of duty.[6]
Corporate Taxes in India

Corporate Tax relates to the taxation of companies in India. For the purpose of taxation laws, a Company means:

- An Indian company, or a corporate body incorporated inside or outside India
- Any institution, association or body whether incorporated or not, and whether domestic or non-resident, which is declared as a company by the Central Board of Direct Taxes (CBDT)

Income of a company

Before we head on to talking about what the rates of taxation for companies are, let’s take a look at what makes up the ‘income’ of a company. Generally, the income of a company falls under any of the following 4 heads of income:

- Profits or gains from the business
- Income from property, whether it is housing, commercial, self occupied or let out. If the property is used in the company’s business operations, it does not fall under this head.
- Capital gains
- Income from other sources including winnings from lotteries, races and interest on securities.

The resultant figure is set off against any carried forward profits / loss which is then subject to deductions that are available under relevant headings. This net income is liable to income tax.

Domestic Company and Corporate Tax

A domestic company is a company formed and registered under the Companies Act 1956 or any other company which is liable to income tax. It can be either a private or public company. Here are some of the highlights of corporate taxation for domestic companies in India.

- Domestic companies are subject to a flat rate of 30% as corporate tax on their earnings.
- If the company has a turnover of Rs. 1 crore or more, 5% surcharge is levied on the tax paid by the company.
- 3% education cess is also payable.
- Tax is levied on the global earnings of a domestic company, i.e. income from all sources is taxable.

Foreign companies and Corporate Tax

For the purpose of corporate taxation, a company whose control and management lies wholly outside India is a foreign company. It must also be noted that such companies should not have made arrangements to pay dividends within India. The taxation of foreign companies is not as straight-forward as that of a domestic company.
Highlights of how foreign companies are taxed:

<table>
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<tr>
<th>Tax rates for</th>
<th>Non-treaty foreign companies</th>
<th>Foreign companies under the US treat</th>
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</thead>
<tbody>
<tr>
<td>Dividends</td>
<td>20%</td>
<td>15%</td>
</tr>
<tr>
<td>Interest</td>
<td>20%</td>
<td>15%</td>
</tr>
<tr>
<td>Royalties</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Interest Gains</td>
<td>20%</td>
<td>15%</td>
</tr>
<tr>
<td>Technical Service</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Other Income</td>
<td>55%</td>
<td>55%</td>
</tr>
</tbody>
</table>

Taxation of foreign companies also depends on the taxation agreements between India and the country of the company. The withholding tax requirements, the DTAA and other agreements should be kept in mind.

Did you know that just a few months before the recent Union Budget, there was a lot of talk of the corporate tax rate being reduced from the flat 30% to 25% for domestic companies? Well that did not happen, however you should know that 30% is at par with most other countries in the world.

SECTION 115-O :— TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES

- The Domestic Company shall, in addition to the income tax chargeable in respect of its total income, be liable to pay additional income tax on any amount declared, distributed or paid by such company by way of dividend (whether interim or otherwise), whether out of current or accumulated profits.

- Such dividend distribution tax shall be payable @ 15% plus surcharge @ 5% plus education cess @ 2% plus SHES @ 1% of amount so declared, distributed or paid.

- The amount referred to in Sec. 115-O(1) (as above) i.e. dividend to be distributed shall be reduced by

  1. the amount of dividend, if any, received by the domestic company during the financial year, if—

     a. such dividend is received from its subsidiary;

     b. the subsidiary has paid tax under this section on such dividend; and

     c. the domestic company is not a subsidiary of any other company.
However, that the same amount of dividend shall not be taken into account for reduction more than once.

A company shall be a subsidiary of another company, if such other company, holds more than 50% of nominal value of equity share capital of the company.

2. the amount of dividend paid to any person for, or on behalf of, the New Pension System Trust established on the 27th day of February, 2008 under the provisions of the Indian Trusts Act, 1882.

The holding company should not be a subsidiary of any other company i.e. benefit u/s 115-O (1A) is available only to the ultimate holding company. But ultimate holding company can claim the benefit on dividend received from multiple subsidiary companies.

Dividend received from other type of subsidiaries i.e. subsidiaries having Controlling composition of board, sub-subsidiaries, joint venture, etc. shall not qualify benefit u/s 115-O(1A).

- The expression ‘dividend’ shall have the same meaning as is given in clause (22) of Section 2, but shall not include sub-clause (e) of clause (22) of Section 2. Dividend u/s 2(22)(e) is not covered by this Chapter and the same shall be taxable in the hands of the shareholder and the company shall not pay tax on such dividend.

- Due Date :—

The principal officer of the domestic company and the company shall be liable to pay the tax on the dividend distribution profit within 14 days from the date of declaration or distribution or payment of any dividend, whichever is earlier.

- The tax on the dividend distribution profit shall be payable whether or not the domestic company is liable to pay income tax on its total income computed in accordance with the provision of this Act.

- The tax on dividend distribution profit shall be treated as the final payment of the tax in respect of the amount declared, distributed or paid as dividends and no further credit shall be claimed by the company or by any other person in respect of the amount so paid.

- The company or the shareholder shall not be allowed any deduction in respect of the amount which has been charges to tax or the tax thereon under Sec. 115-O(1).

The interpretation of this clause is that no deduction shall be allowed to the shareholder under any provision of the Income tax Act, 1961 in respect of any expenditure which he has incurred on collection or earning of the dividend (Sec. 14A). No deduction shall be allowed to the company under any provision of the Income tax Act, 1961 in respect of the dividend so paid or tax thereon.

- The distributed profit on which tax is paid u/s 115-O (1) shall be exempted in the hands of share holder u/s 10(34).

- The tax on distributed profits shall be payable by domestic company whether or not such profit is distributed out of current year profit or accumulated profit.
• Dividend received from a foreign company is not covered by Sec.115-O and shall not be exempted in the hands of shareholders u/s 10(34). Such dividend is taxable in the hands of shareholder at the normal tax rates.

• Dividend on both preference shares and equity shares shall be considered.

• Exemptions for Companies Developing, Operating or Maintaining SEZ (Sec. 115-O(6)

No tax on distributed profits shall be chargeable in respect of the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a Special Economic Zone for any assessment year on any amount declared, distributed or paid by such Developer or enterprise, by way of dividends (whether interim or otherwise) on or after the 1st day of April, 2005 out of the current income either in the hands of the Developer or enterprise or the person receiving such dividend. [The provision of this subsection is done away with effect from 1-6-2011]. Accordingly dividend distribution tax is chargeable on amount declared, distributed by way of dividend by the said undertaking or enterprise after 1-6-2011.

SECTION 115-P:— INTEREST PAYABLE FOR NON-PAYMENT OF TAX BY DOMESTIC COMPANIES

Where the principal officer of domestic company and the company fail to pay the whole or any part of tax on distributed profits within the time i.e. 14 days, he or it shall be liable to pay simple interest @ 1% for every month or part thereof on amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

SECTION 115-Q:— CONSEQUENCES FOR NON PAYMENT OF DIVIDEND DISTRIBUTION TAX

• If principal officer of a domestic company and the company does not pay tax on distributed profits in accordance with the provisions of Section 115-O, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of the Income Tax Act, 1961 for the collection and recovery of income tax shall apply. The assessee who is deemed to be in default in making the payment of tax on distributed profits is liable for penalty u/s 221 of the Act.

CHAPTER XII–E OF THE INCOME-TAX ACT, 1961
SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED INCOME

SECTION 115-R:— TAX ON DISTRIBUTED INCOME TO UNIT HOLDERS

Any amount of income distributed by (i) a specified company, or (ii) a mutual fund to is unit holders shall be chargeable to tax and such specified company or mutual fund shall be liable to pay additional income tax on such distributed income at the following rate:
<table>
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<tr>
<th>Sr. No.</th>
<th>Particulars</th>
<th>Rate of tax</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Income is distributed by a money market mutual fund or a liquid fund to-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Individual or HUF</td>
<td>25% + 5% SC + 2% EC + 1% SHEC (w.e.f. 1-6-2011)</td>
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<tr>
<td></td>
<td>Any person other than Individual or HUF</td>
<td>30% + 5% SC + 2% EC + 1% SHEC (w.e.f. 1-6-2011)</td>
</tr>
<tr>
<td>2</td>
<td>Income is distributed by a fund other than money market mutual fund or a liquid fund to-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Individual or HUF</td>
<td>12.5% + 5% SC + 2% EC + 1% SHEC</td>
</tr>
<tr>
<td></td>
<td>Any person other than Individual or HUF</td>
<td>30% + 5% SC + 2% EC + 1% SHEC (w.e.f. 1-6-2011)</td>
</tr>
</tbody>
</table>

**PROVISION OF SEC.115R SHALL NOT APPLY IN RESPECT OF ANY INCOME DISTRIBUTED**

- by the Administrator of specified undertaking, to the unit holders; or

- to a unit holder of an equity oriented fund in respect of any distribution made from such fund.

For the purpose of this clause “Administrator” means the Administrator as referred to in clause (a) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 and "specified company" means a company as referred to in clause (h) of section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002.
The administrator of specified undertaking shall not be required to pay the tax on income distributed to the unit holders. Even the unit holders are also exempt from tax in respect of such incomes u/s 10(35).

- Due Date :

The person responsible for making payment of income distributed by the specified company or a Mutual Fund and the specified company or the Mutual Fund, as the case may be, shall be liable to pay the tax on the distribution income within 14 days from the date of distribution or payment of such income whichever is earlier.

Ø The person responsible for making payment of income distributed by the Unit Trust of India or a Mutual Fund and the Unit Trust of India or the Mutual Fund, as the case may be, shall be filed on or before 15th day of September in each year, in case of the Unit Trust of India statement of distributed income in Form No. 63 and in case of Mutual Fund statement of distributed income in Form No. 63A and verified by specified persons (an accountant) in the manner indicated therein to the Assessing Officer so designated by the Chief Commissioner or Commissioner of Income-tax within whose area of jurisdiction, the principal office of the Unit Trust of India or the concerned Mutual Fund is situated or in any other case, to the Assessing Officer within whose area of jurisdiction, the principal office of the Unit Trust of India or the concerned Mutual Fund is situated.

- The Unit Trust of India or the Mutual Fund shall not be allowed any deduction in respect of the amount which has been charged to tax or the tax thereon u/s 115R(1) or u/s 115R(2).

- Unit holder shall not be liable to pay tax on income distributed on units by the specified company or a mutual fund or administrator by virtue of section 10(35).

- The specified company or a mutual fund will not be liable to pay the tax in respect of income distributed to a unit holder of equity oriented funds. Even the unit holder shall not be liable to pay tax on such income since it is exempted u/s 10(35) in hands of the unit holder.

- Tax is on distributed income i.e. amount of income distributed by mutual fund or the specified company. Therefore, redemption of units or repurchase of units is not covered by this chapter.

SECTION 115-S :— INTEREST PAYABLE FOR NON-PAYMENT OF TAX

Where the person responsible for making payments of the income distributed by the specified company or a Mutual Fund and the specified company or a Mutual Fund, as the case may be, fails to pay the whole or any part of the tax as is referred to in sub-section (1) or sub-section (2) of section 115R, within the 14 days mention above, he or it shall be liable to pay simple interest at the rate of 1% for every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

SECTION 115-T :— CONSEQUENCES FOR NON PAYMENT OF ADDITIONAL INCOME TAX ON INCOME DISTRIBUTED TO UNITHOLDERS

Where any person responsible for making payment of income distributed defaults to pay tax on distributed profits in accordance with the provisions sub-section (1) and sub-section (2) of Section 115-R,
then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of The Income Tax Act, 1961 as applicable for the collection and recovery of taxes thereon shall apply accordingly.

Unit-2

Tax Planning for New Business

Tax Management with reference to Location and Nature of New Business

TAX MANAGEMENT IN LOCATION OF THE NEW BUSINESS

1. Sec. [10A] : Tax Holiday for newly established undertaking in Free Trade Zone:

First 5 Years – 100 % of profits and gains is allowed as deduction

Next 2 Years : 50% of such Profit and Gains is deductible for further 2 assessment years.

Next 3 Years : for the next three consecutive assessment years, so much of the amount not exceeding 50% of the profit as is debited to the profit and loss account year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Allowance Reserve Account") to be created and utilised for the purposes of the business of the assessee

2. Sec. [80IA] : an [undertaking] which,—(a) is set up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March, 2010;

(b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on the 1st day of April, 1999 and ending on the 31st day of March, 2010.

(c) undertakes substantial renovation and modernisation of the existing network of transmission or distribution lines at any time during the period beginning on the 1st day of April, 2004 and ending on the 31st day of March, 2010.

Deductions allowed is 100% or 30% of profits from such eligible business

3. Sec. [80IB] : Deduction in respect of Profits of Industrial Undertaking located in backward State or District. Deduction allowed is either 100% and/or 30% for 10 years depending upon case to case.

4. Sec. [80IB(11B)] : The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area shall be 100% of the profits and gains of such business for a period of five (5) consecutive assessment years, beginning with the initial assessment year.

5. Sec. [80IC] : Profits from Industrial Undertaking located in the specified States,. States are State of Jammu & Kashmir, Himachala Pradesh, Uttarakanchal and North Eastern States. Deduction allowed is 100% of such profit.
6. **Sec. [80 LA]:** Where the gross total income of an assessee,— (i) being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an Offshore Banking Unit in a Special Economic Zone; or (ii) being a Unit of an International Financial Services Centre, there shall be allowed a deduction from such income, of an amount equal to— 100% of such income for five consecutive assessment years beginning with the assessment year.

**Tax Management In Nature Of The New Business**

**TAX MANAGEMENT IN NATURE OF THE NEW BUSINESS**

1. **Sec. [10(1)]:** Agricultural Income—fully exempted (100%).
2. **Sec. [10(23FB)]:** Dividend or Long-Term Capital Gain (LTCG) accruing to Venture Capital or a Venture Company—100% tax exempted.

“venture capital company” means such company—
(i) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992

“venture capital fund” means such fund—
(i) operating under a trust deed registered under the provisions of the Registration Act, 1908 or operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963;
(ii) which has been granted a certificate of registration under the Securities and Exchange Board of India Act, 1992.

3. **Sec. [33 AB]:** Tea Development Account, Coffee Development Account and Rubber Development Account: Where an assessee carrying on business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of his income, whichever is earlier,— deposited with the National Bank any amount or amounts in an account the assessee shall be allowed a deduction of—

(a) a sum equal to the amount or the aggregate of the amounts so deposited; or
(b) a sum equal to 40% [forty] per cent of the profits of such business (computed under the head “Profits and gains of business or profession” before making any deduction under this section), whichever is less:

4. **Sec. [35 D]:** Amortization of Certain Preliminary Expenses: Where an assessee, being an Indian company or a person (other than a company) who is resident in India, incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2),—

(i) before the commencement of his business, or
(ii) after the commencement of his business, in connection with the extension of his [industrial] undertaking or in connection with his setting up a new [industrial] unit, the assessee shall be allowed a deduction of an amount equal to one-tenth (1/10 th.) of such expenditure for each of the ten successive previous years beginning with the previous year in which
the business commences or the new [industrial] unit commences production or operation:

5. Sec. [35 E]: Profits from Prospecting Certain Minerals: Where an assessee, being an Indian company or a person (other than a company) who is resident in India, is engaged in any operations relating to prospecting for, or extraction or production of, any mineral and incurs, after the 31st day of March, 1970, any the assessee shall be allowed for each one of the relevant previous years a deduction of an amount equal to one-tenth (1/10) of the amount of such expenditure.

6. Sec. [35 ABB]: Expenditure for obtaining licence to operate telecommunication services: In respect of any expenditure, being in the nature of capital expenditure, incurred for acquiring any right to operate telecommunication services and for which payment has actually been made to obtain a licence, there shall be allowed a deduction equal to the appropriate fraction of the amount of such expenditure.

7. Sec. [36(1)(viii)]: Special Reserve Created by Financial Corporation: in respect of any special reserve created and maintained by a specified entity, an amount not exceeding 20% of the profits derived from eligible business computed under the head “Profits and gains of business or profession” (before making any deduction under this clause) carried to such reserve account: Provided that where the aggregate of the amounts carried to such reserve account from time to time exceeds twice the amount of the paid up share capital and of the general reserves of the specified entity, no allowance under this clause shall be made in respect of such excess.

8. Sec. [42]: Special provision for deductions in the case of business for prospecting, etc., for mineral oil: For the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral, there shall be made in lieu of, or in addition to, the allowances admissible under this Act

9. Sec. [44BB]: Special provision for computing profits and gains in connection with the business of exploration, etc., of mineral oils: If an assessee engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used in the prospecting for, or extraction or production of, mineral oils, then 10% of the aggregate of the amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”

10. Sec. [44 AD]: Special provision for computing profits and gains of business of civil construction, etc.: in the case of an assessee engaged in the business of civil construction or supply of labour for civil construction, a sum equal to 8% of the gross receipts paid or payable to the assessee in the previous year on account of such business or, as the case may be, a sum higher than the aforesaid sum as declared by the assessee in his return of income, shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”:

11. Sec. [44 AE]: Special provision for computing profits and gains of business of plying, hiring or leasing goods carriages: If an assessee engaged in the business of plying, hiring or leasing such goods carriages and who owns not more than 10 goods carriages and, the income of such business chargeable to tax under the head "Profits and gains of business or profession" shall be deemed to be the aggregate of the profits and gains, computed as follows:

(i) An amount equal to Rs.3,500 [three thousand five hundred rupees] for every month or part
of a month for a heavy goods vehicle.
(ii) An amount equal to Rs. 3,150 [three thousand one hundred and fifty rupees] for every month or part of a month for other than a heavy goods vehicle.

12. Sec. [44 AF]: Special provisions for computing profits and gains of retail business: If the assessee engaged in retail trade in any goods or merchandise, a sum equal to 5% (five per cent) of the total turnover shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

13. Sec. [44B]: Special provision for computing profits and gains of shipping business in the case of non-residents: in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7½% (seven and a half per cent) of the aggregate of the amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

14. Sec. [44 BBA]: Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents: in the case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to 5% (five per cent) of the aggregate of the amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

15. Sec. [44 BBB]: Special provision for computing profits and gains of foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects: in the case of an assessee, being a foreign company, engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government, a sum equal to (10%) ten per cent of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head “Profits and gains of business or profession”.

16. Sec. [44 D]: Special provisions for computing income by way of royalties, etc., in the case of foreign companies: in the case of an assessee, being a foreign company, —

(a) the deductions admissible under the said sections in computing the income by way of royalty or fees for technical services received shall not exceed in the aggregate 20% (twenty per cent) of the gross amount of such royalty or fees;

(b) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty or fees for technical services received.

17. Sec. [80 IA]: Deductions in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development, etc.: Deductions allowed is 100% or 30% of profits from such eligible business. The profits from such business shall be computed as if such eligible business were the only source of income of the assessee.

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<tr>
<th>Nature of Industry</th>
<th>Assessee</th>
<th>Period of commencement of business</th>
<th>Deductions</th>
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MBA, M.Com, MA (SOC), B.Ed
<table>
<thead>
<tr>
<th>Infrastructure facility (new undertaking; agreement with the Central Govt.)</th>
<th>Indian Company</th>
<th>On or after 1-4-1995</th>
<th>100% for 10 years out of 20 years. In case of Port out of 15 years.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunication (New undertaking: new Plant)</td>
<td>Any undertaking. In case of domestic satellite Indian Company</td>
<td>1-4-95 to 31-3-2005</td>
<td>100% for first 5 years; 30% for next 5 years.</td>
</tr>
<tr>
<td>Industrial Park or SEZ</td>
<td>Any undertaking</td>
<td>100% for 10 years out of 5 years</td>
<td></td>
</tr>
<tr>
<td>Power ( New undertaking : New Plant)</td>
<td>Any undertaking</td>
<td>New netword – 1-4-99 to 31-3-2006</td>
<td>100% for 10 years out of 15 years</td>
</tr>
</tbody>
</table>

18. Sec. [80-IA (2A)]: the deduction in computing the total income of an undertaking providing telecommunication services shall be 100% (hundred per cent) of the profits and gains of the eligible business for the first five assessment years commencing at any time during the periods and thereafter, thirty per cent. of such profits and gains for further five assessment years;

19. Sec. [80-IB (11A)]: The amount of deduction in a case of an undertaking deriving profit from the business of processing preservation and packing of fruits or vegetables or from the integrated business of handling, storage and transportation of foodgrains, shall be 100% (hundred per cent) of the profits and gains derived from such undertaking for five assessment years and thereafter, 25% (twenty-five per cent) or 30% (thirty per cent. where the assessee is a company) of the profits and gains derived from the operation of such business in a manner that the total period of deduction does not exceed ten consecutive assessment years.

20. Sec. [80-IB (11B)]: The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area shall be 100% (hundred per cent) of the profits and gains of such business for a period of five consecutive assessment years, beginning with the initial assessment year.

21. Sec. [80-IB (11)]: the amount of deduction in a case of industrial undertaking deriving profit from the business of setting up and operating a cold chain facility for agricultural produce, shall be 100% (hundred per cent). of the profits and gains derived from such industrial undertaking for five assessment years beginning with the initial assessment year and thereafter, 25% (twenty-five percent) or 30% (thirty per cent) where the assessee is a company) of the profits and gains derived from the operation of such facility in a manner that the total period of deduction does not exceed ten consecutive assessment years.

22. Sec. [80-IB (7A)]: The amount of deduction in the case of any multiplex theatre shall be 50% (fifty per cent) of the profits and gains derived, from the business of building, owning and operating a multiplex theatre, for period of five consecutive years beginning from the initial assessment year in any place:
23. Sec. [80-IB (7B)]: The amount of deduction in the case of any convention centre shall be 50% (fifty per cent) of the profits and gains derived, by the assessee from the business of building, owning and operating a convention centre, for a period of five consecutive years beginning from the initial assessment year;

24. Sec. [80-JJA]: Deduction in respect of profit and gains from business of collecting and processing of bio-degradable waste: Where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas or], making pellets or briquettes for fuel or organic manure, there shall be allowed a deduction of an amount equal to the whole of such profits and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.


Business Organization Nature And Scope
Meaning of Business Organization
Business organization is composed of two words, business and organization. In order to understand the nature of business organization, it is necessary that the meaning of these two words is made clear to the readers.
(1) Business
Business is a human economic activity. It involves continuous and regular production and distribution of goods and services with a view to earn profit. Money flowing in and earning of profit through the satisfaction of the customers are the two measuring rods of the success of a business.
(2) Organization
The meaning of the word organization is generally divided into two parts (i) material organization and (ii) human organization.
(i) Material Organization
The material organization is the determining and providing of necessary raw materials, tools, capital, personnel etc in an enterprise fonts smooth functioning.
(ii) Human Organization
It is the appointment of qualified staff, dividing the duties and re of the personnel employed. Then grouping these duties in the form of posts and delegating authority to each post so that work is carried out as planned.

Business Organization
Thus is a process or an art of establishing effective cooperation between the factors of production (land, material, capital equipment, personnel) for producing or acquiring wealth with a view to earn profit in an enterprise. Scope of business organization. Business organization thus is a process or an art of establishing effective cooperation between the factors of production (land, material, capital equipment, personnel) for producing or acquiring wealth with a view to earn profit in an enterprise.
Scope of Business Organization
The scope of business organization has considerably expanded after the Industrial Revolution. The process of production is now quite complicated. An organization is needed to determine what each person
will do and how much authority each will have. The role of business organization in various forms of business ownership is discussed in brief.

(1) **In Sole Proprietorship**
Form of business, the organization structure is very simply. The entrepreneur generally introduces his own capital. He alone is the sole organizer, financier, decision taker, operator, and controller and above all responsible for all the success and failures of business, there is generally rule sub-division of main work into small groups.

(2) **In a Partnership Form of Business**
Ownership, each partner provides capital, labour and management according to an agreement the partners determine among themselves the extent to which each partner shall take part in the management. The pattern of division of activities, determination of responsibilities. Delegation of authority etc depends upon the nature and size of business. As the partnership business is generally run on small scale, the business organization structure is relatively simple, temporary and informal.

(3) **In a Company Form of Business**
There is a formal pattern of organization. The work of organization begins even before its incorporation by the promoters. This work of organization continues after incorporation. An organization chart of responsibilities is prepared. The duties and responsibilities of the personnel employed are defined, procedures are laid down. Methods are evolved discussed and put before the personnel in clear terms. The scope of business organization in corporate business is quite wide and complicated.

**Importance of Business Organization**

(1) **Product Growth**
Activities directed towards production are better grouped through organization. It encourages product growth and diversification.

(2) **Efficient Use**
Organization helps in the efficient use of factors of production and thus reduces cost of production of goods.

(3) **Technological Improvements**
A good organization provides for the optimum-use of technological improvements.

(4) **Creative Thinking**
It stimulates independent creative thinking in various departments of production.

(5) **Use of Skilled Salesman**
It is useful in providing skilled salesman for satisfying the various needs of the customers.

(6) **Quick Decisions**
The business organization makes easy to take quick decisions.

(7) **Recognition of The Problem**
The recognition of the problem, selection of the solution, issuing of the necessary orders can be taken with correct Timings in sound organization.

(8) **Fixing of Responsibility**
Fixing of responsibility can easily be pinpointed.

(9) **Feed Back**
An organization makes possible to take decisions about production on objective facts gathered from the market.

(10) **Mark Functions**
All the marketing functions of goods such as buying! Selling, transporting, storage, financing, risks taking
product Standardization and grading, etc., are solved by the business organization.

(11) Minimum Cost
The organization helps to attain the goals and objectives of the business at the minimum cost

Export Incentives
The Government of India has framed several schemes to promote exports and to obtain foreign exchange. These schemes grants incentive and other benefits. The few important export incentives, from the point of view of indirect taxes are briefed below:

Free Trade Zones (FTZ)
Several FTZs have been established at various places in India like Kandla, Noida, Cochin, etc. No excise duties are payable on goods manufactured in these zones provided they are made for export purpose. Goods being brought in these zones from different parts of the country are brought without the payment of any excise duty. Moreover, no customs duties are payable on imported raw material and components used in the manufacture of such goods being exported. If entire production is not sold outside the country, the unit has the provision of selling 25% of their production in India. On such sale, the excise duty is payable at 50% of basic plus additional customs or normal excise duty payable if the goods were produced elsewhere in India, whichever is higher.

India[edit]
See also: List of Special Economic Zones in India

- Inspira Pharma and Renewable Energy Park, Aurangabad, Maharashtra, India
- Sricity Multi product SEZ, part of Sricity which is a developing satellite city in the epicentre of Andhra Pradesh & Tamil Nadu, India
- Arshiya International Ltd, India's first Free Trade and Warehousing Zone[13] The largest multi-product Free trade and warehousing infrastructure in India. Arshiya's first 165 acre FTWZ is operational in Panvel, Mumbai, and is to be followed by one in Khurja near Delhi. Arshiya's Mega Logistics Hub at Khurja to have 135 acre FTWZ, 130 acre Industrial and Distribution Hub (Distripark) & 50 acre Rail siding. Arshiya International will be developing three more Free Trade and Warehousing zones in Central, South and East of India.
- Kandlar Trade Free Zone, India
- Cochin Special Economic Zone is a Special Economic Zone in Cochin, in the State of Kerala in southwest India, set up for export-oriented ventures. The Special Economic Zone is a foreign territory within India with special rules for facilitating foreign direct investment. The Zone is run directly by the Government of India. Cochin SEZ is a multi-product Zone. Cochin is strategically located. It is in southwest India, just 11 nautical miles off the international sea route from Europe to the Pacific Rim. Cochin is being developed by the Dubai Ports International as a container
transhipment terminal with direct sailings to important markets of the world, which could position it as Hub for South Asia

Advantages of free trade

**Free trade** occurs when there are no artificial barriers put in place by governments to restrict the flow of goods and services between trading nations.

When trade barriers, such as tariffs and subsidies are put in place, they protect domestic producers from international competition and redirect, rather than create trade flows.

i. **Increased production**

Free trade enables countries to specialise in the production of those commodities in which they have a [comparative advantage](#). With specialisation countries are able to take advantage of efficiencies generated from economies of scale and increased output.

International trade increases the size of a firm’s market, resulting in lower average costs and increased productivity, ultimately leading to increased production.

ii. **Production efficiencies**

Free trade improves the efficiency of resource allocation. The more efficient use of resources leads to higher productivity and increasing total domestic output of goods and services.

Increased competition promotes innovative production methods, the use of new technology, marketing and distribution methods.

iii. **Benefits to consumers**

Consumers benefit in the domestic economy as they can now obtain a greater variety of goods and services.

The increased competition ensures goods and services, as well as inputs, are supplied at the lowest prices. For example in Australia imported motor vehicles would cost 35% more if the 1998 tariff levels still applied. Clothing and footwear would also cost around 24% more.

iv. **Foreign exchange gains**

When Australia sells exports overseas it receives hard currency from the countries that buy the goods. This money is then used to pay for imports such as electrical equipment and cars that are produced more cheaply overseas.
v. Employment

Trade liberalisation creates losers and winners as resources move to more productive areas of the economy. Employment will increase in exporting industries and workers will be displaced as import competing industries fold (close down) in the competitive environment. With free trade many jobs have been created in Australia, especially in manufacturing and service industries, which can absorb the unemployment created through restructuring as firms close down or downsize their workforce. When tariffs were increased substantially in the period 1974–1984 for textiles and footwear - employment in the sector actually fell by 50 000, adding to overall unemployment.

vi. Economic growth

The countries involved in free trade experience rising living standards, increased real incomes and higher rates of economic growth. This is created by more competitive industries, increased productivity, efficiency and production levels.

B. Disadvantages of free trade

Although free trade has benefits, there are a number of arguments put forward by lobby groups and protestors who oppose free trade and trade liberalisation. These include:

- With the removal of trade barriers, structural unemployment may occur in the short term. This can impact upon large numbers of workers, their families and local economies. Often it can be difficult for these workers to find employment in growth industries and government assistance is necessary.

- Increased domestic economic instability from international trade cycles, as economies become dependent on global markets. This means that businesses, employees and consumers are more vulnerable to downturns in the economies of our trading partners, eg. Recession in the USA leads to decreased demand for Australian exports, leading to falling export incomes, lower GDP, lower incomes, lower domestic demand and rising unemployment.

- International markets are not a level playing field as countries with surplus products may dump them on world markets at below cost. Some efficient industries may find it difficult to compete for long periods under such conditions. Further, countries whose economies are largely agricultural face unfavourable terms of trade (ratio of export prices to import prices) whereby their export income is much smaller than the import payments they make for high value added imports, leading to large CADs and subsequently large foreign debt levels.

- Developing or new industries may find it difficult to become established in a competitive environment with no short-term protection policies by governments, according to the infant industries argument. It is difficult to develop economies of scale in the face of competition from large foreign TNCs. This can be applied to infant industries or infant economies (developing economies).
○ **Free trade can lead to pollution and other environmental problems** as companies fail to include these costs in the price of goods in trying to compete with companies operating under weaker environmental legislation in some countries.

○ **Pressure to increase protection during the GFC**
  During the global financial crisis and recession of 2008-2009, the impact of falling employment meant that protection pressures started to rise in many countries. In New South Wales, for example, the state government was criticised for purchasing imported uniforms for police and firefighters at cheaper prices rather than purchasing Australian made uniforms from Australian companies. Similar pressures were faced by governments in the United States, Britain and other European countries.

**Electronic Hardware Technology Park / Software Technology Parks**
This scheme is just like FTZ scheme, but it is restricted to units in the electronics and computer hardware and software sector.

**Advance Licence / Duty Exemption Entitlement Scheme (DEEC)**
In this scheme advance licence, either quantity based (Qbal) or value based (Vabal), is given to an exporter against which the raw materials and other components may be imported without payment of customs duty provided the manufactured goods are exported. These licences are transferable in the open market at a price.

**Export Promotion Capital Goods Scheme (EPCG)**
According to this scheme, a domestic manufacturer can import machinery and plant without paying customs duty or settling at a concessional rate of customs duty. But his undertakings should be as mentioned below:

- **Customs Duty Rate**
- **Export Obligation**
- **Time**

  - 10%
  - 4 times exports (on FOB basis) of CIF value of machinery.
  - 5 years
  
  - Nil in case CIF value is Rs200mn or more.
  - 6 times exports (on FOB basis) of CIF value of machinery or 5 times exports on (NFE) basis of CIF value of machinery.
  - 8 years

  - Nil in case CIF value is Rs50mn or more for agriculture, aquaculture, animal husbandry, floriculture, horticulture, poultry and sericulture.
  - 6 times exports (on FOB basis) of CIF value of machinery or 5 times exports on (NFE) basis of CIF value of machinery.
Deemed Exports
The Indian suppliers are entitled for the following benefits in respect of deemed exports:

- Refund of excise duty paid on final products
- Duty drawback
- Imports under DEEC scheme
- Special import licenses based on value of deemed exports

The following categories are treated as deemed exports for seller if the goods are manufactured in India:

- Supply of goods against duty free licences under DEEC scheme
- Supply of goods to a 100 % EOU or a unit in a free trade zone or a unit in a software technology park or a unit in a hardware technology park
- Supply of goods to holders of licence under the EPCG scheme
- Supply of goods to projects financed by multilateral or bilateral agencies or funds notified by the Finance Ministry under international competitive bidding or under limited tender systems in accordance with the procedures of those agencies or funds where legal agreements provide for tender evaluation without including customs duty
- Supply of capital goods and spares upto 10% of the FOR value to fertilizer plants under international competitive bidding
- Supply of goods to any project or purpose in respect of which the Ministry of Finance permits by notification the import of goods at zero customs duty along with benefits of deemed exports to domestic supplies
- Supply of goods to power, oil and gas sectors in respect of which the Ministry of Finance permits by notification benefits of deemed exports to domestic supplies

Manufacture Under Bond
This scheme furnishes a bond with the manufacturer of adequate amount to undertake the export of his production. Against this the manufacturer is allowed to import goods without paying any customs duty,
even if he obtain it from the domestic market without excise duty. The production is made under the supervision of customs or excise authority.

**Duty Drawback**
It means the rebate of duty chargeable on imported material or excisable material used in the manufacturing of goods in and is exported. The exporter may claim drawback or refund of excise and customs duties being paid by his suppliers. The final exporter can claim the drawback on material used for the manufacture of export products. In case of re-import of goods the drawback can be claimed. The following are Drawbacks:

- Customs paid on imported inputs plus excise duty paid on indigenous imports.
- Duty paid on packing material.

Drawback is not allowed on inputs obtained without payment of customs or excise duty. In part payment of customs and excise duty, rebate or refund can be claimed only on the paid part.

In case of re-export of goods, it should be done within 2 years from the date of payment of duty when they were imported. 98% of the duty is allowable as drawback, only after inspection. If the goods imported are used before its re-export, the drawback will be allowed as at reduced percent.

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**Incentives from Government of India to Indian Exporters and how to benefit from them**

**Why Exports?**
Exports are essential for any economy because all export activities generate employment within the
country and result in earning of foreign exchange. It is more important for a country like India where foreign exchange outflow on account of imports is much higher compared to foreign exchange inflows on account of exports.

In fact, as per current statistics of WTO for the year 2009, India ranks No. 3 in trade deficit behind US and UK. US is at first position with a trade deficit of USD 549 billion and UK at second with USD 129 billion and India at 3rd with USD 87 billion. More worrying is the estimate of Ministry of Commerce for the year 2010-11 which expects deficit to touch USD 135 billion. We therefore have no options but to increase our exports substantially for the health of our economy.

Small and Medium Enterprises [SMEs] account for about 45% of the manufacturing output and 40% of total exports of the country. Apart from generating employment for approximately 59 million people SMEs have proved themselves as cost competitive manufacturers.

When major developed countries are yet to come out of recession, India is expected to achieve 8.5% growth annually. The quality goods produced in India, therefore should be able to make their presence felt internationally. To support this, Government of India has taken many measures particularly to neutralise the Indirect Taxation and to boost cost competitiveness of Indian products and services.

Most of these initiatives are announced by Directorate General of Foreign Trade [DGFT] under Policy framework known as ‘Foreign Trade Policy [FTP]’. The schemes announced under FTP form a significant part of strategy of export promotion.

The schemes include ‘exemption’ or ‘neutralisation’ from Indirect taxes (Customs Duty, Excise Duty, Service Tax, etc.) on one hand and performance based rewards by way of duty credits on the other hand. The exemption or neutralisation is offered at pre-export or post-export stage to facilitate manufacturers and merchants to avail the duty exemption or neutralisation. For import or local procurement of inputs required for manufacturing of export products the following instruments are available under FTP. For import or local procurement of inputs required for manufacturing of export products the following instruments are available under FTP:

a) Advance Authorisation [AA] including Annual Advance Authorisation
b) Duty Free Import Authorisation [DFIA]

These instruments offer exemption from payment of Customs/Excise duties on imports/indigenous procurement of inputs.

Duty Entitlement Passbook Scheme [DEPB] and Duty Drawback [DBK] are instruments which offer duty remission or duty refund of input duties post-exports. These instruments neutralise the impact of central duty/taxes on inputs.

The salient features of these instruments are as under:

Advance Authorisation [AA] including Annual Advance Authorisation [AAA]:

- All inputs which are consumed for producing export product can be imported under Advance Authorisation.
- Export items for which advance authorisation is to be obtained should be covered under Standard Input Output Norms [SION]. If SION is not available, application on basis of self declared norms can be made.
- Exempts all duties - Basic Customs Duty [BCD], Additional Customs Duty or Countervailing Duty [CVD], Special Additional Duty [SAD], Anti-dumping duty and Safeguard duty.
- Subject to Actual User Condition.
- AA and materials imported under AA are not transferable.
- Minimum value addition [VA] of 15% is required to be maintained.
• AA is valid for a period of 24 months and export obligation is required to be fulfilled within a period of 36 months.
• AA can be obtained in cases where foreign buyer supplies all or few inputs on ‘free of cost’ basis.
• By invalidating AA for direct import, authorisation holder can procure inputs from local market. This can be done by availing facility of Advance Authorisation for Intermediate Supply or Advance Release Order or Back-to-Back Letter of Credit, as the case maybe.
• Facility of AAA is allowed to Status Certificate holders like Export House, Trading House, etc. and all other categories of exporters having past export performance (in preceding two years).
• Entitlement in terms of CIF value of imports under AAA shall be upto 300% of the FOB value of physical export and / or FOR value of deemed export in preceding licensing year.

Unit-3

Tax planning and Financial Management Decisions

At Financial Decisions, we provide specialist taxation planning advice to ensure that your tax liability is legally minimized and your overall financial plan is structured in the most tax effective manner. Taxation legislation changes constantly and every day new court cases are decided, which influence the interpretation of the legislation. We closely monitor the legislation and rulings and provide our clients with accurate and timely advice. Our team will provide strategic advice in relation to successfully managing your taxation, compliance and accounting affairs. We’ll help structure your business to meet your income tax, accounting and estate planning requirements, including the use of corporations, partnerships, trusts and superannuation funds. We’ll review your superannuation fund and provide guidance on complex legislation, accumulating benefits for your retirement, creating a retirement strategy and obtaining taxation concessions.

We also specialize in self-managed superannuation funds (SMSFs), which suit certain individuals, families and small businesses but must have less than five members. We can assist you to establish a SMSF and provide the necessary support to administer the fund on your behalf. Please call us today for strategic advice on minimizing your taxation and maximizing your future wealth.
Management Decision - Capital Structuring: On should understand the basis of arriving at the decision about capital structure, i.e., debt, equity or preference shares. The factors like risk, cost and control are relevant. In addition one must understand the tax implication and should also consider this while deciding the best mix to optimize shareholder's return. Dividend on share is not allowable deduction in the hand of the company; however, interest on debt paid is allowable deduction. The cost of raising equity is a capital expenditure which can only be capitalized and amortized in certain conditions (may not be amortized in all cases). However, the cost of raising debt is allowed as deduction. This has direct implication in calculating corporate tax liability. On dividend from Indian company, the company is liable to pay DWT and then such dividend is exempt in the hand of the shareholders.

Management Decision: Make or Buy: In Financial management course, students are taught to understand the basis of arriving at the make or buy decision considering capacity utilization, inadequacy of fund, cost of fund, latest technology, variable cost of manufacturing etc. While arriving at this decision due consideration must also be given to tax implication as this will certainly influence the decision. One must consider that if one decides to make, there is less outflow due to tax benefit on depreciation/interest and tax advantage available due to location of manufacturing in a particular area. These tax advantages have already been listed earlier. If the company is able to take advantage of any of these tax incentives, the decision to make may come out better in comparison to decision to buy.

Management Decision: Own or Lease: Concept of leasing is gaining immense popularity. One private airline has recently sold and taken back the same aircraft on lease. In the process it got some fund in its account. One factor which influenced its decision was that the lease rental paid to foreign enterprise is not subject to withholding tax if the lease agreement has been approved by the Central Government. Other factors which must be considered for tax implications are that in case of buying the asset, the assessee will be entitled to deduction on the account of depreciation and interest, while in case of lease he will be entitled to deduction on account of lease rental which will be higher in the initial years. Hence, tax consideration will also influence management decision to own or lease.

Capital Gain: It is important to understand that long term capital gain tax is less than normal tax on business or interest income. Further in case of equities, where security transaction tax is paid, there is no long-term capital gain and short-term capital gain is only charged at 10%. Even if the taxpayer has long term capital gain he has the opportunity to reduce it by properly investing it in approved bonds of National Highway Authority or Rural electrification Corporation under section 54EC or investing in house property under section 54 and 54F. Thus if some one has an option to earn regularly or through capital gain, the earning through capital gain will attract less tax. This will influence the investment decision of the taxpayer.

Amalgamation: There is limitation in the Income-tax Act for carry forward of losses. It is quite possible that one of the group companies is making profit and another group company is making losses. Some of these losses may be getting lapsed due to time limitation. One can not transfer profit of one Group Company to another just like that as it would amount to tax avoidance and can invite trouble. The tax planning in such cases could be to merge the two companies. However, it must be ensured that the conditions of merger as given in the Income-tax Act are satisfied. These are:

1. All property and liability of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of amalgamation.
2. Shareholders holding not less than 75% in value of the shares in the amalgamating company or companies become shareholders of the amalgamated company by virtue of the amalgamation.
3. Conditions as prescribed in section 72A of the Income-tax Act are satisfied by both amalgamating company and the amalgamated company.
Corporate Finance - Factors that Influence a Company's Capital-Structure Decision

The primary factors that influence a company's capital-structure decision are:

1. Business Risk

Excluding debt, business risk is the basic risk of the company's operations. The greater the business risk, the lower the optimal debt ratio.

As an example, let's compare a utility company with a retail apparel company. A utility company generally has more stability in earnings. The company has less risk in its business given its stable revenue stream. However, a retail apparel company has the potential for a bit more variability in its earnings. Since the sales of a retail apparel company are driven primarily by trends in the fashion industry, the business risk of a retail apparel company is much higher. Thus, a retail apparel company would have a lower optimal debt ratio so that investors feel comfortable with the company's ability to meet its responsibilities with the capital structure in both good times and bad.

2. Company's Tax Exposure

Debt payments are tax deductible. As such, if a company's tax rate is high, using debt as a means of financing a project is attractive because the tax deductibility of the debt payments protects some income from taxes.

3. Financial Flexibility

This is essentially the firm's ability to raise capital in bad times. It should come as no surprise that companies typically have no problem raising capital when sales are growing and earnings are strong. However, given a company's strong cash flow in the good times, raising capital is not as hard. Companies should make an effort to be prudent when raising capital in the good times, not stretching its capabilities too far. The lower a company's debt level, the more financial flexibility a company has.

The airline industry is a good example. In good times, the industry generates significant amounts of sales and thus cash flow. However, in bad times, that situation is reversed and the industry is in a position where it needs to borrow funds. If an airline becomes too debt ridden, it may have a decreased ability to raise debt capital during these bad times because investors may doubt the airline's ability to service its existing debt when it has new debt loaded on top.

4. Management Style

Management styles range from aggressive to conservative. The more conservative a management's approach is, the less inclined it is to use debt to increase profits. An aggressive management may try to grow the firm quickly, using significant amounts of debt to ramp up the growth of the company's earnings per share (EPS).

5. Growth Rate
Firms that are in the growth stage of their cycle typically finance that growth through debt, borrowing money to grow faster. The conflict that arises with this method is that the revenues of growth firms are typically unstable and unproven. As such, a high debt load is usually not appropriate.

More stable and mature firms typically need less debt to finance growth as its revenues are stable and proven. These firms also generate cash flow, which can be used to finance projects when they arise.

6. Market Conditions
Market conditions can have a significant impact on a company's capital-structure condition.
Suppose a firm needs to borrow funds for a new plant. If the market is struggling, meaning investors are limiting companies' access to capital because of market concerns, the interest rate to borrow may be higher than a company would want to pay. In that situation, it may be prudent for a company to wait until market conditions return to a more normal state before the company tries to access funds for the plant.

DIVIDENDS
The following aspects may generally be kept in mind in the matter of dividend on shares.

1. Dividends can be declared or paid for a financial year out of profits of that financial year or previous years after providing for at least the prescribed depreciation or the losses for each of those years, whichever is less.

2. In case of inadequacy of profits, the Company may declare dividends out of accumulated reserves provided the following conditions are satisfied with:
   a. The rate of dividend shall not exceed the average rate at which dividends are paid in the preceding 5 financial years or 10% whichever is less.
   b. The total amount used from reserves shall not exceed 10% of the paid-up capital and free reserves and such amount shall first be used to set off against losses of that financial year.
   c. The remaining reserves shall not fall below 15% of its paid-up share capital.

3. Before declaration/payment of dividends, a Company shall transfer to reserves at least the following percentage of its profits after depreciation:

<table>
<thead>
<tr>
<th>Dividend as % of paid-up</th>
<th>% of profits to be transferred to</th>
</tr>
</thead>
</table>

M. Murali, Asst. Prof.
MBA, M.Com, MA (SOC), B.Ed
4. A Company can transfer to reserves more than 10% of its profits
   
i. Where dividend is declared, —
   a. dividend is declared/paid at a rate equal to the average rate of dividend in the preceding three years.
   b. in case bonus shares were issued during this period of 3 preceding financial years, then the dividend declared/paid during that financial year shall be an amount at least equal to the average amount of dividend declared over the 3 years immediately preceding the financial year.

Provided that where net profits after tax are
   i. lower by 20 per cent or
   ii. more than the average net profits after tax of the two financial years immediately preceding. Conditions in this paragraph will not apply.
   iii. Further, where the Company does not declare any dividend,—

the Company can make transfers to reserves from profits of that year of an amount not exceeding the average amount of dividends distributed in the three preceding financial years.

5. The dividend declared shall be transferred within 5 days of declaration in a separate bank account. Dividends not paid/claimed within 30 days of such declaration shall be transferred to a separate bank account.

6. Dividends shall be payable only in cash.

Interoperate dividends

• a) Dividends received on common and preferred stock held in other corporations. They are included in income for tax purposes, but if they are received from a taxable Canadian corporation, the full amount of the dividend is not taxable and can flow through the receiving company to their shareholders without tax consequences. This avoids the triple taxation; b)
Dividends received by a corporation from investments in common and preferred shares held in other corporations.

**BONUS SHARES**

1. Generally, fully paid-up bonus shares can be issued out of free reserves, share premium account and capital redemption reserve.

2. The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 also provide conditions for such issue, which, in particular include the following:
   
   a. When there are any convertible debentures pending conversion, similar benefit shall be extended through reservation to such holders.
   
   b. Revaluation reserves cannot be used for issue of bonus shares.
   
   c. Bonus shares cannot be issued in lieu of dividend.
   
   d. Before issuing bonus shares, the Company shall ensure that all partly paid-up shares are made fully paid-up.
   
   e. The company should not have defaulted in payment of interest or the repayment of principal on fixed deposits or other debt securities and payment of statutory dues such as provident fund, etc.
   
   f. Bonus issue has to be implemented with 15 days of Board Meeting where bonus issue is approved. Where the articles require amendment to permit capitalization of reserves for such bonus issue, the bonus issue should be implemented within 2 months of such Board Meeting. Bonus issue once announced, cannot be withdrawn.

'Interoperate Investment'

Interoperate investments are accounted for differently than other funds held by a company. Short-term investments that are expected to be turned into cash are considered current assets, while other investments are considered non-current assets. When companies buy interoperate investments, dividend and interest revenue is reported on the income statement.

Definition of 'Interoperate Investment'

Securities that are purchased by corporations rather than individual investors. Interoperate investments allow a company to achieve higher growth rates compared to keeping all of its funds in cash. These investments can also be used for strategic purposes like forming a joint ventures or making acquisitions. Companies purchase securities from other companies, banks and governments in order to take advantage
of the returns from these securities. Marketable securities that can readily be exchanged for cash, such as notes and stocks, are usually preferred for this type of investment

**Tax benefit**

One of the advantages to shareholders in the receipt of bonus share is the beneficial treatment of such dividends with regard to incomes taxes. When a shareholder receives cash dividend from company, this is included in his ordinary income and taxed at ordinary income tax rate. But the receipt of bonus shares by the shareholder is not taxable as income.

**Indication of higher future profits**

The issue of bonus shares is normally interpreted by shareholders as an indication of higher profitability. When the profits of a company do not rise, it declares a bonus issue; the company will experience a dilution of earnings as a result of the additional shares outstanding. Since a dilution of earnings is not desirable, directors usually declare bonus shares only when they expect rise in earnings to offset the additional outstanding shares.

**Future dividends may increases**

If a company has been following a policy of paying a fixed amount of dividend per share and continues it after the declaration of the bonus issue, the total cash dividends of the shareholders will increase in the future.

**Psychological value**

The declaration of the bonus issue may have a favorable psychological effect on shareholders. The receipt of bonus shares given them a chance to sell the shares to make capital gains without impairing their principal investment.

**Conservation of cash**

The declaration of a bonus issue allows the company to declare a dividend without using up cash that may be needed to finance the profitable investment opportunities within the company. The company is thus, able to retain earnings and at the same time satisfy the desires of shareholders to receive dividend.

**More attractive share price**
Sometimes the intention of a company in issuing bonus shares is to reduce the market price of the share and make it more attractive to investors. If the market price of a company’s share is very high, it may not appeal to small investors.

**Unit-4**

**Tax Planning and Management Decisions**

**Tax Management with reference to – Lease or Buy Decisions**

Definition of ‘Tax Planning’

Logical analysis of a financial situation or plan from a tax perspective, to align financial goals with tax efficiency planning. The purpose of tax planning is to discover how to accomplish all of the other elements of a financial plan in the most tax-efficient manner possible. Tax planning thus allows the other elements of a financial plan to interact more effectively by minimizing tax liability.

**Tax Management**

Just as everyone knows you can count on death and taxes, you know that you can count on one thin thing in managing taxes: *change*. A changing constituent base, changing ownership of properties, changing regulations, changing reporting requirements.

OpenRDA’s **Tax Management** system is designed to manage change. You define codes, classifications and other data types to match your needs. Use the import/export capabilities to accept updated appraisals and send data to reporting agencies. The Tax Management Modules (Real Property and Personal Property) give you the tools you need for recording, tracking and calculating taxes. Seamless integration with Financial Management, Bank Reconciliation, Collections, and Budget Preparation keeps your financials up-to-date and ensures data consistency. User-defined tables, expressions, and formulas process supplements, unique taxes, or charges. A powerful editor that simplifies the task of editing individual records when needed

**Features:**

- Powerful on-line editor updates taxpayer, property and assessed value data on-line
- Print detail and summary reports on demand
- User-defined codes and classifications simplify data management
- Land books and property books supported
- Automatically computes tax levies, late payment penalties and simple interest due
- Interface with 3rd party assessors packages to import/export data
- Information accessed via property ID, owner name or property location or other user-defined criteria
- Creates and maintains detailed records for each transaction including:
  - Property ID
LEASE OR BUY DECISIONS

Assets may be purchased or taken on lease. Apart from tax angle other factors also are important in taking lease or buy decisions like rate of change in technology.

Advantages when Assets are taken on Lease: Lease Rental can be claimed as deduction as revenue expenditure. However Depreciation cannot be claimed since assets are not owned by the assessee.

Advantage when Assets are Purchased: Depreciation on specified assets can be claimed as deduction u/s 32. the Assets may be purchased outrightly or may be taken on loan. Where the asset is taken on loan interest amount can either be claimed as revenue expenditure or can be capitalized. But where interest is paid after the asset is first put us use, the deduction on account of interest shall be claimed as revenue expenditure, i.e. such interest cannot be capitalized.

Note:
>> Since the lease rentals and loan are repayable in instalments, then the cash outflow for each separate year should be converted into present value of today's cost, i.e. Cash Inflow.

HOW TO SOLVE QUESTIONS

Where the Asset is Purchased on Loan:

1. Compute Repayment of Loan spread over a number of years.
2. Compute Interest on Loan spread over a number of years.
3. Compute each Outflow (Interest + repayment of Loan) spread over a number of years.
4. Compute Depreciation on Assets spread over a number of years.
5. Compute Tax saved on deduction claimed (Interest + depreciation) spread over a number of years.
6. Compute adjusted cash outflow which is \((3 - 5)\)
7. Compute present value of adjusted cash outflow.

**Where the Asset is Leased:**

1. Compute the time processing fees in zero year.
2. Computer Lease Rental spread over a number of years.
3. Compute Cash Outflow (processing fees + lease rental) spread over a number of years.
4. Compute Tax saved on deduction claimed (processing fees + lease rental) spread over a number of years.
5. Compute adjusted cash Outflow which is \((3 - 4)\)
6. Compute present value of adjusted cash outflow.

**What is the Present Value (PV Value):**

It is the discontinue value, its opposite is future value of cash investment which you make today. In simple terms what is the value of cash in ‘Zero year’ when there is cash outflow in 5th year or for that matter nth year. To discount the cash outflow occurring in 5th year, there is table given which is known as annuity table. This is shown below by way of illustration.

E.g. Computer Present Value of cash outflow from the following information:

<table>
<thead>
<tr>
<th>Cash Outflow</th>
<th>1st Year</th>
<th>2nd Year</th>
<th>3rd. Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rs.80,000</td>
<td>Rs. 40,000</td>
<td>Rs. 50,000</td>
<td></td>
</tr>
<tr>
<td>PV factor at 10% of internal return</td>
<td>0.909</td>
<td>0.826</td>
<td>0.751</td>
</tr>
</tbody>
</table>

**Solutions:**

Discounted Value in Zero Year

| Rs. 72,720 | Rs. 33,040 | Rs. 37,550 |

The Value of Rs. 72,720, Rs. 33,040, Rs. 37,550 represents discounted value of Zero Year.

**Tax Management with reference to – ‘Sale of Scientific Research Asset’**

**Sale of Scientific Research Asset**

**SCIENTIFIC RESEARCH ASSET SOLD AFTER HAVING BEEN USED FOR THE PURPOSE OF BUSINESS.**

As per explanation 1 to section 43(1) where an asset is used in the business after it ceases to be used for scientific research related to that business the actual cost of the asset to be included in the relevant block of asset shall be taken as nil as 100% deduction has already been allowed. If such asset is sold then the value of block shall be reduce by the sale value of the asset.

**SECTION 41(3). SCIENTIFIC RESEARCH ASSET SOLD WITHOUT HAVING BEEN USED**
FOR THE PURPOSE OF BUSINESS

(1) Where an asset representing expenditure of a capital nature on scientific research, is sold, (2) without having been used for other purposes, and (3) the proceeds of the sale together with the actual amount of the educations made, the amount of the deduction exceed the amount of the capital expenditure (4) the excess or the amount of the deductions so made, whichever is the less, (5) shall be chargeable to income-tax as income of the business or profession of the previous year in which the sale took place.

The Clause is applicable even if the business is not in existence during PY.

ANALYSIS:

1. Profit from Business = Sale price or cost whichever is lower.
2. Capital Gain = Sale consideration minus cost of acquisition. If LTCA minus indexed cost of acquisition. There can be no loss under the head Capital Gai

TAX PLANNING VIEW:

Tax planning question can be whether the scientific research asset should be sold by using for the purpose of business or without being used for the purpose of business.

1. Scientific research asset can either be sold without being used for the purpose of business as such. Sale of scientific research asset as such shall give rise to capital gain which can be either short-term capital gain or long-term capital gain.
2. Sale of Scientific Research Asset after it is put to use for the purpose of business shall reduce the depreciation for subsequent years. Capital gain shall arise depending upon the block of asset. As per section 50 Capital Gain can arise only if on the last day of the PY.
3. Block of Assets do not exist; or
4. WDV is Zero.

make or buy decision

Determination of whether it is more advantageous to make a particular item in-house, or to buy it from a supplier. The choice involves both qualitative (such as quality control) and quantitative (such as the relative cost) factors.

Specific deductions: repairs & renewals: Overview

This section is intended to take you through the issues that you need to consider when looking at whether the cost of 'repairs' is allowable expenditure.

The general position is that the cost of:

☐ a repair is normally allowable expenditure, but

☐ replacing the asset or of making a significant improvement to the asset as a whole (the 'entirety') will be capital expenditure and not allowable as a deduction.

This guidance looks at the questions of what is the asset as opposed to part of an asset; and what is an improvement or alteration?
Timing – Relief is given when the cost of the repair is deducted in the profit & loss account in line with accountancy principles (UK GAAP). Further guidance on timing can be found at BIM46905.

Replacing an asset – Replacing a part is a repair to the larger asset, replacing the whole asset is not a repair, and is not an allowable deduction for tax purposes because it is capital expenditure. For guidance on what is the asset and whether you are repairing or replacing an asset see BIM46910.

Integral features – Replacing certain 'integral features' of a building or structure is treated as capital expenditure. For guidance on what are integral features see BIM46945.

Improvements – The cost of improvements to an asset are not allowable expenses – for guidance on what is an improvement see BIM46915.

Alterations – the cost of altering an asset so it does something different are not allowable. For guidance on what is an alteration see BIM46915.

New materials – repairs are often carried out using new materials. The use of new materials does not mean that the repair is not allowable. For guidance on cases involving the use of new materials, see BIM46920.

New technology – the introduction of new technology may mean that the new parts are better than or last longer than the old, but the question to ask is whether the asset as a whole has been improved. If it does the same job as it did before then it may well be simply a repair. For guidance on this point see BIM46925.

Change of ownership – although an asset has been recently acquired the cost of repairs will usually remain allowable expenditure. For example the cost of routine repairs and maintenance remain allowable expenditure. If an asset is acquired in a run down condition then the cost of putting the asset into a useable condition is capital expenditure and not an allowable deduction. For further guidance on this point see BIM46935.

Capital allowances – The capital allowances legislation contains deeming provisions that treats significant amounts of work on features in a building, including the electrical or air conditioning system as capital expenditure which is not allowed as a revenue deduction. For further guidance on this point and other issues involving capital allowances see BIM46945 and CA 22340.

The capital allowances legislation also provides an entitlement to allowances in certain circumstances in respect of expenditure incurred on plant or machinery that is or becomes a fixture. For further guidance see CA26025 onwards.

Character of the asset – As a final check, you need to consider the results of the work carried out. If as a result of the work the asset can simply be used to do the same job as before then it is likely to be a repair and therefore allowable expenditure. If it can do more or can do something different then the character of the asset has changed and the work is likely not to be an allowable expense. For further guidance on this point see

Asset Shutdown

If you want to stop calculating periodic depreciation from a certain period or a specified period for certain assets. Then you should use the functionality of Asset Shutdown.

You should identify the depreciation key where you want asset shutdown activated and then tick the asset shutdown on the asset master data with the time interval.

Continuous Asset Evaluation,
collaborating with the Departments of State, Justice, and Treasury, the Department of Homeland Security has developed the Continuous Asset Evaluation, Situational Awareness and Risk Scoring reference architecture. As an architectural reference, CAESARS represents a solution for making assessments on a continuous or nearly continuous basis—this is a prerequisite for moving IT security management from isolated assessments that support infrequent authorization decisions to continuous risk management as described in the current federal guidance of the National Institute of Standards and Technology and Office of Management and Budget mandates.

The CAESARS approach provides a means of monitoring security controls and focusing staff efforts on those controls most likely to enhance the agency's information security posture.

Unit 5

Tax Issues Relating to Amalgamation

Tax Issues

Definition of 'Original Issue
The discount from par value at the time that a bond or other debt instrument is issued. It is the difference between the stated redemption price at maturity and the issue price.

Common parlance
Amalgamation means merger of one or more companies with another company or the merger of two or more companies to form one company.

The Companies Act 1956
A merger or amalgamation has not been specifically defined under the Companies Act.

A merger of two companies involves a scheme of restructuring under the Companies Act, 1956 *. The process involves the following approvals:

- Approval of the Board of Directors of the two companies.
- Approval of the shareholders of the two companies in a general meeting.
- Approval of the High Courts of relevant jurisdiction.

The High Courts within whose jurisdiction the registered offices of the companies are situated should approve the scheme of merger. This process could typically take six to eight months.
The Income-tax Act 1961
The Income-tax Act provides for capital gains tax exemption to a company being amalgamated into another company, and also to the shareholders of the amalgamating company **. The following conditions have to be satisfied to classify a transaction as an 'amalgamation' under the Act ***: -
* Section 391 of the Companies Act, 1956.
** Section 47(vi) and 47(vii) of the Income-tax Act, 1961.
*** Section 2(1B) of the Income-tax Act, 1961.

All the property of the amalgamating company immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

- 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; and
- Shareholders holding not less than three-fourths in value of the shares in the amalgamating company become shareholders of the amalgamated company by virtue of the amalgamation.

Accounting Standards
As per para 3 of 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.
Amalgamation in the nature of merger is an amalgamation, which satisfies all the following conditions: -

- All the assets and liabilities of the transferor company become, after amalgamation, the assets and liabilities of the transferee company.
- Shareholders holding not less than 90% of the face value of the equity shares of the transferor company (other than the equity shares already held therein, immediately before the amalgamation, by the transferee company or its subsidiaries or their nominees) become equity shareholders of the transferee company by virtue of the amalgamation.
- The consideration for the amalgamation receivable by those equity shareholders of the transferor company who agree to become equity shareholders of the transferee company is discharged by the transferee company wholly by the issue of equity shares in the transferee company, except that cash may be paid in respect of any fractional shares.
- The business of the transferor company is intended to be carried on, after the amalgamation, by the transferee company.
- No adjustment is intended to be made to the book values of the assets and liabilities of the transferor company when they are incorporated in the financial statements of the transferee company except to ensure uniformity of accounting policies.
• Amalgamation in the nature of purchase is an amalgamation, which does not satisfy any one, or more of the conditions specified above, vis-à-vis for a merger.

**Capital Gains**

The Income-tax Act provides for capital gains tax exemption to a company being amalgamated into another company, and also to the shareholders of the amalgamating company on the fulfillment of specified conditions.

**Depreciation**

1. The transferor company would be eligible for depreciation up to the date of amalgamation.
2. Amendment to Software Technology Park of India (STPI) and Customs approvals
3. Applications would have to be made for seeking amendments to the STPI and Customs approvals obtained by the transferor company for its Export Oriented Undertakings (EOU) unit, to reflect the change in the legal entity.

**Stamp duty**

Stamp duty would be levied on the documents executed for the transfer of properties, based on the value of the properties conveyed by the documents. The rates would depend upon the nature of the property and its location.

**Sales tax**

Transfer of assets as part of a merger should not be liable to sales-tax.

**Legal & Tax Issues - Transferee Company**

**Income tax - depreciation**

The Act provides that *where any assets are transferred by an amalgamating company to an amalgamated company, in a scheme of merger, and the merged company is an Indian company, the actual cost of the transferred capital asset to the amalgamated company would be the same as it would have been if the amalgamating company has continued to hold the capital asset for the purposes of its own business.*

*Explanation 7 to section 43(1) of the Income-tax Act, 1961.*

Further, where any block of assets is transferred by the amalgamating company to the amalgamated company in a scheme of amalgamation, the actual cost of the block of assets in the hands of the amalgamated company would be the written down value of the block of assets in the hands of the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed during the year of transfer.
Availability of tax losses of the amalgamating company to the amalgamated company

The following conditions need to be complied with.

The amalgamating company must have:

1. Been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years.
2. Held continuously on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation.
3. The amalgamated company must:
4. Hold continuously for a minimum period of five years from the date of the amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation.
5. Continue the business of the amalgamating company for a minimum period of five years from the date of amalgamation.
6. Fulfill such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

**Tax Benefits in Amalgamation**

Mergers and acquisitions are an important tool of economic development and every effort should be made to incentivize the merger process in the country. Fiscal statutes form an important means of economic development by providing benefits to the concerned businesses. Large scale mergers are occurring at a fast pace within and outside the country. In this regard the income tax legislation in India is quite development oriented for domestic companies going in for merger or amalgamation and acquisition. In India, the Income Tax Act, 1961 is the primary legislation dealing with taxability of income arising in the hands of an individual or business entity. An important question that arises here is: What are the benefits available under the Income Tax Act, 1961, to companies going in for merger or acquisition. These benefits are available in the form of allowable deductions from the income in the hands of an individual or companies. They apply equally to companies going in for merger or acquisition in India. The focus of the present paper is to highlight the deductions available to companies going in for mergers. A firm can achieve growth in several ways. It can grow internally or externally. Internal Growth can be achieved if a firm expands its existing activities by up scaling capacities or establishing new firm with fresh investments in existing product markets. Where a firm grows internally, it can face problems with regard to the size of the existing market or product, no growth potential in future or government restriction on capacity enhancement. The income tax legislation acts as an aid to external growth by providing deductions under its provisions. Fiscal statutes are a significant source of economic development and create space for growth of industrial activities within the country. Therefore a legal metamorphosis occurs when a merger takes place. The Income Tax Act, 1961 contains special provisions so as to minimize the ambiguities in ascertaining the tax liabilities of the merged entity. In India, the primary fiscal legislation dealing with mergers is concerned solely with the amalgamation of companies and does not refer to amalgamation between other forms of legal entities like partnership firms or sole proprietorship. The
following type of mergers is envisaged: merger of one or more company with some other company and the merger of to or more companies form a new company.

Though the income tax deductions stand discontinued at any time, but being part of legislations point towards their recurring nature and availability at any time for a company.

NATURE OF THE STUDY

The nature of the study is a doctrinal one. The subject matter of the study being on the notions of Tax Benefits in Amalgamation, it would have been impracticable to carry out a non-doctrinal research project without analyzing such clauses and that too in absentia of the latest case laws. Therefore, the researcher has opted for doctrinal research project.

SCOPE OF THE STUDY

It is made clear at the outset that the scope is confined to the provisions of

Income Tax Act, 1961

Securities laws

Exchange control regulations

Company law

Stamp Duty laws

OBJECTIVE OF THE STUDY

The object behind carrying out this non-doctrinal research on the subject matter of the provisions of Indian Tax Act is to have thorough understanding of Benefits of Tax whenever a company amalgamates with another and the reasons and objects envisaged behind the same.

HYPOTHESIS

In order to conduct a research work, some important hypotheses are to be formulated. The focal points and assumptions are normally available through the formulation of hypothesis. The major hypotheses developed on the basis of study of available literature and evaluation of primary as well as secondary data and work done earlier including related studies is that:

i) The researcher assumes that the object behind having Prevention of Food Adulteration Act is for the benefit of the people i.e. it is a Social Beneficial Legislation.

ii) The researcher also presumes that for the interpretation of the Act, Judicial Trend has to be seen.
RESEARCH QUESTIONS

What are the benefits of tax while dealing in context of Amalgamation?

RESEARCH METHODOLOGY

The quality and value of research depends upon the proper and particular methodology adopted for the completion of research work. Looking at the vastness of the research topic, doctrinal legal research methodology has been adopted. To make an authenticated study of the research topic ‘Tax Benefits of Amalgamation’ enormous amount of study material is required. The relevant information and data necessary for its completion has been gathered from both primary as well as secondary sources available in the books, journals, periodicals, research articles and proceedings of the books on Taxation law and websites.

Keeping in view the need of present research, various cases filed in the Supreme Court as well as in the High Court on the issue of interpretation of non obstante clauses and the judgments therein have also been used as a source of information. The judgments pronounced in the cases have been analysed in detail and included a means of diagnosis.

From the collected material and information, researcher proposes to critically analyse the topic of the study and tries to reach the core aspects of the study.

Tax Benefits or Aspects of Amalgamation Under Income Tax Act 1961

DEFINITION OF AMALGAMATION UNDER THE INCOME TAX ACT, 1961:

Section 2(1B) of the Income Tax Act, 1961 defines the term “amalgamation” as follows:

“amalgamation”, in relation to companies, means the merger of one or more companies with another company or the merger of two or more 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

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;

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;

shareholders holding not less than 14(three-fourths) in value of the shares in the amalgamating company or companies (there than shares already held therein immediately before the amalgamation by, or by a nominee for, 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,
otherwise than as a result of the 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."

It will be noticed that the definition uses the expression “amalgamating company” and “amalgamated company” to refer to the expressions “transferor company” and “transferee company” respectively. An important issue that arises in the case of amalgamation is that of capital gains arising from the transfer of shares or any kind of capital gains arising with respect to taxation of the capital gains. However the company may also stand to lose in cases of amalgamation as mergers in the Indian context are viewed as a tax planning measure. The deductibility has to be seen in the hands of the transferee company.

To constitute “amalgamation” under the Income Tax Act, there must be satisfied the three conditions specified clauses(i), (ii) and (iii) of the definition.

THE FOLLOWING BENEFITS OR PROVISIONS ARE THERE IN THE INCOME TAX ACT, 1961 FOR CASES OF AMALGAMATION OF COMPANIES:

INVESTMENT ALLOWANCE:

Investment allowance in the Act has been inserted in place of Development Rebate. The purpose of this allowance is to provide for deduction on any purchases made in the form of ship, aircraft, machinery, plant. The rate of investment allowance is 25% of the actual cost of the ship, aircraft, machinery or plant. Therefore it could be termed as a deduction on the investment made by the person which is allowed to him at the time of calculation of his taxable income. The section provides for exemption from application of the provision in certain cases mentioned in the Section itself. Sub section (2) of the section assumes importance in light of the fact that it provides for the meaning to be given to the words ship, aircraft and plant and machinery by stating their purposes or the object with which it is to be used. For example, clause (b) of sub section (2) provides for the purposes of installation of plant or machinery which may be generation of electricity or distribution of the same, in a small scale industrial undertaking for the manufacture of any article, for the purposes of business of construction, manufacture or production of any article. Sub section (5) of the section provides for disallowance of the investment allowance in certain circumstances. The purpose of creation of an investment allowance is the creation of a reserve called the Investment Allowance Reserved Account for the purposes of acquiring new ship or aircraft or machinery and plant, and for other purposes of business of the undertaking except for distribution of dividends, profits or remittances outside India as profits. Sub section (6) stipulates conditions to be followed in case of an amalgamation and the amalgamated company is supposed to take over the mantle of the maintenance and creation of the reserve for the aforesaid utilization in the business.

The term manufacture in the provision is to be understood in the manner concerning production of articles for use from raw or prepared materials by giving such materials new forms, qualities or combinations whether by hand, labour or machines and if the change made in the article results in a new and different article then it would amount to manufacturing activity.

CURRENT STATUS OF THE BENEFIT: Notification dated 19 March 1990 was issued to discontinue investment allowance from the assessment year 1991-92.
DEVELOPMENT REBATE:

This rebate is granted at varying rates, in respect of ships, machinery and plant provided:

the machinery or plant is not an office appliance, or a road transport vehicle.

it is not installed in any office premises.

the asset is new.

it is owned by the assessee.

it is wholly used for the purposes of the assessee’s business.

the particulars prescribed for the purpose of depreciation allowance have been furnished.

Sub section (3) provides for cases in which amalgamation of companies occurs and it says that the amalgamated company shall continue to fulfill the conditions mentioned in sub section (3) of section 34 in respect of the reserve created by the amalgamating company and in respect of the period within which the ship, machinery or plant shall not be sold or otherwise transferred and accordingly provides for any default. The same sub section provides for the balance amount of the development rebate to be allowed to the amalgamated company or the new entity.

CASE OF AMALGAMATION: The right to development rebate would be lost even if a transfer of the asset is affected within eight years merely as a step in business reorganization or expansion. Only in two
cases of business reorganization is the bar against transfer of assets removed i.e. when the two companies amalgamate and when a firm is succeeded by a company. But this benefit is available only when the amalgamation takes place as per the conditions laid down in s 2(1B) of the Income Tax Act, 1961.

CURRENT STATUS OF DEVELOPMENT REBATE: The development rebate has been discontinued from 31 May 1977 and at present stands discontinued.

DEVELOPMENT ALLOWANCE:

Under section 33 A, an assessee who is carrying on the business of growing and manufacturing tea in India is entitled to a deduction while computing his profits by way of development allowance with reference to the actual cost of planting tea bushes. Here the actual cost planting comprises the cost of planting and replanting and the cost of upkeep thereof, for the previous year in which the land has been prepared for planting and the three succeeding years. This benefit of deduction is available under the current legal provision to companies carrying on a similar kind of business and going in for amalgamation. The section is applicable to an assessee carrying on the business of growing and manufacturing tea in India. The allowance is available only if the assessee grows and manufactures tea in the country. Allowance is granted under this section at the following rates:

50% of the actual cost of planting tea bushes, where such tea bushes are planted on a land and not planted with any other tea bushes planted earlier (such cost being incurred between 1 Apr 1965 and 31 Mar 1990).

30% of the actual cost of planting tea bushes where tea bushes are planted in replacement of tea bushes that have died or have become permanently useless on any land already planted (such cost being incurred between 1 Apr 1965 and 31 Mar 1970).

Sub section (5) provides that all the conditions relating to creation and maintenance of reserve and sale and otherwise transfer of the land should be fulfilled by the amalgamated company just as they would have been fulfilled by the amalgamating company.

EXPENDITURE INCURRED ON SCIENTIFIC RESEARCH:

According to section 35(5), where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers to the amalgamated company (being an Indian company) any asset representing expenditure of a capital nature on scientific research -

the amalgamating company shall not be allowed the deduction under clause (ii) or clause (iii) of sub-section (2); and

the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not so sold or otherwise transferred the asset.

The Madras High Court held in Tamil Nadu Civil Supplies Corporation Ltd v CIT that, after the Research Centre was taken over by the assessee, entire actual expenditure incurred by assessee was
allowable, therefore, the Tribunal was not justified in allowing proportionate expenditure. The research, for the purposes of the present section, need not necessarily be related to present manufacturing activity. It was held in CIT v National Rayon Corporation Ltd. that, ‘the expression “related to business” does not mean related to present manufacturing activities of the assessee. In this case assess was all along using imported wood pulp for the manufacture of rayon incurred expenditure on research for making pulp out of bamboo since it proposed to set up a plant for making bamboo pulp. The expenditure on such research could not be disallowed because it did not relate to the present manufacturing activity of the assessee.

EXPENDITURE ON ACQUISITION OF PATENT RIGHTS OR COPYRIGHTS:

Section 35 A of the Income Tax Act deals with expenditure on acquisition of patent rights or copyrights.

According to its sub-section (1), in respect of any expenditure of a capital nature incurred after the 28th day of February, 1966 but before the 1st day of April, 1998, on the acquisition of patent rights or copyrights, used for the purposes of the business, there shall, be allowed for each of the relevant previous year, a deduction equal to the appropriate fraction of the amount of such expenditure. Sub-section (6) of this section provides that, where, in a scheme of amalgamation, the amalgamating company sells or otherwise transfers the rights to the amalgamated company (being an Indian company),

the provisions of sub-sections (3) and (4) shall not apply in the case of the amalgamating company; and

the provisions of this section shall, as far as may be, apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not so sold or otherwise transferred the rights.

Sub-section (6) was inserted in section 35(A) by the Finance (No.2) Act, 1967, to provide deduction to amalgamated companies. The scope of its insertion is elaborated in the following extract of the circular No 5-P, dated 9.10.1997, which read as under:

―Where the amalgamating company sell or otherwise transfers to the amalgamated company (being an Indian Company) any capital assets used by it for scientific research related to its business or any capital asset of the nature of patent right or copyrights or any capital assets used for promoting family planning amount its employee, the amalgamated company will be entitled to amortize the capital cost of such assets against its profits under the relevant provision of the Income Tax Act, viz., sections 35, 35A and 36 (1) (ix), in the same manner and to the same extent as the amalgamating company would have been, if it had not sold or transferred the asset to the amalgamating company will not be entitled to any of the terminal benefits under the provisions of section 35, 35 A and 36 9i) (ix).‖

Where an assessee has purchased patent rights or copyrights, he is entitled to a deduction under section 35 A for a period of 14 years in equal installments. If during such period the assessee merges with another company, the amalgamated company would then have the right to claim the unexpired installment as a deduction from its total income. However, where the whole or any part of the right are sold by the amalgamated company after amalgamation and the sale proceeds exceeds the amount of the cost of acquisition of the asset which remains unallowed as deduction, the excess amount would be chargeable to income-tax in the hands of the amalgamated company. If the sale price even exceeds the cost of acquisition, the difference between such price and the cost would be the capital gains which would be taxed in the hands of the amalgamated company.
AMORTISATION OF CERTAIN PRELIMINARY EXPENSES:

Section 35D of the Income Tax Act deals with amortization of certain preliminary expenses. According to its sub-section (1), where an assessee being an Indian Company or a person (other than a company) who is resident in India, incurs, after the 31st day of March, 1970, any expenditure specified in sub-section (2) before the commencement of his business, or after the commencement of his business, in connection with the extension of his industrial undertaking or in connection with his setting up a new industrial unit,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of an amount equal to one-tenth of such expenditure for each of the ten successive previous years beginning with the previous year in which the business commences or, as the case may be, the previous year in which the extension of the industrial undertaking is completed or the new industrial unit commences production or operation. The section grants deduction in respect of expenditure which may otherwise be disallowed as an expenditure of a capital nature. This implies that expenses of a capital nature which are generally disallowable as deductions at the time of calculation of taxable income, may be allowed by virtue of this section of the Act. The expenditure may be incurred in respect of any of the following:

preparation of feasibility report.
preparation of project report.
conducting market survey or any other survey necessary for the business of the assessee.
engineering services relating to the business of the assessee.
legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee.
where the assessee is a company, also expenditure, by way of legal charges for drafting the Memorandum and Articles of Association of the company.
On printing of the Memorandum and Articles of Association.
By way of fees for registering the company under the provisions of the Companies Act, 1956.
In connection with the issue, for public subscription, of shares in or debentures of the company, being underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus.

Such other items of expenditure (not being expenditure eligible for any allowance or deduction under any other provision of this Act) as may be prescribed.
Section 35D is an enabling provision which enables an assessee to amortize w.e.f. assessment year 1999-2000 its preliminary expenses incurred after 31.3.1998 by an Indian Company or a person resident in India. The expenses can be amortized in five equal installments for five successive previous years i.e one fifth of the expenditure shall be allowed as deduction, for a period of five successive previous years. And the aggregate amount of the preliminary expense incurred after 31.3.98 should not exceed 5% of the cost of project and in case of a company as its option, 5% of the capital employed. However, if it exceeds 5% then the expenditure shall be limited to 5% of the cost of project. This certainly depends on a case to case basis.

AMORTISATION OF EXPENDITURE IN CASE OF AMALGAMATION OR DEMERGER:

Section 35DD has been inserted in the Income Tax Act w.e.f 1 April, 2000 by the Finance Act, 1999 to provide for amortization of expenditure in case of amalgamation and demerger. It provides that, where an assessee, being an Indian company, incurs any expenditure, on or after the 1st day of April, 1999, wholly and exclusively for the purposes of amalgamation or demerger of an undertaking, the assessee shall be allowed a deduction of an amount equal to one-fifth of such expenditure for each of the five successive previous years beginning with the previous year in which the amalgamation or demerger takes place. However, no deduction shall be allowed in respect of the expenditure mentioned in sub-section (1) under any other provision of this Act. According to sub-section (1) of section 35DD, any expenditure incurred in connection with amalgamation or demerger of any undertaking is allowable in five equal installments over a period of five years beginning with the year of amalgamation or demerger. However, following conditions need to be fulfilled:

The entity making the expenditure shall be an Indian company

The expenditure shall be incurred on or after 1-4-1999.

Further, no deduction shall be allowed under any other provisions of the Act, as per sub-section (2) of section 35DD.

The separation of two or more existing business undertakings operated by a single corporate entity can be effected in a tax-neutral manner. The tax-neutral separation of a business undertaking is termed a de-merger. The key provisions under Indian law relating to de-merger are discussed below.

INCOME TAX LAW

Tax Neutrality: under Indian tax law de-merger is defined as the transfer of one or more undertakings to any resulting company, pursuant to an arrangement under sections 391 to 394 of the Indian Companies Act 1956, in such a manner that as a result of the de-merger:

All the property and liabilities relating to the undertaking being transferred by the de-merged company immediately before the de-merger become the property and liabilities of the resulting company.
Such property and liabilities of the undertaking(s) should be transferred at values appearing in the books of account of the de-merged company. For determining the value of the property, any revaluation should be ignored.

In consideration of a de-merger, the resulting company issues its shares to the shareholders of the de-merged company on a pro-rata basis.

Shareholders holding three-quarters of the shares in the de-merged company become shareholders of the resultant company (the shares already held, if any, by the resultant company or its nominees are excluded for the purposes of calculation).

The transfer of the undertaking is on a going-concern basis.

Undertaking is defined to include 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, or any combination thereof not constituting a business activity.

In a de-merger, the shareholders of the de-merged company receive shares in the resultant company. The cost of acquisition of original shares in the de-merged company is split between the shares in the resultant company and the de-merged company in the same proportion as the net-book value of the assets transferred in a de-merger bears to the net worth of the de-merged company before de-merger.

Generally, the transfer of any capital asset is subject to transfer tax (capital gains tax) in India. However, a de-merger enjoys a dual tax-neutrality with respect to transfer taxes under Indian tax law; both the de-merged company transferring the undertaking and the shareholders transferring their part of the value of shares in the de-merged company are exempted from tax. To achieve tax neutrality for the de-merged company transferring the undertaking, the resultant company should be an Indian company.

Other implications of income tax law are as follows:

The unabsorbed business losses, including depreciation (that is, amortization of capital assets) of the de-merged company directly related to the undertaking transferred to the resultant company are treated as unabsorbed business losses or depreciation of the resultant company. If such losses, including depreciation, are not directly related to the undertaking being transferred, the losses should be apportioned between the de-merged company and the resulting company in the proportion in which the assets of the undertaking have been retained by the de-merged company and transferred to the resulting company.

If any undertaking of the de-merged company enjoys any tax incentive, generally the incentive can be claimed by the resulting company for the unexpired period, even after the de-merger.

The total depreciation on assets transferred to the resulting company in a financial year shall be apportioned between the de-merged company and the resulting company in the ratio of the number of days for which the assets were used by each during the year. Depreciation up to the effective date of transfer shall be available to the de-merged company and, thereafter, to the resulting company.
The expenses of a de-merger can be amortized in five, equal annual installments commencing with the year in which the de-merger takes place.

Step-up in the value of the assets is not permissible either in the books or for tax purposes.

**SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS:**

Section 43C of the Income Tax Act provides that, where an asset, which become the property of an amalgamated company under a scheme of amalgamation, is sold after the 29th February, 1998, be the amalgamated company as stock-in-trade of the business carried on by it, the cost of acquisition of that asset to the amalgamated company in computing the profits and gains from the sale such asset be the cost of acquisition of that asset to the amalgamating company, as increased by the cost, if any, incurred, wholly and exclusively in connection with such transfer by the amalgamating company. This means that in case where an amalgamation occurs, the cost of an asset to be ascertained for the purposes of taxing the gains or profits made from the sale of such asset, is to be taken at the same value which might have been incurred by the amalgamating company and any expenditure made by the amalgamated company on the asset should be taken into consideration while providing for deduction to the amalgamated company.

**CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION ALLOWANCE IN AMALGAMATION:**

This section constitutes an exception to the general rule that the unabsorbed depreciation allowance of the previous owner of a business cannot be carried forward and set off by the successor and that a business loss can be carried forward and set off the business profits of a subsequent year only by the assessee who has incurred the loss. Where a company owning an industrial undertaking, ship, hotel or a banking company merges into another company this section permits set off if certain conditions are fulfilled. These conditions are as follows:

The amalgamated company shall continuously hold at least three fourths in value of the assets of the amalgamating company for a minimum period of five years from the date of amalgamation.

The amalgamated company shall continue the business of the amalgamating company for at least five years from the date of amalgamation.

It should fulfill other conditions notified by the Central Government to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

After the amendment made by the Finance Act of 2003 with effect from 1 Apr 2004, two further conditions need to be fulfilled which are as:

it should have been engaged in the business for at least three years during which the accumulated loss has occurred or the unabsorbed depreciation had accumulated.
It should have continuously held on the date of amalgamation at least three fourths of the book value of the fixed assets, which it held two years prior to the date of amalgamation.

Under the old provisions, in a case of amalgamation, shareholders holding not less than nine-tenths in value of shares in the amalgamating company were required to become shareholders of the amalgamated company. This condition has been relaxed. After the Amendment vide Finance Act, 1999, shareholders holding three-fourths in value of the share shall be required to become shareholders of the amalgamated company. The provisions of section 72A of the Income-Tax Act, 1961, have been on the statute book since 1977. The main object of enacting this provision was to encourage merger of sick companies with profitable ones. Unfortunately, this provision has not served its purpose in view of the vague and onerous conditions, subject of litigation.

From the provision of erstwhile section 72A, it may be seen that there were number of conditions including satisfaction of the Government, on the recommendation of the specified authority, laid down for such amalgamation. Besides, the amalgamated company was required to submit proposed scheme of amalgamation to the specified authority and thereupon, such an authority would make a recommendation to the Central Government, in that behalf. All these conditions have omitted, after the amendment of section 72A, vide Finance Act, 1999, with effect from 1st April 2000.

Sub-section (1) of section 72A provides that, where there has been an amalgamation of a company owning an industrial undertaking or a ship with another company, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set-off carry forward of loss and allowance for depreciation shall apply accordingly.

Tax Benefit on Slump Sale

Section 293 of the Companies Act empowers the Board of Directors of a company, after obtaining the consent of the company in general meeting to sell lease or otherwise dispose off the whole or substantially the whole of the undertaking(s) of a company. The transaction in this case, is normally of either of the following type:

Sale of a running concern.

Sale of a concern which is being wound up.

Sale of a Running Concern

This type of sale as a going concern provides for the continuation of the running of the undertaking without any interruption. But there is always a problem of fixing a value in the case of a running concern for all tangible and intangible assets including fixing a value for the infrastructure and other environmental facilities available. In view of all this, the seller normally fixes a lump sum price called ‘slump price’. The noun ‘slump’ means ‘a gross amount, a lump’. Similarly, ‘slump sum’ means a ‘lump
A slump sale transaction would, therefore, mean a sale or a transaction which has a lump sum price for consideration.

**Sale in the Course of Winding up**

On the other hand a sale in the course of winding up, is nothing but a realization sale aimed at collecting the maximum price for distributing to the creditors and the balance to the contributories (the shareholders). By the very nature of the transaction, this is a piece meal sale and not a slump sale. In this case, there will be liability to tax as per the provisions of the Income-tax Act. Slump sale as defined under Section 2(42C) of the Income-tax Act, 1961 means the transfer of one or more undertaking as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. In other words, it is a sale where the assessee transfers one or more undertaking as a whole including all the assets and liabilities as a going concern. The consideration is fixed for the whole undertaking arid received by the transferor. It is not fixed for each of the asset of the undertaking. The assessee may also transfer a division instead of the undertaking as a whole by way of such sale. Thus it may be noted that the undertaking as a whole or the division transferred shall be a capital asset.

**TAX ASPECTS FOR A SLUMP SALE**

Normally, any sale of a capital asset will give rise to a capital receipt and any profit derived may give rise to capital Gains in certain cases. This is true in the case of sale of an undertaking also.

In Doughty v. Commissioner of Taxes, the Privy Council laid down the following principles: The sale of a whole concern engaged in production process, e.g. dairy farming or sheep rearing, does not give rise to a revenue profit. The same might be said of a manufacturing business which is sold with the lease holds and plant, even if there are added to the sale piece goods in stock and even if these piece goods form a very substantial part of the aggregate sold. Where, however, business consists entirely in buying and selling, it is difficult to distinguish for income tax purpose between an ordinary and realization sale, the object in either case being to dispose of the goods at a profit. The fact that the stock is sold out in one sale does not render the profit obtained any different in kind from the profit obtained by a series of gradual and smaller sales. In the case of such a realization sale, if there is an item which can be traced as representing the stock-in-trade, though it is in conjunction with the sale of the whole concern and a transfer of all the assets for a single unapportion consideration, there cannot be said to be any revenue profit realised on the sale of the stock-in-trade which is sold with all the other assets, although the business of the concern may consist entirely in buying and selling. The Supreme Court, based on the above decision held in the following two cases that the price received on the sale of industrial undertaking is a capital receipt. CITv. West Coast Chemicals and Industries Ltd. Where a slump price is paid and no portion is attributable to the stock-in-trade, it may not be possible to say that there is a profit other than what results from the appreciation of capital. The essence of the matter, however, is that an extra amount has been gained by the selling out or the exchange but whether it can fairly be said that there was a trading was a trading, from which alone profit can arise in business. CIT v. Mugneeran Bangur and Co. In the case of a concern carrying on the business of buying land, developing it and then selling it, it is easy to distinguish a realization sale from an ordinary sale, and it is very difficult to attribute part of the slump price to the cost of land sold in the realization sale. The mere fact that in the schedule the price of land was stated does not lead to the conclusion that part of the slump price is necessarily attributable to the land sold.
The same view was also reiterated by the Gujarat High Court in the following cases:


2. Artex Manufacturing Co. v. CIT.

At the same time, the Gujarat High Court also recognized that when an undertaking as a whole is sold as a going concern there will be liability under the head Capital Gains. In 126 ITR 1 the Gujarat High Court stated as follows:

It is well settled that business is property and the undertaking of a business is a capital assets of the owner of the undertaking. When an undertaking as a whole is transferred as a going concern together with its goodwill and all other assets, what is sold is not the individual itemized property but what is sold is the capital asset consisting of the business of the undertaking and any tax that can be attracted to such a transaction for a slump price at book value would be merely capital gains tax and nothing else but capital gains tax. Plant or machinery of any fixture or furniture is not being sold as such. What is sold is the business of undertaking for a slump price. If the capital assets, namely, the business of the undertaking, has a greater value than its original cost of acquisition, then, capital gains may be attracted in the ordinary case of a sale of an undertaking.

The Bombay High Court also recognized that there will be a capital gains tax when a sale of business as a whole occurs.

Transfer of shares by shareholders of amalgamated company

The term “transfer” has been defined in Section 2 (47) of the Income-tax Act, 1961. The given definition is not exhaustive but inclusive. It hints at sale, exchange, relinquishment of an asset, extinguishment of any right therein, compulsory acquisition thereof etc. Therefore, other modes of transfer as are understood in particular contexts or in their ordinary sense are also liable to capital gain subject to the other conditions regarding taxability under the head “Capital gains”. However, Section 47 of the Income-tax Act, 1961 contains a large number of transactions which are not regarded as transfer for the purpose of taxability under the head “Capital gains”. Sub-section (vii) of Section 47 specifically exempts from taxability of any transfer by a shareholder, in a scheme of Amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –

The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and

The amalgamated company is an Indian company. No exchange or relinquishment involved.

It has been held in CIT v. Rasiklal Manektal (HUF) that in the event of amalgamation of companies, transfer of shares by the shareholders of the amalgamating company and allotment of shares in their names by the amalgamated company does not involve “exchange” or “relinquishment”.
Conclusion

From the aforementioned it could be seen that the following tax benefits pertain to the transferor company by virtue of the specific provisions of the Income Tax Act, 1961 after an amalgamation:

Investment Allowance- under Section 32A(6)

Development Rebate- under Section 33(3)

Development allowance- under Section 33A(5)

Scientific research expenditure- under Section 35(5)

Expenditure on acquisition of patent rights or copyrights- under Section 35A(6)

Amortization of certain preliminary expenses- under Section 35D(5)

Deduction for expenditure on prospecting, etc. for minerals- under Section 35E(7)

Merger of an Indian company into a foreign company is not envisaged by the Companies Act, 1956. No tax exemption has been provided under Income-tax Act, 1961 in case of amalgamation of an Indian company into a foreign company wherein the amalgamated company is a foreign company. Recommendation by JJ Irani Report followed by Companies Bill 2008 on Company Law is to allow merger of an Indian company into foreign company. Short form mergers are also proposed. All these provisions and reforms prove to be advantageous not only to the Indian Inc. but also to the foreign entities as well as taxing authorities in long term leading to the smooth running of business.