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TAX FLASH NEWS

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Sale of business on a 'going concern' basis is a 'slump sale' and not a sale of depreciable asset under Section 50(2) of the Income-tax Act – Supreme Court

Background

Recently, the Supreme Court of India in the case of Equinox Solution Pvt. Ltd.[1] (the taxpayer) while dealing with a case prior to the introduction of slump sale provisions[2] held that sale of entire running business on 'going concern' basis is a slump sale. It is not treated as a sale of depreciable asset since Section 50(2)[3] of the Income-tax Act, 1961 (the Act) applies to a case where any block of assets are transferred by the taxpayer. Where the entire running business with assets and liabilities is sold by the taxpayer in one go, it cannot be treated as 'short-term capital asset'. The provisions of Section 50(2) of the Act would apply to a case where the taxpayer transfers one or more block of assets, which he was using running of his business. However, in this case, the taxpayer sold the entire business as a running concern.

Facts of the case

- The taxpayer was engaged in the business of manufacturing sheet metal components out of CRPA & OP sheds at Ahmadabad. On 31 December 1990, the taxpayer sold their entire running business in one go with all its assets and liabilities on 31 December 1990.

- The taxpayer filed their income tax return for the Assessment Year 1991-1992. In the return of income, the taxpayer claimed deduction under Section 48(2)[4] of the Act as it stood then by treating the sale to be in the nature of 'slump sale' of the going concern being in the nature of long-term capital gain in the hands of the taxpayer.

- The Assessing Officer (AO) did not accept the contention of the taxpayer in claiming the deduction. The AO held that the case of the taxpayer was covered under Section 50(2) of the Act because it was in the nature of short-term capital gain as specified in Section 50(2) of the Act and hence did not fall under Section 48(2) of the Act as claimed by the taxpayer. Accordingly, the AO reworked the claim of the deduction treating the same to be falling under Section 50(2) of the Act and framed the assessment order.

- The Commissioner of Income-tax Appeals [CIT(A)] allowed the taxpayer's appeal in so far as it related to the issue of deduction. Since the taxpayer has sold their entire running business in one go with its assets and liabilities at a slump price, provisions of Section 50(2) of the Act could not be applied to such sale. The CIT(A) held that it was not a case of sale of any individual or one block asset which may attract the provisions of Section 50(2) of the Act. He held that the undertaking is a capital asset

[1] CIT v. Equinox Solution Pvt. Ltd. (Civil Appeal No. 4399 OF 2007) – Taxsutra.com

[2] Section 50B of the Act introduced by the Finance Act, 1999 with effect from 1 April 2000 i.e. Assessment Year 2000-01

[3] **Special provision for computation of capital gains in case of depreciable asset** - Where any block of assets ceases to exist as such, for the reason that all the assets in that block are transferred during the previous year, the cost of acquisition of the block of assets shall be the written down value of the block of assets at the beginning of the previous year, as increased by the actual cost of any asset falling within that block of assets, acquired by the taxpayer during the previous year and the income received or accruing as a result of such transfer or transfers shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

[4] This section has been amended by the Finance Act 1992 with effect from 1 April 1993 – This case was prior to 1992

owned by the taxpayer for a period of six years. Such asset is in the nature of the long-term capital asset and the same having been sold in one go as a running concerned, it cannot be termed a 'short-term capital gain' so as to attract the provisions of Section 50(2) of the Act. Accordingly, the CIT(A) allowed the taxpayer to claim the deduction.

- The Tribunal concurred with the reasoning, and the conclusion arrived at by the CIT(A). Subsequently, the High Court also dismissed the tax department's appeal.

Supreme Court's ruling

- No fault can be found in the reasoning, and the conclusion arrived at by the CIT(A). In our view the CIT(A)'s order was rightly upheld by the Tribunal and then by the High Court calling no interference by the Supreme Court in this appeal.

- The present case does not fall within the four corners of Section 50(2) of the Act. Section 50(2) of the Act applies to a case where any block of assets are transferred by the taxpayer. Where the entire running business with assets and liabilities is sold by the taxpayer in one go, such sale cannot be considered as a 'short-term capital asset'.

- The provisions of Section 50(2) of the Act would apply to a case where the taxpayer transfers one or more block of assets, which he was using in running of his business. This is not the case here because in this case, the taxpayer sold the entire business as a running concern.

- As rightly noticed by the CIT(A) that the entire running business with all assets and liabilities having been sold in one go by the taxpayer, it was a slump sale of a 'long-term capital asset'. It was, therefore, required to be taxed accordingly.

- The Supreme Court finds support with various decisions[5]. In the case of Premier Automobiles Ltd., the Bombay High Court examined this question in detail on somewhat similar facts and had taken a similar view. The tax department was not able to cite any decision taking a contrary view nor was he able to point out any error in the decisions cited by the taxpayer. Accordingly, the tax department's appeal was dismissed.

Our comments

This decision deals with a case of slump sale prior to the introduction of provisions of Section 50B of the Act. The taxability of slump sale transactions has been a matter of debate before the courts.

Prior to the introduction of slump sale provisions, courts have held that slump sale is a sale of business on a going concern basis where the lump sum price cannot be attributed to individual assets or liabilities. In the case of Artex Manufacturing Co.[6], the Supreme Court observed that the sale of the business on a going concern basis 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. However, in the case of Electric Control Gear Mfg. Co.[7] it was held that the sale of the business on a going concern was regarded as a slump sale since in that case, there was nothing to show that the slump price is attributable to any individual asset.

Further, the Supreme Court in the case of PNB Finance Ltd.[8] after considering the provisions of Sections 41(2), 45 and 50B of the Act held that gain from slump sale transactions is neither taxable as business income under Section 41(2) nor as capital gains under Section 45 of the Act. The Supreme Court held that to attract Section 41(2), the subject matter should be depreciable assets and the consideration received should be capable of allocation between various assets. In the case of a slump sale, there is an undertaking which gets transferred (including depreciable and non-depreciable assets), and it is not possible to allocate slump price to depreciable assets, and therefore, the same cannot be taxed under Section 41(2) of the Act.

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[5] CIT v. Artex Manufacturing Co. [1997] 227 ITR 260 (SC), Premier Automobiles Ltd. v. ITO [2003] 264 ITR 193 (Bom)

[6] CIT v. Artex Manufacturing Co. [1997] 227 ITR 260 (SC)
[7] CIT v. Electric Control Gear Mfg. Co. [1997] 227 ITR 278 (SC)
[8] PNB Finance Ltd. v. CIT [2008] 307 ITR 75 (SC)

The Supreme Court while dealing with a case prior to the introduction of Section 50B of the Act held that sale of the entire business on a 'going concern' basis is a slump sale, and it is not treated as the sale of a depreciable asset under Section 50(2) of the Act.

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