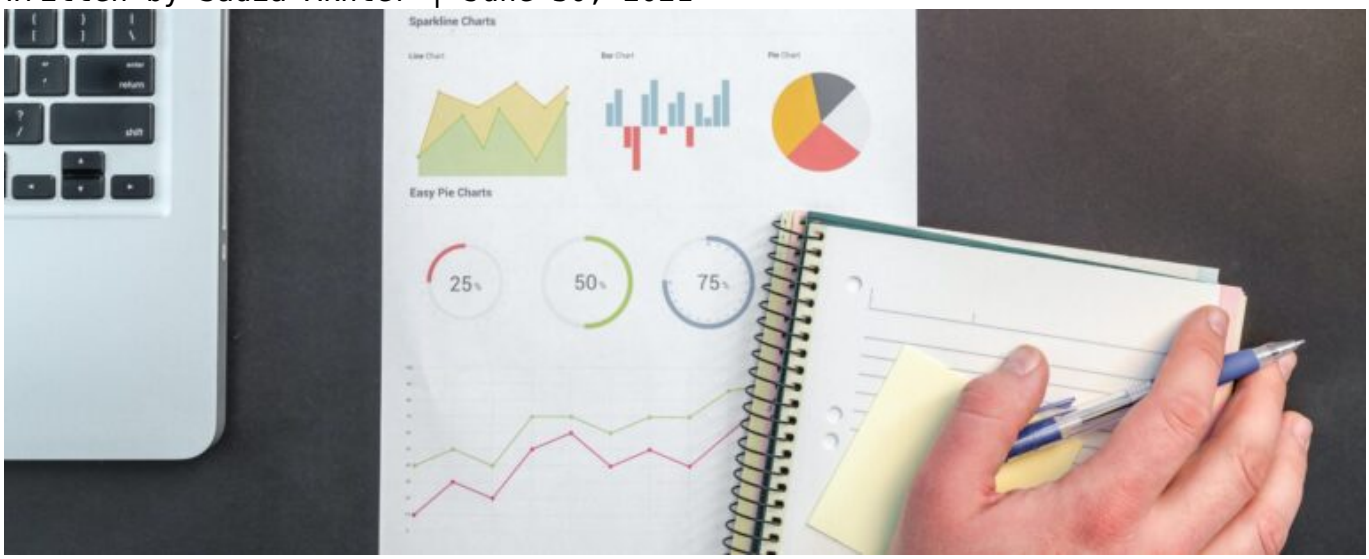
Slump Sales – Examining The Changing Dynamics Of Present-Day Acquisitions
written by Sadia Akhter | June 30, 2021



In recent years, business dynamics have evolved considerably and have been changing constantly to adapt to the social and economic environments. The businesses that we see today have become so multi-faceted that companies operate under multiple brands/names across different sectors of the industry. We see today that even a single entity has separate segments or undertakings with its own set of assets and liabilities – each focused on a different business sector. This has resulted in the growing trend of restructuring a business through the sale of a segment or undertaking. This selling of a business undertaking is called a slump sale(slump sale under income tax act). The taxation of slump sales has always remained a matter of controversy. Until 2000, there existed no specific provision in the Income Tax Act, 1961 ('Act') that specifically dealt with the taxation of slump sale under income tax act. As there was no specific provision, an undertaking that got transferred in a slump sale *inter-alia* included intangible assets whose values are not determinable and as such, the surplus arising out of the transfer of the undertaking was not taxable as capital gains. Further, as the values do not get assigned to individual assets and liabilities, the sale was also not taxable under Section 41(2) and Section 50 of the Act. Therefore, slump sales were not chargeable to tax till 2000.

The Inception of Slump Sales

To close the gap in these loopholes, the Finance Act, 1999, which came into effect from 1st April 2000, inserted Section 50B and Section 2(42)(C) in the Act to provide for taxation of slump sale. Section 2(42)(c) of the Act defined a 'slump sale' as *the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.'*

Further, the term 'undertaking' has been defined in explanation to section 2 (19AA) to include any part of an undertaking, or a unit or division of an undertaking or a business activity when taken as a whole but does not include individual assets or liabilities or any combination thereof not constituting a business activity. Furthermore, Section 50B of the Act provides a mechanism for the computation of capital gains in case of a slump sale by recognising the 'net worth' as the cost of acquisition.

Given that the definition of 'slump sale' only includes transfer by way of sale, there arose a question as to whether a slump exchange would be covered

by the provisions of Section 50B of the Act. It was interpreted by many courts that a slump sale would not include other means of transfer such as an exchange, relinquishment etc.

The rationale for such an interpretation was that Section 50B of the Act contains a special provision for the computation of capital gains in case of a slump sale. Further, Section 2 (42) (C) of the Act defines “slump sale” as the transfer of one or more undertakings as a result of the sale for lump sum consideration without value being assigned to the individual assets and liabilities in such cases.

Therefore, it was interpreted by some courts that other means of transfer listed in Sub-Section (47) of Section 2 of the Act in relation to the definition of the word – ‘transfer’ concerning a capital asset like an exchange, relinquishment etc., are excluded from the ambit of definition of slump sale.

Taxation of Slump Exchange – The Debate

The issue of whether exchange comes under the domain of a slump sale has been subject to judicial scrutiny time and again. A slump exchange covers those scenarios wherein the seller receives consideration other than in the form of money. Recently, the Madras High Court in the case of *Areva T&D Ltd[1],* held that a slump exchange does not attract provisions of Section 50B. Here the business was transferred under a scheme of arrangement by the assessee to its subsidiary company in exchange for equity shares.

The argument presented by the assesses was that Section 50B cannot be applied as the transfer constitutes an ‘exchange’ and not a ‘sale’, therefore not amounting to slump sale. Whereas the Revenue contended that even exchange could qualify as slump sale and is thus liable to taxation.

The Court relied on Section 54 of the Transfer of Property Act, 1882, to understand the meaning of ‘sale’. The said section defines ‘sale’ as a ‘transfer of ownership in exchange for a price’. Further, ‘price’ is defined in the Sales of Goods Act, 1930, as a ‘money consideration for the sale of goods.’ In light of the above two definitions, the Court observed that to fall within the ambit of ‘slump sale’, monetary consideration is essential.

Therefore, to bring more clarity and to include exchange transactions for non-monetary consideration in case of slump sale within the ambit of slump sale under Income Tax Act, an amendment was made to Section 2(42C) of the same through the Finance Act 2021.

The Finance Act, 2021

1. Broadening the term ‘slump sale’

The Finance Act 2021 has amended the provisions of the Act related to the scope of the term ‘slump sale’ to cover all types of transfers as specified under Section 2 (47) of the Act.

Since then, many courts interpreted that transfers such as exchange, relinquishment etc. were excluded from the definition of slump sale, it became important to make the intention of law clear. Therefore, the Finance Act 2021 has amended Section 2(42C) to widen the scope of the term ’slump sale’ to include all types of ’transfer’ as defined in Section 2(47).

Accordingly, in Section 2 (42C), the words “undertaking as a result of the sale” have been substituted by the words “undertaking, by any means,”. For further lucidity, explanation 3 has been inserted, to clarify that for the purpose of a slump sale under income tax act, “transfer” shall have the meaning as assigned to it in Section 2(47) of the Act.

2. Amendment to the calculation of capital gains tax

The Finance Act, 2021 has substituted Section 50B (2) of the Act to provide that the “Fair Market Value” (“FMV”) of the capital assets – as on the date of transfer – will be regarded as the sale consideration to calculate capital gain on transfer of such capital assets on slump sale. Further, the manner of calculating such a fair market value has been prescribed by the Central Board of Direct Taxes through the slump sale rules. The rule offers two methods to calculate the FMV of the capital assets transferred by way of slump sale under income tax act.

It is significant to note that the amendment on the determination of consideration amount on slump sale under income tax act is applicable retrospectively from FY 20-21. Therefore, this will lead to companies having to re-visit slump sale transactions entered by them in FY 20-21, to determine any additional tax liability.

Conclusion

The Finance Act, 2021 has provided much-needed clarity on the aspect of slump sale under income tax act. The long-debated topic on the taxation of slump exchange finally sees some clarity. However, the amendment as to the calculation of fair market value may certainly lead to higher tax liability in cases where the transfer of capital assets is at book value or lower than fair market value.

Further, as per the pre-amended provision of section 50B (2) the Act, to calculate the capital gain in case of slump sale, the “net worth” of the undertaking or the division is deemed to be the cost of acquisition and cost of improvement for Section 48 and 49 with no indexation benefits.

Though the Act has been amended to consider the fair market value of capital assets as sale consideration, there is no corresponding amendment in Section 48(2) concerning the allowability of benefit of indexation as per the second proviso to Section 48 while computing net worth for those undertakings, which are held for more than 36 months. Therefore, this is likely to continue, and companies shall not be able to obtain the benefit of indexation for calculation of FMV of Slump Sale under income tax act

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[1] Areva T & D Ltd. v. CIT, [2020] 119 taxmann.com 171

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