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CORPORATE RESTRUCTURING AND TAX NEUTRALITY

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Abstract

Corporate restructuring is the process of rearrangement of business activities and has become the buzzword to cope with the fierce competitive environment prevailing all throughout the globe in the era of globalization and liberalization. To face the growing challenges, the corporate entities are under sheer pressure to go for redefining their strategies on a continuous move based on their core competencies and market excellences to enter into new venture resulting corporate restructuring. The Income tax laws have been eager to cater different tax exemptions to give fillips to such reorganizations for the noble mission to protect corporate entities from the fierce competitions as well as to help them survive and grow for the greater interests of the society at large.

Keywords: Restructuring, Tax Exemptions, Corporate Entities.

CORPORATE RESTRUCTURING: CONCEPT AND MEANING

Corporate restructuring is the deliberate corporate re-organization process as well as the re-arrangement of the affairs of corporate enterprises undertaken with the prime objective to reduce or avert the business risks involved in the process of carrying business activities under fierce competitive environments. Mergers, Acquisitions and Business Alliances (MAA), are the common strategies to usher corporate business restructuring with much fervour and zeal to ward off cut throat competitions and have become the prime corporate endeavour as a matter of robust corporate practice and ideology especially in the era of globalization and liberalization to sustain business growth and prosperity.

Amid all adversities of wild competitions, the corporate entities with their unflinching passion for further advancement, strive for accumulating power and flavour of growth through the deliberate process of corporate restructuring. The process of corporate restructuring is a dynamic process to help corporate entities strategically come together under one corporate umbrella to protect and safeguard themselves from the gruelling impact of market cruelties and market shocks caused by hectic market competitions as well as to safeguard the corporate assets and opportunities from their injudicious and colossal devastation by means of market competitions and thus to boost up the adoption of best possible venture by dint of appropriate alternative use and exploration of available resources to the ultimate satisfaction of the corporate entities and the society as a whole. Corporate restructuring represents various forms of business alliance like merger, amalgamation, acquisition, demerger etc. to avoid the unwanted corporate failures and corporate financial bankruptcy. It is a matter of great concern to pay adequate heed to these corporate collapses since the corporate entities very often had to face the misery of corporate destitution caused by abject competitions or sheer inability to keep pace with the global scenario and also to take drastic measure so as to foil or frustrate the financial stringency and corporate debacle. The corporate failures have the terrific impact on the society since the society experiences the adversities like moratorium in employment opportunities, lack of effective use of available resources, inadequacy in revenue generation from business operations in the forms of both direct and indirect taxes that are highly necessary for meeting the social overheads for the greater interests of human kind. To tackle the situation, there are various provisions under the Companies Act and also in the Income Tax Act to instigate the corporate bodies to go for corporate restructuring through the accredited process of merger, acquisition etc. such that the cruel claws of competitions cannot prey the progress of human development and advancements and as a result of which the corporate bodies enjoy the strategic corporate buoyancy as far as practicable. Tax Exemption and

TAX NEUTRALITY

The Indian Income Tax Act, 1961 has propounded a lot of enactments to offer specific tax concessions/exemptions on capital gains; carry forward and set off of unabsorbed depreciation and loss etc. in case of merger and acquisition of companies to boost up industrial and business

developments. The basic intension of the tax legislation rests on the premises in titillating and motivating the business houses to go more and more for mergers and amalgamations by giving them the fillips in the form of various tax exemptions and advantages under the Income Tax Act, 1961 making the venture of merger/amalgamation and demerger proposals tax neutral, less hazardous and wealth prolific. The chief purpose of tax enactments in persuading corporate mergers and amalgamations is to formulate a balanced approach in the economy such that there are less of aggressive competitions in vogue amongst business entities operating under the same lines of business in domestic as well as international boundaries and also that there are no dearth of business opportunities, lack of employment opportunities and entrepreneurship to best satisfy the common people. Tax neutrality is the specific advantage offered under the Income Tax Act on the lines that even if the business entities prefer merger or restructuring, they will not be debarred from the entitlement of tax benefits like carry forward and set off of past losses and unabsorbed depreciation of the non-existent companies despite change in the ownership of companies since under the normal provision of corporate tax laws carry forward of past losses and unabsorbed depreciation is not allowable if a change in ownership of business takes place. Over and above this, exemptions are provided from capital gains arising on transfer of assets in the process of reorganization and also in allowing depreciation on assets almost in the same footing as is allowable in the hands of the companies before merger or amalgamation. This way tax neutrality is highly geared up to convince the corporate enterprises in the realm of corporate restructuring.

MERGER OR AMALGAMATION

A merger occurs when two or more companies unite together to form a single company. A merger in India is known as amalgamation and the two terms merger and amalgamation are used interchangeably to connote the same thing. However, the term merger is very similar and is almost akin to acquisition or takeover process, except that in the case of a merger existing stockholders of both companies involved retain a shared interest in the new corporation. By contrast, in an acquisition process one company purchases the bulk of another company's stock, creating an uneven balance of ownership in the acquirer company.

Amalgamation is the blending of two or more existing undertakings into one undertaking. Amalgamation of companies means either merger of one or more companies with another company or the merger of two or more companies into one company or merger of two or more companies into a single entity. However, section 2(1B) of the Act prescribes the following conditions to be fulfilled for a merger to be qualified as an amalgamation:

1. All the properties of the amalgamating company immediately before the amalgamation should become the property of the amalgamated company by virtue of the amalgamation.
2. All liabilities of the amalgamating company immediately before the amalgamation should become the liabilities of the amalgamated company by virtue of the amalgamation.
3. Shareholders holding not less than three-fourths (in value) of the shares in the amalgamating company (other than shares already held by the amalgamated company or by its nominee) should become shareholders of the amalgamated company by virtue of the amalgamation.

DEMERGER

The term 'demerger' is sometimes used to indicate the effective opposite of a merger, where one company splits into two. A demerger is a form of corporate restructure in which the undertaking of a company is transferred to another company under a scheme of demerger whereby the transferor company is called 'demerged' company and the transferee company is called as 'resulting' company. The basic concept of demerger requires transfer of an undertaking from an existing company (Transferor Company) to another existing company (Transferee Company) in terms of the provision of section 2(19AA) of the Act. Sections 391-394 of the Companies Act 1956 govern demerger. There are some conditions to be satisfied to treat transfer of undertaking as demerger.

The stipulations favouring merger of corporate entities hinge on some plausible reasons like economies of scale, growth, diversification, tax shields etc. which pose a large effect on companies those undertake merger process as the demanding way of taming and tackling undue and unhealthy competitions and rivalry with the basic objective to add shareholders' value.

TAX IMPLICATIONS OF CORPORATE RESTRUCTURING

In the process of corporate restructuring, corporate tax legislation plays a significant role model to inspire and accelerate the process of amalgamation and demerger of companies for the greater interests of the companies reconstructed and the society in general. The Various Tax Exemptions

TAX CONCESSIONS ON AMALGAMATION/DEMERGER OF COMPANIES

If an amalgamation takes place within the meaning of section 2(1B) of the Act, the tax concession available under various provisions of the Income Tax Act may be grouped under three categories:

1. Tax concession availableto the amalgamating company
2. Tax concession available to the shareholders of the amalgamating company
3. Tax concession available to the amalgamated company

I. Tax Concession available to the amalgamating company:

a) Exemption from capital gains on transfer of capital asset to amalgamated Indian company: According to section 47(vi) of the Act if capital gains arise on transfer of any capital asset in the scheme of amalgamation, by an amalgamating company to the amalgamated company, such capital gain shall be exempt from tax provided the amalgamated company is an Indian company.

b) Exemption from capital gains on transfer of capital asset in an Indian company held by a foreign company to another foreign company: According to section 47(via) of the Act if capital gains arise on transfer of shares held in Indian company by amalgamating foreign company to amalgamated foreign company, such capital gain shall be exempt from tax provided:

i) at least 25 % of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
ii) such transfer does not attract tax liability on capital gains in the country in which the amalgamating company is incorporated.

II. Tax concessions available to the shareholders of an amalgamating company

a) Under section 47(vii) of the Act, capital gains arising from the transfer of shares in a scheme of amalgamation, such capital gains shall be exempt from tax, if the following conditions are satisfied:

i) The transfer of shares is made in consideration of the allotment to the shareholders of any share or shares in the amalgamated company; and
ii) The amalgamated company is an Indian company

b) Under section 49(2) of the Act when the shares so received from the amalgamated company are later on sold or transferred, the cost of shares of the amalgamating company shall be the cost of shares of the amalgamated company. Further, for determining whether the shares in the amalgamated are long-term capital assets or not, the period of holding shall be computed from the date of acquisition of shares in the amalgamating company.

III. Tax concessions available to the amalgamated company: The amalgamated company shall be eligible for tax concessions only if the following two conditions are satisfied

- The amalgamation satisfies all the three conditions laid down in section 2(1B) and
- The amalgamated company is an Indian company

a) Carry forward and set off of accumulated business losses and unabsorbed depreciation of the amalgamating company

The Income Tax Act, 1961 prescribes that unabsorbed depreciation of assets and accumulated business loss can be carried forward only by the same assessee under whose hands the loss incurred or depreciation remains unabsorbed except in case of succession of business by inheritance. However, under the provisions of Section 72A of the Act, in the case of amalgamation of a company, owning an industrial undertaking or a ship or a hotel with another company or the amalgamation of a banking company with a specified bank, the amalgamated company is entitled to carry forward the unabsorbed depreciation and brought forward loss of the amalgamating company provided certain conditions are fulfilled. Accordingly, the accumulated business loss and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss and depreciation of the amalgamated company for the previous year in which amalgamation is effected and the amalgamated company shall be entitled to carry forward unabsorbed depreciation of the amalgamating company for a fresh period of 8 years there from and set off unabsorbed business loss for further indefinite period by virtue of

section 72A of the Income Tax Act. To attain this tax neutrality, the amalgamating as well as the amalgamated companies are required to satisfy the following conditions:

i) Conditions to be fulfilled by the amalgamating company

- The amalgamating company should have been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
- The amalgamating company has held continuously as on the date of amalgamation at least three-fourths of the book value assets held by it, two years prior to the date of amalgamation.

ii) Conditions to be fulfilled by the amalgamated company

- The amalgamated company holds continuously for a minimum period of five years from the date of amalgamation at least seventy five per cent in the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
- The amalgamated company continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
- The amalgamated company fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

b) Tax Treatment on Depreciation on Assets transferred in a scheme of amalgamation or demerger

The provisions of section 32 of the Income Tax Act regarding depreciation charge on assets are waived and are not strictly observed in case of amalgamation or demerger of companies where an asset is transferred to an Indian amalgamated or resulting company under a scheme of amalgamation or demerger.

i) Depreciation chargeable in the year of amalgamation or demerger to be computed as follows:

- The amount of depreciation of the previous year in which the ownership of assets changes because of business restructuring has to computed as usual;
- The amount of depreciation so arrived at shall be apportioned between the amalgamating and the amalgamated companies (the demerged and the resulting companies in case of demerger) in the ratio of number of days for which the assets are used by them during the previous year in which ownership of assets changes because of amalgamation and demerger. ii) Depreciation chargeable in the subsequent years of amalgamation or demerger to be computed as follows:
- Where an asset is transferred in a scheme of amalgamation/demerger, to an Indian company, the actual cost of a capital asset transferred by virtue of section 43(1) the Act shall be taken to be the same as it would have been if the amalgamating company/demerged company had continued to hold the capital asset for the purpose of its own business.
- Where in any previous year, any block of asset is transferred in a scheme of amalgamation/demerger (by the amalgamating company to the Indian amalgamated company or by demerged company to resulting Indian company), then actual cost of the block of asset in the case of amalgamated /resulting company, shall be the written down value of block of assets as in the case of amalgamating/demerged company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said previous year.

c) Tax Treatment on Transfer of Assets

The chargeability of section 45(1) under the Income Tax Act to attract capital gains tax liability on transfer of capital assets is not to be applied in a scheme of amalgamation or demerger of companies on the presupposition that transfer of asset is not to be construed as transfer. In terms of section 43C of the Act, while computing the profit or loss on sale of assets as stock in trade which has become the property of the amalgamated company under a scheme of amalgamation, the cost of acquisition of such asset to the amalgamated company shall be cost of acquisition of such asset to the amalgamating company plus an increase in cost due to any improvement made thereto and expenditure incurred wholly and exclusively in connection with such transfer.

d) Tax Treatment of Expenditure on Amalgamation and Demerger

Section 35DD of the Act prescribes that in a scheme of amalgamation or demerger, an assessee being an Indian company, is allowed a deduction equal to one-fifth of expenditure incurred wholly and exclusively for the purpose during five successive previous years commencing with the previous year in which the amalgamation or demerger takes

place. A tax planning measure may be undertaken on the lines that the aforesaid expenditure on amalgamation/demerger should be incurred or paid as far as practicable and possible by the amalgamated company instead of by the amalgamating company. This will ensure the availability of deduction of one-fifth of such expenditure in the four immediately subsequent years which otherwise will not be available in the hands of amalgamating company because of ceasing its existence by the process of amalgamation/demerger and any such hardship will not arise in the case of amalgamated company which can very well get the advantage of claiming the deduction in the year of amalgamation as also in the four immediately subsequent years.

e) Carry forward and Set-off of Losses and Unabsorbed Depreciation on Demerger

In terms of section 72A, the accumulated business loss and unabsorbed depreciation of the undertaking transferred by the demerged company in the process of demerger are allowed to be set-off and carry forward by the resulting company as follows:

- Where the loss or unabsorbed depreciation is directly relatable to the undertaking transferred by the demerged company to the resulting company, such loss or unabsorbed depreciation shall be entitled to be wholly set-off or carried forward by the resulting company.
- But where nexus between the loss or unabsorbed depreciation and the undertaking transferred by the demerged company to the resulting company is not prominent or indirectly relatable, then the amount of loss or unabsorbed depreciation shall be apportioned between the demerged and the resulting company in the same proportion in which the assets of the undertaking have been retained by the demerged company and those transferred to the resulting company and will be allowed to be set-off and carried forward accordingly in the respective hands of demerged and the resulting company.

CONCLUSION

The business enterprises all over the globe have to undergo various changes in their corporate lives on a continuous basis to keep pace with the devastating impact of business rivalry, market ups and down and the ongoing corporate restructuring process through merger, acquisition, demerger etc. It has become a common feature for the business organizations to go for corporate restructuring with the objective to grow and prosper amid all hazards embedded therein. It is also observed that many enterprises consider it advantageous to merge with the superior counterparts for the sake of betterment through extended market facility in home and foreign markets, wide customer chain, sophisticated and improved technology of production, good research and development facility and so on. There are other advantages of corporate restructuring to achieve tax shields and tax exemptions as provided under the Income Tax Act, 1961 that inspire many corporate bodies to amalgamate or merge with other corporate bodies in a tax neutral situation. In essence, it may be highlighted that corporate enterprises should go for business reorganizations through the conduit of amalgamation, merger, demerger etc. if it is really conducive for their overall growth and prosperity and also for the greater interest of their diversified stakeholders and the society as a whole.

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