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TAX FLASH NEWS

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Exclusion of defunct or superfluous assets in a slump sale is a commercial decision. Therefore, the taxpayer is entitled to 20 per cent tax rate under Section 50B of the Income-tax Act

Background

Recently, the Delhi High Court in the case of Triune Projects Private Limited[1] (the taxpayer) held that the transaction of sale is a genuine slump sale which qualifies for the tax treatment under Section 50B of the Income-tax Act, 1961 (the Act). The High Court observed that the sale was for a going concern, which included ongoing service contracts, employment contracts and other tangible and intangible assets such as technical know-how, etc. To expect a purchaser to buy and pay value for defunct or superfluous assets does not go well with the commercial sense. Therefore, if certain assets or properties are left out because they would cause inconvenience or lead to some kind of a trouble for the purchasing party, it is well within its right to exclude it from the list of assets.

Facts of the case

- The taxpayer is engaged in the business of design, engineering and consultancy in the oil and gas (both onshore and offshore), petroleum refinery and allied sectors. The taxpayer provides a range of services starting from conception of the project which includes feasibility study, process design and detail engineering procurement services, construction supervision, etc.

- On 22 September 2006, the taxpayer entered into a slump sale agreement (the agreement) with the buyer. The agreement had the effect of transferring the business undertaking entered by the taxpayer as a going concern. All tangible assets and liabilities together with goodwill were conveyed for a lump sum consideration of INR 458.5 million. The net book value of the assets so transferred was INR52.7 million.

- In the return filed, the taxpayer declared a corresponding income and since its undertaking had been in existence for more than three years, computed long term capital gains under Section 50B of the Act and offered 20 per cent of it as tax.

- The Assessing Officer (AO) rejected the taxpayer's claim holding inter alia that the slump sale tax claim was a 'sham transaction' designed to avoid tax liability by artificially inflating assets value and that the assets so transferred were short term in nature. The AO decided that the considerations, i.e., lump sum amount received was income from other sources and directed a higher rate of tax.

- The Commissioner of Income-tax (Appeals) [CIT(A] upheld the finding that the transaction was not genuine and so had colourable device.

- The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal), in the present case, negated the order of CIT(A), which had concluded that the slump sale reported by the taxpayer was not genuine, and remitted the matter to the AO to decide the issue afresh in view of the submission of the taxpayer.

- In the meantime, the buyer, [formerly known as 'Saipem Triune Engineering Private Limited' (the buyer)], appealed to the Tribunal against a similar finding that the transaction was colourable and there was no expression of slump sale which resulted in purchase of such assets. The Tribunal in the buyer's appeal

[1] Triune Projects Private Limited v. DCIT [ITA No.448//2016 CM. APPL.26426/] – taxsutra.com

accepted the genuineness of this slump sale agreement and set aside the findings of the AO and CIT(A). The Tribunal, however, remanded the matter with respect to valuation of goodwill to the AO.

- On the issue with respect to the valuation of goodwill, the buyer's case went upto the Delhi High Court[2] and the Court held that goodwill was an intangible asset and the question of its valuation, in any manner, other than the one disclosed by the taxpayer could not have arisen, and in doing so, relied upon the decision of the Supreme Court in the case of Smifs Securities Ltd[3]. Therefore, the excess consideration paid over and above the value of the net tangible asset, was none other than the value of the goodwill.

High Court's ruling

- The High Court observed that the taxpayer relied upon the operative portion of the decision in the case of the buyer and stated that a transaction held to be not a device or a sham, in the hands of one of the parties cannot transform itself to a suspect and a sham transaction in the hands of the other party. It was observed that the decision of the Tribunal in the case of the buyer was affirmed by the High Court to the effect that the transaction was not a sham or was not a colourable device. In these circumstances, unless there are exceptional facts to the contrary, the same finding has to be maintained in the case of the seller.

- The tax department contended that two assets i.e. one in the form of bad debt and another shown to be written off were retained by the seller. In the circumstances the entire undertaking was not sold. To satisfy the pre-requisites of a slump sale, as defined in Section 2(42C) of the Act, the undertaking had to be transferred as a whole. So far as the tax department's contention with respect to the retention of two assets that were not sold as a part of the going concern by the taxpayer, the argument was found to be insubstantial.

- The sale transaction was reported for a total consideration of INR458.3 million. The sale was for a going concern, which included ongoing service contracts, employment contracts and other tangible assets, and intangible assets such as technical know-how, etc. To expect a purchaser to buy and pay value for defunct or superfluous assets flies in the face of commercial sense. Unfortunately, the tax department's understanding is that in a going concern the buyer is bound to pay good money, transact and purchase bad and irrecoverable debts. Not only does it fly in the face of common and commercial understanding, but it is not even a pre-condition, as is evident from the definition of 'undertaking' as given in Explanation (1) to Section 2 (19AA) of the Act.

- This definition of 'undertaking' is what has been engrafted into by reference, under Section 2(42C) of the Act. Therefore, if certain assets or properties are left out because they would cause inconvenience or lead to some kind of a trouble for the purchasing party, it is well within its right to exclude it from the list of assets.

- It is thus, held that the slump sale qualifies for treatment under Section 50B of the Act.

Our comments

The issue with respect to 'slump sale' under Section 50B of the Act vis-à-vis the taxability at the lower rate upon the satisfaction of the conditions mentioned therein has been a subject matter of debate before the Courts/Tribunal.

In the instant case, the High Court discussing the commercial angle in slump sale transaction, observed that to expect a purchaser to buy and pay value for defunct or superfluous assets does not go well with the commercial sense. The High Court has observed that inspite of excluding certain assets from the list of assets eligible for the slump sale transaction, the transaction qualifies the test of Section 50B of the Act and is eligible for the beneficial tax rate of 20 per cent.

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[2] Triune Energy Services Pvt. Ltd. v DCIT, 2015-TIOL-2701-HC-Del-IT
[3] CIT v Smifs Securities Ltd. 348 ITR 302 (SC)

Section 2(42C) read with Explanation 1 to Section 2(19AA) of the Act defines 'slump sale' as a transfer of one or more undertakings[4] as a result of sale for a lumpsum consideration without assigning values to individual assets and liabilities. This definition does not as a pre-condition require to include the value of defunct or superfluous assets.

The Mumbai Tribunal in the case of Rohan Software (P.) Ltd.[5] held that the applicability of Section 50B of the Act cannot be avoided merely because certain assets were excluded as long as the business was transferred as a whole.

[4] Undertaking shall include any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole, but does not include individual assets or liabilities or any combination thereof not constituting a business activity.
[5] Rohan Software (P.) Ltd. v ITO [2008] 21 SOT 258 (Mum)

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