GRAND ACADEMIC PORTAL
RESEARCH JOURNALS

GAP GYAN
A GLOBAL JOURNAL OF SOCIAL SCIENCES
(ISSN – 2581-5830)
Impact Factor – SJIF – 4.998, IIFS - 4.375
Globally peer-reviewed and open access journal.

MERGER—A DEVICE FOR CORPORATE TAX PLANNING AN OVERVIEW

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Abstract

Every person wants to share minimum to the kitty of the Revenue and effect to this one is always in search of the ways to pay minimum tax. Tax Planning may be regarded as a method of intelligent application of expert knowledge of planning one's or corporate body's affairs with a view to securing consciously provided tax benefits. Tax avoidance and evasion are subterfuges and are deplorable. From the view point of Tax Planning Amalgamation leads to the reduction in the tax liability of the Amalgamated Company. The past accumulated losses and unabsorbed depreciation of the amalgamating company shall be deemed the loss and depreciation of the amalgamated company for the previous year in which the amalgamation is affected. Discussion of all methods of Tax planning is not within the power and capacity of this paper. An attempt has been made to discuss a few of them in this paper.

Keywords: *Tax Planning, Tax Avoidance, Tax Evasion, Amalgamation, Accumulated Losses, Unabsorbed Depreciation*

INTRODUCTION

Every person wants to share minimum to the kitty of the Revenue and effect to this one is always in search of the ways to pay minimum tax. Tax Planning is the one of the devices of fixing less tax- liability. Tax avoidance and evasion are subterfuges and are deplorable. In this article an attempt has been made to elaborate some techniques of Tax-Planning with the help of Amalgamation, Merger and Demerger.

CONCEPT OF TAX-PLANNING

Tax-Planning refers to the scientific planning of an individual's operations in such a way as to attract minimum tax liability or deferment of the tax liability for the subsequent year by getting benefits of various incentives, concessions, rebates, allowances and relief specified in the applicable laws by using the expert knowledge with a view to securing the tax benefits legally provided for in the applicable laws. It does not reflect that the undue advantages of loopholes of the tax laws are taken for evading tax benefits. It simply refers to a course of action with which a taxpayer is seeking benefits in tax, which are clearly mentioned in the laws and are not prohibited under the laws. Tax Planning may be regarded as a method of intelligent application of expert knowledge of planning one's or corporate body's affairs with a view to securing consciously provided tax benefits.

OBJECTIVES OF TAX-PLANNING

The objectives of Tax Planning can be narrated as under:
1.Reduction of Tax Liability: A taxpayer can save maximum by making arrangements of his affairs in accordance with the requirements of the existing laws. It may possible that a taxpayer may suffer a heavy burden of tax not because of the dosage of tax administered by the applicable laws, but because of his own lack of awareness of the legal requirements. By planning tax affairs properly and availing the deductions and exemptions admissible under the existing laws, a taxpayer can retain a maximum part of his benefits. A taxpayer can succeed in reducing his tax liability by keeping an awareness of the implications of the various existing laws.
2.Minimization of Litigation: A taxpayer tries to minimize his tax liability while the tax assessing authorities tries to maximize revenues within the limit of existing laws. This leads some times protected litigation and delay in collection of taxes. A sound tax planning pays good dividends in this context. If the taxpayer in accordance with the provisions of the existing laws adopts a proper tax planning, it will minimize the incidence of litigation. This will save him from the hardships and inconveniences caused by the unnecessary litigations, which takes a long period for the final verdict before the appropriate court.

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3. Healthy Growth of Economy: With the help of proper tax planning there will be a smooth flow of tax-revenues from the taxpayers to the tax authorities without recriminations. As a result of this huge amount will be made available for national projects, which aimed at general prosperity of the national economy. This will lead to a healthy growth of economy.

4. Economic Stability: By proper tax planning, a smooth tax flow from the taxpayer to the tax administration without recriminations is ensured. This will lead to economic stability by way of getting revenues for productive investments from the taxpayers.

5. Productive Investment: The prime objective of tax planning is to channelize the tax revenues to the various investment schemes.

METHODS OF TAX PLANNING

Discussion of all methods of Tax planning is not within the power and capacity of this paper. It can be elaborate into a number of methods keeping in view location, type of business, type or scale of activity, investment options, form of business organization and capital structure decisions. An attempt has been made to discuss a few of them in this paper.

Types of amalgamations: Amalgamation falls into two categories:

(I) Amalgamation in the nature of merger: In this case, there is a genuine pooling not merely of the assets and liabilities of the amalgamating companies but also of the shareholders' interests and of the businesses of these companies. Such amalgamations are in the nature of "Merger" and for these five various conditions are required to satisfy.

(II) Amalgamation in the nature of purchase: In this case, there is a genuine pooling of only the assets and liabilities of the amalgamating companies. Moreover, if any one or more of the five specified conditions does not satisfy, then it is amalgamation in the nature of purchase.

Amalgamation under the Companies Act: In the Companies Act-1956, the term Amalgamation has not been defined. In accounting sense, Amalgamation refers to two or more existing companies merging to form a new company and merging companies goes into dissolution. The process by which Amalgamation is affected is called "Merger". The one, which merges, is known as "the amalgamating company" and the other with which it merged or formed because of merger is known as "the amalgamated company". The amalgamating company goes out of existence by dissolution. Sections 390 to 396A of the Companies Act deal with provisions relating to Amalgamation. A scheme of Amalgamation requires the approval of the competent court. The term Amalgamation as interpreted by the courts, include absorption. Absorption refers to takeover of the business of an existing company by another existing company and the taken over company loses its existence. Thus, under the Company Law Amalgamation refers to absorption of assets and liabilities of one company by another or the absorption of two or more companies by a newly formed company. In western countries, an Amalgamation is referred to as Merger and Acquisition is the name for absorption. They refer to this process of consolidation as Mergers and Acquisitions.

Amalgamation under the Income Tax Act: Section 2(1B) of the Income Tax Act-1961 defines amalgamation. The merger of one or more existing companies with another company or the merger of two or more existing companies to form a new company would be amalgamation under the Income Tax Act. In other words, either the amalgamated company may be an existing company or a newly formed company to get the benefits provided under the tax laws. To avail of the benefit of amalgamation under the Income Tax Act the following conditions must necessarily be satisfied:

1. All the property of the amalgamating company becomes the property of the amalgamated company.
2. All the liability of the amalgamating company should become the liability of the amalgamated company.
3. Shareholders holding not less than three-fourth in value of the shares in the amalgamating company should become the shareholders of the amalgamated company. For this purpose, shares held by the amalgamation by the amalgamated company or its nominee or subsidiary are excluded.

From the view point of Tax Planning Amalgamation leads to the reduction in the tax liability of the Amalgamated Company. The past accumulated losses and unabsorbed depreciation of the amalgamating company shall be deemed the loss and depreciation of the amalgamated company for the previous year in which the amalgamation is affected. To get these benefits of the amalgamation the various conditions laid down under section 72A of the Income Tax Act-1961 must be fulfilled. These conditions are as follows:

1. The amalgamated company must hold 75% in the book value of the fixed assets of the amalgamating company which it has acquired on account of the amalgamation for five years from the effective date of amalgamation.
2. The amalgamated company should be one owning an industrial undertaking or a ship.

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3. The amalgamated company owning an industrial undertaking of the amalgamating company by way of the Amalgamation, shall achieve the level of production of at least 50% of the installed capacity of the said undertaking before the end of 4 years from the date of Amalgamation. Moreover, such minimum level should be maintained till the end of five years from the effective date of amalgamation.
4. The amalgamated company should continue the business of the amalgamating company at least for five years from the effective date of amalgamation.
5. The amalgamated company shall furnish a certificate in the prescribed form duly verified by Charted Accountant with reference to the books of accounts and other documents showing the particulars of production, along with the return of income for the assessment year relevant to the previous year during which the prescribed level of production is achieved and for the subsequent assessment years relevant to the previous years falling within five years from the effective date of amalgamation to Assessing Officer.
6. The amalgamated company shall fulfill the other conditions as have been prescribed to ensure the revival of the business of the amalgamating company.

Reverse Merger: In recent times, there is a trend of reverse merger among the corporate units at world level. When an existing profit-making company merges into a loss-making company with a view to becoming eligible to carry forward the past accumulated loses and unabsorbed depreciation without restoring to the aid of section 72A of the Income Tax Act-1961 is known as Reverse Merger. Incase of Reverse Merger the profit-making company extinct its name and the surviving sick company attains its name. It is actually a device of by-passing merger under section 72A. This device is becoming popular these days because of the following two reasons:
1. The past accumulated loses and unabsorbed depreciation are carried forward.
2. Goodwill, which consists, in the name of profit-making company is also retained because after some time the amalgamated company can change its name to the old name.

Example: Kirloskar Pneumatics Ltd. was merged with Kirloskar Tractors Ltd., a sick unit, and initially lost its name but after one year it changed its name as it was prior to merger.

Illustration: Assume that X Ltd. is a sick company, which has a huge past accumulated loss. Y Ltd. is a profit-making company with huge taxable profits. Both has two alternatives; one is to merge with each other and both can merge with Z Ltd. The set-off of past accumulated loses and unabsorbed depreciation can be illustrated as under.

Merger Alternatives	**Whether set-off of past accumulated loses And unabsorbed depreciation is allowable**		
	Merger does not fulfillthe conditions of Sec.2(1B) & 72A	Merger fulfill the conditions of Sec.2(1B) but does not fulfill the conditions of 72A	Merger fulfill the conditions of Sec.2(1B) & 72A
1. X Ltd. Merges into Y Ltd.	No	No	Yes
2. Y Ltd. Merges into X Ltd.	**Yes**	**Yes**	**Yes**
3. Merger of X & Y Ltd. in to Z Ltd.	No	No	Yes

Demerger: Demerger is not the opposite of the term merger. It is known as hiving off. A corporate giant may have two divisions, one of which is not doing as expectations or is doing exceptionally well. In both cases, it would be desirable to spilt off into a separate company to get sharp focus. If a corporate giant affects such process, would be termed as Demerger. To get the benefits of Demerger, it should be in accordance with the various conditions laid down in the Section 2(19AA) of the Income Tax Act-1961, which are as under:
1. The transfer of the undertaking is on a going concern basis.
2. The Demerger should be in accordance with the conditions, if any, notified under Sub-section (5) of Section 72A by the Central Government in this regard.
3 The shareholders holding not less than 75% in value of the shares in the demerged company become the shareholders of the resulting company.
4. All assets and liabilities of the undertaking, being transferred by the demerged company, immediate before the Demerger, become the assets and liabilities of the resulting company by virtue of the Demerger.
5. The assets and liabilities of the undertaking should be transferred at "Book value".
6. The resulting company issues its shares to the shareholders of the demerged company on a proportionate basis, in consideration of the Demerger.

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Tax Benefits: The past accumulated losses and unabsorbed depreciation of the demerged company would be allowed to carried forward and set-off in the hands of resulting company. In case of Demerger the resulting company can carry forward the losses for the remaining period out of the permissible Assessment Years.

Prerequisites of Effective Tax Planning:

1. Perfect and Update Knowledge of Tax Laws: It is said that, "A little knowledge is very dangerous". Hence, one should have a perfect knowledge of the applicable tax laws and their implications. Not only the perfect knowledge but also update knowledge of the applicable tax laws is also essential. For the update knowledge, one must be aware of latest verdicts of the various honorable courts. One must also keep the full track of the circulars issued by the CBDT from time to time.

2. Full Transparency of Information: One should make full disclosure of all material information and that should be furnished to the Tax Authorities. This is an absolute prerequisite of tax planning because misrepresentation in any form would lead to the imposition of penalties. The penalty often ranging from 100 to 300% of the amount of tax sought to be evaluate under Section 271(1C).

3. Within the Framework of Laws: The tax planning should be made within the framework of the applicable laws. It means that colorable devices, which are entered into just with a view to circumvent law, must be avoided.

4. Maintenance of Proper Records: One must keep all the records in relation to incomes and expenditure. The relevant records must be maintained properly so that it can be presented before the Tax Authorities as and when asked to be presented.

5. A tax-planning model must be capable of attaining the desired objectives of a business and be amenable to its possible future changes.

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