

SOME QUESTIONS OF INSURANCE ACT, 1938 – ANSWERED



Question 1:

What are the requirements with respect to minimum paid up capital for carrying on insurance business?

Answer:

Requirement as to Capital (Section 6)

(1) Minimum paid up capital required

No insurer carrying on the business of life insurance, general insurance, health insurance or re-insurance in India, shall be registered unless he has, -

- (i) a paid-up equity capital of ₹ 100 crore, in case of a person carrying on the business of life insurance or general insurance; or
- (ii) a paid-up equity capital of ₹ 100 crore, in case of a person carrying on exclusively the business of health insurance; or
- (iii) a paid-up equity capital of ₹ 200 crore, in case of a person carrying on exclusively the business as a re-insurer.

(2) Minimum net owned funds required for foreign insurer

No insurer, as defined in sub-clause (d) of clause (9) of section 2 (viz. a foreign company engaged in re-insurance business through a branch established in India) shall be registered unless he has net owned funds of not less than ₹ 5,000 crore.

Question 2:

State the provisions relating to voting rights in case of shares of an insurance company.



Answer:

Requirements as to capital structure and voting rights (Section 6A)

(1) Requirements as to capital structure [Section 6A(1)]

No public company limited by shares having its registered office in India, shall carry on life insurance business or general insurance business or health insurance business or re-insurance business, unless it satisfies the following conditions:

- (i) That the capital of the company consists of equity shares each having a single face value and such other form of capital, as may be specified by the regulations.
- (ii) That the voting rights of shareholders are restricted to equity shares.
- (iii) That, except during any period not exceeding 1 year allowed by the company for payment of calls on shares, the paid-up amount is the same for all shares, whether existing or new.

(2) Requirements as to voting rights [Section 6A(2)]

Notwithstanding anything to the contrary contained in any law for the time being in force or in the memorandum or articles of association but subject to the other provisions contained in this section the voting right of every shareholder of any public company as aforesaid shall in all cases be strictly proportionate to the paid-up amount of equity shares held by him.

Question 3:

What are the provisions relating to audit of accounts of insurance company?

Answer:

Audit (Section 12)

The balance sheet, profit and loss account, revenue account and profit and loss appropriation account of every insurer, in respect of all insurance business transacted by him, shall, unless they are subject to audit under the Companies Act, 2013, be audited annually by an auditor, and the auditor shall in the audit of all such accounts have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by section 147 of the Companies Act, 2013.

Question 4:

Explain the provisions relating to actuarial report and abstract.

Answer:

Actuarial report and abstract (Section 13)



(1) Annual investigation of financial condition of insurer [Section 13(1)]

Every insurer carrying on life insurance business shall, once at least every year cause an investigation to be made by an actuary into the financial condition of the life insurance business carried on by him, including a valuation of his liabilities in respect thereto and shall cause an abstract of the report of such actuary to be made in accordance with the regulations.

(2) Relaxation by Authority [First Proviso to Section 13(1)]

The Authority may, having regard to the circumstances of any particular insurer, allow him to have the investigation made as at a date not later than 2 years from the date as at which the previous investigation was made,

(3) Abstract of Report | Second Proviso to Section 13(1)]

Every insurer shall cause an abstract of the report of the actuary to be made in such manner as may be specified by the regulations.

(4) Statement to be appended to Abstract [Section 13(4)]

There shall be appended to every such abstract a statement prepared in such form and in such manner as may be specified by the regulations.

(5) Relaxation w.r.t. appending Statement [Proviso to Section 13(4)]

If the investigation is made annually by any insurer, the statement need not be appended every year but shall be appended at least once in every 3 years.

Question 5:

What records with respect to policies and claims are required to be maintained by an insurer?

Answer:

Record of policies and claims (Section 14)

(1) Particulars to be contained in records of policies and claims [Section 14(1)]

Every insurer, in respect of all business transacted by him, shall maintain -

- (a) a record of policies, in which shall be entered, in respect of every policy issued by the insurer, the name and address of the policyholder, the date when the policy was effected and a record of any assignment or nomination of which the insurer has notice;
- (b) a record of claims, every claim made together with the date of the claim, the name and address of the claimant and the date on which the claim was discharged, or, in the case of a claim which is rejected, the date of rejection and the grounds thereof; and
- (c) a record of policies and claims in accordance with clauses (a) and (b) may be maintained in any such form, including electronic mode, as may be specified by the regulations made under this Act.

(2) Issue of policies in electronic form [Section 14(2)]



Every insurer shall, in respect of all business transacted by him, endeavour to issue policies above a specified threshold in terms of sum assured and premium in electronic form, in the manner and form to be specified by the regulations made under this Act.

Question 6:

What returns are required to be submitted by an insurer to the Authority?

Answer:

Submission of returns (Section 15)

(1) Submission of accounts, statements and abstract to Authority | Section 15(1)]

The audited accounts and statements referred to in section 11 or sub-section (5) of section 13 and the abstract and statement referred to in section 13 shall be printed, and four copies thereof shall be furnished as returns to the Authority within 6 months from the end of the period to which they refer.

(2) Signing [Section 15(2)]

Of the four copies so furnished, one shall be signed in the case of a company by the chairman and two directors and by the principal officer of the company and, if the company has a managing director by that managing director and one shall be signed by the auditor who made the audit or the actuary who made the valuation, as the case may be.

Question 7:

State the manner of investment of assets by an insurer.

Answer:

Investment of assets (Section 27,27A, 27B and 27C)

(1) Investment of certain sum by an insurer carrying on life insurance business [Section 27(1)]

Every insurer shall invest and at all times keep invested assets equivalent to not less than the sum of-

- (a) the amount of his liabilities to holders of life insurance policies in India on account of matured claims, and
- (b) the amount required to meet the liability on policies of life insurance maturing for payment in India, less -
 - (i) the amount of premiums which have fallen due to the insurer on such policies but have not been paid and the days of grace for payment of which have not expired, and



- (ii) any amount due to the insurer for loans granted on and within the surrender values of policies of life insurance maturing for payment in India issued by him or by an insurer whose business he has acquired and in respect of which he has assumed liability in the following manner:
- (2) (a) 25% of the said sum in Government securities, a further sum equal to not less than 25% of the said sum in Government securities or other approved securities; and
(b) the balance in any of the approved investments, as may be specified by the regulations subject to the limitations, conditions and restrictions specified therein.
- (3) **Investment of certain sum by an insurer carrying on general insurance business [Section 27(2)]**
In the case of an insurer carrying on general insurance business, 20% of the assets in Government Securities, a further sum equal to not less than 10% of the assets in Government Securities or other, approved securities and the balance in any other investment in accordance with the regulations of the Authority and subject to such limitations, conditions and restrictions as may be specified by the Authority in this regard.

Points to be noted are:

1. As per Section 27A, no insurer carrying on life insurance business shall invest or keep invested any part of his controlled fund and no insurer carrying on general insurance business shall invest or keep invested any part of his assets otherwise than in any of the approved investments as may be specified by the regulations subject to such limitations, conditions and restrictions therein.
2. As per Section 27B, all assets of an insurer carrying on general insurance business shall, subject to such conditions, if any, as may be prescribed, be deemed to be assets invested or kept invested in approved investments specified in section 27.
3. As per Section 27C, an insurer may invest not more than 5% in aggregate of his controlled fund or assets as referred to in sub-section (2) of section 27 in the companies belonging to the promoters, subject to such conditions as may be specified by the regulations.

Question 8:

State the provisions with respect to making of loans by an insurer to directors and other persons.

Answer:

Prohibition of loans (Section 29)

(1) Prohibition on loans to certain persons [Section 29(1)]

No insurer shall grant loans or temporary advances either on hypothecation of property or on personal security or otherwise, except loans on life insurance policies issued by him within their surrender value, to any director, manager, actuary, auditor or officer of the insurer, to any other company or firm in which any



such director, manager, actuary or officer holds the position of a director, manager, actuary, officer or partner.

(2) No prohibition on loans to a banking company [First Proviso to Section 29(1)]

Nothing contained in Section 29(1) shall apply to such loans, made by an insurer to a banking company, as may be specified by the Authority.

(3) No prohibition on loans to subsidiary or holding company [Second Proviso to Section 29(1)]

Nothing in Section.29 shall prohibit a company from granting such loans or advances to a subsidiary company or to any other company of which the company granting the loan or advance is a subsidiary company if the previous approval of the Authority is obtained for such loan or advance.

(4) Non-applicability of Section 185 of the Companies Act, 2013 [Section 29(2)]

The provisions of section 185 of the Companies Act, 2013 shall not apply to a loan granted to a director of an insurer being a company, if the loan is one granted on the security of a policy on which the insurer bears the risk and the policy was issued to the director on his own life, and the loan is within the surrender value of the policy.

Question 9:

Are the directors personally liable for any loss sustained by an insurer or policyholders?

Answer:

Liability of directors, etc., for loss due to contravention of Section 27, 27A, 27B, 27C, 27D or Section 29 (Section 30)

If by reason of a contravention of any of the provisions of section 27, 27A, 27B, 27C, 27D or section 29, any loss is sustained by the insurer or by the policyholders, every director, manager or officer who is knowingly a party to such contravention shall, without prejudice to any other penalty to which he may be liable under this Act, be jointly and severally liable to make good the amount of such loss.

Question 10:

State the provisions with respect to liability of an insurer to underwrite third party risks of motor vehicles.

Answer:

Obligation of insurer in respect of insurance business in third party risks of motor vehicles (Section 32D)

(1) Mandatory underwriting w.r.t. third party risks [Section 32D]

Every insurer carrying on general insurance business shall, after the commencement of the Insurance Laws (Amendment) Act, 2015, underwrite such minimum percentage of insurance business in third party risks of motor vehicles as may be specified by the regulations.



(2) Exemption by Authority [Proviso to Section 32D]

The Authority may, by regulations, exempt any insurer who is primarily engaged in the business of health, re-insurance, agriculture, export credit guarantee, from the application of Section 32D.

Question 11:

State the powers of the Authority with respect to conduct of investigation and inspection of an insurer.

Answer:

Power of investigation and inspection by authority (Section 33)

(1) Order of investigation by Authority [Section 33(1)]

The Authority may, at any time, if it considers expedient to do so by order in writing, direct any person (herein referred to as 'Investigating Officer') specified in the order to investigate the affairs of any insurer or intermediary or insurance intermediary, as the case may be, and to report to the Authority on any investigation made by such Investigating Officer.

(2) Assistance of auditor or actuary [Proviso to Section 33(1)]

The Investigating Officer may, wherever necessary, employ any auditor or actuary or both for the purpose of assisting him in any investigation under this section.

(3) Inspection of books of account [Section 33(2)]

Notwithstanding anything to the contrary contained in section 210 of the Companies Act, 2013, the Investigating Officer may, at any time, and shall, on being directed so to do by the Authority, cause an inspection to be made by one or more of his officers of the books of account of any insurer or intermediary or insurance intermediary, as the case may be, and the Investigating Officer shall supply to the insurer or intermediary or insurance intermediary, as the case may be, a copy of the report on such inspection.

(4) Duties of officers of insurer and others [Section 33(3)]

It shall be the duty of every manager, managing director or other officer of the insurer including a service provider, contractor of an insurer where services are outsourced by the insurer, or intermediary or insurance intermediary, as the case may be, to produce before the Investigating Officer directed to make the investigation under sub-section (1), or inspection under subsection (2), all such books of account, registers, other documents and the database in his custody or power and to furnish him with any statement and information relating to the affairs of the insurer or intermediary or insurance intermediary, as the case may be, as the Investigating Officer may require of him within such time as the said Investigating Officer may specify.

(5) Power to examine on oath [Section 33(4)]

Any Investigating Officer, directed to make an investigation under sub-section (1), or inspection under sub-section (2), may examine on oath, any manager, managing director or other officer of the insurer



including a service provider or contractor where the services are outsourced by the insurer or intermediary or insurance intermediary, as the case may be, in relation to his business.

(6) Report to the Authority [Section 33(5)]

The Investigating Officer shall, if he has been directed by the Authority to cause an inspection to be made, make a report to the Authority on such inspection.

(7) Powers of the Authority on receipt of Report [Section 33(6)]

On receipt of any report under sub-section (1) or sub-section (5), the Authority may, after giving such opportunity to the insurer or intermediary or insurance intermediary, as the case may be, to make a representation in connection with the report as, in the opinion of the Authority, seems reasonable, by order in writing, -

- (a) require the insurer, to take such action in respect of any matter arising out of the report as the Authority may think fit; or
- (b) cancel the registration of the insurer or intermediary or insurance intermediary, as the case may be; or
- (c) direct any person to apply to the court for the winding up of the insurer or intermediary or insurance intermediary, as the case may be, if it is a company, whether the registration of the insurer or intermediary or insurance intermediary, as the case may be, has been cancelled under clause (b) or not.

(8) Expenses of investigation [Section 33(9)]

All expenses of, and incidental to, any investigation made under this section shall be defrayed by the insurer or intermediary or insurance intermediary, as the case may be, shall have priority over the debts due from the insurer and shall be recoverable as an arrear of land revenue.

Question 12:

State the prohibitions with respect to payment of commission for procuring insurance business.

Answer:

Prohibition of payment by way of commission or otherwise for procuring business (Section 40)

(1) Prohibition on payment of remuneration [Section 40(1)]

No person shall, pay or contract to pay any remuneration or reward, whether by way of commission or otherwise for soliciting or procuring insurance business in India to any person except an insurance agent or an intermediary or insurance intermediary in such manner as may be specified by the regulations.

(2) Receipt of remuneration by insurance agent or intermediary or insurance intermediary [Section 40(2)]

No insurance agent or intermediary or insurance intermediary shall receive or contract to receive commission or remuneration in any form in respect of policies issued in India, by an insurer in any form in respect of policies issued in India, by an insurer except in accordance with the regulations specified in this regard.



PROJECT BETA

Beta of a Project

Beta of a Project is the Weighted Average of the Beta of all the Assets and the projects.

β

Project Beta = Beta of Assets = Beta of Liabilities

Beta of Assets = Weighted Average Beta of Equity and Debt Employed in the Project

Beta Balance Sheet for Single Project:

Single Project Balance Sheet (Assuming No Taxes):

Liabilities	Weight	Beta	Assets=Capital Employed	Weight	Beta
Equity [E]	W_E	β_E	Project A	1.00	β_A
Debt [D]	W_D	β_D			
Total	1.00	β_A	Total		β_A

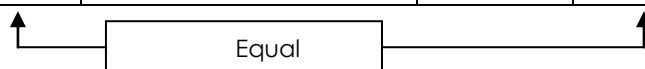
Beta of Project A [β_A] = Weighted Average Beta of Sources of Capital

$$= W_E \times \beta_E + W_D \times \beta_D$$

Beta Balance Sheet for two Projects:

(a) Assuming No Taxes:

Liabilities	Weight	Beta	Assets=Capital Employed	Weight	Beta
Equity [E]	W_E	β_E	Project A	W_A	β_A
Debt [D]	W_D	β_D	Project B	W_B	β_B
Total	1.00		Total	1.00	



- ▶ Beta of Assets [β_{Assets}] = Beta of Liabilities [$\beta_{Liabilities}$]
- ▶ Weighted Average Asset Beta = Weighted Average Beta of sources of capital
- ▶ $W_A \times \beta_A + W_B \times \beta_B = W_E \times \beta_E + W_D \times \beta_D$

(b) If taxes are considered : Weight of Debt will be measured as $W_D \times (1 - \text{tax rate})$



FORMULA

$$\text{Project Beta } \beta_P = \frac{\beta_E \times \text{Equity}}{\text{Equity} + \text{Debt}(1 - \text{Tax})} + \frac{\beta_{\text{Debt}} \times \text{Debt}(1 - \text{tax})}{\text{Equity} + \text{Debt}(1 - \text{Tax})}$$

Where – β_E represents the Beta of Equity of the Project

β_D represents the Beta of Debt of the Project.

The determination of cost of capital under the CAPM approach involves the estimation of Beta, risk-free rate and market return. Beta is generally determined by comparing the return of the firm or the project as the case may be with the market return and ascertaining the relationship.

Example 1:

The total market value of the equity share of RE Company is ₹6000000 and the total value of debt is ₹4000000. The treasurer estimate that the beta of the stock is currently 1.5 and that the expected risk premium on the market is 10%. The Treasury bill rate is 8%.

Required:

(a) What is the beta of the company's existing portfolio of assets?

(b) Estimate the company's cost of capital and the discount rate for an expansion of the company's present business.

Solution:

(a) Beta of Company's existing portfolio of assets

$$\beta_A = \left[\beta_E \times \frac{E}{E+D} \right] + \left[\beta_D \times \frac{D}{D+E} \right]$$

Where β_A = Beta of company assets

β_E = Beta of equity i.e. 1.5

β_D = Beta of Debt (company's debt capital is risk less, $\beta_D = 0$)

E = Value of Equity ₹60 lacs

D = Value of Debt ₹40 lacs

D+E = Total Value = ₹100 lacs

Also given $R_m - R_f = 10\%$ and $R_f = 8\%$

Substituting the required information we get

$$\beta_A = 0.90$$

(b) Estimation of company's cost of capital

= Risk free return + beta × risk premium

$$= 0.08 + 0.9 \times 0.10 = 17\%$$

In the case of expansion plan the company would use 17% as the discount factor. Whereas in the case of diversification company would use appropriate discount factor depending on its risk profile.



Example 2:

The following table shows how various betas change as you take a given firm and perform a pure capital structure change. Fill in the questions. Assume asset beta remains same in all calculation.

D/(D+E)	β_D	β_E	β_A
0.00	?	?	?
0.20	0.10	0.90	?
0.40	0.15	?	?
?	0.20	1.40	?
0.70	?	1.53	?

Solution:

First row: Since there is no debt, therefore equity beta equals the asset beta. Whatever is the equity beta the same would be asset beta.

Second row: $\beta_A = (D/E+D) \beta_D + (E/E+D) \beta_E = 0.2 \times 0.1 + 0.8 \times 0.9 = 0.74$

Third row: We solve for β_E : $\beta_E = \beta_A + (D/E)[\beta_A - \beta_D] = 0.74 + (0.4/0.6) \times (0.74 - 0.15) = 1.1333$

Fourth row we solve for D/(E+D):

$$0.74 = x \times 0.2 + (1-x) \times 1.4$$

$$x = (1.4 - 0.74)/(1.4 - 0.2) = 0.55$$

Last row we solve for β_D :

$$0.74 = 0.7 \times \beta_D + 0.3 \times 1.53$$

$$\beta_D = (0.74 - 0.3 \times 1.53)/0.7 = 0.401$$

The completed table would then be:

D/(E+D)	β_D	β_E	β_A
0.00	-	0.74	0.74
0.20	0.10	0.90	0.74
0.40	0.15	1.13	0.74
0.55	0.20	1.40	0.74
0.70	0.40	1.53	0.74

Debt beta and equity beta both increase as D/(E+D) goes up.

Example: 3

Company A has an asset beta of 1.2 and is 70% equity and 30% debt financed. The expected return on the market is 12% and the risk free rate is 3%. The beta of the company's debt is 0.

(a) What is the expected return on the equity of Company A?

(b) How much of the expected return on the equity comes from financial risk?

Solution:

First let us find out the equity beta for company A:

$$\beta_E = \beta_A + (D/E)[\beta_A - \beta_D] = 1.2 + (30/70) \times [1.2 - 0] = 1.714$$

So the expected return: $= 0.03 + 1.714(0.12 - 0.03) = 0.184$ or 18.4%

The 3% risk free rate is the non-risk compensation and the 15.4% comes from financial risk.



DEDUCTION UNDER CHAPTER VI-A

Sec.	Applicability	Points to Remember
80A	All Assessees	<ol style="list-style-type: none"> 1. Chapter VI-A Deductions cannot exceed GTI. 2. No Deduction if claim not made in Return of Income. 3. No deduction if not claimed under specified sections. 4. Transfer of Goods from Eligible Undertakings to be taken as at Market Value. 5. No Deduction against -(a) LTCG, (b) STCG subject to STT, (c) NR Presumptive Taxation. 6. No deduction if Return not filed for Sec.80-IA/IAB/IB/IC/ID/IE.
80A	Members of AOP/BOI	If deduction is allowed on total income of AOP/ BOI, then no deduction for Members.

BRIEF HIGHLIGHTS OF DEDUCTIONS

Section	Applicability	Nature of Payment/ Receipt	Amount of Deduction
80C	Individuals/HUF	Prescribed Investments / Savings	Max. ₹ 1,50,000 including 80CCC/80CCD(1).
80CCC	Individuals	LIC or other Insurance Pension Plan	Maximum of ₹ 1,50,000
80CCD	Salaried Employees or any Other Individual.	Contribution to approved Pension Plan	<p>Employees: Least of: Amount paid or 10% of Salary.</p> <p>Others: Least of: Amount paid or 10% of Gross Total Income.</p> <p>W.e.f. AY 2016-17, Additional Deduction u/s 80CCD(1B) for Employee Contribution to National Pension Scheme (NPS) ₹ 50,000. [Note: This is an Additional Deduction and shall not be included in the overall ceiling limit of ₹ 1,50,000 u/s 80CCE.]</p>
80CCG	Resident Individual	Acquisition of Listed Equity Shares in accordance with a scheme notified by CG	Least of 50% of amount invested, or ₹ 25,000. GTI should not exceed ₹ 12 Lakhs.



CMA Students Newsletter (For Final Students)

Vol.6C: March 31, 2016

80D	Individuals [Note: HUF are eligible to claim for Mediclaim policy and Medical Expenditure only]	Mediclaim Policy (or) Contribution to the CGHS or other notified scheme (or) Payment for Preventive Health Check-up (or) Medical Expenditure for Very Senior Citizen	<ul style="list-style-type: none"> Self, Spouse, and Dependent Children (aggregate) - ₹ 25,000 Parents - ₹ 25,000, Senior Citizen - ₹ 30,000 Max. ₹ 5,000 for Preventive Health Checkup included in above limits. Payment in any mode other than cash (except Checkup). Medical Expenditure for very Senior Citizen on whom Health Insurance not eligible or paid Maximum ₹ 30,000 	
80DD	Resident Individual/ HUF	Expenditure on Handicapped Dependents. Fixed Deduction irrespective amount spend	General: ₹ 75,000 Severe Disability: ₹ 1,25,000	
80DDB	Resident Individual/ HUF	Expenditure on Specified Diseases	Expenditure for	Maximum
			(a) General - other than (b) & (c)	₹ 40,000
			(b) Senior Citizen	₹ 60,000
			(c) Very Senior Citizen	₹ 80,000
(Actual Expenditure subject to Max. limits as above)				
80E	Individuals	Interest on Repayment of loan taken for Higher Education.	<ul style="list-style-type: none"> No Limit as to amounts Education of Self, Spouse, Children, Student for whom Assessee is a Legal Guardian. 	
80EE	Individuals	Interest on Loan taken for Residential House property	(a) Max ₹ 1,00,000 for AY 2014-2015 & AY 2015-2016, (b) Loan ≤ ₹ 25 Lakhs, (c) Property ≤ ₹ 40 Lakhs, (d) No other House Property of Assessee.	
80G	All Assesseees	Donation to Notified Funds Other Donations	<ul style="list-style-type: none"> 100% or 50% of Donation-Depending on the Fund. Qualifying Amt = 10% of Adjusted Total Income 	
80GG	Individuals	Rental Payment in case of Non-receipt of HRA	Least of (a) Rent paid less 10% of Adjusted GTI, or (b) ₹ 2,000 p.m. or (c) 25% of Adjusted GTI.	
80GGA	All Assesseees	Donations	Eligible Instn. / Fund u/s 35 / 35CCA / 35AC	
80GGB	Indian Company	Donation to Political Party or an Electoral Trust	Actual Amount donated, in any mode other than Cash.	
80GGC	Any person except Local Authority or AJP funded by Govt.	Donation to Political Party or an Electoral Trust	Actual Amount donated, in any mode other than Cash.	
80JJA	All Assesseees	Treating Bio-Degradable Waste	100% of Profit for first 5 Ays.	
80JJA	All Assesseees	Providing Additional Employment	30% of Additional Wages Paid for 3 Ays.	



CMA Students Newsletter (For Final Students)

Vol.6C: March 31, 2016

80LA	Off Shore Banking Units of Banks and Fin. Instns.	Income from Off-Shore Banking Unit	First 5 Years: 100% Next 5 Years: 50% of such income
80QQB	Resident Individual	Royalty Income from Books	Least of - Whole of such Income or ₹ 3,00,000
80RRB	Resident Individual	Income from Patent registered on or after 1.4.03	Least of - Whole of such Income or ₹ 3,00,000
80P	Co-operative Society	Income from specified activities	Whole of Such Income
80TTA	Individual or HUF	Interest on Deposits in a Savings A/c (Bank, Post Office, Co-Op)	Least of Interest Income or ₹ 10,000
80U	Handicapped Res. Individuals	NA	General: ₹ 75,000 Severe Disability: ₹ 1,25,000

Note:

- **Payment out of Taxable Income:** Deductions u/s 80CCC, 80D, 80E, 80EE, is available only if the payment / contribution / expenditure is made out of Income chargeable to tax.
- **For Sec.80G,80GGA,** no deduction shall be allowed in respect of any sum exceeding ₹ 10,000, unless such sum is paid by any mode other than cash.

HIGHLIGHTS OF SEC. 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID, 80-IE

Particulars	80-IA	80-IAB	80-IB	80-IC	80-ID	80-IE
Nature of Business	Engaged in Infrastructure Development	Developers of Special Economic Zone	Other Undertakings engaged in misc. business, not covered u/s 80-IA	Manufacture of articles specified in Sch. XIV (not in Sch. XIII) or undertaking Substantial Expansion	Hotel (located in specified area/ district having World Heritage Site), Convention Centre	Production of Eligible Articles (or) Substantial Expansion of Eligible Business
Eligible Assessee	Any Assessee	Any Assessee	Any Assessee	Undertakings in Special Category Backward States	Undertaking in specified areas	Undertaking in North-Eastern States
Period of Deduction	10 consecutive Asst. Yrs. (in some cases 10 out 15 AYs)	10 consecutive Asst. Yrs. Out of 15 Asst. Years.	Varies for different undertakings	10 Assessment Years	5 consecutive Assessment years	10 consecutive Assessment years



CMA Students Newsletter (For Final Students)

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Quantum of Dedn. Years 1 to 5	100%	100%	Varies for different undertakings	100%	100%	100%
Years 6 to 10	Companies - 30% Others - 25%	100%		For Sikkim and NE States - 100%, For Himachal Pradesh & Uttaranchal 30% for Co's, 25% Others	NA	100%
Form of Audit Report	Form 10CCB	10CCBA / 10CCBB / 10CCBC	Not Prescribed	Not Applicable	10CCBBA	Not Applicable
Tfr of Business	Transferee entitled to deduction for the remaining period					

Important Case Decisions

80-IA /80-IAB / 80-IB, etc. - General

- Ministry of Commerce vs CBDT Approval:** Once approval is granted by Ministry of Commerce to an Industrial Park, CBDT is required to notify same for purpose of Sec.80-IA, and that the deduction u/s 80-IA cannot be denied based on the reason that it is not notified by CBDT. **DCIT vs Ganesh Housing Corporation Ltd 25 Taxmann.com 305 (SC)**
- Period of Exemption:** Sec.80-IB should be allowed to the Assessee for the remaining years up to the period for which his entitlement would accrue, provided the condition mentioned in Sec.80-IB is fulfilled. **[Praveen Soni vs CIT (2011) 333 ITR 324 (Del.)]**
- Housing Project - Essence of Activities:** An Assessee, engaged in the business of developing a Housing Project, cannot be denied deduction u/s 80-IB(10) on the ground that the ownership of land has not yet been transferred to the Assessee and the approval to build the Housing Project has been taken in the name of the Land Owner, though the Assessee assumes the entire risks and rewards of the project. **[Radhe Developers (2012) 341ITR 403 (Guj.)]**
- Extension of Certain Housing Projects - eligible:** An additional building was constructed on a plot of land and approval for the same is obtained in the year 2002, deduction u/s 80-IB(10) cannot be denied in respect of the said building on the contention that it was an extension of an earlier project for construction of four buildings, in respect of which approval was obtained before 1.10.1998. **[Vandana Properties (2012) 206 Taxman 584 (Bom.)]**
- Partly approved Housing Project:** Deduction u/s 80-IB to be given proportionately for eligible units though the Housing Project may consist of both eligible and ineligible units. **[Viswas Promoters (P) Ltd 255 CTR 149 (Mad) (2013)]**



6. **New Undertaking vs New Assessee:** Deduction u/s 80-IB is available only to a new industrial undertaking and **not** to a New Assessee. [**Textile Machinery Corporation Ltd 107 ITR 195 (SC)**]
7. **Eligible Industrial Undertaking:** Deduction u/s 80-IB is available in respect of the profit or gain derived from the **eligible industrial undertaking** of the Assessee. [**Canara Workshops P Ltd 161 ITR 320 (SC)**]
8. **Loss to be set off - Contrary View:** If the Assessee is **incurring loss from one unit** and making **profits from other unit**, **loss** of the unit is **to be adjusted** before determining the Gross Total Income. If the Gross Total Income is 'Nil', Assessee is not entitled to claim deductions under Chapter VI-A. [**Synco Industries Ltd 299 ITR 444 (SC) 168 Taxmann 224**]

80-IA /80-IAB / 80-IB, etc. - Incomes eligible / not eligible for deduction

9. **Freight Subsidy:** Freight Subsidy received from Government cannot be treated as Profit derived from Business, for the purpose of Sec.80-IA [**CIT vs Kiran Enterprises 327 ITR 520 (HP.)**]
10. **Interest Subsidy:** Interest Subsidy received from State Government cannot be treated as "Profits derived from Industrial Undertaking" and hence not eligible for deduction u/s 80-IB [**CIT vs Gheria Oil Gramudyog Workers Welfare Association (2011) 330 ITR 117**]
11. **Int on Deposits - Not Income:** Interest derived from deposit with Electricity Board is not Business Income, and not entitled to tax deduction u/s 80-IB. [**Pandian Chemicals Ltd 262 ITR 278 (SC)**]
12. **Service Income and Commission:** Assessee engaged in manufacture and selling of additives on Commission basis, was not entitled to deduction u/s 80-IB in respect of Service Income and Commission, because those incomes were not derived from activity of industrial undertaking. **Indian Additives Ltd vs DCIT 25 Taxmann.com 412 (SC)**
13. **Duty Drawback:** Duty Drawback Receipt / DEPB benefits do not form part of the Net Profits of Eligible Industrial Undertaking for the purpose of Sec.80-I/80-IA/80-IB. [**Liberty India vs CIT (SC) 183 Taxman 349**] [**CIT vs Orchev Pharma (P) Ltd 25 taxmann.com 518 (SC)**]
14. **Refund of Excise Duty:** The payment of Central Excise Duty had a direct nexus with the manufacturing activity and similarly, the refund of the Central Excise Duty also had a direct nexus with the manufacturing activity, being a profit-linked incentive, since payment of the Central Excise Duty would not arise in the absence of any industrial activity. Therefore, the refund of Excise Duty had to be taken into account for purposes of Sec.80-IB. [**Meghalaya Steels Ltd. (2011) 332 ITR 91**]
15. **Standing Charges not eligible for Sec.80-IC:** The standing charges are in the nature of compensation for non-utilization or under-utilization of Plant and Machinery due to lack of orders. The said charges were paid to compensate the Assessee for failure to produce and market its products. Therefore, such standing charges are not eligible for deduction u/s 80-IC. [**Pine Packaging (P) Ltd (2012) 209 Taxman 74**]



80-IA /80-IAB / 80-IB, etc. - Meaning of Manufacture

16. **Starting Period of Exemption:** Manufacturing for the purpose of marketing starts only with Commercial Production, namely, when the final product to the satisfaction of the Manufacturer has been brought into existence and it is fit for marketing, and not with mere trial production. **[CIT vs Nestor Pharmaceuticals Ltd 322 ITR 631 (Del.)]**
17. **Manufacture:** Procurement of parts and assembling them to make Windmill falls within the meaning of "Manufacture" and "Production" to be entitled for deduction under Sec.80-IB. **[CIT vs Chiranjeevi Wind Energy Ltd (2011) 333 ITR 192 (Mad.)]**
18. **Job Work:** No deduction u/s 80-IB if the Assessee gets the work done on Jobwork basis. **Mahender Kumar Aggarwal [2005] TIOL 131 (All.)**
19. Sawing Marble Blocks into Slabs and Tiles and polishing amounts to "Manufacture or Production". **[Arihant Tiles and Marbles 320 ITR 79 (SC)]**
20. Duplication of Blank CD with Master Media amounts to "manufacture". Deduction u/s 80- IA is available. **[CIT vs Oracle Software India Limited 320 ITR 546 (SC)]**
21. **Manufacture or Production:** According to Sec.80-IB, the Assessee Company must be engaged in the business of manufacture or production of any article or thing. **[Hotel & Allied Trade P Ltd 245 ITR 538, Indian Hotels Co. Ltd and Others 245 ITR 538 (SC)]**
22. **Activities held as Manufacture:** Blending & Bottling of Indian Manufactured Foreign Liquor (IMFL) would amount to manufacture for purpose of claiming deduction u/s 80-IB **[CIT Vs Vinbros & Co 25 taxmann.com 367 (SC)]** The process of bottling of gas into gas cylinders, which requires a very specialised process and independent plant and machinery, amounts to production of "gas cylinders" containing gas for the purpose of claiming deduction u/s 80-IB. **[Puttur Petro Products P. Ltd. v. ACIT [2014] 361 ITR 290 (Kar.)]** Conversion of Gram Dal into Besan amounts to Manufacture' u/s 80-IB (4) **[[Shree Triveni Foods [2015] 59 taxmann.com 292 (HP)(HC)]]**
23. **Manufacture:** Texturing & Twisting of Polyester Yarn amounts to manufacture for purpose of deduction u/s 80-IA **[CIT Vs Yashasvi Yarn Ltd 25 taxmann.com 266 (SC)]**
24. **Meaning of Production:** Conversion of Jumbo Rolls of Photographic Films into small flats and rolls in the desired sizes amounts to production. The word production or produce when used in juxtaposition with the word 'manufacture' takes in bringing into existence new goods by a process, which may or may not amount to manufacture. It also takes in all the by-products, intermediate products and residual products, which emerge in the course of manufacture of goods. **[Computer Graphics Ltd vs 308 ITR 98 (SC)]**
25. **Ineligible Activities under Manufacture**
 - **Peeling and Freezing of Shrimps** does not amount to manufacture and not eligible for deduction u/s 80-IB. **[Relish Foods 237 ITR 579 (SC)]**
 - Since no manufacture of articles or things is carried out in **Hatcheries**, it is not eligible for deduction u/s 80-IB. **[Venkateswara Hatcheries (P) Ltd 237 ITR 174 (SC)]**



- Mere change in the form of the same commodity does not necessarily involve change of identity and the process is not treated as manufacture. Hence, conversion of **Chicory Root into Chicory Powder** by roasting and powdering is not manufacture for deduction u/s 80-IB. [**Sacs Eagle Chicory 255 ITR 178 (SC)**]
 - Mixing of different kinds of tea is blending, but is not manufacture or production under the Income Tax Act. [**CIT vs M/s Tara Agencies 292 ITR 444 (SC)**]
- 26. Industrial undertakings other than infrastructure developments:** If cameraman, editor, sound technicians are engaged by the assessee, and they used their own equipments for filming, processing, sound recording and mixing or machines are hired on contract basis but they do not transfer these equipments to assessee. Rim production unit or a Company is an industrial undertaking and, therefore, sec. 80IB can be invoked by it. [**CIT vs. Shri Jyoti Prakash Dutta 25th July 2014 (BOM)**]
- 27. Workers employed in manufacturing process:** Drivers & Cleaners could not be treated as workers employed in the manufacturing process, complying with condition specified u/s 80-IB(2)(iv) [**Shree Triveni Foods [2015] 59 taxmann.com 292 (HP)(HC)**]
- 28. Sec.80-IB(10) is prospective in Nature:** Restriction on extent of commercial space in Housing Project imposed by way of amendment to Sec. 80-IB(10) with effect from 1-4-2005, does not apply to Housing Project approved before 1-4-2005 even though completed after 1-4-2005. [**Sarkar Builders [2015] 57 taxmann.com 313 (SC)**]



CONDITIONS FOR ALLOWING CENVAT CREDIT [RULE 4 OF CENVAT CREDIT RULES, 2004]

Time limit for availment of CENVAT credit in respect of inputs —

- **Timing of taking credit in case of manufacturer or provider of output service:** The CENVAT credit in respect of inputs may be taken immediately on receipt of the inputs in the factory of the manufacturer or in the premises of the provider of output service or in the premises of the job worker, in case goods are sent directly to the job worker on the direction of the manufacturer or the provider of output service, as the case may be.
- **Time limit of taking credit:** Credit to be taken within 1 year from date of issue of duty paying documents. The manufacturer or the provider of output service shall not take CENVAT credit after 1 year of the date of issue of any of the documents specified in Rule 9(1) of Cenvat Credit Rules, 2004.

In case of bill of entry, 1 year would start from date of 'clearance order'.

Example 1: Assessee files bill of entry on 01-09-2014, which is returned 'assessed' by Customs Department on 05-09-2014. The assessee pays customs duty with CVD, etc. on 07-09-2014 and clearance order is passed on 08-09-2014. The assessee takes credit on said bill of entry on 08-09-2015. Whether credit is valid?

Answer: It was held in **Mangalore Refinery & Petrochemicals Ltd. v. CCE 2012 (278) E.L.T. 289 (Kar.)** that 1 year period has to be computed from date of handing over to importer clearance (out-of-charge) order, as without that they cannot get goods for home consumption. If, after handing over of that order, assessee commits any delay in getting the goods, assessee cannot take advantage thereof. Hence, credit is valid, as it is taken within 1 year from 08-09-2014.

- **Time-limit applies to credit and not for 're-credit' [Circular No. 990/14/2014-CX-8, dated 19-11-2014] :** Purpose of amendment is to ensure that after issue of a document under rule 9(1), credit is taken for the first time within 1 year of the issue of the document. Once this condition is met, the limitation has no further application.

Time limit for availment of CENVAT credit in respect of input services —

- **CENVAT Credit on input service on receipt of invoice [Rule 4(7)]:** The CENVAT credit in respect of input service shall be allowed, on or after the day on which the invoice, bill or, as the case may be, challan referred to in Rule 9, is received.

Reversal of CENVAT Credit in case the payment is not made within 3 months and re-credit after payment: In case the payment of the value of input service and the service tax paid or payable as indicated in the invoice, bill or, as the case may be, challan referred to in rule 9 is not made within 3 months of the date of the invoice, bill or, as the case may be, challan, the manufacturer or the service provider who has taken credit on such input service, shall pay an amount equal to the CENVAT credit availed on such input service.

Subsequently if the payment is made, the manufacturer or output service provider shall be entitled to take the credit of the amount equivalent to the CENVAT credit paid earlier subject to the other provisions of these rules.



- **In case of full reverse charge, CENVAT credit admissible only on payment of service tax :** In respect of input service where whole of the service tax is liable to be paid by the recipient of service, credit shall be allowed after the service tax is paid.
- **In case of partial reverse charge, CENVAT credit admissible on payment service tax thereon:** In respect of input service where part of the service tax is liable to be paid by the recipient of service, credit of service tax shall be allowed as under -
 - (i) For service receiver's portion: Only after payment of service tax to the treasury of the Government by the receiver of service.
 - (ii) For service provider's portion: CENVAT credit shall be allowed, on or after the day on which the invoice, bill or, as the case may be, challan referred to in Rule 9, is received.
- **Discounted payment - Proportionate credit admissible:** Even if the service receiver doesn't pay the full invoice value of taxable services, he can take proportionate credit of the service tax relating to proportionate value of the taxable services paid. - Circular No. 122/03/2010-ST, dated 30-4-2010.
- **Reversal of credit when payment is refunded or credit note is given to manufacturer or service receiver:** If any payment or part thereof, made towards an input service is refunded or a credit note is received by the manufacturer or the service provider, who has taken credit on such input service, he shall pay an amount equal to the CENVAT credit availed in respect of the amount so refunded or credited.

Time limit for availment of CENVAT credit in respect of capital goods:

- **Availment of credit not exceeding 50% in year of acquisition:** The CENVAT credit in respect of capital goods received in a factory; or in the premises of the provider of output service; or outside the factory of the manufacturer of the final products, for generation of electricity for captive use within the factory; or in the premises of the job worker, in case capital goods are sent directly to the job worker on the direction of the manufacturer or the provider of output service, as the case may be, at any point of time in a given financial year shall be taken only for an amount not exceeding 50% of the duty paid on such capital goods in the same financial year.

CENVAT credit in respect of capital goods may be taken by the provider of output service when the capital goods are delivered to such provider, subject to maintenance of documentary evidence of delivery and location of the capital goods, irrespective of whether it is received in the premises or not.

- **Balance credit to be allowed in subsequent years, provided capital goods are in possession:** The balance of CENVAT credit may be taken in any financial year subsequent to the financial year in which the capital goods were received in the factory of the manufacturer, or in the premises of the provider of output service, if the capital goods are in the possession of the manufacturer of final products, or provider of output service in such subsequent years.

In case of components, spares and accessories, refractories and refractory materials, moulds and dies and goods falling under heading No. 6805, grinding wheels and the like, and parts thereof falling under heading 6804 of the First Schedule to the Excise Tariff Act, the assessee can take the balance of CENVAT Credit in subsequent financial year even if the capital goods are not in the possession of the manufacturer/ service provider in such subsequent years.



- **100% Credit shall be allowed in year of acquisition in certain cases:**
 - 100% Credit to be allowed if capital goods are removed in the year of acquisition:** If the capital goods are removed as such in the year of acquisition, the credit for the whole amount of duty paid on such goods shall be allowed in the same financial year.
 - 100% Credit of Additional duties of customs leviable under section 3(5) of the Customs Tariff Act:** The CENVAT credit of the additional duty leviable under section 3(5) of the Customs Tariff Act in respect of capital goods shall be allowed immediately on receipt of the capital goods in the factory of a manufacturer.
 - 100% Credit to units availing SSI Exemption:** Where an assessee is eligible to avail the exemption under a notification based on the value of clearances in a financial year, the CENVAT credit in respect of capital goods received by such assessee shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year.
- **Credit available even if capital goods acquired on lease, hire purchase or loan agreement:** The CENVAT credit in respect of the capital goods shall be allowed to a manufacturer, provider of output service even if the capital goods are acquired by him on lease, hire purchase or loan agreement, from a financing company.
- **Credit not admissible if depreciation claimed on duty element:** The CENVAT credit in respect of capital goods shall not be allowed in respect of that part of the value of capital goods which represents the amount of duty on such capital goods, which the manufacturer or the provider of output service claims as depreciation under section 32 of the Income-tax Act, 1961.

Example 2: Madhu receives a machine in his factory. He utilises 50% of the duty paid thereon as CENVAT credit even before the erection of the machine. Can he do so?

Answer: As per Rule 4(2)(a) of Cenvat Credit Rules, credit upto 50% of duty paid on capital goods may be taken on receipt of capital goods in factory of manufacturer. There is no requirement that capital goods must have been installed/erected/put to use or the like. Hence, Madhu can take 50% credit before erection of machine and utilize it in accordance with rules.

Example 3: XYZ Pvt. Ltd., a manufacturer, has furnished the following information (inputs/capital goods referred to herein are received in December 2015, except as otherwise directed and all the invoices in respect of input services are received in December 2015). You are required to determine the total CENVAT credit that can be availed by XYZ Pvt. Ltd. during the month of December, 2015 assuming that it is not eligible for SSI-exemption under Excise law .:

No.	Particulars	Date of invoice	Excise duty/ Service tax (₹)
(i)	Input 'A'	Invoice dated 23.11.2014	1,56,000
(ii)	Machinery falling under Chapter 82 — Machinery was received in September 2014 itself	Invoice dated 12.11.2014	3,54,670
(iii)	Input service 'X'	Invoice dated 12.01.2015	45,340
(iv)	GTA service for bringing raw materials to the factory	Invoice dated	11,124



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	[Payment has not been made to GTA but service tax has been paid under reverse charge]	14.12.2015 Value of service -3,00,000	
(v)	Works Contract services for repair and maintenance of finished product [Payment of service/ tax has not been made to contractor who is an Individual but partial service tax (50% of total) has been paid under reverse charge]	Invoice dated 10.12.2015 Value of service in ₹ 1,50,000 (as computed as per rules)	18,540 (total)

Answer:

Credit available during the month of December, 2015

Particulars	Reasons	₹
Input 'A'	Credit not allowed, as time-limit of 1 year from date of issue of invoice already expired	Time-barred
Machinery (Chapter 82)	50% credit was available during year 2014-15 and balance 50% of ₹ 3,54,670 is eligible for credit on 01-04-2015 itself. It is assumed that such balance credit was not taken on 01-04-2015 and is still pending to be taken. Time-limit of 1 year does not apply to 'capital goods' falling under Rule 2(a) of Cenvat Credit Rules.	1,77,335
Input service 'X'	Credit allowable, as within 1 year from date of issue of invoice	45,340
GTA service	It is a case of full reverse charge; hence, credit is allowed on payment of service tax to government — Whether payment is made to service provider or not is not relevant	11,124
Works Contract Services	50% tax payable by service recipient can be taken on payment of tax to Government. Balance tax can be taken as credit on receipt of invoice. Since invoice is received in December, 2015, hence it can be taken as credit on receipt of invoice.	18,540
Total CENVAT credit		2,52,339



PURCHASE CONSIDERATION IN CASE OF AMALGAMATION

In case of amalgamation as the transferee company (purchasing company) is purchasing the business of Transferor Company, the transferee company shall pay purchase consideration to the transferor company.

Consideration for the amalgamation means total of the shares and other securities issued and payment made in form of cash or other assets by the transferee company to shareholders of the transferor company.

It can be paid in any form viz., cash, shares, debentures etc.

Purchase consideration does not vary with the methods of accounting used. Whether it is pooling of interest method or it is purchase method.



Computation of Purchase Consideration:

Example 1:

A Ltd. and B Ltd. were amalgamated on and from 31st March, 2016. A new company X Ltd. was formed to take over the business of the existing companies. The Balance sheets of A Ltd and B Ltd as on 31st March, 2016 are given below:

(₹ in Lakhs)

Liabilities	A Ltd.	B Ltd.	Assets	A Ltd.	B Ltd.
Share capital:			Fixed assets:		
Equity Shares of ₹ 100 each	850	725	Land and Building	460	275
10% Preference Share of ₹ 100 each	320	175	Plant and Machinery	325	210
Reserves and surplus:			Investments	75	50
Revaluation Reserve	125	80	Current Asset and		
General reserve	240	160	Loans and Advances:		
Investment Allowance	50	30	Stock	325	269
			Sundry Debtors	305	270
			Bills receivable	25	—



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Reserve			Cash and Bank	385	251
Profit and Loss Account	75	52			
Secured Loans:					
13% Debentures (₹100 each)	50	28			
Unsecured Loan:					
Public Deposits	25	—			
Current liabilities and Provision:					
Sundry creditors	145	75			
Bills Payable	20	—			
	1,900	1,325		1,900	1,325

Other Information:

- (i) 13% debentures of A Ltd and B Ltd are discharged by X Ltd. by issuing such number of its 15% debentures of ₹ 100 each so as to maintain the same amount to interest.
- (ii) Preference shareholders of the two companies are issued equivalent number of 15% preference shares of X Ltd. at a price of ₹ 125 per share (face value ₹ 100)
- (iii) X Ltd. will issue 4 equity shares for each equity share of A Ltd. and 3 equity shares for each equity share of B Ltd. The shares are to be issued @ ₹ 35 each, having a face value of ₹10 per share.
- (iv) Investment allowance reserve is to be maintained for two more years.
- (v) Compute the purchase consideration.

Note: Unsecured Loans in assumed to be of less than 12 months hence treated on short term borrowings ignoring interest.

Solution:

Method 1: Amalgamation in the Nature of Merger

WN # 1 : Calculation of Purchase Consideration

Particulars	A Ltd.	B Ltd.
a. Equity Shares:		
i. No. of Shares outstanding	8.50	7.25
ii. Exchange Ratio	4:1	3:1
iii. No. of Shares to be issued	34	21.75
iv. Issue price per share (₹)	35	35
v. Purchase Consideration	1190	761.25
• Share capital	340	217.50
• Securities Premium	850	543.75
b. Preference Shares:		
i. No. of Shares outstanding	3.2	1.75



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ii. Exchange Ratio	1:1	1:1
iii. No. of Shares to be issued	3.2	1.75
iv. Issue price per share (₹)	125	125
v. Purchase Consideration	400	218.75
• Share capital	320	175.00
• Securities Premium	80	43.75
c. Total Consideration {a(iv) + b(iv)}	1590	980.00
		₹ 2,570 Lakhs

Example 2:

The summarized Balance Sheets of P Ltd. and R Ltd. for the year ended 31.3.2016 are as under:

	P Ltd. ₹	R Ltd. ₹		P Ltd. ₹	R Ltd. ₹
Equity Share capital (in shares of ₹ 100 each)	24,00,000	12,00,000	Fixed Assets	55,00,000	27,00,000
8% Preference Share capital (in share of ₹ 100 each)	8,00,000	—	Current Assets	25,00,000	23,00,000
10% Preference Share capital (in shares of ₹ 100 each)	—	4,00,000			
Reserves	30,00,000	24,00,000			
Current liabilities	18,00,000	10,00,000			
	80,00,000	50,00,000		80,00,000	50,00,000

1. The following information is provided:

	P Ltd. ₹	R Ltd. ₹
a) Profit before tax	10,64,000	4,80,000
b) Taxation	4,00,000	2,00,000
c) Preference dividend	64,000	40,000
d) Equity dividend	2,88,000	1,92,000

2. The Equity shares of both the companies are quoted in the market. Both the companies are carrying on similar manufacturing operations.

3. P. Ltd. proposes to absorb R Ltd. as on 31.3.2016. The terms of absorption are as under:



- a. Preference shareholders of R Ltd. will receive 8% preference shares of P Ltd. sufficient to increase the income of preference shareholders of R Ltd. by 10%
- b. The equity shareholders of R Ltd. will receive equity shares of P Ltd. on the following basis:
- The equity shares of R Ltd. will be valued by applying to the earnings per share of R Ltd. 75% of price earnings ratio of P Ltd. based on the results of 2015-2016 of both the companies.
 - The market price of equity shares of P Ltd. is ₹ 400 per share.
 - The number of shares to be issued to the equity shareholders of R Ltd. will be based on the above market value.
 - In addition to equity shares, 8% preference share of P Ltd. will be issued to the equity shareholders of R Ltd. to make up for the loss in income arising from the above exchange of shares based on the dividends for the year 2015-2016.
4. The assets and liabilities of R Ltd. as on 31.3.2016 are revalued by professional valuer as under:
- | | Increased by
₹ | Decreased by
₹ |
|---------------------|-------------------|-------------------|
| Fixed assets | 1,60,000 | — |
| Current assets | — | 2,00,000 |
| Current liabilities | | 40,000 |
5. For the next two years, no increase in the rate of equity dividend is expected.
You are required to calculate the purchase consideration.

Solution:

I. Purchase Consideration

A. Preference Shareholders

8% preference shares of P Ltd. sufficient to increase income by 10%.

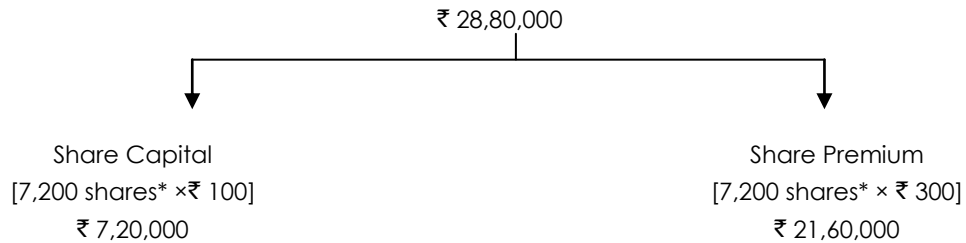
Particulars	₹
Current income from Preference shares of R Ltd. (₹ 4,00,000 × 10%)	40,000
Add : 10% increase	4,000
Income from Preference Share of P Ltd.	44,000
Value of 8% Preference Shares of R Ltd. To be issued [44,000×100/8]	₹5,50,000

B. Equity Shareholders

- i. Consideration by way of Equity shares



Valuation of shares of P Ltd.
(12,000 shares × ₹ 240 [WN # 3])



* No. of shares to be issued = ₹ 28,80,000 ÷ ₹ 400
= 7,200 Shares

ii. Consideration by way of Preference Shares

Particulars	₹
i. Current equity dividend from R Ltd.	1,92,000
ii. Expected Equity dividend from P Ltd.	86,400
iii. Loss in income	1,05,600
iv. Value of 8% Preference Shares to be issued (1,05,600 ÷ 8%)	13,20,000

C. Total Purchase Consideration

[5,50,000 + 28,80,000 + 13,20,000] ₹ 47,50,000

WN # 1 : Computation of EPS

Particulars	P Ltd.	R Ltd
Profit before tax (PBT)	10,64,000	4,80,000
Less: Tax (given)	<u>(4,00,000)</u>	<u>(2,00,000)</u>
Profit after tax (PAT)	6,64,000	2,80,000
Less: Preference dividend	<u>(64,000)</u>	<u>(40,000)</u>
Profit available to equity shareholders	<u>6,00,000</u>	<u>2,40,000</u>
Earnings per share (Profit for Equity Shareholders ÷ No of Shares)	<u>25</u>	<u>20</u>

WN # 2: P/E ratio of R Ltd.

$$P/E \text{ ratio} = \frac{\text{Market Price}}{\text{EPS}} = \frac{400}{25} = ₹ 16$$

$$75\% \text{ of P/E ratio} = (16 \times 0.75) = ₹ 12$$

WN # 3 : Value per share of P Ltd.

$$\begin{aligned} &= \text{EPS} \times \text{P/E ratio} \\ &= ₹ 20 \times 12 \\ &= ₹ 240. \end{aligned}$$



Computation of Purchase Consideration when the Purchasing Company is holding shares in Selling Company —

Example 3.

The Balance Sheets of S Ltd. and H Ltd. as on 31.3.16 was as follows.

	(₹ in Lakhs)	
<i>Liabilities</i>	<i>S Ltd.</i>	<i>H Ltd.</i>
Equity Share capital	80	25
Reserves and surplus	400	75
10% 25,000 Debentures of ₹ 100 each	–	25
Other Liabilities	120	–
	600	125
<i>Assets</i>		
Fixed assets at cost	200	75
Less: Depreciation	<u>100</u>	100
Investments in H Ltd.		<u>50</u>
2 Lakhs Equity shares of ₹ 10 each at cost	32	
10% 25,000 debentures of ₹ 100 each at cost	<u>24</u>	56
Current assets	800	300
Less: Current liabilities	<u>(356)</u>	<u>(200)</u>
	600	125

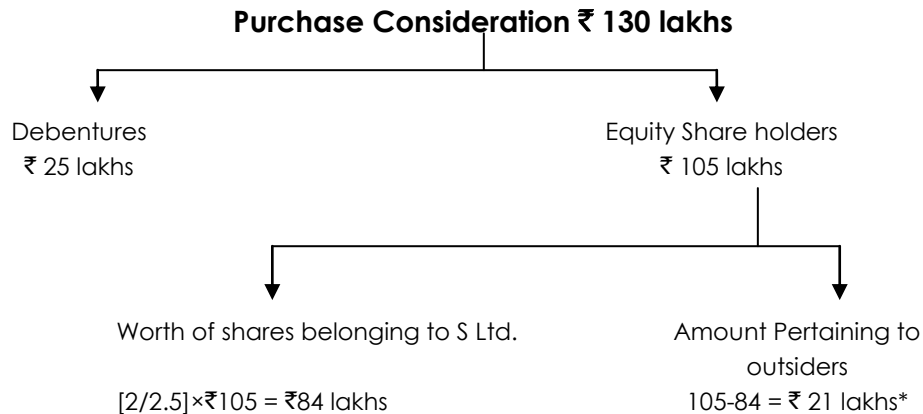
In a scheme of absorption duly approved by the Court, the assets of 'H' Ltd. were taken over at an agreed value of ₹ 130 lakhs. The liabilities were taken over at par. Outside shareholders of 'H' Ltd. were allotted equity shares in S Ltd. at a premium of ₹ 90 per share in satisfaction of other claims in 'H' Ltd. for purposes of recording in the books of 'S' Ltd. Fixed assets taken over from 'H' Ltd. were revalued at ₹ 40 lakhs.

The scheme was put through on 1st April, 2016.

Compute the purchase consideration.

Solution:

Actual purchase consideration is already agreed as ₹130 lakhs.



Computation of Purchase Consideration when the Selling Company is holding shares in Purchasing Company —

Example 4.

Following are the Balance sheets of two companies, A Ltd. and B Ltd. as at December 31, 2015.

Liabilities	A Ltd. ₹	B Ltd. ₹	Assets	A Ltd. ₹	B Ltd. ₹
Equity Share Capital: (Shares of ₹ 10 each)	5,00,000	3,00,000	Sundry Assets	7,50,000	3,50,000
Reserve	1,00,000	55,000	10,000 Shares in A Ltd.	—	1,00,000
Creditors	1,50,000	95,000			
Total	7,50,000	4,50,000	Total	7,50,000	4,50,000

A Ltd. was to absorb B Ltd. on the basis of intrinsic value of the shares, the purchase consideration was to be discharged in the form of fully paid shares, entries to be made at par value only. A sum of ₹ 20,000 is owed by A Ltd. to B Ltd. Also included in the stocks of A Ltd. ₹ 30,000 goods supplied by B Ltd. cost plus 20%.

Compute the purchase consideration.

Solution:

Calculation of Purchase consideration - Net Assets Method

WN # 1: Intrinsic value of share

Particulars	A Ltd (₹)	B Ltd. (₹)
a) Sundry Assets	7,50,000	3,50,000
b) Investments in A Ltd. 10,000 shares @ ₹ 12 each	—	1,20,000
c) Creditors	<u>(1,50,000)</u>	<u>(95,000)</u>
d) Net Assets	<u>6,00,000</u>	<u>3,75,000</u>
e) No. of shares outstanding	50,000	30,000
f) Intrinsic Value of shares [d ÷ e]	12	12.5



WN # 2: Purchase Consideration

Particulars	Amount
a) No. of shares of B Ltd.	30,000
b) Value of shares @ ₹ 12.50	₹ 3,75,000
c) No. of shares issuable based on intrinsic value of ₹ 12 (3,75,000 ÷ 12)	31,250
d) No. of shares held by B Ltd.	<u>(10,000)</u>
e) Net shares to be issued	<u>21,250</u>
f) Total consideration at par (21,250 x ₹ 10)	₹ 2,12,500

Cross Holding —

Computation of purchase consideration when both transferor and transferee companies are holding the shares of each other.

Example 5.

The following are the Balance Sheets of A Ltd. and B Ltd. as on 31st December 2015.

Liabilities	A Ltd. ₹	B Ltd. ₹	Assets	A Ltd. ₹	B Ltd. ₹
Share capital			Fixed Assets	7,00,000	2,50,000
Equity shares of ₹ 10 each	6,00,000	3,00,000	Investment:		
10% Preference shares of ₹ 10 each	2,00,000	1,00,000	6,000 shares of B Ltd.	80,000	-
Reserves and surplus	3,00,000	2,00,000	5,000 shares of A Ltd.	-	80,000
Secured loans:			Current Assets:		
12% Debentures	2,00,000	1,50,000	Stock	2,40,000	3,20,000
Current liabilities			Debtors	3,60,000	1,90,000
Sundry creditors	2,20,000	1,25,000	Bills receivable	60,000	20,000
Bills payable	30,000	25,000	Cash at bank	1,10,000	40,000
	15,50,000	9,00,000		15,50,000	9,00,000

Fixed assets of both the companies are to be revalued at 15% above book value. Stock in-trade and Debtors are taken over at 5% lesser than their book value. Both the companies are to pay 10% Equity dividend, Preference dividend having been already paid.

After the above transactions are given effect to, A Ltd. will absorb B Ltd. on the following terms.

- i. 8 Equity shares of ₹ 10 each will be issued by A Ltd. at par against 6 shares of B Ltd.



- ii. 10% Preference Shareholders of B Ltd. will be paid at 10% discount by issue of 10% Preference Shares of ₹ 100 each at par in A Ltd.
- iii. 12% Debenture holders of B Ltd. are to be paid at 8% premium by 12% Debentures in A Ltd. issued at a discount of 10%.
- iv. ₹ 30,000 is to be paid by A Ltd. to B Ltd. for Liquidation expenses. Sundry creditors of B Ltd. include ₹ 10,000 due to A Ltd.

Compute the Purchase Consideration.

Solution:

Part - I Purchase consideration payable by A Ltd.

A. Equity share holders:

No of equity shares of B Ltd.	30,000
Less: Held by A Ltd.	<u>6,000</u>
No. of equity shares held by outsiders	<u>24,000</u>
Exchange ratio	8:6
No. of equity shares to be issued by A Ltd. $(24,000 \times 8/6)$	32,000
Less: Already held by B Ltd. in A Ltd.	<u>(5,000)</u>
No. of equity shares to be issued now	<u>27,000</u>
Value of shares to be issued $27,000 \times 10 =$	₹ 2,70,000

B. Preference share holders:

Preference Share capital of B Ltd.	1,00,000
Payable at discount of 10% $[100,000 - (10\% \text{ of } 100,000)]$	90,000
10% Preference shares to be issued at par by A Ltd. to B Ltd.	₹ 90,000

C. Purchase consideration (A+B)

₹ 3,60,000

