

# Demystifying “Splitting-up or Reconstruction of Business” for Sec.115BAB Purposes - Part 1

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## 1. Introduction

On 20th September 2019, the Government of India introduced the Taxation Laws (Amendment) Ordinance 2019 (“Ordinance”). The Ordinance has inserted a new section 115BAB with effect from assessment year 2020-21 in the Income Tax Act, 1961 (“ITA 1961”). Section 115BAB of the ITA 1961 provides an option to a domestic manufacturing company to pay tax at a lower rate of 17.16% (15% + surcharge of 10% + cess of 4%) pursuant to fulfillment of following conditions:

- The company has been set-up and registered on or after 1st October 2019 and has commenced manufacturing on or before 31st March 2023.
- ***The company is not formed by splitting up, or the reconstruction, of a business already in existence.***
- The company does not use any machinery or plant previously used for any purpose. Used plant and machinery to the extent of 20% of total value of plant and machinery is permissible.
- The company is not engaged in any business other than business of manufacture or production of any article or thing and research in relation to, or distribution of, such article or thing manufactured or produced by it.
- The company does not avail specified exemptions/ incentives.

The reduced tax rate shall be at the option of the company. However, once the company opts for lower rate of tax given under this section, it shall not be able to subsequently withdraw the option. Companies opting for reduced rate under section 115BAB of the ITA 1961 shall be exempted from MAT.

In this article, we shall discuss the different connotations of the phrase “splitting up, or the reconstruction, of a business already in existence” considering various judicial precedents and bring clarity in the minds of the readers.

## 2. Meaning of “splitting up” and “reconstruction”

The expressions “splitting up” and “reconstruction” have been quoted in various sections of chapter III and chapter VI-A of the ITA 1961. However, there has been no attempt so far to define statutorily either of the two concepts, e.g., “splitting up” or “reconstruction”. Various judicial precedents have sought to clarify the possible interpretations of the aforesaid concepts in the context of peculiar facts of each case.

- The Delhi High Court in the case of Mahaan Foods Ltd.[\[1\]](#) held that the term “splitting up of the business already in existence” indicates a case where the integrity of a business earlier in existence is broken up and different sections of the activities previously conducted are carried on independently.
- The Karnataka High Court in the case of T. Satish U. Pai[\[2\]](#) held that in order to hold that there is a splitting up of a business already in existence, there must be some material to hold that either some asset of an existing business is divided and another business is set up from such splitting

up of assets, or that the two businesses are the same and one formed was an integral part of the earlier one and it was only a question of breaking up of the same business. It implies a unity of control in regard to two businesses, i.e., earlier one in existence and a new one which is brought into existence.....In a case, where the same person carries on business and brings into existence another business of the same nature by the user of the assets belonging to the earlier business, it may be said that the unity of control continues and the business brought into existence is a part of the earlier existing business.

- In the case of Deco De Trend<sup>[3]</sup>, some members of assessee firm were directors of a closely held company and some workmen working in assessee firm were also working in the said company. Though both were engaged in similar line of export, while company dealt with low end products, assessee firm dealt with high end products. Further, the assessee firm was constituted with capital contribution by partner's personal fund. The Madras High Court held that it could not be said that assessee firm was a mere splitting up of business of company.
- The Supreme Court in the case of Textile Machinery Corporation Ltd.<sup>[4]</sup> held that the term 'reconstruction' implies that the identity of the business should not be lost, and substantially the same business should be carried on by substantially the same person. The true test is not whether the new industrial undertaking connotes expansion of the existing business but whether it is all the same a new and identifiable undertaking separate and distinct from the existing business.
- The Bombay High Court in the case of Gaekwar Foam and Rubber Co. Ltd.<sup>[5]</sup> held that the reconstruction of a business or an industrial undertaking must necessarily involve the concept that the original business or undertaking is not to cease functioning, and its identity is not to be set to be lost or abandoned. The concept essentially rests on changes but the changes must be constructive and not destructive. There must be something positive about the whole matter as opposed to negative. The underlying idea of a reconstruction evidently must be - and this is brought out by the section itself - of a 'business already in existence'. There must be a continuation of the activities and business of the same industrial undertaking. The undertaking must continue to carry on the same business though in some altered or varied form. If the alteration and changes are substantial, there would be little scope for describing what emerges as a reconstruction of the business.
- The Delhi High Court in the case of Ganga Sugar Corporation Ltd.<sup>[6]</sup> held that in the reconstruction of a business, as in the reconstruction of a company, there is an element of transfer of assets and of some change, however partial or restricted it may be, of ownership of the assets. The transfer, however, need not be of all the assets. It is nonetheless imperative that there should be continuity and preservation of the old undertaking though in an altered form. The concept of reconstruction of business would not be attracted when a company which is already running one industrial unit sets up another industrial unit. The new industrial unit would not lose its separate and independent identity even though it has been set up by a company which is already running an industrial unit before the setting up of the new unit.
- In the case of Sagun Gems (P.) Ltd.<sup>[7]</sup>, the assessee company purchased new plant and machinery. Further, capital introduced by directors were from their own sources and not by transferring from existing concern. Moreover, out of 70 employees employed by assessee company, only 8 employees were related to existing concern. The Rajasthan High Court held that assessee company could not be said to be a restructured company.
- In the case of Caliber Point Business Solutions Ltd.<sup>[8]</sup>, the assessee company was engaged in the BPO business and its parent company was in the business of software development and to some extent also in BPO business. The two businesses were not similar and by starting the BPO business under the name and style of the assessee company, the integrity of the existing software development business of the parent company was not impaired. The Mumbai Tribunal held that parent-subsidiary relationship and transfer of minor office equipment and vehicles by the parent company to the assessee company cannot be the base for arriving at the conclusion that there is a splitting and reconstruction of the business of the parent company.

### 3. Closing Thoughts

To summarize the aforesaid, "splitting up" refers to a situation where a business carried on is segmented and thereafter carried out in two or more undertakings. Splitting up of a business would also involve something similar. It means that two businesses were an integral part earlier. In a splitting up, the integrity, of the existing business is impaired.

The term “reconstruction” implies that the existing business emerges in an altered form and the identity of the existing business is lost to that extent. The establishment of the new unit destabilizes the existing business.

To reiterate, the expansion of business through a new and integrated undertaking does not tantamount to splitting up or reconstruction of the existing business. A new undertaking that satisfies the following conditions could not be said to have been formed by splitting up or reconstruction of an existing business:

- Separate and distinct identity of the new undertaking;
- Fresh investment in the undertaking;
- Employment of requisite manpower therein;
- Manufacture of articles or rendering of services from such undertaking; and
- Earning of profits clearly attributable to said undertaking

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[1] CIT v. Mahaan Foods Ltd. (2008) 216 CTR 148 (Delhi High Court)  
/ [\[TS-5426-HC-2008\(DELHI\)-O\]](#)

[2] T. Satish U. Pai v. CIT (1979) 119 ITR 877 (Karnataka High Court)  
/ [\[TS-5625-HC-1978\(KARNATAKA\)-O\]](#)

[3] CIT v. Deco De Trend (2013) (Madras High Court) / [\[TS-378-HC-2013\(MAD\)-O\]](#)

[4] Textile Machinery Corporation Ltd. v. CIT (1977) 107 ITR 195 (Supreme Court)  
/ [\[TS-12-SC-1977-O\]](#)

[5] CIT v. Gaekwar Foam and Rubber Co. Ltd. (1959) 35 ITR 662 (Bombay High Court)  
/ [\[TS-5-HC-1958\(BOM\)-O\]](#)

[6] CIT v. Ganga Sugar Corporation Ltd. (1973) 92 ITR 173 (Delhi High Court)

[7] CIT v. Sagun Gems (P.) Ltd. (2013) (Rajasthan High Court)  
/ [\[TS-5569-HC-2012\(RAJASTHAN\)-O\]](#)

[\[8\]](#) ITO v. Caliber Point Business Solutions Ltd. ITA 4306/Mum/2010 (Mumbai Tribunal) /