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Itemised sale of assets, in substance, held to be a slump sale taxable under section 50-B

In brief

In the recent case of Mahindra Engineering & Chemical Products Ltd.[1] (the assessee or the company), the Income-tax Appellate Tribunal, Mumbai (the Tribunal) held that transfer of significant tangible and intangible assets of a business, even though through separate individual agreements, was in the nature of a transfer of a single undertaking.

The Tribunal held that, in substance, the transfers were a slump sale of a business undertaking on a going concern basis rather than an itemised sale of assets individually, and were taxable under section 50B of the Income-tax Act, 1961 (the Act).

Facts

- During FY 1999-00, the assessee sold, transferred and assigned trademarks, copyrights, know-how, assets and goodwill pertaining to two business divisions as an itemised sale to Pidilite Industries Ltd. (PIL) by entering into separate agreements, which indicated values for each asset separately.

- The tax return treated the sale of assets as an itemised sale. Consideration received towards non-compete fees, sale of goodwill, trademarks, know-how

[1] Mahindra Engineering & Chemical Products Ltd *v.*ITO [TS-253-ITAI-2012 (Mum)].

and copyright, was not offered to tax in the tax return treating it as a capital receipt.

- The assessing officer (AO) passed an order under section 143(3) of the Act accepting the stand adopted by the assessee in the return of income.

Proceedings under section 263 of the Act

- The Commissioner of Income-tax Appeals (CIT(A)) found the AO's order to be erroneous and prejudicial to the interest of the revenue and passed an order under section 263 of the Act against it.
- The assessee preferred an appeal against the CIT order, but the Tribunal upheld the revision order passed by the CIT.

Assessment proceedings under section 143(2) of the Act

- Subsequent to the CIT's order under section 263 of the Act, the AO issued a fresh notice under section 143(2) of the Act.
- The assessee contended that the various transfers were not in the nature of a slump sale but in fact were sale of individual tangible and intangible assets of the business at arm's length prices.
- After considering the assessee's contention, the AO held the transaction to be a case of slump sale.
- On assessee's appeal, the CIT(A) held that the AO was justified in treating the sale of the business division as a slump sale in accordance with the provisions of section 50B of the Act and the AO's order was upheld.

Issue

Should the various transactions of the sale of tangible and intangible assets of the two business divisions be considered as a slump sale under section 50B of the Act, as opposed to considering the transfers as individual sale of assets?

Revenue's contentions

- The assessee had sold the entire business and not just separate assets; the M-Seal business unit transferred was a complete division by itself.
- During the appeal against the proceedings under section 263 of the Act, the CIT and the Tribunal had already held that the assessee had not revealed the basis for the valuation of assets at any stage.
- Furthermore, the brand of the business (M-Seal) had acquired tremendous goodwill.
- The revenue authorities relied on the decision in the case of PNB Finance Ltd[2], in which the Supreme Court held that the banking undertaking, *inter alia*, included intangible assets such as goodwill, tenancy rights, manpower and the value of the banking licence. Hence, item-wise earmarking was not possible.
- Furthermore, the revenue authorities relied on the decision in the case of Accelerated Freeze Drying Co. Ltd[3], in which the Kerala High Court held that section 50B is the only provision that provides for computation of capital gains in the case of a slump sale. This is despite the fact that the sale of a business undertaking as a going concern will involve the sale of assets forming a block of assets on which depreciation will be allowed.

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[2] PNB Finance Ltd. *v.* CIT [2008] 307 ITR 75 (SC)
[3] CIT *v.* Accelerated Freeze Drying Co. Ltd. [2010] 337 ITR 440 (Kerala)

Assessee's contentions

- The transaction was not a slump sale and individual items were given separate prices in various agreements. There was also no transfer of land and liabilities related to the business division.
- PIL was not related to the assessee in any manner and the transactions were at arm's length.
- Section 2(42C) of the Act would not apply since the transaction was an itemised sale of tangible and intangible assets with individual values assigned.
- The AO, CIT(A) and the Tribunal had decided the matter without referring to section 2(42C) of the Act.
- The cases relied upon by the CIT(A) were not applicable in the given case since no price was determined for individual items in those cases. The assessee had specifically arrived at individual prices for each of the tangible and intangible assets transferred.
- The assessee relied on the decision of the Supreme Court in the cases of Artex Manufacturing Co.[4] and Electric Control Gear Mfg. Co.[5] and the decision of the Mumbai Tribunal (Special Bench) in the case of Summit Securities Ltd[6].
- The assessee also contended that while disposing the appeal against the order made under section 263 of the Act, the Tribunal had not given any finding that the provisions of section 50B of the Act were applicable or that the assessee had sold the whole business to PIL.

Tribunal's ruling

- Introduced with effect from 1 April, 2000, section 50B of the Act is a special provision for computing capital gains chargeable to tax in the case of a slump sale, and therefore, would prevail over the general provisions in the case of any conflict.
- A combined reading of sections 2(42C), 2(19AA) and 50B of the Act reveals that section 50B of the Act is the only provision that provides for the computation of capital gains in the case of a slump sale.
- The Tribunal observed that "undertaking" as defined in explanation 1 to section 2(19AA) of the Act includes any part of an undertaking or a unit or division of an undertaking or a business activity taken as a whole.
- As per explanation 2 to section 2(42C) of the Act, the value determined for registration purposes shall not be regarded as the value of the assets or liabilities.
- The Tribunal noted that in the commercial world, transactions have to be seen and considered in totality and, under taxation laws, substance rather than form should be the deciding factor. The treatment given by the assessee to a transaction in his books of account or an agreement entered into by him does not and cannot alter the real character of that transaction.
- On detailed perusal of the agreements, facts and other documents, the Tribunal observed that:
  - By transferring all the tangible and intangible assets, except the land, the assessee had sold the business as a whole and PIL could start the business of the two divisions on the land it owned;

[4] CIT *v.* Artex Manufacturing Co. [1997] 227 ITR 260 (SC)
[5] CIT *v.* Electric Control Gear Mfg. Co. [1997] 227 ITR 278 (SC)
[6] DCIT *v.* Summit Securities Ltd. [TS-140-ITAT-2012(Mum)]

- Non-transfer of a plot of land could not be a deciding factor in determining the nature of the transactions as the business was not affected by the non-transfer of land;
- Registered and unregistered trademarks of two business divisions were also transferred and the assessee agreed to use a different trademark (other than M-Seal) for the insulating compounds manufactured by its cable jointing business;
- The Directors' report to the shareholders of the assessee stated that the two divisions were sold 'entirely and exclusively' to PIL;
- In the main agreement, the definition of the cable jointing business specifically excluded the two business divisions transferred by the assessee;
- PIL agreed that it would not enter into or compete with the assessee in the manufacture of cable jointing kits, cable jointing terminations and components, and cable jointing insulating compounds;

- The assessee did not file any valuation report or provide any basis of how it arrived at the valuation of assets.
- The facts of the case under consideration are different from the case laws relied upon by the assessee and hence not applicable.
- The decision of the Mumbai Tribunal (Special Bench) in the case of Summit Securities Ltd.[7] is not applicable in the given case, since in that case the Special Bench did not decide on the issue of whether the transaction was a slump sale or an itemised sale.
- The Tribunal, in its order deciding the appeal filed by the assessee against the CIT's order under section 263 of the Act, held that the assessee sold its entire business to PIL even though the agreements were different. Therefore, in pith and substance, the assessee had sold the entire business to PIL.
- Based on the substance of the transactions and combined reading of the sections and agreements, the Tribunal held that the assessee sold the entire business of sealants and adhesives as a whole to PIL and that the transaction in question would be taxable as a slump sale under section 50B of the Act.

Conclusion

While the Act defines a slump sale as a sale of an undertaking for a lumpsum consideration, the Tribunal has looked into the substance of all agreements read together and considered the transaction to be in the nature of a slump sale.

This is an interesting case where, the Tribunal has to look at the substance of a transaction, looked through the arrangement and denied claim based on form.

[7] DCIT *v.* Summit Securities Ltd. [TS-140-ITAT-2012(Mum)]

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