Sale on “going concern” basis is “slump sale,” not sale of depreciable asset covered under section 50(2)

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In brief

In a recent judgement1, the Supreme Court (SC) has analysed the taxability of sale of business on a going concern basis and held that the sale is a slump sale and not sale of depreciable assets covered under section 50(2) of the Income-tax Act, 1961 (the Act).

In detail

Facts

- The taxpayer1 was a company engaged in the business of manufacturing sheet metal components. It decided to sell its entire business, with all the assets and liabilities.

- The taxpayer filed its return of income, treating the sale to be in the nature of “slump sale” of going concern, resulting in long-term capital gain. Accordingly, it claimed deduction under section 48(2) of the Act.

- The tax officer (TO), did not accept the contention of the taxpayer. According to the TO the sale was of short-term capital asset, covered under section 50(2) of the Act. The TO recomputed the gain as short-term gain under section 50, without allowing deduction under section 48(2), as claimed by the taxpayer.

- The taxpayer’s contention being accepted by the lower appellate and judicial forums, the revenue authorities appealed before the SC.

Issue before the SC

Whether the sale of business on a going concern basis was liable to be taxed as long-term capital gain entitle to deduction under the section 48(2) of the Act or as short-term capital gain under section 50(2) of the Act.

Taxpayer’s contention

The taxpayer contended that the sale of business on a going concern basis was in the nature of slump sale. Further, the undertaking, being in the nature of long-term capital asset was entitled to deduction under section 48(2) of the Act.

Revenue’s contention

The Revenue contended that the taxpayer’s case was covered under section 50(2) of the Act resulting in short-term capital gain specified therein. Hence, gain on sale of business was not entitled to deduction under section 48(2) of the Act.

Supreme Court’s ruling

- The SC opined that the case of the taxpayer did not fall within the four corners of section 50(2) of the Act. The said section applies where

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1 TS-149-SC-2017
any block of assets was transferred, but where the entire business, carried on by the taxpayer for > 3 years, was sold along with assets and liabilities, such sale could not be considered as “short-term capital assets” liable to be taxed under section 50(2).

- The taxpayer sold the entire business as a going concern, with all assets and liabilities; therefore, it was rightly noticed by the CIT(A) that it was a case of slump sale of a “long-term capital asset.” Hence, it was required to be taxed accordingly.

- The SC further stated that the said view was also supported with the law laid down by it in the case of Artex Manufacturing Co². This view was also taken by the Bombay HC in the case of Premier Automobiles Limited³.
- The Revenue was not able to cite any decision taking a contrary view nor was it able to point out any error in the decisions cited by the taxpayer.
- Accordingly, the SC dismissed the appeal of the revenue authorities.

**The takeaways**

This is an important decision considering the changing scenario of upsurge in business takeovers and acquisitions. The SC has confirmed that sale of business carried on for long-term, on a going concern basis is a slump sale, and thus, should be liable to be taxed as long-term capital gains. It may be noted that similar ruling was given by the SC in the case of Electric Control Gear Manufacturing Company⁴.

**Let’s talk**

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

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³ [2003] 264 ITR 193 (Bombay) / [2003] 129 Taxman 289 (Bombay)  