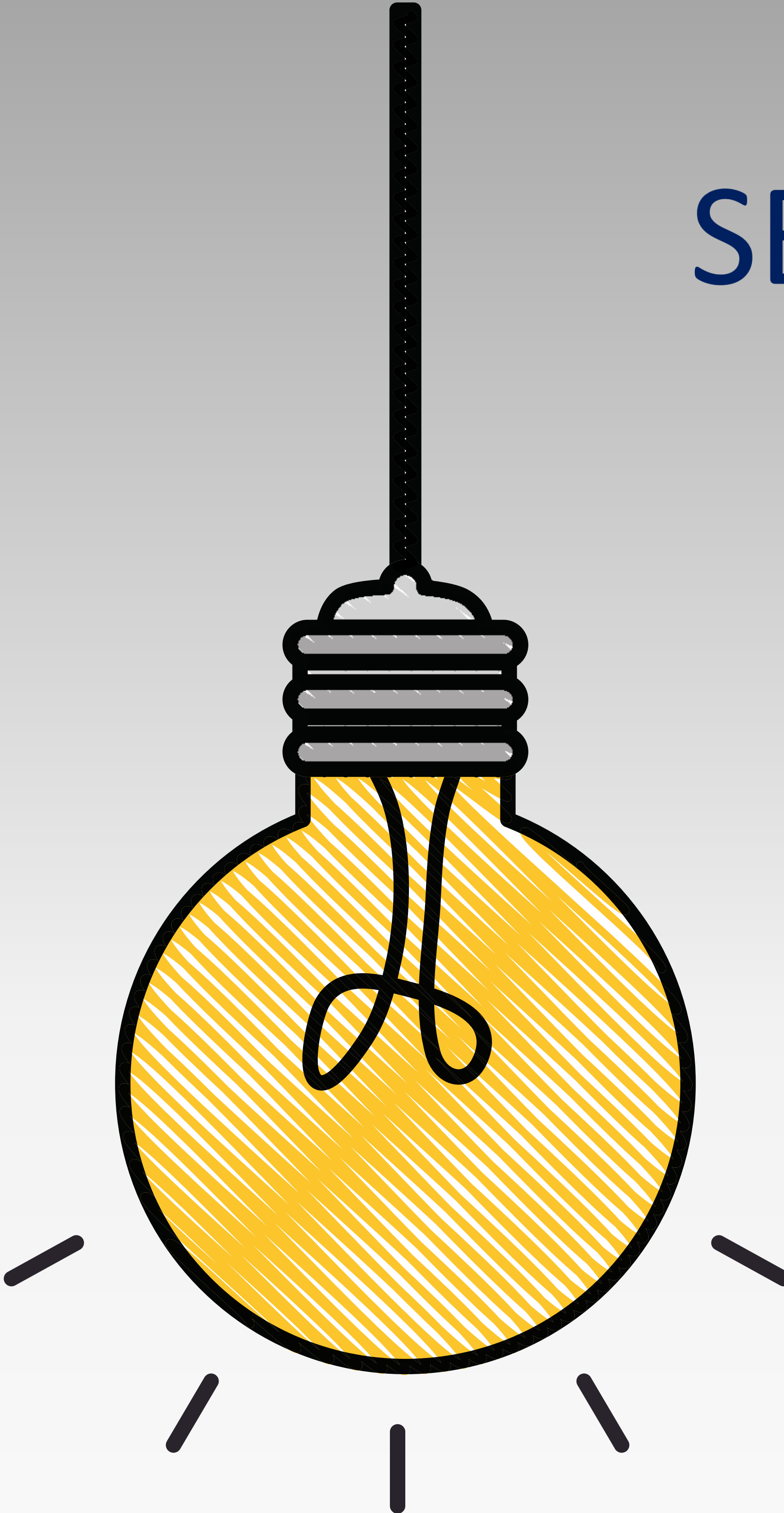


SBS Wiki

monthly e-Journal

Volume - 112 November - 2023 Pages 1-15

For Private Circulation Only

SBS AND COMPANY LLP

CHARTERED ACCOUNTANTS

SBS Wiki

monthly e-Journal

November 2023

Foreword

Dear Readers,

In this edition, we have come up with an article on the recently notified provision as to applicability of dematerialization of securities to private limited companies, other than a Small Company. Till now Private Limited Companies were outside the ambit of dematerialization, and if required they on a voluntary basis could get their shares dematerialized. Whereas with amendment to the Companies Prospectus and Allotment Rules, dematerialization of securities is made applilcable to a private limited companies, other than a Small Company. The provisions relating to the amendment, and the process involved and the Point of view for the amendment, forms part of the discussion in the Article.

The next article is on the determination of time limit for passing the assessment order when the case has been referred to transfer pricing officer. When two different sections i.e., section 153 and section 144C deals with the time limit for completion of assessment, there is a room for ambiguity. In this article, interplay between section 153 and section 144C has been discussed.

Lastly, we have also collated certain important judgments under Direct tax and provided our comments wherever necessary.

I hope that you will have good time reading this edition and please do share your feedback.

Thanking You,

Suresh Babu S

Founder & Chairman

Contents

Dematerialization of Securities by Private Companies 1

Interaction and interplay between the time limits under section 153 and section 144C 6

Summary of Income Tax Decisions 11

Corporate Laws

Dematerialization of Securities by Private Companies

Dematerialisation of Securities is now made applicable to Private Limited Companies. Though this decision seems to be a step forward for the safety of the stakeholders and to avoid instances of fraud, manipulated and falsified transfer of securities, ending-up in unnecessary litigations holdings, this is an attempt to have a concrete information as to the share related transactions of Private business houses. The decision may seem a bit harsh and like yet another compliance and expense being slapped-on. In this article, we look into the provisions relating to the Dematerialisation and the issues relating thereto.

-Contributed by CS D.V.K. Phanindra
phanindra@sbsandco.com

1. When we hear of "Dematerialisation of Securities", it is often associated with, as being applicable to Listed entities. However, vide the Amendment Rules[1], a new (Rule 9A), was inserted after the existing Rule-9, making the Dematerialisation of Securities applicable to every unlisted Public Company, and accordingly, the amended Rule mandated that:

   (a) Every unlisted public Company making an offer for issue of Securities or buy-back of securities or issue of bonus shares or rights shares shall ensure that before making such offer, the entire holding of its promoters, directors, Key Managerial Personnel has been dematerialised in accordance with the provisions of the Depositories Act, 1996; and

   (b) Every holder of securities who intends to transfer such securities on or after 02.10.2018, shall get their securities dematerialised before the transfer; or who subscribes to any securities of a unlisted public company on or after 02.10.2018, shall ensure that all his securities are held in dematerialised form before subscription; and

   (c) The Company shall obtain International Securities Identification Number (ISIN) from a Depository; and inform the same to all the existing Shareholders; and

   (d) The Company shall make timely payment of admission fees and also the Annual fees to be paid Depository, RTA and also maintain security deposit at all times, of not less than

[1] The Companies (Prospectus and Allotment of Securities) Third Amendment Rules, 2018; Dt:10.09.2018, effective from 02.10.2018.

two years, fees with the Depository and RTA, in such form in accordance with the agreement executed between the parties; and

(e) File Audit Report[2] in Form PAS-6, on a half yearly basis to the Registrar of Companies, with in days from the conclusion of each half year duly certified by PCS or a PCA., along with a prescribed fees; and

(f) The Company which has defaulted in the payment of the fees as mentioned above, shall not make offer of any securities or buyback its securities or issue any bonus or right shares till the payments to depositories or registrar to an issue and share transfer agent are made.

2. Vide Amendment Rules[3], exception was provided to the Dematerialisation of Securities of a Unlisted Public Company, which was:

(a) A Nidhi Company;
(b) A Government Company; or
(c) A Wholly Owned Subsidiary.

Accordingly, by virtue of proviso to Clause (b) of Section 2(71), a Private Limited Company, being a Subsidiary of Public Company, is also deemed to be a Public Company. Only a wholly owned subsidiary of a Public Company, was exempted from dematerialization of the Securities; so, where Private Limited Company not being a Wholly owned subsidiary of a Public Company, but just a subsidiary, is still required to Dematerialise its Securities, in terms of the Rule-9A.

3. The above was the position in law till 27.10.2023. Vide Amendment Rules[4], a new (Rule 9B), was inserted after the existing Rule-9A, making the Dematerialisation of Securities applicable to every Private Company other than a "**Small Company**", and accordingly the amended Rule mandated that:

(a) Every Private Company as on 31.03.2023, which is not a Small Company, as per the audited Financial Statements of 31.03.2023, shall dematerialise its securities within 18 months from the closure of the year i.e.., on or before **30.09.2024;** and

(b) Every Private Company making an offer for issue of Securities or buy-back of securities or issue of bonus shares or rights shares shall ensure that before making such offer, the entire holding of its promoters, directors, Key Managerial Personnel has been dematerialised in accordance with the provisions of the Depositories Act, 1996; and

[2] To be filed under Regulation 55A of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996.

[3] The Companies (Prospectus and Allotment of Securities) Amendment Rules, 2019; Dt:22.01.2019.

[4] The Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023; Dt:27.10.2023.

(c) Every holder of securities who intends to transfer such securities on or after 30.09.2024, shall get their securities dematerialised before the transfer; or who subscribes to any securities of a unlisted public company on or after 30.09.2024, shall ensure that all his securities are held in dematerialised form before subscription.

(d) The provisions of Sub-Rule (4) to (10) of Rule 9A, as applicable to an unlisted Public Company, to apply mutatis-mutandis to the Dematerialisation of Securities by a Private Limited Company, accordingly, obtaining of ISIN, the payment of fees to the Depository and RTA, and filing of Half-yearly return with ROC, in form PAS-6 and other compliances is also applicable to a Private Limited Company.

(e) The Amended Rules also provide that the Dematerialisation of Securities shall not apply in case of a Government Company. Accordingly, a Government Company, which by virtue of its Articles either being a Public Limited Company or a Private Limited, is not required to Dematerialise its shares under either Rule-9A or Rule-9B.

Small Company[5]: Pursuant to the provisions of Section 2(85) of the Companies Act, 2013, a "**Small Company**" means a Company other than a Public Company, whose paid-up share capital **does not exceed Rs.4 Crores** and whose turnover as per Profit and Loss account for the immediately preceding financial year **does not exceed Rs. 40 Crores.** **Accordingly, a Private Limited Company, being a Small Company as per the limits above, is not required to comply with the Dematerialisation.**

4. Having seen the provisions relating to the Dematerialisation, now let us see the process involved. Mainly Two (02) steps are involved, **(1)** Obtaining of ISIN; and **(2)** Dematerialisation of Securities.

Step-1: The Process of obtaining International Securities Identification Number (ISIN) Step by Step:

(a) Appointment of RTA by the Company and entering into the required agreement with the RTA.

(b) Submission of Application to the Depository (NSDL or CDSL, as the case may be), for obtaining ISIN. Normally, the following information/documents are required by the Depository (including but not limited to):

   i. Board Resolution for appointment of NSDL or CDSL, as the case may be, as the Depository;

   ii. Signing of the Tripartite Agreement between RTA, Company, and the

[5] As per the latest amended limits, notified vide the Companies (Specification of definition details) Amendment Rules, 2022; Dt: 15.09.2022

Depository on Non-Judicial stamp paper of appropriate value;

iii. Master Creation Form, as per the format, provided by the respective Depository;

iv. Certified copies of the MOA, AOA and Certificate of Registration;

v. Certified copies of the latest audited Financial Statements;

vi. Certified copies of the PAN / TAN;

vii. Such other documents, declarations and undertaking as may be required by the Depository and the requisite Fees;

(c) The documents duly verified, are to be uploaded to the Depository by RTA for creation of ISIN;

(d) Any additional information or documentation may be sought-for by the Depository in the process of ISIN, and after due verification, the depository will issue/allot ISIN to the Company.

(e) In the meanwhile, the Company has to request all the Shareholders to open Demat accounts, if they already do not have one.

(f) Post the receipt of the ISIN, the same is to be informed to the Shareholders, asking them to dematerialise their Physical shares.

Step-2: Dematerialisation of Securities:

(a) Every Shareholder has to submit a demat request form along with their physical share certificate to their Depository Participant (DP);

(b) The Depository Participant will generate a Demat Request Number and dispatch the Demat Request Form (DRF) along with the cancelled physical share certificate(s) to the company;

(c) The RTA will send the Demat Confirmation Report (DCR) to the Company;

(d) The Company will verify the documents and send the duly filled Demat Confirmation Report (DCR) to RTA;

(e) Upon receiving the Demand Confirmation Report, and verifying the same, the RTA will credit shares to respective shareholders' Demat accounts.

Having seen the position under the law and also the process of Dematerialisation in brief, let us try to see through the intention of the law makers, behind the said Rule of Dematerialisation of Securities both for Unlisted Public Companies and by Private Limited Companies (other than Small Companies). The Government has “hit two birds with one stone”, by which:

i. Creation of a secondary check mechanism, to corroborate the information filed by the Private Companies with the MCA Portal;

ii. Has nipped from the bud, any possibility of fraudulent, manipulated and falsified transfer of securities, which take place in the

physical mode;

iii. Created a platform for regularisation of Corporate Actions in Private Companies;

iv. Framed a mechanism through the depository for collection of stamp duties; at the time of allotment of Securities and also on transfer of securities.

As regards the statement that additional burden as to cost of appointing Depository, RTA and filing compliances is cast on the Company, are to be brushed away, and for Company with a capital of Rs.4 Crores and turnover of Rs.40 Crores, these costs should not be significant, and the same is for the betterment and bring transparency to the operations.

Income Tax - Transfer Pricing

Interaction and interplay between the time limits under section 153 and section 144C

Section 153 of the Income Tax Act deals with time limit for passing the order by the assessing officer under various scenarios. Further, section 144C being a separate code deals with transfer pricing cases and provides time limit for filing the objections, issue of directions and passing the final assessment order. When two different sections deals with the passing the final assessment order, it imperative to understand the interplay between the time limits specified under section 153 and section 144C. In this article, the interplay of section 153 and section 144C has been discussed with the aid of some judicial precedents.

-Contributed by CA Narendra

narendrar@sbsandco.com

Background:

<u>Time limit for completion of assessment/reassessment - Section 153:</u>

1. Section 153 of the IT Act provides time limits for completion of assessment, passing of consequential orders and completion of fresh assessment in the case of set aside cases. Section 153(1) of the Act deals with the time limit for completion of assessment. It states that no order of assessment shall be made under section 143 or section 144 after the expiry of 12 months[6] from the end of assessment.

2. Further, section 153(3) deals with the time limit for completing the assessment in case where the original assessment order has been set aside. It states that fresh assessment may be made at any time before the expiry of 9 months from the end of the financial year in which set aside order was received by the PCCIT/CCIT/PCIT/CIT. Though section 153 (3) contains the word 'may', the courts have held that such an order of fresh assessment shall be passed within the time limit specified under section 153(3).

3. However, in the case of any reference has been made under section 92CA (1) i.e., reference to the Transfer Pricing Officer for determination of

[6] In respect of assessment year 2022-23 and afterwards (same time limit for the AY 2019-20 as well).

arm's length price, the period of limitation specified under section 153(1) / (3) shall be extended by another 12 months. Which means that when a reference has been under section 92CA has been made, time limit for completion of assessment under section 153(1) is 24 months from the end of assessment year and time limit for completion of fresh assessment is 21 months from the end of financial year in which the set aside order is received.

Procedure under section 144C:

4. Section 144C has been inserted into the Income Tax Act with the objective of creating a separate appellate mechanism for timely and effective disposal of the specific cases (transfer pricing cases[7]). Provisions of section 144C are applicable in the following cases:

   - Assessee is an 'eligible assessee,'
   - AO shall pass an order with any variation which is prejudicial to the interest of the assessee.
   - Such an order shall be passed on or after 01.10.2009.

5. If all the above conditions are satisfied, AO in the first instance shall pass a draft assessment order before passing the final assessment order. Upon receipt of the draft assessment order, the eligible assessee may file objections before the DRP within the time frame provided under section 144C. Subsequently, the DRP, after following the procedure under section 144C, issue directions to the assessing officer within the time limits. Finally, after consideration of the DRP directions, the AO passes the final assessment order. Time limits for filing the objections, issuing the directions and passing the final assessment order has been provided below:

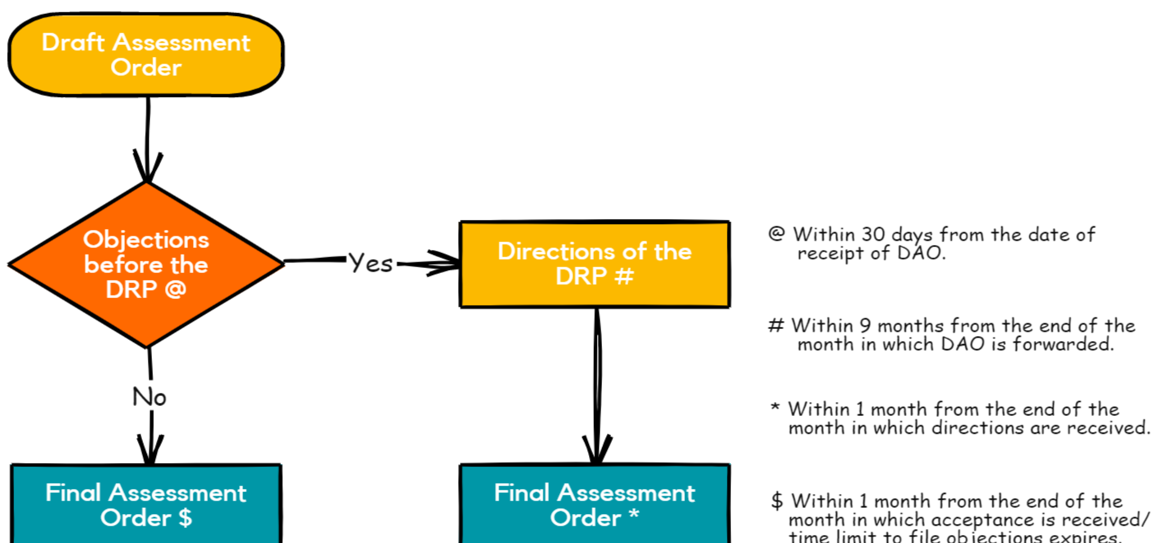


Chart depicting the timelines under section 144C.

[7] Presently, provisions of section 144C are applicable to non-residents and foreign companies as well.

Issue involved:

6. As per the provisions of section 153, assessment shall be completed within a period of 12 months from the end of assessment year (additional 12 months period in the case of transfer pricing cases). On the other hand, section 144C states that the final assessment order shall be passed within a period of one month from the end of the month in which directions of the DRP are received. The question arises is, if any variation is proposed as specified under section 144C, whether the final assessment order as stated in section 144C shall be passed within the overall time specified in section 153?

7. Which means that whether the procedure provided under section 144C shall be subsumed into the normal assessment time period and completed withing the time limit specified 153 of the Act?

8. Section 144C (12) states that DRP shall issue its directions within a period of 9 months from the end of the month in which the draft order is forwarded to the assessee. The question arises is what is the time limit for issue of directions when the case is remanded by the appellate authorities to the file of DRP?

9. Unlike CIT(A) where there is no hardbound time limit for passing the order, DRP shall issue the directions within the specific time limit. This is because, only after the receipt of directions of the DRP, the assessing officer proceeds to pass the final assessment order.

10. In this regard, while interpreting the provisions of section 144C with regard to computing the limits for the purpose of issue of directions of the DRP, the single member bench of the Hon'ble Madras High Court in the case of Roca Bathroom Products (P.) Ltd.[8] has held that though section 144C is a self-contained code, it does not mean that proceedings on remand to the DRP may be done at leisure sans the imposition of any time limit at all.

11. The revenue referred to section 144C (13) and has argued that final assessment order, notwithstanding anything contained in section 153, can be passed within a period of 1 month from the end of the month in which directions of the DRP are received by him. In this regard, the Hon'ble High Court has held that the time limit specified in section 144C (13) triggers only for the purpose of passing the final assessment order and not for the procedure envisaged in section 144C. Accordingly, the Hon'ble High Court has held that as the DRP has not issued the directions within the time limits, assessment order passed by the assessing officer is barred by limitation.

12. Aggrieved by the order of the single bench, the revenue has filed an appeal before the division bench of the Hon'ble Madras High Court. The division bench of the Hon'ble Madras High Court has provided much more detailed interpretation to the provisions of section 144C and section 153.

[8] [2021] 127 taxmann.com 332 (Madras)

After the detailed discussion, the High Court has held as follows:

- ***The provisions of Sections 144C and 153 are not mutually exclusive, but are rather mutually inclusive. The period of limitation prescribed under Section 153 (2A) or 153 (3) is applicable, when the matters are remanded back irrespective of whether it is to the Assessing Officer or TPO or the DRP, the duty is on the assessing officer to pass orders.***

- ***Even in case of remand, the TPO or the DRP have to follow the time limits as provided under the Act. The entire proceedings including the hearing and directions have to be issued by the DRP within 9 months as contemplated under section 144C(12) of the Income-tax Act,***

- Irrespective of whether the DRP concludes the proceedings and issues directions or not, within 9 months, the Assessing officer is to pass orders within the stipulated time,

- In matter involving transfer pricing, upon remand to DRP, the Assessing officer is to pass a denova draft order and the entire proceedings as in the original assessment, would have to be completed within 12 months, as the very purpose of extension is to ensure that orders are passed within the extended period, as otherwise the extension becomes meaningless.

- ***The outer time limit of 33 months[9] in case of reference to TPO under Section 153, would not refer to draft order, but only to final order and hence, the entire proceedings would have to be concluded within the time limits prescribed,***

- The non-obstante clause would not exclude the operation of Section 153 as a whole. It only implies that irrespective of availability of larger time to conclude the proceedings, final orders are to be passed within one month in line with the scheme of the Act,

- When no period of limitation is prescribed, orders are to be passed within a reasonable time, which in any case cannot be beyond 3 years. However, when the statute prescribes a particular period within which orders are to be passed, then such period, irrespective of whether it is short or long, shall be applicable.

(Emphasis supplied)

13. However, against the order of the divisional bench of the Hon'ble Madras High Court in the case of Roca Bathroom Products (P.) Ltd (supra), revenue has filed an SLP before the Hon'ble Supreme Court[10] and same is accepted and pending for hearing before the Hon'ble Supreme

[9] 21 months for completion of assessment (12 months as per the existing law) and additional 12 months in the case of TP reference.

[10] Roca Bathroom Products (P.) Ltd. [2023] 147 taxmann.com 224 (SC)

Court.

14. Recently, a similar view, as that of judgement given by the Hon'ble Madras High Court, has been given by the Hon'ble Bombay High Court in the case of Shelf Drilling Ron Tappmeyer Ltd.[11] wherein the High Court has held that the assessment has to be concluded within twelve months as provided in section 153(3) of the Act when there has been remand to the AO by the ITAT under section 254 of the Act. Within this twelve-month prescribed, the AO has to ensure that the entire procedure prescribed under section 144C is completed and pass a final assessment order.

15. The Bombay High Court has further held that the exclusion of applicability of section 153, in so far as non-obstante clause in sub-section (13) of section 144C is concerned, it is for limited purpose to ensure that dehors larger time available, an order based on the directions of the DRP has to be passed within 30 days from the end of the receipt of such directions. The section and sub-section have to be read as a whole with connected provisions to decipher the meaning and intentions.

16. On reading the judgments of the Hon'ble High Courts, it can be found that the entire procedure specified under section 144C is subsumed into section 153 and the entire process of assessment shall be completed within the time specified in section 153.

17. However, the Hon'ble Bombay High Court in the case of Lionbridge Technologies (P.) Ltd[12] has held that the AO has to pass the draft assessment order within the time limit specified under section 153. Which means that once the draft assessment order is passed within the time limit specified under section 153, then procedure prescribed under section 144C would trigger and time limit specified under section 144C (13) shall be followed to pass the final assessment order. The above view has been regularly followed by the revenue for passing the draft assessment order.

18. Surprisingly, the Hon'ble High Courts have held that entire proceedings including the procedure under section 144C have to be completed within the time specified under section 153. It is very interesting to wait for the order of the Hon'ble Supreme Court. This is because, provisions of section 144C, after the amendment by Finance Act,2020, are not only applicable to transfer pricing references but also applicable to non-residents and foreign companies. In those case, if there is no transfer pricing references, entire procedure may need to be completed within a period of 12 months[13] from the assessment year.

[11] [2023] 153 taxmann.com 162 (Bombay)

[12] [2018] 100 taxmann.com 413 (Bombay)

[13] As time limit to complete the assessment is 12 months from the end of assessment year from the AY 2022-23

Summary of Income Tax Decisions

Hon'ble Supreme Court in the case of Bharti Hexacom Limited[14] held that:- Payment of the variable license fee made to government periodically on revenue sharing basis is capital in nature by applying the original obligation test.

1. In a noteworthy legal case, the Hon'ble Supreme Court overturned the Delhi High Court's ruling, designating license fees paid periodically as a capital payment. The case involved a telecom operator bound by a license agreement with the government, initially structured under the Telecom Policy, 1994 with a lump-sum payment. Subsequently, the Telecom Policy, 1999 introduced a shift, stipulating periodic payments based on revenue sharing.

2. Due to the periodic nature of the license fees, the assessee treated them as revenue expenditure, claiming deductions under Section 37 of the Act. The revenue, however, argued that these payments should be categorized as capital under Section 35ABB, as they were linked to the original obligation of acquiring the right to operate the license. The contention emphasized that the mode of payment should not dictate the transaction's nature, the altered format post-migration did not alter the essence of the payment.

3. Various High Courts, including Bombay and Karnataka, had previously considered the payment as revenue following the Delhi High Court's ruling. The Delhi High Court interpreted payments under the prior policy as establishing the license and those under the new policy as operating and maintaining it. As these variable payments did not provide further benefit, they were not treated as capital payments.

4. The Apex court, on interpreting the provisions of section 35ABB of the Act, highlighted that the payment would be capital when it is primarily paid to acquire a right to operate telecom services. Further, the terms of the original agreement provides that even though the licensee obtains the right to establish the license from the lumpsum payment made under prior policy, the licensee loses the right to operate and maintain the same if he fails to pay the periodical payments, which depict that the periodical payments are clearly have nexus with the original obligation, i.e., payment of license fee as consideration for the right to

[14] [TS-605-SC-2023]

establish, maintain and operate telecommunication services as a composite whole. This is because in the absence of a right to establish, maintenance and operation of telecommunication services is not possible. Hence, the cumulative expenditure would have to be held to be capital in nature. This composite right cannot be bifurcated into parts solely on the basis of mode of the payments, which was artificially bifurcated by the Delhi High Court in its ruling.

5. Thus, it was held that the payment is a mandatory payment traceable to the foundational document i.e., the license agreement as modified post migration to the 1999 policy. Non-payment consequences included the removal of the licensee from the trade. Therefore, this intrinsic payment, essential to the license's existence and the trade itself, was characterized as capital. Accordingly, the appeal of the revenue was allowed.

Our Comments:

6. The categorization of an expense into revenue or capital depends on practical and business considerations rather than juristic classification or modes of payment. There may be instances of treating an expenditure as capital when it was paid on variable basis, similarly, a lumpsum payment can be categorized as a revenue item. What is to be observed is whether the payment is a part of process of profit earning to the assessee or is necessary to acquire a permanent character. The former shall be treated as revenue item and the latter shall be treated as capital item.

*****

Mumbai Tribunal in the case of Indium IV (Mauritius) Holdings Limited[15] - Allows Mauritian entity to carry forward of Long-Term Capital Loss along with DTAA exemption for Short Term Capital Gains.

1. The Mumbai Tribunal has granted permission for the carry forward of long-term capital loss (LTCL) under Section 74(1) of the Act, to a Mauritius-based investment entity. Simultaneously, the exemption of short-term capital gains (STCG) under the India-Mauritius Double Taxation Avoidance Agreement (DTAA) was acknowledged and claimed accordingly. The facts of the case were that, for AY 2017-18, the assessee reported a loss of Rs.14.35 Crores, carried forwarded under Section 74(1), and claimed STCG exemption of Rs.2.19 Crores under Article 13 of the India-Mauritius DTAA. The Revenue argued that since capital gains from Indian transactions by a Mauritius tax

15 [TS-591-ITAT-2023(Mum)]

resident are exempt, the carry forward of capital losses is irrelevant. In simple terms, revenue contended that assessee cannot take both the benefits under the Act and DTAA for two incomes under the same income head.

2. The ITAT emphasized the distinction between STCG/STCL and LTCG/LTCL as separate streams of income under the head of capital gains. It asserted that section 90(2) applies to each income stream, not the head of income. The ITAT relied on a Bangalore ITAT decision in IBM World Trade Corp[16], affirmed by the Karnataka High Court, stating that an Assessee can adopt the Act's provisions for one income source while applying DTAA provisions for another source. It also referred to the Dimension Data[17] case, citing the IBM ruling and an ITAT Special Bench decision in Montgomery Emerging Markets, emphasizing the independence of LTCG and STCG as distinct income sources despite being grouped under the same head. The ITAT, relying on the Montgomery Emerging Markets[18] ruling, maintained that different benefits can be claimed in the same year.

3. The ITAT analyzed the Act's provisions, clarifying that STCL can be carried forward or intra-head adjusted, while LTCL can only be carried forward or intra-head adjusted and cannot be set off against STCG. Noting the legislative distinction, the ITAT affirmed that short-term and long-term assets within the Capital Gains head results in separate sources of income. It concluded that the Assessee rightfully applied the beneficial provisions of the India-Mauritius DTAA for STCG and allowed the carry forward of LTCL under Section 74 of the Act.

Our Comments:

4. Section 90(2) of the Act allows the assessee to choose the provisions of Act or of DTAA whichever beneficial to the assessee. There is a debate on whether the assessee can claim benefits of DTAA in respect of certain streams of income and tax remaining income as per the provisions of the domestic law. In this case, the ITAT has moved one step further and clearly distinguished both the streams of the income and held the provisions can be applied independently.

*****

Gujarat High Court in the case of Jigar Jashwantlal Shah[19] - Allocation of right shares in proportion to own share holding and relatives share holding does not attract the provisions of Section 56(2)(vii)(c) of the Act.

---

16 [2012] 54 SOT 39 (Bangalore)
17 [2018] 99 taxmann.com 270 (Mumbai)
18 (2006) (100 ITD 217) (Mum Trib.) (SB)
19 [TS-598-HC-2023(GUJ)]

1. The facts of the case were, in the assessment year 2013-14, the Revenue observed that the assessee received a director's salary from a company that issued 200,000 right shares at a face value of Rs. 10 each to the assessee. The Revenue subjected the assessee to reassessment, contending that the fair market value of the shares was Rs. 255 per share, resulting in a taxable differential amount of Rs. 4.90 crore. The CIT(A) reduced the FMV to Rs. 205.55 per share, asserting that Section 56(2)(vii)(c) did not apply to the assessee for 103,000 right shares issued in proportion to existing shareholding. However, it applied to the remaining 97,000 shares issued to the assessee in proportion to renunciation of rights by his wife, father, and third parties.

2. The Income Tax Appellate Tribunal (ITAT) upheld the CIT(A) order for 103,000 shares, further stating that Section 56(2)(vii)(c) do not apply to the 82,200 shares arising from right renunciation by relatives, as 'relatives' are excluded from the purview of Section 56(2)(vii)(c). The ITAT supported the applicability of Section 56(2)(vii)(c) to only 14,800 shares since the renunciation of rights by a third party led to a disproportionate allocation of shares to the assessee. The ITAT also upheld the CIT(A)'s order, determining FMV based on the last Annual General Meeting (AGM) approved balance sheet, as the balance sheet was not prepared on the allotment date.

3. The Gujarat High Court determined that the issuance of new shares by a company as right shares constitutes the creation of property. Merely receiving such shares does not qualify as a transfer under Section 56(2)(vii)(c). The court emphasized the crucial distinction between the "creation" and "transfer" of shares, noting that the shares allotted to the assessee did not originate from any individual, a fundamental requirement for invoking Section 56(2)(vii)(c). The property must exist beforehand for the application of Section 56(2)(vii)(c), aligning with the legislative intent.

4. Referring to the Explanatory note to the Finance Bill, 2010 and Citing Supreme Court rulings in Khoday Distilleries[20] and Shri Gopal Jalan[21], the court defined "allotment" as the appropriation of a certain number of shares to a person out of previously unappropriated capital, emphasizing that shares do not exist until such allotment occurs.

5. Therefore, the High Court concurred with the ITAT's findings and held section 56(2) is applicable on 14,800 shares which were

[20] [2008] 307 ITR 312 (SC) (176 Taxmann 142)]

[21] 1964 (3) SCC 698

received from renunciation of right shares by a third party, because receiving shares on account of renunciation leads to disproportionate allocation of shares. Accordingly, High Court dismissed both Assessee's and Revenue's appeals for lacking a substantial question of law and upheld ITAT's decision.

Our Comments:

6. When the right shares were proportionately allocated, it results in creation of existing capital into new shares and hence, there is no transfer of any fresh value to the assessee's holding. However, when the rights are renounced in favour of the assessee by a third party, it results in income being earned by the assessee and provisions of section 56(2)(vii)(c) would be applicable.

SBS Connect

iOS & Android Apps

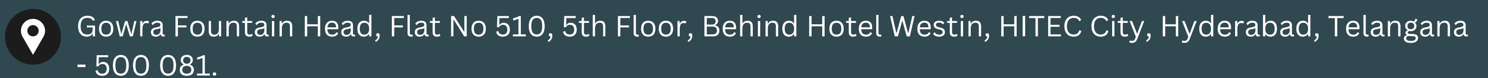
SBS Connect - This app is designed and hosted exclusively for the Clients of our organization. In a dynamic world of taxation and compliance laws, we find that the app is a better way to stay connected with the clients.

Download Now

Download on the App Store

GET IT ON Google Play

© All Rights Reserved with SBS and Company LLP



Gowra Fountain Head, Flat No 510, 5th Floor, Behind Hotel Westin, HITEC City, Hyderabad, Telangana - 500 081.

Disclaimer

The articles contained in SBS Wiki, are contributed by the respective resource persons and any opinion mentioned therein is his/their personal opInion. SBS Wiki is intended to be circulated among fellow professional and clients of the Firm, to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). The information provided is not for solicitation of any kind of work and the Firm does not intend to advertise its services or solicit work through SBS Wiki. The information is not intended to be relied upon as the sole basis for any decision. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser. SBS AND COMPANY LLP [Firm] does not endorse any of the content/opinion contained in any of the articles in SBS Wiki, and shall not be responsible for any loss whatsoever sustained by any person who relies on the same.