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Slump Sale Transactions - Taxation Issues in India

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SLUMP-SALE TRANSACTIONS – TAXATION ISSUES IN INDIA

Abstract

This article examines the considerations required to constitute a slump-sale under the Indian tax laws. The article also explains the major questions concerning the computation of Capital-gains and the non-applicability of Sales-tax on Slump-Sale transactions. The analysis is based on the present position of the law through a study of the most significant case laws on the subject.

a. Introduction

The concept of ‘Slump-sale’ was incorporated in the Income Tax Act, 1961 (“IT Act”) by the inclusion of S. 2(42C) into the provision by the Finance Act, 1999. A ‘Slump-sale’ is defined 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.

From the above definition it may be observed that the IT Act recognises ‘Slump-sale’ as a transfer of an ‘undertaking’ i.e. a part or a unit or a division of a company, which constitutes a business activity when taken as a whole. In other words, a ‘Slump-sale’ would mean a transfer of an entire business for a single consideration without assigning any value to individual assets and liabilities. Also, under the concept of a ‘Slump-sale’ the business is sold on a ‘going concern basis’, i.e. after the transfer of all assets/ liabilities, contracts, employees, etc the business would be able to carry on its activities as earlier.

b. What constitutes a Slump-Sale – Judicial position

In the case of Bharat Bijlee Limited v. The Addl CIT¹, it was held that in order to constitute a ‘Slump-sale’ under S. 2(42C) of the IT Act, the transfer must be as a result of a ‘sale’ i.e. for a money consideration and not by way of an ‘exchange’. The presence of money consideration is an essential element in a transaction of sale. If the undertaking was transferred in consideration of shares & bonds, it was a case of ‘exchange’ and not ‘sale’ and hence S. 2(42C) and S. 50B of the IT Act would not apply. The ITAT, in this case relied on the Supreme Court judgment in the case of CIT v. M/s Motors and General Stores Pvt Limited², wherein the Court had held that the

¹ (2011) TIOL 197 ITAT-Mum.
² 1967 SCR(3) 876.
presence of money consideration was an essential element in a transaction of sale. If the consideration was not money but some other valuable consideration it may be an exchange or barter but not a sale.

In the case of *In Re: M/s Indo Rama Textiles Ltd*³, the Delhi High Court highlighted another test to ascertain a ‘Slump-sale’. The Court relied on the Bombay High Court judgment in the case of *Premier Automobiles Ltd v. ITO & Anr*⁴, which held that the basic test which one must apply to ascertain whether there exists a ‘Slump-sale’ is the continuity of business, and the Punjab and Haryana High Court judgment in the case of *CIT v. Max India Ltd.*⁵, which held that for a sale to be termed a ‘Slump-sale’ it is not essential that all assets and liabilities should be transferred. Even if some assets and liabilities are retained, the sale would not lose its character, if the transfer is on a going concern basis. Thus, the Delhi High Court held that the non-transfer of some of the assets being used by the transferee would not affect the status of a ‘Slump-sale’ if the undertaking transferred was a ‘going-concern’.

However, the ‘Slump-sale’ provisions do not apply where assets of an undertaking are transferred without the transfer of liabilities. The above position is arrived at from an analysis of the following, firstly, the definition of an ‘undertaking’ which was highlighted by the Supreme Court in *R.C. Cooper v. UOI*⁶ as ‘including any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole’, and secondly, as per explanation 1 to S. 50B of the IT Act, which enumerates that ‘net worth’ is the difference between ‘aggregate value of total assets of the undertaking or division’ and ‘value of liabilities of such undertaking or division’, hence only the transfer of assets would not amount to a ‘Slump-sale’. The above position was also accepted by the ITAT in the case of *Weikfield Products Co. (I) Pvt Ltd. v. DCIT*⁷.

Also, prior to the insertion of S. 2(42C) in the IT Act, the Courts had held that a ‘Slump-sale’ is a sale of a business on a going concern basis where the lump sum price cannot be attributed to individual assets or liabilities. The Supreme Court, in the case of *CIT v. Artex Manufacturing*

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³ Company Petition No. 4 of 2003.
⁴ 2003 264 ITR 193 (Bom).
⁵ 2009 319 ITR 68 (P&H).
⁶ 1970 AIR 564.
⁷ (2001) 71 TTJ Pune 518.
treated the sale of the business on a going concern for a lump sum consideration as an itemised sale on the ground that the slump price was determined by the valuer on the basis of itemised assets. Further, in the case of *CIT v. Electric Control Gear Mfg. Co.*⁹, the Supreme Court regarded the sale of a business on a going concern as a ‘Slump-sale’ since there was nothing to show that the slump price was attributable to any asset.

c. **Computation of Capital-gains on Slump-Sale transactions**

Apart from the insertion of S. 2(42C), the Finance Act, 1999 also inserted S. 50B to the IT Act, which laid down a special computing mechanism for the computation of capital gains on a ‘Slump-sale’ transaction. As per S. 50B, the profits or gains arising from a ‘Slump-sale’, as defined under S. 2(42C), become chargeable under the head ‘Capital Gains’. S. 50B also provides for the mechanism to compute ‘Net worth’ which is deemed to be the cost of acquisition of the undertaking being transferred for the purposes of S. 48 and 49 so as to enable the computation of capital gains.

As laid down in the case of *Zuari Industries Ltd v. CIT*¹⁰, the ITAT held that S. 50B in the IT Act was introduced by the Finance Act, 1999 and though prior to this there were disputes as to whether a transfer of business or an undertaking by way of ‘Slump-sale’ constituted transfer of capital asset and whether there was any cost of acquisition of such business or undertaking or division, however after the insertion of S. 50B, it is amply clear that the profits on a transfer of such asset are chargeable to tax under the head ‘capital gains’ and the cost of acquisition for the purpose of S. 48 would be the net worth as computed under S. 50B.

The Supreme Court, in the case of *PNB Finance Ltd. v. Commissioner of Income Tax-I, New Delhi*¹¹, emphasised the position before the insertion of S. 50B of the IT Act, and held that prior to the insertion of S. 50B gains from slump transactions was neither taxable as business income under S. 41(2) nor as Capital gains under S. 45 of the IT Act. It further emphasised that in order to attract S. 41(2), the subject matter should be depreciable assets and the consideration received should be capable of allocation between various assets. In case of a ‘Slump-sale’, there is an

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⁸ 227 ITR 260 (SC).
⁹ 227 ITR 278 (SC).
undertaking which gets transferred (including depreciable and non depreciable assets) and it is not possible to allocate slump price to depreciable assets, therefore, the same cannot be taxed under S. 41(2). In order to tax the same as capital gains, the Court followed the judgment as laid down in the case of CIT v. B. C. Srinivasa Setty\(^{12}\) and held that the charging section and the computation sections are an integrated code and if one fails the other fails too. In case of ‘Slump-sale’, there are a bundle of assets (including intangible assets like goodwill) that are transferred and in the absence of any specific provision like S. 50B of the IT Act, it is not possible to determine the cost of the said assets and thus, the computation mechanism fails and so does the charging section.

Thus, it was held that a ‘Slump-sale’ transaction was not chargeable to capital gains tax prior to insertion of S. 50B in the IT Act.

d. **Non-applicability of Sales-tax on Slump-sale transactions**

With respect to the question as to whether sales tax would be applicable on ‘Slump-sale’ transactions, the judicial position is that no sales tax would be payable on the transfer of a business as a going concern, including the transfer of a whole unit or division of any business under the value-added tax laws or the local sales tax laws. This is based on the rationale that the sale of an entire business cannot be equated with the sale of movable goods, the latter being subject to sales tax only.

The Andhra Pradesh High Court in the case of *Coromondal Fertilizers Limited v. State of AP*\(^{13}\) and *Spectra Bottling Co. v. State of AP*\(^{14}\) held that a sale of business would not be construed as a sale in the course of business and hence would not be subject to sales tax.

Further, in a scenario where only a unit or a particular branch of the target company is sold, Courts in the cases of *The Deputy Commissioner of Sales Tax (Law) v. Dat Pathe*\(^{15}\), *The Deputy Commissioner of Commercial Taxes v. K. Behanan Thomas*\(^{16}\) and *Lohia Machines Limited v.*

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\(^{12}\) 128 ITR 294.  
\(^{13}\) 1998 (6) ALT 730.  
\(^{14}\) (1999) 112 STC 1 AP.  
\(^{15}\) 1985 (059) STC 0374 Kerala.  
\(^{16}\) 1977 (039) STC 0325 Madras.
Commissioner of Sales tax, U.P\textsuperscript{17} have held that if a person is carrying on his business through different units/ branches separately identifiable from each other, the transfer of one unit/ business as a going concern having separately identifiable assets, liabilities, income and expenditure would be considered as transfer of business as a ‘going concern’ and accordingly not attract any VAT/ Sales tax liability.

However, it needs to be taken into consideration that in the case of \textit{State of Tamil Nadu v. T.M.T. Drill (Private) Ltd.}\textsuperscript{18}, it has been held that a business will not be considered to be sold ‘as a whole/ going concern’ unless the entire ‘assets’ of the business are transferred. If certain assets are retained and are not transferred, the turnover resulting from such a sale/ transfer will not be exempt under the provisions of the VAT laws.

e. \textbf{Exclusion of certain liabilities in case of a Slump-sale transaction}

As has been highlighted earlier, the concept of ‘Slump-sale’ envisages the business to be sold on a ‘going concern basis’ i.e. after the transfer of all assets and liabilities, contracts, employees, etc, so that the business would be able to carry on its activities as earlier. However, as has been held by the Punjab and Haryana High Court in the case of \textit{CIT v. Max India Ltd.}\textsuperscript{19}, that for a sale to be termed a ‘slump sale’ it is not essential that all assets and liabilities should be transferred, even in case some assets and liabilities are retained, the sale would not lose its character, if the transfer is on a going concern basis.

Following the above, there is a provision for the exclusion of certain liabilities is case of a ‘Slump-sale’. The Delhi Bench of the ITAT in the case of \textit{ECE Industries Ltd. v. Deputy Commissioner of Income Tax}\textsuperscript{20}, held that certain liabilities may be excluded which are past liabilities and which do not have any direct relationship with the running of the smooth functioning of the business of the concern. However, it also mentioned that no exclusion of any statutory liability or liability on account of running of the business is allowed, and those mandatorily have to be transferred with the unit in the ‘slump sale’ transaction.

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\textsuperscript{17} 1998 (110) STC 0305 Allahabad.
\textsuperscript{18} 1991 (082) STC 0059 Mad.
\textsuperscript{19} (2009) 319 ITR 68 (P&H).
\textsuperscript{20} (2007) 111 TTJ (Delhi) 11.
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f. **Conclusion**

While a ‘Slump-sale’ is an attractive option for a business entity desirous of transferring an undertaking, however, given the uncertain judicial climate and the myriad complexities involved with respect to the determination of the taxability aspect, it is prudent for parties to examine each aspect on a case to case basis before venturing into any such arrangement for the transfer of their business.