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FACULTY OF COMMERCE AND MANAGEMENT

COURSE: B.COM VI SEM.

SUBJECT: Corporate Tax Planning

SUBJECT CODE: BCH 403

LECTURE: 25

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LECTURE-25

TAX PLANNING RELATING TO: MERGERS AND DEMERGERS OF COMPANIES

1. The amalgamated company holds continuously for a minimum period of five yearsfrom the date of amalgamation at least three-fourths in the book value of fixed assetsof the amalgamating company acquired in a scheme of amalgamation

2. The amalgamated company continues the business of the amalgamating companyfor a minimum period of five years from the date of amalgamation.

3. The amalgamated company fulfils such other conditions as may be prescribed toensure the revival of the business of the amalgamating company or to ensure that theamalgamation is for genuine business purpose.

b)Expenditure on scientific research [Sec. 35(5)]: When an amalgamating companytransfers any asset represented by capital expenditure on the scientific research to theamalgamated Indian company in a scheme of amalgamation provisions of section 35 shall be applicable-

Unabsorbed expenditure on scientific research of the amalgamating company will beallowed to

If such asset ceases to be used in the previous year for scientific research related tothe business of amalgamated company and is sold by the amalgamated company thesale price to the extend of cost of asset shall be treated as business income and theexcess of sale price over the cost shall be subject to the provisions of capital gain.

c)Amortization of expenditure in case of Amalgamation [Sec. 35DD]:

Under Sec 35DDfor expenditure incurred in connection with the amalgamation the assessee shall beallowed a deduction of an amount equal to one-fifth of such expenditure for each of thefive successive previous years beginning with the previous year in which theamalgamation takes place.

d)Treatment of preliminary expenses [Sec. 35D(5)]:

When and amalgamating companymerges with an amalgamated company under a scheme of amalgamation, the amount of preliminary expenses of the amalgamating company to the extend not yet written off shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.

e)Expenditure for obtaining a licence to operate telecommunication services [Sec.35ABB(6)]:

Where in a scheme of amalgamation, the amalgamating company sells or otherwise transfer its licence to the amalgamated company (Being an Indian Company), the provisions of Section 35ABB which were applicable to the amalgamating company shall become applicable in the same manner to the amalgamated company, consequently:

- The expenditure on acquisition on license, not yet written off, shall be allowed to the amalgamated company in the same number of balance installments.
- Where such licence is sold by the amalgamated company, the treatment of the deficiency/surplus will be same as would have been in the case of amalgamating company.

f**)Treatment of capital expenditure on family planning [U/S 36(1)(ix)]**:

If Asset representing capital expenditure on family planning is transferred by the amalgamating company to the amalgamated company under a scheme of amalgamation, such expenditure shall be allowed as deduction to the amalgamated company in the same manner as would have been allowed to the amalgamating company.

g)Treatment of bad debts [Sec. 36(1)(vii)]:

When due to amalgamation debts of the amalgamating company has been taken over by amalgamated company, and subsequently, such debts turn out to be bad, it shall be allowed as deduction to the amalgamated company.

Double Taxation Avoidance Agreements

DTAA refers to an accord between two countries, aiming at elimination of double taxation. These are bilateral economic agreements wherein the countries concerned assess the sacrifices and advantages which the treaty brings for each contracting nation. It would promote exchange of goods, persons, services and investment of capital among such countries .Indian Government is actively pushing DTAA negotiations with several countries to help its residents in understanding their tax jurisdictions and accountability towards the appropriate authorities. So far India has signed DTAA with 81 countries and discussion is on with many others. The natures of DTAA‟s entered by India are greatly diverse in their nature and contents.

Objectives

DTAA treaties must help in avoiding and alleviating the burden of double taxation prevailing in the international arena. The tax treaties must clarify the taxpayer to know with certainty of his potential tax liability in the country, where he is carrying on economic activities. Tax Treaties must ensure that there is no prejudice between foreign tax payers who has permanent enterprise in the source countries and domestic tax payers of such countries. Treaties are made with the aim of allocation of taxes between treaty nations and the prevention of tax avoidance. The treaties must also ensure that equal and fair treatment of tax payers having different residential status, resolving differences in taxing the income and exchange of information and other details among treaty partners.

Classification

Double taxation avoidance agreements may be classified into comprehensive agreements and limited agreements based on the scope of such agreements. Comprehensive Double Taxation Avoidance Agreements provide for taxes on income, capital gains and capital investments where as Limited Double Taxation Avoidance Agreements denote income from shipping and air transport or legacy and gifts. Comprehensive agreements ensure that the taxpayers in both the countries would be treated on equitable manner in respect of the issues relating to double taxation. Active & Passive Income Passive Income refers to income derived from investment in tangible / intangible assets., Immovable property, dividend, interest, royalties, capital gains, pensions etc. Active income is the income derived from carrying on active cross border business operations or by personal effort and exertion in case of employment eg. Business profits, shipping, air transport, employment etc.

Current Scenario in India

The Indian Income Tax Act, 1961 administrates the taxation of income accrued in India. As per Section 5 of the Income Tax Act, 1961 residents of India are liable to tax on their global income and non-residents are taxed only on income that has its source in India. The Provisions of DTAA override the general provisions of taxing statute of a particular country. It is now well settled that in India the provisions of the DTAA override the provisions of the domestic statute. Moreover, with the insertion of Sec.90 (2) in the Indian Income Tax Act, it is clear that assessee have an option of choosing to be governed either by the provisions of particular DTAA or the provisions of the Income Tax Act, whichever are more beneficial. Further if Income tax Act itself does notlevy any tax on some income then Tax Treaty has no power to levy any tax on such income. Section 90(2) of the Income Tax Act recognizes this principle.

Relief to the tax payer

In order to prevent the hardship of double taxation, relief is provided to the tax payer. Such reliefis provided by two ways:

Bilateral Relief

Bilateral relief is provided in section 90 and 90A of the Indian Income Tax Act. Bilateral relief is provided through following methods:

(i) Exemption Method

One method of avoiding double taxation is for the residence country to altogether exclude foreign income from its tax base. The country of source is then given exclusive right to tax such incomes. This is known as complete exemption method and is sometimes followed in respect of profits attributable to foreign permanent establishments or income from immovable property.I ndian tax treaties with Denmark, Norway and Sweden embody with respect to certain incomes.

(ii) Credit Method

This method reflects the underline concept that the resident remains liable in the country of residence on its global income, however as far the quantum of tax liabilities is concerned credit for tax paid in the source country is given by the residence country against its domestic tax as if the foreign tax were paid to the country of residence itself.

(iii) Tax Sparing

One of the aims of the Indian Double Taxation Avoidance Agreements is to stimulate foreign investment flows in India from foreign developed countries. One way to achieve this aim is to let the investor to preserve to himself/itself benefits of tax incentives available in India for such investments. This is done through “Tax Sparing”. Here the tax credit is allowed by the country of its residence, not only in respect of taxes actually paid by it in India but also in respect of those taxes India forgoes due to its fiscal incentive provisions under the Indian Income Tax Act.