Slump Sale – Concept and Recent Amendments

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Slump sale is considered as one of the most effective modes of business restructuring, particularly because of ease in implementing it, and shorter implementation time frame.

Slump sale refers to sale of a **business undertaking** for a lump sum consideration, without values being assigned to individual assets and liabilities.

Meaning of the term 'business undertaking'

To constitute a slump sale, the business undertaking or a unit or a division of the undertaking should be transferred as a whole. Individual assets or liabilities or any combination thereof cannot constitute a business activity and thus, business must be sold on a lock, stock and barrel basis i.e. as a whole, constituting an income earning apparatus and having its own identity to qualify as a slump sale transaction.

Key characteristics of a business undertaking inferred from certain judicial precedents[1] are as under:

- It should be a distinct and a separate business activity, i.e. collection / combination of assets or liabilities constituting a business activity;

- It should be carried on with a view to earn profits;

- The undertaking should be an integrated unit capable of producing goods and services independently;

- It should be capable of being owned and transferred.

Meaning and taxability of 'slump exchange'

A slump sale transaction can be structured as a cash or a non-cash transaction, i.e. an exchange.

Slump exchange covers those transactions wherein non – monetary consideration is received in lieu of transfer of a business undertaking.

As per Section 2(47)(i) of the Income Tax Act, 1961 ('IT Act'), **transfer** includes the sale, exchange or relinquishment of a capital asset. Prior to Budget 2021, Section 2(42C) of the IT Act defined slump sale as transfer of an undertaking **as a result of the sale** for a lump sum consideration.

Accordingly, it was contended that the intent was to make a distinction between the terms 'transfer' and 'sale' and that transfer is a broader term which includes both sale and exchange. Since the definition of slump sale referred to only ***'transfer by way of sale',*** a transaction of ***'exchange'*** would not constitute as a slump sale for the purposes of erstwhile Section 2(42C) of the IT Act.

Basis this, a view was taken that slump exchange is not covered by the provisions of Section 50B of the IT Act, which provided for a mechanism to determine cost of acquisition in case of slump sale. Therefore, it was contended that the computation mechanism for determination of the cost of acquisition fails and gains from a slump exchange transaction cannot be computed in accordance with the provisions of Section 50B. Hence a slump exchange transaction is not subject to capital gains tax.

It is pertinent to note that there were conflicting high court judgements (both positive and negative) on the above subject matter. The rulings were generally in favour of the assessee and had taken a positive view that slump exchange cannot be subject to capital gains tax due to failure of computation mechanism. However, the risk of litigation or possibility of questioning by the tax authorities could not be ruled out on this issue of taxability of a slump exchange transaction.

A few positive judicial precedents in this regard have been provided below:

- In the case of **Bharat Bijlee Limited**[2], the Revenue contended that mere fact that the consideration was the value of the shares or bonds issued pursuant to such a transfer would not put such a transfer outside the purview of a slump sale and Section 50B of the IT Act had been specifically enacted to cover such transfers of undertaking on a going concern basis.

On the other hand, the assessee contended that for a slump sale, the transfer had to be by way of sale, i.e., a price in money should be paid and received. As there was no money consideration received for the transfer of Lift Division, it was a case of an exchange and not a sale (since the consideration was in the form of shares or bonds).

Bombay High Court held that a slump exchange cannot be construed to be a slump sale taxable under Section 50B of the IT Act, as the said section is applicable only to a business sale and not exchange of a business with any other form of asset.

- In **Areva T&D Ltd**[3], Madras High Court, relying on the decision of the Bombay High Court in the case of Bharat Bijlee Limited, held that the transfer pursuant to approval of scheme of arrangement is not a contractual transfer but a statutorily approved transfer and cannot be brought within definition of word 'sale'. Accordingly, transfer of assessee's non-transmission and distribution business in exchange of issuance and allotment of equity shares under a scheme of arrangement approved by High Court is not a slump sale exigible to capital gains tax under section 50 of the Act. It may be noted here that the tax department had filed a Special Leave Petition ('SLP') with the Supreme Court against the said High Court order. The Supreme Court found merit in the tax department's appeal and has recently granted leave to the SLP. Therefore, this has given the tax department a chance to argue on the taxability of slump exchange before the Supreme Court. Further, it may also be noted that since the law with respect to taxability of slump exchange has been amended vide Finance Act, 2021, the decision of the Supreme Court in the above matter will be relevant for taxability of slump exchange transactions prior to 1 April 2021.

- In **Bennett Coleman & Co. Ltd.**[4], Mumbai ITAT held that the transaction of hiving off a division was considered as exchange and not sale consequent to which it didn't fall under the definition of "Slump Sale". Moreover, the consideration was not money but equity shares and debentures due to which it was held that the provisions under Section 50B of the IT Act would not be attracted.

- In **Motor and General Stores (P.) Ltd**[5], the Supreme Court held that the transaction of exchanging 5% tax free cumulative preference shares as consideration in exchange of all equipments and machinery fittings as per the exchange deed did not amount to sale within the purview of the second

proviso to section 10(2)(vii) of 1922 Act.

Following are certain negative judgements on the issue:

- In **SREI Infrastructure Finance Ltd**[6], Delhi High Court held that provisions of 'slump sale' (as per section 50B of the Act) were applicable to all cases involving transfer of an undertaking for a lump sum consideration without values being assigned to the individual assets and liabilities, thus including transfer of undertaking through a court approved scheme of arrangement.

- In the case of **Artex Manufacturing Company**[7], the Supreme Court held that the sale of business on a going concern for a lump-sum non-monetary consideration was transfer by way of sale on the ground that the slump price was determined by the value on the basis of itemized assets, though this price was not mentioned in the agreement.

Similar principle has been laid out by the Apex Court in the case of**R.R. Ramakrishna Pillai**[8] and **Dhampur Sugar Mills**[9], wherein it was held that transfer of an asset in lieu of non – monetary consideration would come within the purview of a sale transaction.

Taxability of slump exchange post Finance Act, 2021

With a view to override the above laid judicial precedents, in Finance Act, 2021, definition of 'slump sale' has been amended to include all types of transfers (including exchange). The rationale for the said amendment is based on the principle of 'substance over form'. Whether the form of the transaction is that of a slump sale or a slump exchange, in substance it is a transaction of business transfer for a consideration (monetary or non-monetary) and therefore in effect and substance should be construed as a sale, subject to tax under Section 50B of the IT Act.

Therefore, through this amendment, exchange and other forms of transfer have come within the ambit of capital gains tax, thus settling the ambiguity around taxability of slump exchanges.

Although slump exchange has been brought within the ambit of capital gains tax, it may still be an efficient tool for business delinking without cash flow involvement.

Amendment in manner of computation of consideration in case of slump sale

Prior to amendment in Finance Act, 2021, consideration provided in the Business Transfer Agreement was considered to be the slump sale consideration without any question being raised regarding the basis for its determination, or whether it was equivalent to Fair Market Value ('FMV') of the business being transferred or not. However, as per the newly issued valuation rules the consideration shall be deemed to be higher of the following and shall be the basis for computation of the capital gains tax to be levied on the slump sale:

- FMV of capital assets transferred on slump sale

- FMV of consideration received or accruing on transfer of capital asset on slump sale

Following is the formula for determining FMV1 and FMV2:

FMV 1	**FMV2**
A+B+C+D – L	**E+F+G+H**
A = Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) as appearing in the books of accounts of the undertaking transferred by way of slump sale, as reduced by the following amount which relate to such undertaking: **(i)** any amount of income tax paid, if any, less the amount of income tax refund claimed, if any and	**E** = Value of **monetary consideration** received or accruing pursuant to transfer

(ii) any amount shown as asset (including the unamortised amount of deferred expenditure) which does not represent the value of any asset	
B = Price which the **jewellery and artistic work** would fetch if sold in the open market on the basis of valuation report obtained from a registered valuer	**F** = FMV of **non-monetary consideration** received or accruing as a result of the transfer, represented by property[10]. FMV of the said property to be determined in prescribed manner[11]
C = FMV of **shares and securities**[12]	**G** = Value of the **non-monetary consideration** received or accruing as a result of transfer, represented by property **other than immovable property and other than the property referred to in Rule 11UA(1).** The value would be equal to the price which the property would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer.
D = Stamp duty value of immovable property	**H** = Stamp duty value of immovable property in case the non-monetary consideration received or accruing as a result of the transfer is represented by the immovable property
L= Book value of liabilities as appearing in the books of accounts of the undertaking transferred by way of slump sale, but not including the following which relates to such undertaking: (i) equity paid-up share capital (ii) amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer (iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation (iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable on book profits (i.e. Minimum Alternate Tax) (v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities (vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares	
FMV1 = A+B+C+D – L	**FMV2 = E+F+G+H**
Full value of sale consideration u/s 50B = Higher of FMV1 or FMV2	

The rationale for introduction of definite formulas for determination of the slump sale consideration, basis FMV of capital assets transferred could be the government's intent to discourage business transfers at less than book value as the same leads to a loss in revenue to the exchequer. Similar provisions have been already introduced in earlier Budgets for sale of shares, land and building, etc. and has now been extended to slump sale.

Further, introduction of the rules puts to rest the controversy on whether Section 50C should be made applicable to slump sale transactions taxable under Section 50B. As per the prescribed formula, land and

building have to be considered to be transferred at circle value for determination of slump sale consideration and therefore, the concept provided in Section 50C has been incorporated in Section 50B as well.

Key issues in valuation rule prescribed for slump sale transactions

Assignment of values to individual assets and liabilities

It is important to note the concept of slump sale is wherein the entire business undertaking is transferred as a whole, without assignment of values to individual assets and liabilities. Also, explanation 2 to section 2(42C) of the IT Act states that the determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities.

However, the mechanism for calculating FMV of the undertaking provides for assignment of values to each asset and liability in the prescribed manner.

Fair value of consideration vis-à-vis fair value of net assets transferred

If the intent of introducing valuation rules is to make all kinds of slump sale (including slump exchange) subject to capital gains tax basis fair value, the same could have been achieved by just prescribing rules for determination of value of consideration for slump sale.

The legislature could have avoided laying out rules for determination of value of the undertaking to cover situation where in value of the undertaking is more than value of consideration, and thereby avoided going against the principle that the undertaking being transferred through slump sale should not just be a combination of assets and liabilities.

Intra – group transactions

Slump sale transactions at equal to or less than book value generally happen within group companies and therefore the government may, in accordance with the concept of group taxation, as adopted in various economies, consider to exempt such transactions.

Further capital gains in book value transactions would, in most cases, be only on account of difference in tax WDV of depreciable assets and book WDV of depreciable assets or book value and circle value of land and building and therefore, may not entail a very high tax levy.

Therefore, the government should focus on high value third party transactions, wherein there may be a significant difference between tax net worth and transaction value and therefore a probability of a higher tax levy.

Effective date of rules

Furthermore, the amendment with respect to computation of consideration in case of slump sale, as well as the notification prescribing the rules, does not specify the date from which such amendment shall be effective. Considering the amendment is a conceptual change in the manner in which tax is computed on a slump sale, the amendment should apply to future transactions, i.e. slump sale taking place post 1 April, 2021, so that the taxpayer has a clear visibility of his taxes, and an opportunity to effectively plan the same.

It is expected that the legislature will take note of abovementioned anomalies, and appropriate clarifications will be issued in this regard.

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[1] Sree Yellamma Cotton, Woollen and Silk Mills Co Ltd, AIR 1969 Mysore 280

Textile Machinery Corporation Ltd. v. CIT (1977) 107 ITR 195 (SC) [TS-12-SC-1977-O]

Triune Projects (P.) Ltd. v. DCIT [TS-6237-HC-2016(DELHI)-O]

CIT, Jalandhar-I v. Max India Ltd. [TS-6103-HC-2008(PUNJAB AND HARYANA)-O]

[2] [TS-270-HC-2014(BOM)]

[3] [TS-458-HC-2020(MAD)]

[4] [TS-5872-ITAT-2018(MUMBAI)-O]

[5] [1967] 66 ITR 692 (SC) [TS-5-SC-1967-O]

[6] [TS-237-HC-2012(DELHI)-O]

[7] (1997), 227 ITR 260 (SC) [TS-19-SC-1997-O]

[8] (1967) 66 ITR 725 (SC) [TS-4-SC-1967-O]

[9] (2006) 147 STC 57

[10] Property referred to in Rule 11UA (1) includes jewellery, archaeological collections, drawings, paintings, sculptures or any work of art and shares and securities

[11] provided in Rule 11UA(1)

[12] as determined in the manner provided in Rule 11UA(1)