

Demerger- Special Focus on GST

Apr 15, 2020



Rajat Mohan

Senior Partner, AMRG & Associates

There has been a recent surge in company spin-offs and demergers in the Indian Economy. Most demerger decisions signify Board's view that Demergers can open up better growth prospects for companies as well as giving investors greater choice.

There are critical issues revolving around the demerger transaction which requires a well plan to be laid out in order to attain compliance with the applicable legal frameworks on the entity.

It is important for professionals and businesses to understand the roots and offshoots of a demerger with a special focus on GST laws.

Now let us see some critical aspects of GST arising out of a Demerger.

1. Transactions between appointed date and effective date

Every Demerger would have two crucial dates, i.e., appointed date and effective date.

The appointed date is understood as the date from which the scheme comes into force which is also specified in the scheme of arrangement, and the effective date is the date when the demerger is completed in all respects marking the receipt of the approval of the NCLT and correspondingly filing the necessary documents thereof with the Registrar of Companies.

Generally scheme of arrangement as approved by NCLT provides that from the Appointed Date and till the Effective Date, transferor company should act as a trustee of a transferee company and carry on all their respective business and in trust for the transferee Company, thereby all the profits or losses accruing or arising to the transferor companies for all purposes be treated and accrued as the profits or losses of the transferee company.

While carrying on such business the Transferor Companies should not, without prior written consent of the Transferee Company, undertake any new business or any major policy decisions in respect of the management of the Company.

GST being a transaction tax needs to be collected and paid by Transferrer company from appointed date till effective date of demerger. On and after effective date transferee company is liable take a new GST registration and is liable to collect and discharge GST to government.

2. Effective date missed



GST provisions provide that the liability to pay tax by the transferee will arise with effect from the date of transfer. NCLT order specifies that the effective date of the order of demerger shall be the date when the transferee duly submits the copy of order with the Registrar of company. Thus, resultant company is liable to be registered from effective date in order to discharge the tax liability on supplies made post demerger.

Resultant company is advised to proactively apply for the registration beforehand so that it is registered under GST from the effective date itself and can duly discharge its GST liability and further avoid any penal action from the GST authority for the failure to comply with provisions of the Act.

In case resultant company fails to register under GST from the effective date and in the meantime transferor company is discharging the tax liability on its behalf, then authorities will be hounding it with the directions to pay tax again as it was liable to discharge tax on the supplies made post-effective date in line with the NCLT order as well as GST provisions.

3. Pending Litigations

One of the biggest concerns of resultant company would be pending litigation or demands on demerged company. Even most fierce of the due diligence cannot give a surety that there is no non-compliance of GST. This results in high tax risk for resulting company on new management of demerged entity. This leads us to understand as to where our GST law stands and who is responsible for payment of GST in case of any demand due to past non-compliance.

GST law states that transferor and transferee both shall be, jointly and severally liable for tax, interest and penalty due from the taxable person up to the time of such transfer. However, post such date only transferee shall be liable for to pay tax, interest and penalties.

Particulars

Supplies effected before the date of transfer

Supplies effected from date of transfer

Liability of transferor or transferee

Transferor and Transferee would be jointly and severally liable.

Transferee

Provisions of GST law does not come to rescue to transferee Company, in fact they further escalate the risk by burdening them with pre-transfer liabilities. Thereby transferee company has no other option but to make sure that all the tax liabilities due under GST (CGST & SGST / IGST) laws in relation to transactions made before the date of transfer is fully discharged with applicable interest, if any. Further such transferee shall also ensure that there is no pending proceedings against such undertaking, to ensure that the transition process is smooth.

In order to safeguard itself, transferee company must have an affidavit signed with transferor regarding pre-transfer tax liabilities.

4. Transfer of Input tax credit

GST law stipulates that in case of change in constitution of registered person due to sale, merger,

demerger, amalgamation, lease or transfer or change in the ownership of business, transferor company can transfer the input tax credit remaining unutilized in the electronic credit ledger to such sold, merged, demerged, amalgamated company. This transfer of unutilized tax credit can be made by way filing Form ITC-02 on the Common Portal. Both the companies need to make sure that this form is filed on time to save cash flow issues in the resultant company as well as misutilization of tax credits by demerging company.

5. Sale of stock vs. transfer by delivery Challan

Demerger Involves transfer of business wherein consideration is identified against each asset. With effect from the appointed date the demerged undertaking shall stand transferred to and vested in resultant company as a going concern. All the properties whether moveable or immovable, real or personal, corporeal or incorporeal, present or contingent enjoyed by Demerged Undertaking shall be transferred to and vested in or deemed to be transferred to and vested in resultant company.

Now the company has two options to transfer the business assets to the resultant company:

Option 1 : Transfer of stock through delivery challan: Ideally speaking stock should move from the transferor company to the resulting company under the cover of delivery challan. Such delivery challan denotes movement of goods otherwise than by way of supply. In case of demerger entire transaction is exempted on account of a going concern transfer.

Option 2: Sale of stock: In case the transferor company transfers the stock by raising GST invoice on the resultant company, It stands in a risky position as it might get excluded from the scope of entry of notification which provides for exemption to the sale of going concern only if such transfer is by way of an independent unit. Tax officer might create a legal ground that any such separate sale of stock by way of sale denotes that a transaction has been segregated and is taxed separately

Such sale of stock is also in contravention with the NCLT sanctioned scheme which expressly provides that all assets whether corporeal or incorporeal stands transferred to resulting company from the effective date.

Thus it is advised that the stock should be ideally transferred in the scheme of demerger using the delivery challan rather than under a sale invoice.

6. Going concern

Under GST law exemption is available on account of Transfer of a going concern, which means transfer of a running business which is capable of being carried on by the purchaser as an independent business, but shall not cover mere or predominant transfer of an activity comprising a service. In other words any transfer of an undertaking which is not on going concern or is on piecemeal basis then no specific exemption is available and this would render each component of transfer being taxable under GST regime.

Thereby in order to fall under the aegis of exemption, transferor and transferee has to ensure that sale of business as a whole will comprise comprehensive sale of immovable property, goods and transfer of unexecuted orders, employees, goodwill etc. Since the transfer in title is not merely a transfer in title of either the immovable property or goods.

The term going concern was examined in the case of **Rajashri Foods Pvt Ltd** vide Advance ruling no. KAR ADRG 06 Dated 23rd April 2018 [[TS-204-AAR-2018-NT](#)] by The Authority for Advance Ruling in Karnataka where it was observed that: A going concern is a concept of accounting and applies to the business of the company as a whole. Transfer of a going concern means transfer of a running business which is capable of being carried on by the purchaser as an independent business.

The taxation regime for “demerger deals” in India is of wide importance due to interplay of overlapping and confusing notifications and judicial views on the topic. Having clear plan of action is of high importance before initiating any demerger deal.