dhruva

Direct Tax Alert

May 26, 2021

The CBDT notifies a rule for computation of deemed consideration under a slump sale

The provisions of section 50B of the Income-tax Act, 1961 (the 'Act') which deal with the computation of capital gains in case of a slump sale were amended by the Finance Act, 2021 with effect from the financial year 2020-21 to provide that the fair market value ('FMV') of capital assets transferred under a slump sale shall be deemed to be the consideration for capital gains computation. The CBDT has now notified the rule prescribing the formula for determining the deemed consideration in case of a slump sale.

Overview of the rule

- The Central Board of Direct Taxes ('CBDT') has by way of a notification[1] amended the Income-tax Rules, 1962 (the 'Rules') and inserted Rule 11UAE which prescribes the method for computing the FMV of capital assets for calculation of deemed consideration in case of a slump sale under section 50B of the Act.
- The rule requires the computation of two FMVs which is referred to in the rule as FMV1 and FMV2. Both the FMVs are required to be computed as on the date of slump sale.
- The FMV1 represents the FMV of the capital assets transferred by way of slump sale and the FMV2 represents the FMV of the consideration received for slump sale.

[1] Notification No 68/2021 dated May 24, 2021.

- The deemed consideration in case of a slump sale will be the higher of two FMVs computed as per the provisions of the rule.

Calculation of FMV1

- The FMV1 is required to be calculated as per the following formula:

FMV1 = A + B + C + D – L, where,
A = The book value of all the assets relating to the undertaking transferred, other than certain assets whose value needs to be considered as per the formula and excluding certain specified assets
B = The FMV of jewellery and artistic work
C = The FMV of shares and securities
D = The stamp duty value of immovable property
L = The book value of all the liabilities relating to the undertaking transferred, excluding certain specified liabilities

- In calculating the book value of the assets relating to the undertaking transferred, the following assets need to be excluded:
  - any amount of income-tax paid after reducing the amount of refund claimed (if any);
  - any amount of unamortised deferred expenditure which does not represent the value of any asset.
- The FMV of jewellery and artistic work needs to be determined considering the price it would fetch if sold in the open market based on the valuation report to be obtained from a registered valuer.
- The FMV of shares and securities needs to be determined in the manner prescribed in Rule 11UA(1) of the Rules. This is the same FMV as required to be considered for certain other provisions e.g., section 56(2)(x) of the Act.
- In the calculation of liabilities of the undertaking to be transferred the following liabilities related to the undertaking need to be excluded:
  - the paid-up equity share capital;
  - dividend on shares where such dividend have not been declared at a general meeting before the date of transfer;
  - reserves and surplus, even if negative, other than those set apart towards depreciation;
  - provision for taxation, with certain adjustments;
  - provisions made for meeting liabilities, other than ascertained liabilities;
  - contingent liabilities other than arrears of dividends in respect of cumulative preference shares.

Calculation of FMV2

- The FMV2 is required to be calculated as per the following formula:

FMV2 = E + F + G + H, where,
E = The value of the monetary consideration received or accruing on the slump sale
F = The FMV of the non-monetary consideration received or accruing on the slump sale which is in the nature of jewellery, artistic work, shares or securities
G = The FMV of the non-monetary consideration received or accruing on the slump sale being the property (other than immovable property, jewellery, artistic work, shares or securities)
H = The stamp duty value of immovable property

- The FMV of non-monetary consideration in the nature of jewellery, artistic work, shares or securities needs to be determined in the manner prescribed in Rule 11UA(1) of the Rules. This is the same FMV as required to be considered for the purpose of certain other provisions e.g., section 56(2)(x) of the Act.
- The FMV of non-monetary consideration (other than immovable property, jewellery, artistic work, shares or securities) needs to be determined considering the price it would fetch if sold in the open market based on the valuation report to be obtained from a registered valuer.

Key Considerations

- Earlier, in the case of a slump sale as part of an internal restructuring within a group, the transaction could have been implemented in a tax neutral manner by providing the consideration equal to the cost i.e. tax net worth calculated as per the provisions of section 50B of the Act, however, given the amendment of section 50B of the Act and the above formula going forward deemed consideration as per Rule 11UAE will have to be considered.
- For computing the tax net worth of an undertaking under section 50B of the Act, the revaluation of assets is required to be ignored. However, there does not appear to be a similar provision under the notified rule, as a result, the assets may need to be considered at their revalued amounts which could result in a higher FMV/ deemed consideration.
- In computing the FMV of capital assets, the deduction of provisions made for unascertained liabilities is not available, however, for computation of tax net worth (i.e. cost) all liabilities relating to the undertaking need to be reduced. This could result in a higher FMV/ deemed consideration.
- Further, in the case of a slump exchange that is now specifically taxable, the value of non-monetary consideration will have to be calculated as per Rule 11UAE.
- One question which arises is the date of effectiveness of the rule. While the amendment in section 50B of the Act is effective from April 1, 2020, the rule is silent on its effectiveness. While one view could be that the rule is effective from the date of its publication in the official gazette, the other view could be that if the rule is held to be procedural in nature, its applicability could therefore be co-terminus with the applicability of the provision i.e. April 1, 2020.

Dhruva Comments

The amendment to section 50B of the Act represents a significant change to the provisions governing the taxation of slump sale under section 50B of the Act. The fair valuation rule brings clarity in the computation of capital gains in a slump sale and broadly follows the existing valuation mechanism prescribed under Rule 11UA of the Rules for substitution of the book value of various assets comprised in the undertaking. However, transfer of businesses in a tax neutral manner to subsidiaries or group companies may be impacted by this amendment, depending on the nature of business and components of assets and liabilities.

Contributors:

Mehul Bheda (Partner)

Kushal Parikh (Principal)

Ketan Sakhala (Senior Associate)

For additional information with respect to this alert, please feel free to reach out.

ADDRESSES

Mumbai
One World Center, 11th floor,
Tower 2B, 841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400013
Tel: +91 22 6108 1000 / 1900

Ahmedabad
B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad 380015
Tel: +91-79-6134 3434

Bengaluru
Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560001
Tel: +91-80-4660 2500

Delhi / NCR
101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana 122002
Tel: +91-124-668 7000

Pune
305, Pride Gateway, Near D-Mart, Baner,
Pune 411045
Tel: +91-20-6730 1000

Kolkata
4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal 700016
Tel: +91-33-66371000

Singapore
Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai
WTS Dhruva Consultants
U-Bora Tower 2, 11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel: + 971 56 900 5849

KEY CONTACTS

Dinesh Kanabar
Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Mehul Bheda (Mumbai/Ahmedabad)
mehul.bheda@dhruvaadvisors.com

Ajay Rotti (Bengaluru)
ajay.rotti@dhruvaadvisors.com

Vaibhav Gupta (Delhi/NCR)
vaibhav.gupta@dhruvaadvisors.com

K. Venkatachalam (Pune)
k.venkatachalam@dhruvaadvisors.com

Aditya Hans (Kolkata)
aditya.hans@dhruvaadvisors.com

Mahip Gupta (Singapore)
mahip.gupta@dhruvaadvisors.com

Nimish Goel (Dubai)
nimish.goel@dhruvaadvisors.com

Dhruva Advisors has been consistently recognised as the **"India Tax Firm of the Year"** at the ITR Asia Tax Awards in 2017, 2018, 2019 and 2020.

Dhruva Advisors has also been recognised as the **"India Disputes and Litigation Firm of the Year"** at the ITR Asia Tax Awards 2018 and 2020.

WTS Dhruva Consultants has been recognised as the **"Best Newcomer Firm of the Year"** at the ITR European Tax Awards 2020.

Dhruva Advisors has been recognised as the **"Best Newcomer Firm of the Year"** at the ITR Asia Tax Awards 2016.

Dhruva Advisors has been consistently recognised as a **Tier 1 Firm in India for General Corporate Tax** by the International Tax Review's in its World Tax Guide.

Dhruva Advisors has been consistently recognised as a **Tier 1 Firm in India for Indirect Taxes** in International Tax Review's Indirect Tax Guide.

Dhruva Advisors has also been consistently recognised as a **Tier 1 Firm in India for its Transfer Pricing** practice ranking table in ITR's World Transfer Pricing guide