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BBA | Semester 6 | UK6DSCMGT304

Business Tax Planning

Course Code: UK6DSCMGT304 • Module 3 Notes

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Module 3: Tax Planning for Specific Management Decisions

Make or Buy, Own vs Lease, Repairs vs Capital, Remuneration, Restructuring, and Slump Sale

Chapter 1: Make or Buy Decisions: Comparative Evaluation and Tax Implications

1.1 Managerial and Fiscal Context of the Make-or-Buy Decision

In modern industrial enterprises, the decision to manufacture a component in-house or procure it from external specialized vendors is one of the most critical operational choices confronting executive management. While conventional managerial accounting approaches the make-or-buy dilemma strictly through the prism of incremental cost analysis—comparing marginal manufacturing costs against vendor purchase prices—corporate tax planning introduces vital dimensions that fundamentally alter cash flow trajectories. Tax laws treat the expenditure incurred in making a component very differently from the invoice price paid to an external vendor, directly influencing taxable profits, capital allowances, and indirect tax credits.

When an enterprise elects to **make** a component internally, the decision often necessitates capital expenditure on specialized plant, machinery, tooling, and factory space. Under the Income Tax Act, 1961, capital expenditures are not deductible in full in the year of incurrence; instead, they are capitalized and depreciated across future tax periods under Section 32. Conversely, operating expenditures incurred in in-house fabrication—such as raw material consumption, direct wages, factory power, and repairs—are fully deductible in the year incurred as revenue expenditure under Section 37(1). Furthermore, research and development costs associated with component design may qualify for specialized deductions or immediate write-offs. In contrast, when an enterprise chooses to **buy**, the entire vendor invoice amount represents an immediate revenue deduction under Section 37(1), requiring zero capital outlays and generating immediate tax shields in the current fiscal year.

1.2 Tax Implications of In-House Manufacturing (The "Make" Alternative)

The decision to produce in-house generates a complex web of fiscal consequences across multiple sections of the tax code:

- **Depreciation and Additional Depreciation:** New plant and machinery installed for manufacturing qualify for normal statutory depreciation under Section 32(1)(ii) at 15% on a written-down value (WDV) basis. If the enterprise is engaged in the manufacture or production of any article or thing and operates under the classical tax regime, it may also claim additional depreciation of 20% under Section 32(1)(iia) in the year of commissioning. Under the concessional corporate regime of Section 115BAA, however, additional depreciation is foregone, though normal depreciation at 15% remains fully available.
- **Revenue Deductibility of Production Overheads:** Direct wages, administrative salaries allocated to production, factory rent, electricity, consumable stores, and machine maintenance are

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fully deductible under Sections 30, 31, and 37(1). These deductions directly shelter taxable operating profits.

- **Inventory Valuation Impact:** Under Section 145A of the Income Tax Act read with ICDS II (Valuation of Inventories), finished goods and work-in-progress must be valued at lower of cost or net realizable value, incorporating all costs of purchase, costs of conversion, and taxes. Higher inventory accumulation defers tax deductions into future periods, as unabsorbed manufacturing costs are carried forward on the balance sheet rather than expensed immediately.
- **Goods and Services Tax (GST) Input Tax Credit (ITC):** The enterprise can avail 100% ITC on raw materials and capital goods under Section 16 of the CGST Act, 2017, provided the final product is not exempt from GST. This eliminates cascading taxes and reduces the effective cash outlay.

1.3 Tax Implications of External Procurement (The "Buy" Alternative)

Outsourcing component requirements to third-party vendors simplifies operational administration and yields distinct fiscal outcomes:

- **Immediate Revenue Expensing:** The entire contract purchase price is deductible as a trading or manufacturing expense in the profit and loss account under Section 37(1), generating an immediate tax reduction without creating a multi-year depreciation schedule.
- **Elimination of Capital Lock-In and Asset Exposure:** The enterprise avoids capital investments in plant, eliminating risks of asset obsolescence, unabsorbed depreciation, and capital losses upon eventual machinery retirement.
- **Withholding Tax (TDS) Compliance:** External procurement contracts must be carefully analyzed to ensure compliance with withholding tax provisions. Standard goods purchases do not attract TDS under Section 194C unless they constitute a job-work contract involving customer-supplied materials. However, Section 194Q requires buyers with turnover exceeding Rs. 10 Crores to deduct tax at source at 0.1% on purchases of goods exceeding Rs. 50 Lakhs from a resident seller. Failure to deduct TDS results in a 30% disallowance of the purchase expenditure under Section 40(a)(ia).
- **Customs Duty on Imported Components:** If components are imported from abroad, Basic Customs Duty (BCD), Social Welfare Surcharge (SWS), and Integrated GST (IGST) are payable at the port of entry. While IGST is creditable under the GST framework, BCD is non-creditable and forms part of product cost, increasing taxable expenditure.

Chapter 2: Own or Lease Decisions: Financial Evaluation and Tax Optimization

2.1 Structural Dynamics: Borrow-and-Buy versus Equipment Leasing

When an enterprise requires substantial capital equipment—such as CNC machines, industrial robotics, aircraft, or commercial real estate—financial management must determine whether to purchase the asset outright (utilizing internal accruals or term debt) or secure the productive use of

the asset through a leasing contract. Under Indian tax jurisprudence and financial accounting standards (Ind AS 116), the ownership structure determines which entity is legally entitled to claim depreciation and how cash outflows are sheltered from corporate income tax.

In an **ownership structure** (Borrow-and-Buy), the investing enterprise holds legal title to the equipment. It finances the asset through equity or term loans, claims statutory depreciation under Section 32, and deducts the interest paid on borrowed capital under Section 36(1)(iii). At the conclusion of the asset's economic life, the enterprise retains the residual scrap value, which may generate a balancing charge under Section 41(2) or a short-term capital loss under Section 50 upon sale from the block of assets. In a **leasing structure**, legal ownership remains with the lessor. The lessee pays periodic lease rentals, which are fully deductible as revenue expenditure under Section 37(1), provided the lease is structured properly. The lessee incurs no upfront capital outlay, maintains borrowing capacity for other operational ventures, and avoids the financial risk of technological obsolescence.

2.2 Tax Mechanics of the Ownership Alternative (Borrow-and-Buy)

The net present value of cash outflows under the ownership alternative is governed by three primary tax factors:

- **Depreciation Tax Shield:** Statutory depreciation is calculated on the Written Down Value (WDV) of the asset block at prescribed rates (e.g., 15% for general plant and machinery, 40% for renewable energy devices and computers). The tax shield generated in year t equals the depreciation charge multiplied by the marginal corporate tax rate:

> $$textDepreciationTaxShield_t = textDepreciation_t timest_c$$
>
> **Variable Definitions:** $Depreciation_t$ is the statutory tax depreciation allowed in year t under Section 32; t_c is the effective corporate tax rate including surcharge and cess.

- **Interest Tax Shield:** Under Section 36(1)(iii), interest paid in respect of capital borrowed for the purposes of the business is fully deductible as a revenue expense once the asset is put to commercial use. (Interest incurred prior to commercial commissioning must be capitalized to the asset cost under Explanation 8 to Section 43(1)). The interest tax shield equals the annual interest expense multiplied by the corporate tax rate:

> $$textInterestTaxShield_t = textInterest_t timest_c$$
>
> **Variable Definitions:** $Interest_t$ is the contractual interest payable on the outstanding loan balance in year t; t_c is the applicable corporate tax rate.

- **Terminal Salvage Value Adjustment:** Upon retirement, the net salvage value realized reduces the WDV of the asset block. If the block ceases to exist or the salvage proceeds exceed the opening WDV plus additions, the excess is treated as short-term capital gains under Section 50, attracting corporate tax at standard rates.

2.3 Tax Mechanics of the Leasing Alternative

In a commercial operating lease, the tax benefits are streamlined and immediate:

- **Full Lease Rental Deductibility:** Lease rentals payable to the lessor are recognized as revenue expenses incurred wholly and exclusively for business purposes under Section 37(1). The annual tax shield generated equals:

> $$text Lease Rental Tax Shield_t = text Lease Rental_t times t_c$$
>
> **Variable Definitions:** *Lease Rental*$_t$ is the gross annual rental paid to the leasing company; t_c is the effective corporate tax rate.

- **Net Annual After-Tax Cash Outflow:** The effective economic cost borne by the lessee in year t is given by:

> $$text After - Tax Lease Outflow_t = text Lease Rental_t times (1 - t_c)$$
>
> **Variable Definitions:** Represents the net cash drainage of leasing after accounting for the tax deduction shelter.

- **Withholding Tax Obligations:** Under Section 194I, the lessee is legally obligated to deduct tax at source on lease rentals. For machinery, plant, and equipment leases, the TDS rate is 2%; for land, building, or furniture leases, the TDS rate is 10%. Compliance is mandatory to prevent disallowance under Section 40(a)(ia).

Chapter 3: Repair, Replacement, Renewal, or Renovation of Capital Assets

3.1 Statutory Framework: Current Repairs (Section 31) versus Capital Expenditure

Corporate asset management frequently involves significant outlays to maintain, rehabilitate, or modernize production infrastructure. Under the Income Tax Act, 1961, the tax treatment of these expenditures depends entirely on whether the outlay constitutes a **"current repair"** under Section 31 or Section 37(1), or represents an expenditure of a **capital nature** subject to capitalization under Section 32.

Section 31 specifically provides that in respect of buildings, machinery, plant, or furniture used for the purposes of the business, the amount paid on account of *current repairs* shall be allowed as a complete revenue deduction. The term "current repairs" has been extensively interpreted by the Supreme Court of India in landmark rulings (including *Ballimal Naval Kishore v. CIT* and *CIT v. Saravana Spinning Mills Pvt. Ltd.*). The judiciary has firmly established that:

- **Preservation vs. Replacement:** A current repair is an outlay incurred to preserve, maintain, or restore an existing asset to its original operating condition. It does not create a new asset or confer an enduring benefit of an entirely novel character.

- **Substantial Renovation:** If an expenditure completely reconstructs or renews the entire asset—such that the old asset is effectively replaced by a new structural entity—the outlay is capital in nature, regardless of whether it is described as a repair in corporate accounts.
- **Revenue Treatment under Section 37(1):** Even if an expenditure does not qualify as a "current repair" under Section 31 (for example, repairs to assets other than plant, machinery, or buildings), it may be claimed as a revenue deduction under the omnibus provisions of Section 37(1), provided it is not personal and not of a capital nature.

3.2 Judicial Tests and Criteria for Classification

Tax authorities and appellate tribunals evaluate repairs and renovations against well-established judicial criteria:

Evaluation Criterion	Current Repair (Revenue - Sec 31 / 37)	Capital Expenditure (Capitalized - Sec 32)
Nature of Work	Routine maintenance, periodic overhaul, replacement of worn-out parts.	Total reconstruction, structural alteration, complete replacement of the core machine.
Enduring Benefit	Restores original operational efficiency without enhancing production capacity.	Brings into existence an asset or advantage of enduring economic benefit.
Production Capacity	Maintains existing rated output and prevents operational disruption.	Substantially increases installed capacity or alters the nature of finished output.
Part of an Asset vs. Entire Unit	Replacement of a cylinder, motor, or valve within an integrated assembly.	Replacement of an entire machine or independent manufacturing unit.
Timing of Incurrence	Incurred periodically during the regular commercial life of the asset.	Initial repairs incurred immediately upon acquiring a second-hand asset to make it usable.

3.3 Tax Planning Strategies for Asset Maintenance Outlays

To maximize immediate tax deductibility and mitigate scrutiny from tax authorities, corporations adopt deliberate maintenance planning protocols:

- **Phased Overhaul Schedules:** Rather than undertaking massive single-year overhauls that aggregate to substantial sums and trigger capital classification scrutiny, companies execute rolling, component-level replacement schedules.
- **Documentation of Maintenance History:** Maintenance logs, technical inspection reports, and engineer certifications should be meticulously preserved to demonstrate that replacements were essential to restore operational functionality rather than expand capacity.

- **Segregation of Composite Contracts:** When contracts involve both structural expansion and routine maintenance, contracts and invoices must distinctly bifurcate capital additions from maintenance charges to preserve revenue deductibility for the latter.

Chapter 4: Tax Planning in Employee Remuneration: Salary Structuring and Perquisites

4.1 The Corporate Objective: Maximizing Net Take-Home while Minimizing Tax Exposure

Employee compensation represents one of the largest operating expenses on a corporate income statement. Under Section 37(1), all reasonable salaries, bonuses, and allowances paid to employees are fully deductible as business expenses against corporate profits. However, from the perspective of human capital retention and executive compensation, the primary objective is to design the **Cost to Company (CTC)** structure such that the employee's tax liability is legally minimized under the Income Tax Act, thereby maximizing real take-home pay without increasing corporate outlays.

Under the Indian tax regime, an employee's salary package consists of three primary components: (a) fully taxable basic salary and dearness allowance, (b) partially or fully exempt statutory allowances governed by Section 10, and (c) non-monetary perquisites evaluated under Section 17(2) read with Rule 3 of the Income Tax Rules, 1962. With the introduction of the revised concessional tax regime under Section 115BAC, employers must structure flexible compensation bands that cater to employees opting for either the old regime (retaining deductions and exemptions) or the new regime (opting for lower slab rates with standard deduction).

4.2 Strategic Salary Components and Tax Exemption Mechanisms

Tax-efficient salary structures incorporate specific allowances and perquisites designed to optimize individual tax brackets:

- **House Rent Allowance (HRA) under Section 10(13A):** Employees residing in rented accommodation can claim exemption on HRA under Rule 2A, being the minimum of: (1) actual HRA received, (2) 50% of basic salary for metro cities (40% for non-metros), or (3) rent paid in excess of 10% of basic salary. This allowance significantly shelters cash salary for urban professionals under the old regime.
- **Corporate Contribution to National Pension System (NPS) under Section 80CCD(2):** Employer contributions to an employee's Tier-I NPS account are deductible up to **14% of salary (Basic + DA) for Central/State Government employees and 10% of salary for private sector employees**. Crucially, deduction under Section 80CCD(2) is available under **both the old regime and the new concessional regime (Section 115BAC)**, making it the most potent tax-saving vehicle in corporate salary structuring.
- **Reimbursement of Communication and Internet Expenses:** Under Rule 3(7)(ix), the provision of telephone, mobile phone, and broadband connections at the employee's residence (or

reimbursement of actual telecommunication bills) is completely tax-exempt in the employee's hands with zero monetary ceiling, provided the connection is utilized for business communication.

- **Company Leased Accommodation vs. Rent-Free Accommodation (RFA):** Under Rule 3(1), where an employer provides leased residential accommodation, the perquisite value taxable in employee hands is restricted to the lower of actual lease rent paid by employer or 10% of salary (for cities with population exceeding 40 Lakhs). This perquisite valuation is frequently lower than paying cash salary to rent equivalent housing, creating substantial tax savings for senior executives.
- **Leave Travel Concession (LTC) under Section 10(5):** Exemption is available for two journeys performed in a statutory block of four calendar years for domestic travel by air (economy class) or rail (AC first class) for the employee and family members.

4.3 Employee Stock Option Plans (ESOPs) and Two-Stage Taxation

ESOPs are widely deployed by high-growth startups and established corporations to align managerial incentives with shareholder wealth creation. In India, ESOPs are subject to a statutory two-stage taxation mechanism:

- **Stage 1: Taxation at Exercise (Perquisite Tax):** When the employee exercises the vested options by paying the exercise price, the difference between the **Fair Market Value (FMV)** of the shares on the date of exercise and the **Exercise Price** is treated as a perquisite under Section 17(2)(vi). The employer must deduct TDS on this perquisite value at applicable slab rates. (For eligible startups recognized under Section 80-IAC, TDS payment on ESOP perquisites is deferred for up to 5 years, until the employee departs, or until the shares are sold, whichever is earliest).
- **Stage 2: Taxation at Sale (Capital Gains Tax):** When the employee subsequently sells the shares, the difference between the **Sale Consideration** and the **FMV on the date of exercise** (which becomes the cost of acquisition) is taxed as Capital Gains under Section 45. If the shares are listed and held for more than 12 months, long-term capital gains exceeding Rs. 1.25 Lakhs are taxed at 12.5% under Section 112A. If unlisted, long-term capital gains (holding period > 24 months) are taxed at 12.5% without indexation under Section 112.

Chapter 5: Corporate Restructuring: Mergers, Amalgamation, and Demerger

5.1 Statutory Definition of Amalgamation (Section 2(1B))

Corporate restructuring through mergers and amalgamations enables businesses to achieve economies of scale, eliminate redundant overheads, and streamline holding structures. From a fiscal perspective, an amalgamation must strictly comply with the conditions specified in **Section 2(1B)** of the Income Tax Act to qualify as a tax-neutral transaction:

- All the property of the amalgamating company (or companies) immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation.
- All the liabilities of the amalgamating company immediately before the amalgamation become the liabilities of the amalgamated company.

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- Shareholders holding not less than **three-fourths (75%) in value of the shares** in the amalgamating company become shareholders of the amalgamated company (other than shares already held by the amalgamated company or its nominees).

5.2 Tax Neutrality and Exemptions in Qualifying Amalgamations

When an amalgamation satisfies Section 2(1B), the Income Tax Act confers comprehensive tax neutrality across all participating entities:

- **Exemption to the Amalgamating Company (Section 47(vi)):** Any transfer of a capital asset by the amalgamating company to the amalgamated company is completely exempt from capital gains tax, provided the amalgamated company is an Indian company.
- **Exemption to Shareholders (Section 47(vii)):** Any transfer by a shareholder of shares in the amalgamating company in exchange for shares in the amalgamated company is exempt from capital gains tax, provided the transfer is made in consideration of the allotment of shares in the amalgamated company.
- **Cost and Holding Period Continuity:** Under Section 49(1) and Section 2(42A), the cost of acquisition of the capital asset in the hands of the amalgamated company is deemed to be the cost to the amalgamating company, and the holding period includes the period during which the asset was held by the amalgamating company.

5.3 Carry Forward and Set-Off of Accumulated Business Losses (Section 72A)

One of the most valuable tax assets in a corporate merger is the ability of the surviving company to absorb and set off the unabsorbed business losses and unabsorbed depreciation of the merged entity against its own taxable profits. Under **Section 72A**, this tax benefit is subject to rigorous statutory conditions:

- **Eligible Entities:** The amalgamating company must own an industrial undertaking (manufacturing, computer software, power generation, telecommunications, etc.) or be a banking company.
- **Continuous Engagement Condition:** The amalgamating company must have been engaged in the business in which the accumulated loss occurred or depreciation remains unabsorbed for **at least three years prior to the merger**.
- **Asset Holding Condition:** The amalgamating company must have held continuously as on the date of amalgamation at least **three-fourths (75%) of the book value of fixed assets** held by it two years prior to the date of amalgamation.
- **Operational Continuity by Amalgamated Company:** The amalgamated company must hold at least 75% of the book value of fixed assets of the amalgamating company for a minimum period of **five years** from the date of amalgamation, and must continue the business of the amalgamating company for at least five years.
- **Fresh Lease of Life for Losses:** Upon fulfilling these conditions, the accumulated business loss of the amalgamating company is deemed to be the loss of the amalgamated company for the previous year in which the amalgamation was effected, granting a **fresh statutory carry-**

forward period of 8 assessment years. Unabsorbed depreciation can be carried forward indefinitely.

5.4 Tax Mechanics of Demerger under Section 2(19AA)

A demerger involves the hiving off of an autonomous business undertaking by a demerged company to a resulting company on a going concern basis. Under Section 2(19AA), a demerger is tax-neutral if all properties and liabilities of the undertaking are transferred at book values, the resulting company issues shares to the shareholders of the demerged company on a proportionate basis, and the transfer constitutes a going concern. Under Section 47(vib) and Section 47(vid), neither the demerged company nor its shareholders incur any capital gains tax on the transaction.

Chapter 6: Slump Sale Mechanics under Section 50B

6.1 Definition and Legal Characteristics of a Slump Sale

Under **Section 2(42C)** of the Income Tax Act, a **"slump sale"** means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to individual assets and liabilities in such sales. The key legal prerequisites of a slump sale include:

- The subject matter of transfer must be an entire "undertaking" or a separable business unit capable of autonomous commercial operation. Transfer of isolated, cherry-picked assets does not qualify as a slump sale.
- The transfer must be executed for a single lump sum monetary consideration. Allocation of values to individual assets in the sale agreement solely for stamp duty registration purposes does not disqualify the transaction from being a slump sale.
- The Finance Act amended Section 2(42C) to expand the scope from "sale" to "transfer by any means", bringing slump exchanges and non-cash restructuring within the ambit of slump transfer provisions.

6.2 Computation of Capital Gains under Section 50B

Section 50B provides a dedicated computational code for determining capital gains arising from a slump sale, overriding general capital gain provisions:

> $$text{Capital Gain/Loss} = text{Full Value of Consideration} - text{Net Worth of the Undertaking}$$
>
> **Statutory Definition:** Under Section 50B, the full value of consideration is determined under Rule 11UAE (Fair Market Value of undertaking), and the net worth constitutes the statutory cost of acquisition and improvement.

6.3 Determination of Net Worth

The "Net Worth" of the undertaking is computed strictly in accordance with Explanation 1 to Section 50B:

- **Depreciable Assets:** Included at the aggregate Written Down Value (WDV) of the block of assets determined under Section 43(6).
- **Section 35AD Capital Assets:** Capital assets for which 100% deduction was claimed under Section 35AD (specified infrastructure/cold chain businesses) are valued at **NIL**.
- **Other Assets:** Included at their book values appearing in the audited books of account of the undertaking.
- **Revaluation Exclusion:** Any revaluation of assets reflected in the books must be completely ignored; revaluation reserves cannot be added to net worth.
- **Liabilities:** All liabilities of the undertaking appearing in the balance sheet are deducted at book value.

6.4 Classification of Gains: Long-Term vs. Short-Term

The classification of capital gains arising from a slump sale is governed by the holding period of the *undertaking* itself, not the individual assets comprising it:

- **Long-Term Capital Gain:** If the undertaking was owned and held by the assessee for **more than 36 months** immediately preceding the date of transfer, the resulting gain is deemed to be long-term capital gain.
- **Short-Term Capital Gain:** If the undertaking was held for 36 months or less, the gain is short-term capital gain.
- **Prohibition of Indexation:** Under the first and second provisos to Section 48, the benefit of **cost inflation indexation is strictly denied** in computing capital gains under Section 50B, regardless of whether the gain is long-term.

Chapter 7: Intra-Group Asset Transfers: Holding and 100% Subsidiary Companies

7.1 Exemption under Section 47(iv) and Section 47(v)

Corporate groups frequently reorganize asset ownership across parent and subsidiary entities to optimize operational focus or regulatory ring-fencing. Under Section 47 of the Income Tax Act, specific intra-group capital asset transfers are exempt from capital gains taxation:

- **Section 47(iv): Holding to 100% Subsidiary:** Any transfer of a capital asset by a company to its subsidiary company is exempt, provided: (1) the parent company or its nominees hold the **entire share capital (100%)** of the subsidiary company, and (2) the subsidiary company is an **Indian company**.
- **Section 47(v): 100% Subsidiary to Holding:** Any transfer of a capital asset by a 100% subsidiary company to its holding company is exempt, provided: (1) the entire share capital is held by the holding company, and (2) the holding company is an **Indian company**.

7.2 Statutory Clawback Provisions under Section 47A

To prevent corporations from exploiting Section 47 exemptions as tax-avoidance conduits—such as transferring an appreciated asset tax-free to a subsidiary and immediately selling the subsidiary's shares—the legislature enacted rigorous clawback rules under **Section 47A(1)**.

The exemption granted under Section 47(iv) or 47(v) is completely revoked and cancelled if, at any time before the expiry of a period of **eight years from the date of the transfer of the capital asset**:

- The capital asset transferred is converted by the transferee company into, or is treated by it as, **stock-in-trade** of its business; OR
- The parent company or its nominees cease to hold the **entire share capital (100%)** of the subsidiary company (for instance, through a dilution, private placement, or sale of even a single share to an external third party).

Fiscal Consequence of Revocation: If any of the above triggering events occur within the 8-year statutory window, the capital gains that were originally exempt under Section 47 are deemed to be income chargeable under the head "Capital Gains" of the **transferor company in the previous year in which such conversion or cessation of shareholding takes place**.

Chapter 8: Comprehensive Worked Numerical Problems in Management Decisions Tax Planning

8.1 Worked Problem 1: Financial and Tax Comparison of Borrow-and-Buy versus Equipment Leasing

Precision AutoTech Ltd. requires an advanced computer-controlled robotic stamping press costing **Rs. 1,00,00,000 (Rs. 1.00 Crore)**. The equipment has an estimated economic life of **5 years**, at the end of which its estimated scrap salvage value is **Rs. 10,00,000 (Rs. 10.00 Lakhs)**. The company's marginal corporate tax rate is **25.168%** (Section 115BAA: 22% basic + 10% surcharge + 4% cess). Its cost of capital (unlevered discount rate) is **10%**.

Management is evaluating two mutually exclusive financing alternatives:

- **Alternative A (Borrow and Buy):** Obtain a 5-year bank term loan for Rs. 1,00,00,000 at an interest rate of **12% per annum**. The loan is repayable in 5 equal annual principal installments of Rs. 20,00,000 at the end of each year, plus interest on the outstanding opening balance. The equipment qualifies for statutory tax depreciation at **15% on WDV**.
- **Alternative B (Lease):** Lease the equipment under an operating lease for 5 years at an annual lease rental of **Rs. 26,00,000 payable at the end of each year**. Maintenance is borne by the lessor.

Step-by-Step Resolution of Alternative A (Borrow and Buy):

1. Debt Service Schedule (Principal and Interest Payments):

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Year	Opening Loan (Rs.)	Principal Repayment (Rs.)	Interest at 12% (Rs.)	Total Cash Outflow (Rs.)	Closing Loan (Rs.)
1	1,00,00,000	20,00,000	12,00,000	32,00,000	80,00,000
2	80,00,000	20,00,000	9,60,000	29,60,000	60,00,000
3	60,00,000	20,00,000	7,20,000	27,20,000	40,00,000
4	40,00,000	20,00,000	4,80,000	24,80,000	20,00,000
5	20,00,000	20,00,000	2,40,000	22,40,000	NIL

2. Depreciation Tax Shield Schedule (15% WDV):

Year	Opening WDV (Rs.)	Depreciation at 15% (Rs.)	Depreciation Tax Shield at 25.168% (Rs.)	Closing WDV (Rs.)
1	1,00,00,000	15,00,000	3,77,520	85,00,000
2	85,00,000	12,75,000	3,20,892	72,25,000
3	72,25,000	10,83,750	2,72,758	61,41,250
4	61,41,250	9,21,188	2,31,845	52,20,062
5	52,20,062	7,83,009	1,97,068	44,37,053

3. Combined Net Cash Outflows and NPV of Borrow-and-Buy:
The discount rate applied for debt-financed outlays is the after-tax cost of debt:

$$k_d = 12\% \times (1 - 0.25168) = 8.98\% \approx 9.0\%$$

Discount Rate: Cash flows are discounted at the after-tax borrowing cost of 9.0%.

Yr	Debt Outflow (Rs.)	Interest Shield (Rs.)	Depn Shield (Rs.)	Salvage Inflow (Rs.)	Net Cash Outflow (Rs.)	PV Factor (9%)	Present Value (Rs.)
1	32,00,000	3,02,016	3,77,520	—	25,20,464	0.9174	23,12,274
2	29,60,000	2,41,613	3,20,892	—	23,97,495	0.8417	20,17,972
3	27,20,000	1,81,210	2,72,758	—	22,66,032	0.7722	17,49,830
4	24,80,000	1,20,806	2,31,845	—	21,27,349	0.7084	15,07,014
5	22,40,000	60,403	1,97,068	(10,00,000)	9,82,529	0.6499	6,38,546

Yr	Debt Outflow (Rs.)	Interest Shield (Rs.)	Depn Shield (Rs.)	Salvage Inflow (Rs.)	Net Cash Outflow (Rs.)	PV Factor (9%)	Present Value (Rs.)
Total Present Value of Cash Outflows (Borrow and Buy)							**Rs. 82,25,636**

Step-by-Step Resolution of Alternative B (Leasing):
Annual lease rental = Rs. 26,00,000.
Annual tax shield at 25.168% = Rs. 26,00,000 × 25.168% = Rs. 6,54,368.
Net annual after-tax lease outflow = Rs. 26,00,000 − Rs. 6,54,368 = **Rs. 19,45,632**.

Year	Gross Lease Rental (Rs.)	Tax Shield at 25.168% (Rs.)	Net Cash Outflow (Rs.)	PV Factor at 9.0%	Present Value (Rs.)
1	26,00,000	6,54,368	19,45,632	0.9174	17,84,923
2	26,00,000	6,54,368	19,45,632	0.8417	16,37,639
3	26,00,000	6,54,368	19,45,632	0.7722	15,02,417
4	26,00,000	6,54,368	19,45,632	0.7084	13,78,286
5	26,00,000	6,54,368	19,45,632	0.6499	12,64,466
Total Present Value of Cash Outflows (Leasing)					**Rs. 75,67,731**

Managerial Decision Recommendation:

$$textNPV Advantage of Leasing = 82,25,636 - 75,67,731 = textRs.6,57,905$$

Strategic Recommendation: Alternative B (Leasing) results in a present value of cash outflows of Rs. 75,67,731 compared to Rs. 82,25,636 under Borrow-and-Buy. Leasing saves **Rs. 6,57,905 in present value terms** and avoids technical obsolescence, making it the financially and fiscally superior choice.

8.2 Worked Problem 2: Slump Sale Capital Gains Computation under Section 50B

Delta Manufacturing Ltd. holds an industrial chemical division established in 2017. On 31st December 2025, the company entered into an agreement to transfer the entire chemical undertaking as a going concern by way of a **slump sale** to Apex Chemicals Ltd. for a total lump sum consideration of **Rs. 9,50,00,000 (Rs. 9.50 Crores)**. No individual values were assigned to specific assets or liabilities.

The balance sheet of the chemical undertaking as on the date of transfer showed the following position:

Liabilities	Amount (Rs.)	Assets	Book Value (Rs.)	Statutory / WDV Value (Rs.)
Capital Reserve (Revaluation)	80,00,000	Plant & Machinery (Depreciable)	4,20,00,000	3,10,00,000 (WDV per IT Act)
Bank Term Loan (Specific to Unit)	1,80,00,000	Factory Building (Depreciable)	2,50,00,000	1,90,00,000 (WDV per IT Act)
Trade Creditors & Payables	1,20,00,000	Specified Asset (Sec 35AD Unit)	90,00,000	NIL (100% written off)
Provisions for Expenses	25,00,000	Debtors & Receivables	1,40,00,000	1,40,00,000 (Book Value)
Head Office Current Account	3,50,00,000	Inventories & Stores	85,00,000	85,00,000 (Book Value)
		Cash and Bank Balances	20,00,000	20,00,000 (Book Value)
Total Liabilities	**10,05,00,000**	**Total Assets**	**10,05,00,000**	**7,45,00,000**

Notes: Book value of factory building reflects a revaluation upward by Rs. 80,00,000 carried out in 2021.

Step-by-Step Resolution:

Step 1: Computation of Net Worth under Section 50B:
In accordance with Explanation 1 to Section 50B:

Particulars	Statutory Valuation (Rs.)
Written Down Value of Plant & Machinery (Sec 43(6))	3,10,00,000
Written Down Value of Factory Building (Sec 43(6)) [Revaluation of Rs. 80 Lakhs ignored]	1,90,00,000
Section 35AD Specified Capital Asset (Statutory value is NIL)	0
Debtors & Receivables (Book Value)	1,40,00,000
Inventories & Stores (Book Value)	85,00,000
Cash and Bank Balances (Book Value)	20,00,000
Total Value of Assets for Net Worth	**7,45,00,000**

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Particulars	Statutory Valuation (Rs.)
Less: Outside Liabilities	
Bank Term Loan	(1,80,00,000)
Trade Creditors & Payables	(1,20,00,000)
Provisions for Expenses	(25,00,000)
Net Worth of Undertaking (Cost of Acquisition)	**4,20,00,000**

Step 2: Determination of Nature of Capital Gain:
The chemical undertaking was established in 2017 and transferred on 31st December 2025 (holding period = 8 years, exceeding 36 months). Therefore, the capital gain is deemed to be a **Long-Term Capital Gain** under Section 50B.

Step 3: Computation of Taxable Long-Term Capital Gains:

$$textLong - TermCapitalGain = textLumpSumConsideration - textNetWorth$$

$$textLTCG = 9,50,00,000 - 4,20,00,000 = textRs.5,30,00,000$$

No Indexation Rule: Under the second proviso to Section 48, cost inflation indexation cannot be claimed on a slump sale, even though the gain is long-term.

Step 4: Tax Liability on Long-Term Capital Gain:
Under Section 112, long-term capital gains for a domestic corporate assessee opting for Section 115BAA are taxed at 20% (plus 10% surcharge and 4% cess = effective rate of 22.88%) or applicable revised rates of 12.5% without indexation (effective rate = 12.5% × 1.10 × 1.04 = 14.30%):

$$textTaxPayableat14.30\% = 5,30,00,000 times 14.30\% = textRs.75,79,000$$

Summary: The slump sale generates taxable LTCG of Rs. 5.30 Crores, creating a corporate tax liability of Rs. 75.79 Lakhs.

8.3 Worked Problem 3: Executive Salary Restructuring and Tax Shield Optimization

An executive is offered a total Cost to Company (CTC) package of **Rs. 30,00,000 per annum**. Management presents two structural options for evaluation under the regular tax regime:

- **Structure 1 (Unoptimized Standard Structure):** Basic Salary Rs. 24,00,000 (80%), Special Allowance Rs. 6,00,000 (20%). No HRA, no NPS, no tax-exempt allowances.
- **Structure 2 (Tax-Optimized Structure):**
  - Basic Salary: Rs. 15,00,000 (50% of CTC).

- House Rent Allowance: Rs. 6,00,000 (Actual rent paid by executive in Kochi = Rs. 40,000 per month = Rs. 4,80,000 per annum).
- Employer NPS Contribution (Section 80CCD(2)): Rs. 1,50,000 (10% of Basic Salary).
- Telephone & Broadband Reimbursement: Rs. 60,000 per annum (against actual bills).
- Food Coupons / Meal Facility: Rs. 30,000 per annum (Rs. 50 per meal × 2 meals × 300 days).
- Uniform and Books Allowance: Rs. 60,000 per annum.
- Special Allowance (Balancing figure): Rs. 6,00,000.

Tax Comparison Table:

Particulars	Structure 1 (Rs.)	Structure 2 (Rs.)
Gross Salary / CTC	30,00,000	30,00,000
Less: Exempt Allowances		
- HRA Exemption (Sec 10(13A)) [Rent paid Rs. 4.8L - 10% of Basic Rs. 1.5L = Rs. 3.3L]	0	(3,30,000)
- Telephone & Broadband (Rule 3(7)(ix))	0	(60,000)
- Food Coupons (Rule 3(7)(iii))	0	(30,000)
- Uniform / Research Allowance (Sec 10(14))	0	(60,000)
Gross Taxable Salary	30,00,000	25,20,000
Less: Standard Deduction under Section 16(ia)	(50,000)	(50,000)
Net Income from Salaries	29,50,000	24,70,000
Less: Chapter VI-A Deductions		
- Section 80C (PPF / ELSS max limit)	(1,50,000)	(1,50,000)
- Section 80CCD(2) Employer NPS Contribution (10% of Basic)	0	(1,50,000)
Total Taxable Income	**28,00,000**	**21,70,000**
Tax on Total Income (Old Slab Rates)	6,52,500	4,63,500
Add: Health and Education Cess at 4%	26,100	18,540
Total Tax Liability	**6,78,600**	**4,82,040**
Annual Tax Saved by Executive	—	**Rs. 1,96,560**

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Synthesis: By restructuring compensation into tax-sheltered allowances and Section 80CCD(2) NPS contributions, the executive saves **Rs. 1,96,560 annually (a 29% reduction in tax burden)** with zero additional cost to the employing organization.

Chapter 9: Strategic Restructuring Decision Matrix and Regulatory Compliance

9.1 Comparative Strategic Matrix: Merger vs. Demerger vs. Slump Sale

Corporate management contemplating structural reorganization must evaluate each statutory route against tax, financial, and operational criteria:

Strategic Parameter	Amalgamation / Merger (Sec 2(1B) / 72A)	Demerger (Sec 2(19AA))	Slump Sale (Sec 2(42C) / 50B)
Transfer Scope	Whole undertaking and corporate identity absorbed into surviving company.	Specific autonomous undertaking carved out into a resulting company.	Autonomous undertaking sold as a going concern to a third party.
Consideration Form	Shares allotted to amalgamating company shareholders.	Shares allotted directly to demerged company shareholders.	Monetary lump sum cash or debt consideration to selling entity.
Tax Neutrality	Completely exempt under Section 47(vi) and 47(vii).	Completely exempt under Section 47(vib) and 47(vid).	Taxable as Capital Gains under Section 50B.
Loss Carry Forward	Losses transferred with fresh 8-year lease under Sec 72A (manufacturing/banks).	Accumulated losses apportioned to resulting company under Sec 72A(4).	Losses remain locked in the selling company; cannot be transferred to buyer.
NCLT Court Approval	Mandatory National Company Law Tribunal scheme (6-12 months).	Mandatory National Company Law Tribunal scheme (6-12 months).	Not required; executed via Business Transfer Agreement (BTA).
Stamp Duty	Concessional rates on amalgamation order in most state stamp laws.	Concessional rates on demerger order in most state stamp laws.	Conveyance stamp duty applicable on immovable property and movable transfer.

9.2 Post-Restructuring Tax Integration Protocol

Following the execution of an amalgamation, demerger, or slump sale, the surviving entity must immediately implement administrative tax integrations:

- **PAN, TAN, and GSTIN Realignment:** Update permanent account numbers, tax deduction numbers, and GST registrations. Input tax credit balances lying in the electronic credit ledger of the transferring unit must be formally transferred via Form GST ITC-02.
- **Advance Tax and TDS Credit Reconciliation:** Reconcile advance tax payments and withholding tax credits under Form 26AS to ensure that taxes paid by the amalgamating entity are legally credited to the amalgamated entity's corporate account.
- **Depreciation Apportionment in the Year of Transition:** Under the 5th proviso to Section 32(1), the statutory depreciation for the previous year in which amalgamation or demerger takes place must be apportioned between the predecessor and successor companies in the ratio of the number of days the assets were used by them.

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