

Interpreting 'Undertaking' - Is Cherry Picking of Assets and Liabilities Permissible?

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Post COVID-19 era, many of the large organisations will implement or explore / evaluate certain group restructuring exercise either with the objective of lowering costs, bringing business synergies, flexibility of new funding or carving out the spoiled arm. Mergers, Demergers, Slump sale etc are various restructuring options in vogue and frequently implemented by various organisations.

For hiving of one of the multiple business slump sale and demerger are among the most common modes used by corporates. Typically, the objectives for such hive-off include unlocking business value, segregation of businesses for attracting third party investments, focussing on core business, etc. While the tax implications for slump sale (generally taxable) and demerger (tax neutral subject to certain conditions) differ under the provisions of Income-tax Act, 1961 ('Act'), the definitions of these terms under the Act are similar to the extent that they require transfer of one or more 'undertakings' in order to constitute a slump sale or demerger. The term 'undertaking' also assumes enormous importance from the perspective of Goods and Services Tax ('GST'). A transfer of business undertaking on a going concern basis is not liable to GST compared to itemised sale of assets which attracts GST liability.

With the above backdrop on importance of the term 'undertaking', let us delve into its definition under the Act. Explanation 1 to Section 2(19AA) of the Act as follows:

For the purposes of this clause, 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.

Dissection of this definition leads to following observations:

- The term covers a 'part of the undertaking', 'a unit or division of the undertaking' or a 'business activity as a whole';
- A cluster of assets and liabilities not constituting a business activity is not an undertaking;

As evident, the thrust is clearly on combination of assets and liabilities constituting a business activity that is capable of being run independently in order to constitute an undertaking. However, the inclusive definition makes it imperative to undertake a case-to-case analysis and one may not be surprised to find

the taxpayers and tax authorities at loggerheads while interpreting the term undertaking. Let us see one such classic debate surrounded around the term undertaking.

Cherry picking of assets and liabilities - whether allowed under slump sale/ demerger?

Non-transfer of some assets and liabilities relatable to the business activity / undertaking has been probably one of the most litigated areas in cases of slump sale/ demerger and there have been various judicial precedents - both for and against the view that the cherry picking should not vitiate the term 'undertaking'. A few noteworthy judicial precedents have been discussed below.

In a landmark ruling pronounced even before the introduction of definitions of slump sale and undertaking in the Act, the **Bombay High Court in case of Premier Automobiles Ltd [TS-40-HC-2003(BOM)-O]**, has laid down the general principles interpreting the expression 'undertaking'. In this case, the High Court laid significant emphasis on the intention of the parties in commercial sense to purchase the business vis vis assets. Once the intention is to transfer the business as a whole which is evidenced from continuity of business by the transferee, the non-transfer of some of the assets or liabilities should not defeat the concept of slump sale.

In case of **Mahalasa Gases & Chemicals (P) Ltd (2005)** certain land parcel, a vehicle, debtors, and other assets were not being transferred. Bangalore Income Tax Appellate Tribunal ('Tribunal' or 'ITAT') held that when deciding whether the sale was a Slump Sale, one has to look at the overall transaction and ascertain whether the basic structure of the unit was transferred. The mere fact that a few assets or liabilities which did not relate to the basic structure which constitutes the business activity are not transferred, cannot vitiate the position that the transfer was of a going concern.

Delhi HC in the case of **Triune Projects Pvt Ltd [TS-6237-HC-2016(DELHI)-O]** has categorically held that if certain assets are left out because they would be redundant or cause inconvenience to the purchasing party, it is well within his rights to exclude it from the list of assets and the same will not vitiate the character of an undertaking .

Above view has also been echoed by certain other Tribunals in the context of slump sale, which have held that non transfer of select assets/liabilities was not fatal to slump sale given that the undertaking includes 'part of the undertaking'.

The learned author **Sampath Iyengar** in his commentary has aptly summarised the scope of the term 'undertaking' as follows:

*The demerger need not be of all business or even of all the undertaking of a single business. Undertaking has been defined widely to cover a part of an undertaking or a unit or a division or a business activity. What is ruled out is only a transfer of an individual asset. In the context of the requirement of transfer of all assets and liabilities, it should be an identifiable unit especially **in the context of further requirement of the transfer having to be of a going concern.***

In contrast to the above favourable view, there are judgements which have been upheld against the assessee - **Pune ITAT in case of Weikfield Products and Mumbai ITAT in the case of Asea Brown Boveri Ltd** to name a couple of them. These precedents have held that for the transaction to fall within the claim of slump sale, all the assets and liabilities should have been taken over and withdrawal of one or more asset forming part of an overall business can frustrate the concept of a slump sale.

In one of the recent high-profile cases, Grasim Industries Ltd received a tax demand notice of Rs 5,872 Cr with respect to the demerger of financial services business of Grasim Industries Ltd into Aditya Birla Financial Services Ltd. The tax authorities held that the said demerger is not compliant with section 2(19AA) of the Act and value of shares allotted by Aditya Birla Financial Services Ltd to shareholders of Grasim Industries tantamount to dividend under the Act. While the information as to which condition the demerger failed to satisfy is not available in public domain, one can only hope that the tax authorities have not questioned the 'undertaking' and that the Grasim saga does not unsettle the gradually settling judicial principles regarding cherry picking of assets and liabilities.

Concluding Remarks:

Based on the principles emanating from the favourable rulings, the view - that all assets and liabilities need not be transferred and as long as the combination of assets and liabilities transferred constitutes business as a whole, the same should be regarded as 'undertaking' - appears to be the better view. The test must be applied is whether the purchaser / transferee company is able to carry on the business without the assets which are not transferred. Given the controversy and likely close scrutiny by tax authorities, it is imperative for the taxpayers to conduct a fact driven analysis of the business being transferred with reference to all the inevitable assets and liabilities pertaining to such business, before triggering a slump sale/ demerger.

Views expressed are personal