

Issues in Capital Gains

Seminar of Young Members
Empowerment Committee(YMEC)

CA N.C. Hegde
June 2016



Contents..

Applicable Provisions – An overview

Charge, Capital asset, Transfer – Basic provisions

Some important principles:

- *Capital gains vs. Business income*
- *Transfer of rights – whether short-term or long-term*
- *Development agreements*
- *Contingent deferred income*
- *FMV as on 1 April 1981 and legal ownership*
- *PMS fee not deductible u/s 48*
- *Distribution of assets of a partnership firm*
- *Apportionment of consideration received*
- *Liberal construction of beneficial Exemption provisions*

Buy-back of shares – Controversy and recent clarification

Depreciable assets

Slump sale

Substitution of stamp duty valuation

Fair Market Value as deemed consideration

India-Mauritius DTAA – Impact of the amending Protocol

Other recent development – Amendment to Rule 8D



Applicable Provisions: An Overview

Capital Gains

Applicable provisions – an overview (1/3)

Chapter IVE of the ITA which deals with income in the nature of Capital Gains broadly comprises:

General Provisions	Special Provisions
<p>Section 45 – Charge</p> <p>Section 47 – Transfers not taxable</p> <p>Section 47A – Exemption withdrawal</p> <p>Section 48 – Mode of computation</p> <p>Section 49 – Cost of acquisition for specified mode</p> <p>Section 51 – Advance money received</p> <p>Sections 54, 54B, 54D, 54E, 54EA, 54EB, 54EC, 54ED, 54EE, 54F, 54G, 54GA, 54GB, 54H } Exemption provisions i.e. capital gains not to be charged in certain cases</p> <p>Section 55 – Adjusted cost of improvement & acquisition</p>	<p>Section 46 – Distribution of assets by liquidating companies</p> <p>Section 46A – Buy-back of shares</p> <p>Sections 50, 50A – Depreciable assets</p> <p>Section 50B – Slump sale</p> <p>Section 50C – Substitution of stamp duty valuation</p> <p>Section 50D – Fair market value to be deemed consideration</p> <p>Section 55A – Reference to Valuation Officer</p>

Capital Gains

Applicable provisions – an overview (2/3)

Section 111A of the ITA:

Provides a concessional tax rate of 15% on short-term capital gains arising from the transfer of an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, provided that:

- The transaction is chargeable to securities transaction tax; or
- Has been undertaken on a recognized stock exchange located in any International Financial Services Centre and the consideration for which is paid/payable in foreign currency*

* *Inserted by the Finance Act, 2016 w.e.f. 1 April 2017*

Section 10(38) of the ITA:

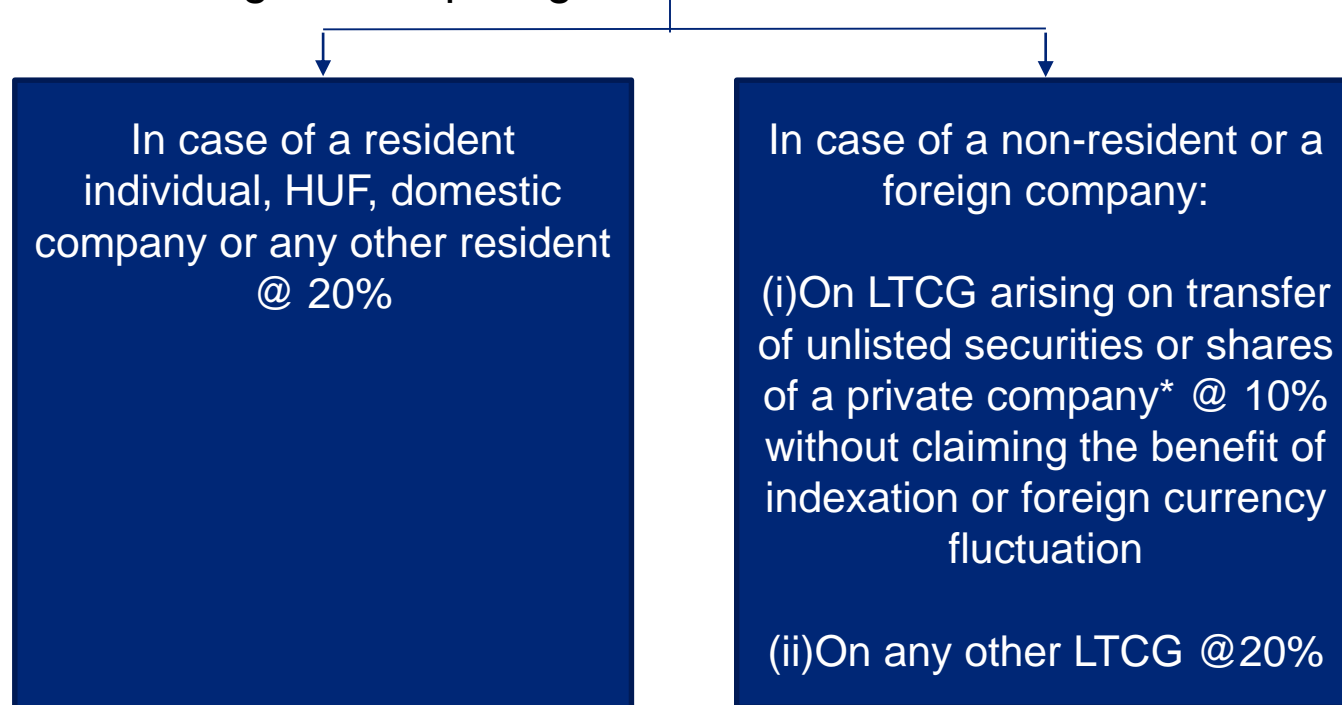
Long-term capital gains arising on the transactions covered under section 111A above, shall be exempt from tax

Capital Gains

Applicable provisions – an overview (3/3)

Section 112 of the ITA:

Tax on long-term capital gains shall be calculated as under:



* *Inserted by the Finance Act, 2016 w.e.f 1 April 2017*

Further, in case of LTCG arising on transfer of listed securities (other than units) or zero coupon bonds, an option to apply a tax rate of 10% is available, provided the indexation benefit is not claimed

Charge, Capital asset, Transfer:

Basic provisions

Some important principles

Charge

Section 45 of the ITA

C
A
P
I
T
A
L

G
A
I
N
S

Profit from the transfer of a capital asset

Profit from money or assets received under insurance due to damage to or destruction of any capital asset

Profit from the conversion of a capital asset into stock-in-trade in the year in which such stock is sold or transferred

Profit from the transfer of beneficial interest in any securities

Profit on transfer of a capital asset by a partner/member to a Firm/AOP/BOI and Profit on distribution of capital assets on the dissolution of a Firm/AOP/BOI

Compulsory acquisition of capital asset under law for which Court enhances compensation approved by Central Government /RBI

Difference between the repurchase price and the capital value of units under the Equity Linked Savings Scheme

Capital asset

Section 2(14) of the ITA

Includes	Excludes
Any property* held, whether or not connected with business * Includes rights in or in relation to an Indian company, including rights of management or control or any other rights	Specified Bonds issued/ notified by the Central Government
Any securities held by FII in terms of SEBI regulations	Stock-in-trade (other than securities held by FII) held for business
Agricultural land (not covered under exclusion)	Agricultural land meeting specified condition
Jewellery, Archaeological collections, Drawings, Paintings, Sculptures or Any work of art	Personal effects i.e. movable property held for personal use

Short-term and Long-term capital asset

Section 2(42A) and section 2(29A) of the ITA

Short-term capital asset	Holding period immediately preceding transfer Not more than
listed security, unit of the UTI, unit of an equity oriented fund, zero coupon bond	12 months
unlisted share of a company	24 months*
unlisted share of a company or a unit of a mutual fund specified u/s 10(23D), which was transferred during 1 April 2014 to 10 July 2014	12 months
any other capital asset	36 months

* *Reduced from 36 months by the Finance Act, 2016 w.e.f. 1 April 2017*

- In the situations specified in Explanation 1 to section 2(42A), the period of holding shall be determined as provided thereunder
- Long-term capital asset means a capital asset which is not a short-term capital asset

Short-term and Long-term capital gains

Section 2(42B) and section 2(29B) of the ITA

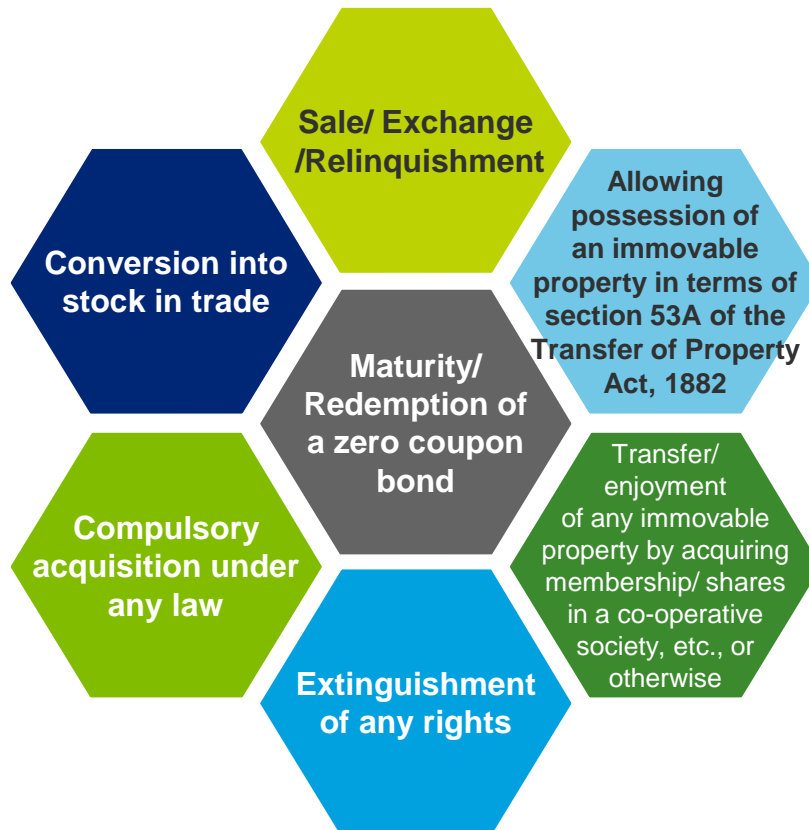
Short-term capital gain means capital gain arising from the transfer of a short-term capital asset

Long-term capital gain means capital gain arising from the transfer of a long-term capital asset

Transfer

Section 2(47) of the ITA

Transfer in relation to a capital asset, includes:



Capital gains vs. Business income

Recent steps to reduce & avoid litigation

Circular No. 6/2016 dated 29 February 2016 – Transfer of listed shares and securities

While recognizing that no universal principle in absolute terms can be laid down to decide the character of income from sale of shares and securities, the CBDT has guided as under:

- Where irrespective of the period of holding, the assessee itself opts to treat the shares/ securities as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income
- In respect of shares/securities held for more than 12 months immediately prior to its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall be accepted by the AO. However, once this stand is taken in a year, the assessee shall not be allowed to adopt a different/contrary stand in this regard in subsequent years
- All other transactions shall continue to be decided based on the earlier CBDT Circulars (Nos. 1827 dated 31 August 1989 and 4/2007 dated 15 June 2007)
- The above guidelines shall not apply where the genuineness of the transaction itself is questionable, such as bogus claim of Long Term Capital Gain/Short Term Capital Loss or any other sham transaction

Recent steps to reduce & avoid litigation

Notification No. 225/12/2016/ITA.II dated 2 May 2016 – Transfer of unlisted shares

The CBDT has directed as under:

- The income arising from transfer of unlisted shares would be considered under the head 'Capital Gains', irrespective of the period of holding
- The AO would however have the discretion to take an appropriate view in situations where:
 - the genuineness of the transaction itself is questionable; or
 - the transfer is related to an issue pertaining to lifting of corporate veil; or
 - the transfer is made along with the control and management of underlying business

Earlier CBDT Circular

Circular No. 4/2007 dated 15 June 2007 (1/2)

- Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence as to whether it has maintained any distinction between shares which are its stock-in-trade and those which are held as investment
- Whether transactions of sale, purchase of shares are trading transactions or in the nature of investment, is a mixed question of law and fact
- Where a company purchases, sells shares, it must be shown that they were held as stock-in-trade and that existence of the power to purchase, sell shares in the memorandum of association is not decisive of the nature of transaction
- The substantial nature of transactions, the manner of maintaining books of account, the magnitude of purchases and sales, the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions

Earlier CBDT Circular

Circular No. 4/2007 dated 15 June 2007 (2/2)

- Ordinarily the purchase, sale of shares with the motive of earning a profit, would result in the transaction being in the nature of trade/adventure in the nature of trade; but where the object of the investment in shares of a company is to derive income by way of dividend, etc., then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt
- It is possible for a taxpayer to have two portfolios, *i.e.* an investment portfolio comprising of securities which are to be treated as capital asset and a trading portfolio comprising of stock-in-trade which is to be treated as trading asset. Where an assessee has two portfolios, the assessee may have income under both heads, *i.e.*, capital gains as well as business income
- No single principle would be decisive and the total effect of all the principles should be considered to determine whether, in a given case, the shares are held by the assessee as investment or stock-in-trade

Radials International vs. ACIT (Delhi HC) (1/2)

Gains From PMS

Section 45 vs. section 28

Gains arising from Portfolio Management Scheme ('PMS') are to be treated as capital gains and not business income

Radials International vs. ACIT (Delhi HC) (2/2)

367 ITR 1 [2014]

Facts of the case:

- Assessee had invested shares through PMS
- Assessee sold the shares and declared the same as capital gains
- Tribunal held against the assessee, declared the income as business income

Held in favor of the assessee:

- The PMS agreement in this case was an agreement of agency and cannot be used to infer any intention to make profit
- 71% of the total shares were held for a period longer than 6 months and resulted in accrual of 81% of the gains and 18% of the total shares were held for less than 90 days
- High court held that, Tribunal erred in holding the transactions as business income and the same be treated as capital gains

Equity Intelligence India Pvt. Ltd. (Ker HC) (1/2)

Gains From PMS

Section 45 vs. section 28

Where assessee carried out activities of trading in shares in systematic manner and its average holding period of different shares ranged from merely 3 days to 3 months, income from sale of shares was to be taxed as business income

Equity Intelligence India Pvt. Ltd. (Ker HC) (2/2)

376 ITR 321 [2015]

Facts of the case:

- Assessee had invested shares through PMS
- Assessee sold the shares and declared the same as capital gains
- Tribunal held against the assessee, declared the income as business income

Held in favor of the revenue:

- CBDT issued circular No. 4/2007, dated 15-6-2007 indicating the tests to draw a distinction between the shares held as stock-in-trade and shares held as investment
- Short period of holding of shares revealed that the assessee had no intention to hold the shares for longer term as an investment

Raj Dulari Bhasin vs. CIT (Delhi HC) (1/3)

Sale of flats not an adventure in the nature of trade

Section 45 vs. section 28

Where in terms of construction agreement, assessee handed over piece of land to builder, for construction of multi storied building, since construction and sale of flats did not change character of asset and there was no material to show that assessee ever had any intention to exploit plot as a commercial venture, transaction could not be characterized as 'an adventure in nature of trade'

Raj Dulari Bhasin vs. CIT (Delhi HC) (2/3)

65 taxmann.com 136 [2016]

Facts of the case:

- Assessee was an owner of a house property – She entered into an agreement with 'C' a 'builder' for construction of additional area on the property in question
- Entire pre-determined cost of construction was to be incurred by the builder and the assessee was to be provided with a flat at a pre-determined cost. The assessee was also entitled to the share of the profit on the sale of the flats
- Assessee filed her return declaring profit from sale of flats as LTCG
- AO opined that since the assessee exploited the land owned by her to be used for construction of multi storey building, the activity undertaken was in the nature of trade and accordingly the profit on sale of flats was assessable as business profit
- CIT(A) and ITAT upheld the assessment order

Raj Dulari Bhasin vs. CIT (Delhi HC) (3/3)

65 taxmann.com 136 [2016]

Held in favour of the assessee:

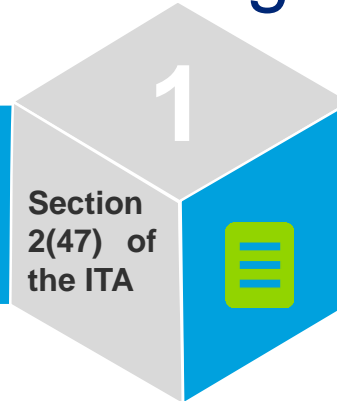
- Merely because the assessee approached the builder for constructing the flats on the portion apart from the already constructed portion, would not make the transaction an 'adventure in the nature of trade'
- As explained in *Shanti Banerjee v. Dy. CIT*, where the construction and sale of the flats did not change the character of the asset and there was no material to show that the assessee ever had the intention to exploit the plot as a commercial venture, the transaction could not be characterized as 'an adventure in the nature of trade' leading to the resultant receipt being business income in her hand
- The CIT(A) and ITAT have proceeded on an erroneous legal premise that the agreement entered into by the assessee with the builder and the consequent sale of the flats by the builder on behalf of the assessee was an adventure in the nature of trade

Development agreements:
Transfer u/s 2(47)(v), year of
taxability, etc.

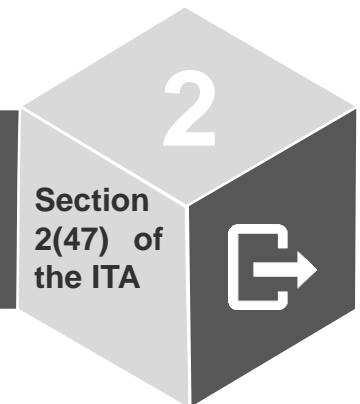
Charanjit Singh Atwal vs. ITO (P&H HC) (1/3)

No transfer when agreement is not registered

Irrevocable general power of attorney which leads to overall control of property in hands of Developer, if that means no exclusive possession by Developer would not constitute transfer



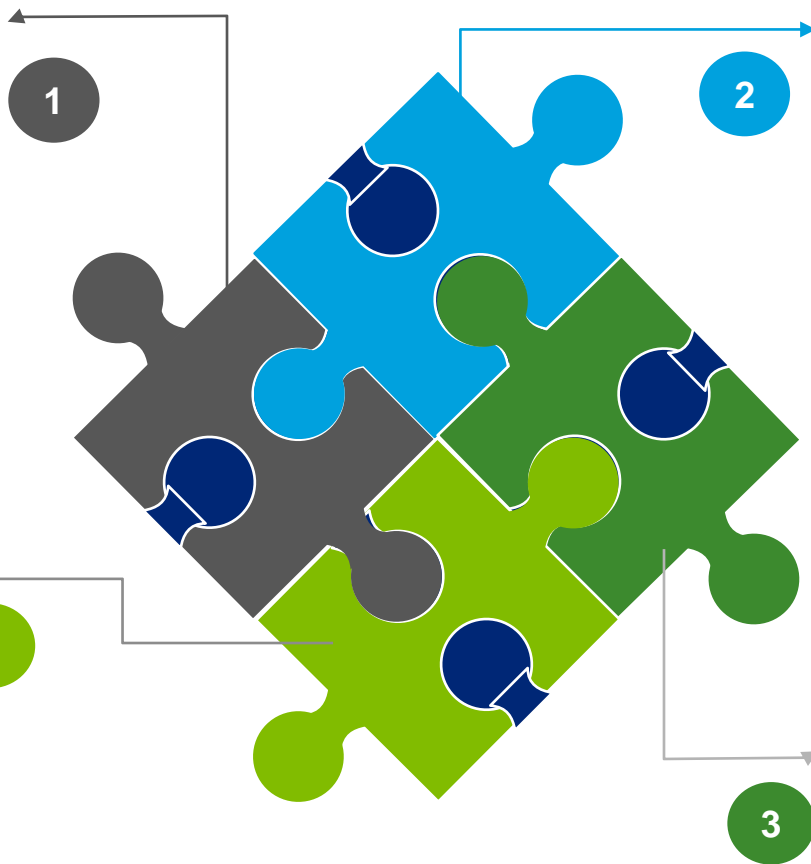
Requirement of registration of agreement of transfer of property as found in section 53A of Transfer of Property Act, 1882 ('TOPA'), will be read in sub-clause (v) of section 2(47). The provisions of section 53A of TOPA have been bodily transposed into section 2(47)(v)



Charanjit Singh Atwal vs. ITO (P&H HC) (2/3)

59 taxmann.com 359 [2015]

Assessee was a member of housing society which owned certain land



Housing society entered into a tripartite joint development agreement with THDC

Accordingly, society assigned all rights in land to THDC and also handed the physical vacant possession of property

By virtue of the said agreement, society would transfer its land in lieu of consideration (monetary and one flat each per member)

Charanjit Singh Atwal vs. ITO (P&H HC) (3/3)

59 taxmann.com 359 [2015]

Facts of the case:

- According to the AO, since the society had assigned all rights in land to THDC, and also handed over the physical vacant possession of the property, it was a case of transfer of capital asset in view of section 2(47) and therefore, assessee was liable to capital gain tax on his share of consideration
- CIT upheld the order of the AO
- ITAT also held in favour of the revenue

Held in favor of the assessee:

- Possession delivered, if at all, was as a licensee for development of property and not in the capacity of a transferee
- Further, in absence of registration of agreement, it would not fall under 53A of TOPA, and hence also not a case of transfer under section 2(47)(v)

CIT vs. Sadia Shaikh (Bombay HC)

(1/2)

No transfer when possession is not given

Section 2(47)(v)

Mere execution of a development agreement is not a transfer if possession as per section 53A of the TOPA is not given

CIT vs. Sadia Shaikh (Bombay HC)

(2/2)

Tax Appeal No. 11 and 12 of 2013 [2014]

Facts of the case:

- Development Agreement was executed in AY 2003-04 with the developer
- However, the possession was not handed over to the developer
- The entire control of the property was with the assessee and the agreement only permitted the development to be carried out by the developer
- Licence to construct the property was in the name of the assessee and occupancy certificate was also given to the assessee
- Agreement was modified subsequently in AY 2008-09

Held in favor of the assessee:

- Capital gains will be chargeable to tax as per the last agreement entered by the assessee
- Assessee will be liable to pay capital gains tax in AY 2008-09 as there was no transfer in AY 2003-04

No capital gains tax on contingent
deferred income

CIT vs. Mrs. Hemal Raju Shete (Bom HC) (1/2)

68 taxmann.com 319 [2016]

Facts of the case:

- Pursuant to an Agreement, the assessee transferred its holding in Unisol to RKHS during AY 2006-07. The Agreement provided for (i) a fixed amount of initial consideration to be received immediately on completion; and (ii) a deferred consideration to be received over a period of four years dependent upon profits made by Unisol in each of the years. The deferred consideration was to be worked out based on a formula and the total consideration was capped at a particular amount in the Agreement
- In its return for AY 2006-07, the assessee offered the initial consideration only to tax as capital gains
- The AO was of the view that the entire consideration (including the deferred consideration) is taxable in the year of transfer of shares itself
- The CIT(A) and ITAT held that there was no certainty of receiving the deferred consideration and notional income could not be taxed

CIT vs. Mrs. Hemal Raju Shete (Bom HC) (2/2)

68 taxmann.com 319 [2016]

Issue under consideration:

Whether the ITAT is justified in holding that the deferred consideration is not taxable in the year of transfer of capital asset?

Held in favor of the assessee:

- The amounts to be received as contingent consideration under the agreement could not be subjected to tax in the year in which transfer took place since the same has not accrued in that year
- The test of accrual is whether there is a right to receive the amount, though later, and whether such right is legally enforceable. In the present case, the assessee has not, pursuant to the agreement, obtained a right to receive the amount or any specified part thereof in that year

Legal ownership not necessary for adopting FMV as on 1 April 1981 in terms of section 55(2)(b)(i)

Stewarts & Lloyds of India Ltd. vs. CIT (Kol Trib.) (1/2)

67 taxmann.com 41 [2016]

Facts of the case:

- Assessee sold a property to 'R' in the year 2003, deducted the indexed cost of acquisition on basis of FMV of the land as on 1-4-1981 from the net sale consideration and computed the LTCL
- AO accepted the LTCL and completed the assessment
- In the proceedings u/s 263, CIT took a view that the assessee became the owner of the land only in April, 1994 when Tamil Nadu Small Scale Industries Development Corporation had sold the property to the assessee by a registered deed and the assessee was only an assignee of the property till then and used the land as tenant/user by virtue of the indenture of assignment dated 3-3-1971
- He therefore concluded that the order of the AO accepting indexed cost of acquisition as on 1-4-1981 was erroneous and prejudicial to the interest of the revenue and was liable to be revised in exercise of powers of revision under section 263

Stewarts & Lloyds of India Ltd. vs. CIT (Kol Trib.) (2/2)

67 taxmann.com 41 [2016]

Held in favor of the assessee:

- The expression 'where the capital asset became the property of the assessee before 1-4-1981' in the context of section 55(2)(b)(i) of the ITA, is rather ambiguous, in the sense that it does not speak of the date of vesting of legal title to the property
- Even the provisions of section 2(47)(v) & (vi) which define what is 'transfer' for the purpose of the ITA, consider possessory rights as akin to legal title
- It is therefore necessary to look into the policy and object of the provisions giving exemption from levy of tax on capital gain
- In the present case the assessee had paid the entire consideration for the property prior to 1-4-1981. Therefore, the claim that the property became property of the assessee before 1-4-1981 as it held the property from the year 1970 has to be accepted, keeping in mind the policy and object of the provisions giving the benefit of inflation by adopting FMV as on 1-4-1981 for properties acquired prior to that date

Expression 'where capital asset became property of assessee before 1-4-1981' as used in section 55(2)(b)(i) of ITA cannot be equated to legal ownership

PMS fee not deductible u/s 48

Capt Avinash Chander Batra vs. DCIT(Mum Trib.) 68 taxmann.com 366 [2016]

PMS fee not deductible u/s 48

- As per provisions of section 48 for computing capital gains, it is required to deduct from full value of consideration, the expenditure incurred wholly and exclusively in connection with such transfer and also the cost of acquisition of the capital asset and cost of any improvement thereto
- It is not relevant and material that the fee paid to portfolio managers is calculated based on purchases or sales of securities, or is a return based fee etc. - the fact of the matter is that these PMS charges are not paid towards cost of acquisition of the capital asset or for improvement of the capital asset, nor are these fees an expenditure incurred wholly and exclusively in connection with transfer of the capital asset and hence the same cannot be allowed as deduction under section 48 from the full value of consideration received or accruing to the assessee as a result of the transfer of the capital asset being shares

Distribution of assets of a partnership firm & succession

Transfer of asset on reconstitution of partnership firm

Section 45(4)

Assessee-firm is liable for capital gain tax arising out of transfer of its asset to retiring partner even in circumstances when partnership is reconstituted on retirement of a partner

60 taxmann.com 349 [2015]

Facts of the case:

- During the year, the assessee-firm was reconstituted on retirement of a partner
- Reconstituted partnership deed was drawn and the assessee-firm transferred an immovable asset being land to the retiring partner at value as mentioned in the partition deed entered between the firm and the outgoing partner
- AO invoked the provisions of section 45(4) and computed capital gains
- Assessee contended that only when there is a transfer of capital asset by way of distribution on the dissolution of a firm or otherwise, can the provisions of section 45(4) be invoked, and in its case there was no distribution as envisaged by section 45(4), since there was no cessation of business as the other partners continued the business as a going concern after the retirement of one of them

Held in favour of the revenue:

- The word 'otherwise' in section 45(4) takes into its sweep, not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner
- Hence, the assessee-firm shall be liable for capital gain tax arising out of transfer of its asset to retiring partner even in circumstances when partnership is reconstituted on retirement of a partner

Riyaz A Sheikh vs. CIT (Bom HC)

41 taxmann.com 455 [2014]

Issue:

Whether amount received by an erstwhile partner on his retirement from partnership firm arising on transfer of goodwill is liable to be taxed as LTCG?

Held in favor of the assessee:

Amounts received by a partner on his retirement from partnership firm are exempt from capital gains tax

Relying on the above decision of the Bom HC, the Chennai ITAT recently held in the case of [Sharadha Terry Products Ltd vs. ACIT \(68 taxmann.com 282\)\[2016\]](#) that amount received by the assessee on retirement as partner from firm towards credit balance standing in capital account and current account, and not for relinquishing or extinguishing its rights over any assets of firm, would not be chargeable under section 45(4) as capital gains

DCIT vs. R.L. Kalathia & Co. (Guj HC)

66 taxmann.com 249 [2016]

Facts of the case:

- The assessee, a partnership firm, was engaged in the business of construction work as builder/ developer/ contractor
- During relevant year, assessee-firm after revaluing its assets, credited partners capital account in the ratio of their shares in firm
- Thereupon, the assessee firm got converted into a limited company by the name of 'K' Ltd. and the shares to the extent of revaluation of assets were allotted to the partners in the firm as the directors of the limited company
- AO took a view that capital gain arising from transfer of assets of assessee-firm to company 'K' was liable to tax under section 45

Held in favour of the assessee:

- Sale of business of assessee-firm as a going concern to company for consideration of paid up share capital does not amount to transfer liable to tax as capital gains

Beneficial provisions of Exemption
are to be liberally construed

Sanjeev Lal vs. CIT (SC)

(1/2)

46 taxmann.com 300 [2014]

Facts of the case:

- Assessee received a residential house property from his grandfather by way of a will and entered into an agreement (December 2002) to sell the said house property
- To avail the benefit available under Section 54 of the ITA, the assessee purchased another residential house property in April 2003
- In the meanwhile, the validity of the will was questioned by another grandson of the testator
- The trial court, by an interim order, restrained the assessee from dealing with the house property
- The suit was dismissed as the person filing the suit expired and there was no representation on his behalf
- The assessee executed the sale deed in September 2004 and claimed the benefit in the return of income for AY 2005-06

Sanjeev Lal vs. CIT (SC)

(2/2)

46 taxmann.com 300 [2014]

- AO did not allow the benefit for the reason that the transfer of the original residential house and purchase of new residential house were not within the prescribed time span
- CIT(A) and ITAT upheld the view and the HC dismissed the assessee's appeal

Issue under consideration:

- Whether the benefit under section 54 of the ITA can be available if the residential house property could not be transferred due to the fact that the said transfer was restrained by an interim order of the High Court?

Held in favor of the assessee:

- Assessee was entitled to relief under section 54 of the ITA

Girish L. Ragha vs. CIT (Bom HC)

69 taxmann.com 95 [2016]

Facts of the case:

- Assessee sold a house property and entered into an agreement with a builder for purchasing flat for which he invested sale proceeds within prescribed period of 2 years
- However, the assessee got occupancy certificate after 4 years and such delay was beyond control

Held in favor of the assessee:

- Since assessee had invested money within stipulated period and delay in obtaining occupancy certificate was beyond control of the assessee, the assessee would be entitled for deduction under section 54 of the ITA

CIT vs. Kuldeep Singh (Delhi HC)

270 CTR 561 [2014]

Facts of the case:

- During the year, the assessee sold his house property. He invested the sale proceeds in purchase of a new flat & claimed deduction u/s 54 of the ITA
- The AO however took a view that legal ownership of the purchased flat never vested with the assessee within the stipulated period and hence rejected the assessee's claim for deduction

Held in favor of the assessee:

- Amount had been invested by the assessee for purchase of flat. However legal title was not passed to the assessee within the period of two years from sale of property
- The basic purpose of section 54 is to ensure that the assessee is not taxed on the capital gains, if he replaced his house with another house
- The word 'purchase' used in section 54(2) of the ITA, indicates that the said word is not restricted to registered sale deed or even possession and has a wider meaning
- The entire sale consideration or the capital gains is not to be brought to tax

ITO vs. Saroja Mokal (Mum Trib)

(1/2)

Section 54F of the ITA

Section 54F

Investment made for the purchase of a new residential house property within a year - even prior to the sale of capital asset raising LTCG, would be entitled to Section 54F exemption

ITO vs. Saroja Mekal (Mum Trib)

(2/2)

153 ITD 397 [2015]

Facts of the case:

- Assessee sold a property resulting in LTCG and claimed the said gains exempt by purchasing a residential flat i.e. Flat B
- AO did not accept the said claim under section 54F, because according to him assessee had more than one residential house property viz., Flat A and Flat B on the date of said transfer
- CIT(A) held that Flat B was the new asset and thus, it cannot be held that assessee had two residential house properties on the date of transfer

Held in favor of the assessee:

- The assessee was eligible to claim exemption

Rustom Homi Vakil vs. ACIT (Mum Trib) (1/3)

Expenditure on Improvement of House – Eligible for Exemption

Section 54

When tax-payer is allowed to purchase or construct residential house without any ceilings as to amount of investment under section 54, then merely because tax-payer has purchased a residential house and thereafter followed it with alternations and modifications carried out to make said house habitable, benefits cannot be denied by revenue under section 54

Rustom Homi Vakil vs. ACIT (Mum Trib) (2/3)

69 taxmann.com 42 [2016]

Facts:

- Assessee sold his tenancy right in a residential house property and invested the sale proceeds in purchase of another house property in a dilapidated condition
- Assessee incurred certain expenditure for improvement to make the house property habitable
- At the time of computing capital gain, assessee claimed deduction of amount towards improvement of purchased property under section 54 of the ITA
- Claim of the assessee towards cost of making the new house habitable was disallowed by the AO who held that 'cost of improvement' as provided under the ITA would be taken into account at time of calculating capital gains when the said property was sold.
- CIT(A) confirmed the order of the AO

Rustom Homi Vakil vs. ACIT (Mum Trib) (3/3)

69 taxmann.com 42 [2016]

Held in favour of the assessee:

- Assessee immediately after purchase of house property undertook extensive civil, plumbing, electrical & painting works to make it habitable. Same tantamounts to construction within the meaning of section 54. Hence, the assessee cannot be denied the benefit under section 54 merely on the ground that the assessee has purchased the new residential house
- Section 54 does not stipulate any condition that if the new residential house is purchased by the tax-payer, then benefit associated with construction of the said new residential house cannot be extended simultaneously. Therefore, benefit as available to construction of the new residential house can be extended to the assessee simultaneously
- The assessee is entitled for benefit under section 54 of expenditure incurred to make the said new residential house 'habitable' and fit for living for residential purposes

Gains on Buy-back of shares: Controversy and recent clarification

Gains on buy-back of shares

Section 46A of the Act (1/2)

- The Finance Act, 1999 introduced section 46A w.e.f. 1 April 2000 to provide that consideration received by a shareholder/holder of other specified securities from a company on purchase of its own shares/other specified securities, will be taxable as capital gains
- Sub-clause (iv) was simultaneously introduced in section 2(22) to provide that dividend would not include payment made by a company on purchase of its own shares in terms of section 77A of the Companies Act, 1956
- The levy of DDT under section 115-O w.e.f. 1 April 2003 and of distribution tax under section 115QA w.e.f. 1 June 2013 on income distributed on buy-back of unlisted shares, led to conflicting interpretation of section 46A and section 2(22)(iv), with the tax authorities seeking to characterize the consideration received for share buy-back prior to 1 June 2013 as dividend and subjecting the same to DDT

Gains on buy-back of shares

Section 46A of the Act (2/2)

- Further, section 115QA earlier did not cover buy-back of shares under section 391 of the Companies Act, 1956. However, the Finance Act, 2016 has provided that w.e.f. 1 June 2016 section 115QA shall cover buy-back of unlisted shares in terms of any provisions of the company law, and would not be restricted to section 77A of the Companies Act, 1956
- The position that thus emerges w.e.f. 1 June 2016 is:
 - Buy-back of unlisted shares will be liable for distribution tax under section 115QA of the Act to be paid by the company
 - Buy-back of listed shares will be taxable in the shareholder's hands as capital gains under section 46A of the ITA
- As regards the conflict of views on the buy-back during the period 1 April 2000 (insertion of section 46A) to 31 May 2013 (upto insertion of section 115QA), the CBDT has issued **Circular No.3/2016 dated 26 February 2016** clarifying that the consideration received would be taxed as capital gains in the recipient's hands and will not be treated as dividend in view of section 2(22)(iv) of the ITA

Gains on depreciable assets:

Basic provisions

Some important principles

Section 50(1) of the ITA

When some asset(s) are transferred and the WDV of the block turns NIL/negative

Where,

- FVC received or accruing as a result of the transfer of the asset
- together with the FVC received or accruing as a result of the transfer of any other capital asset falling within the block of the assets during the previous year,

exceeds the aggregate of the following amounts, namely :—

- expenditure incurred wholly and exclusively in connection with such transfer or transfers;
- the WDV of the block of assets at the beginning of the previous year; and
- the actual cost of any asset falling within the block of assets acquired during the previous year,

such excess shall be deemed to be the CG arising from the transfer of STCA

Section 50(2) of the ITA

When the block ceases to exist

Where,

- any block of assets **ceases to exist** - for the reason that all the assets in that block are transferred during the previous year,

the COA of the block of assets shall be

- the WDV of the block of assets at the beginning of the previous year,
- as increased by the actual cost of any asset falling within that block of assets, acquired during the previous year

and the income received or accruing as a result of such transfer or transfers shall be deemed to be the CG arising from the transfer of STCA

Important Principles

Section 50 of the ITA

Concept of Block of Asset

- Block of assets for the purpose of section 50 would mean assets of all units of assessee having same rate of depreciation **and not** assets of one division or unit having same rate of depreciation
- Mumbai Trib. in the case of ***Deepak N. Phalke v. ITO (153 ITD 249)[2015]***

Absence of Rate of Depreciation

- Land, not being a depreciable asset, cannot form part of block of assets; and in absence of rate of depreciation having been prescribed therefor, provisions of section 50 cannot be invoked in case of sale of land
- Delhi HC in the case of ***I.K. International (P.) Ltd. v. CIT (20 taxmann.com 197)[2012]***

Important Principles

Section 50 of the ITA

Bifurcation Possible?

- Bifurcation of land and building into separate part for the purpose of CG is permissible
- Section 50 does not convert LTCA into STCA
- Bombay HC in the case of ***Cadbury India Ltd. V. CIT (53 taxmann.com 227)[2015]*** based on the view taken in ***ACE Builders(281 ITR 210)[2005]***

No deeming fiction beyond section 48 and 49?

- Set off against long term capital gains
- ***CIT v Manali Investments Limited (39 Taxmann.com 4)(Bom HC)[2013]***
- Rate of tax to be applied
- ***Smita Conductors v DIT (152 ITD 417)(Mum Trib)[2015]***
- Availability of deduction u/s 54EC
- ***Travotel (India)(P) Ltd (69 taxmann.com 445)(Mum Trib)[2016]***

Gains on slump sale:

Basic provisions

Some important principles

Section 50B of the ITA

Gains on slump sale

- Profits or gains arising from the slump sale
- effected in the previous year
- shall be chargeable to income-tax as CG arising from the transfer of LTCA and shall be deemed to be the income of the previous year in which the transfer took place
- **Provided** that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than 36 months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of STCA
- Slump sales prior to section 50B coming into force governed by SC in ***PNB Finance vs. CIT (175 Taxman 242)[2008]***

Section 50B of the ITA

Definitions

- Section 2(42C) - Slump sale means
 - the transfer of one or more undertakings;
 - as a result of the sale;
 - for a lump sum consideration;
 - without values being assigned to the individual assets and liabilities in such sale
- Undertaking includes any part of an undertaking, or a unit or division of an undertaking or a business activity taken as a whole” but does not include "individual assets or liabilities or any combination thereof not constituting a business activity”
- Determination of the value of an asset or liability for the sole purpose of payment of stamp duty, registration fees or other similar taxes or fees shall not be regarded as assignment of values to individual assets or liabilities

Important Principles

Section 50B of the ITA

Does Sale
Include
Exchange?

- Slump sale is for lump sum consideration
- It is nothing but a transfer of a whole or a part business
- For slump sale, transfer has to be by way of sale
- Bombay HC in the case of ***Bharat Bijlee Limited vs. CIT (46 taxmann.com 257)[2014]***

If Separate
Deeds
Entered?

- Sale of trademarks, assets, technical know-how, copyrights and goodwill pertaining to business being carried out by assessee; if found to be part of one transaction - **would be a slump sale**
- Mumbai Trib. in the case of ***Mahindra Engineering & Chemical Products Ltd. V. ITO (20 taxmann.com 568)[2012]***

Important Principles

Section 50B of the ITA

Concept of Negative Networth

- Negative networth cannot be considered as NIL – it has to be added to the sale consideration
- Mumbai Trib. in the case of *DCIT v. Summit Securities Ltd. (135 ITD 99)[2012]*

Sale Consideration	100	100 (A)	100 (B)
Net Worth Calculation			
Depreciable Assets	20	20	20
Book Value – Other Assets	30	30	30
Total Assets	50	50	50
Book Value – Liabilities	30	80	80
Net Worth	20	(30)	-
Capital Gains	80	130	100

Substitution of stamp duty valuation:

Basic provisions

Some important principles

Section 50C of the ITA

Substitution of stamp duty valuation as full value of consideration

Provides that

- if the value stated in the instrument of transfer is less than the valuation adopted/ assessed/ assessable by the stamp duty authorities
- then valuation as adopted/ assessed/ assessable by the stamp duty authorities will be considered for the purpose of computation of CG arising on transfer of land or building or both

Purpose of introduction of section 50C is to curb the menace of black money component in real estate transactions and consequent evasion of tax –
K. R. Palanisamy v. UOI (306 ITR 61) (Mad)[2008]

Important Principles

Section 50C of the ITA

Variation

- If **difference between valuation for the purpose of stamp duty and the sale consideration actually received** by the assessee is **10% or less**, then the value actually received by the assessee should be adopted for the purpose of computing LTCG
- Kolkata Trib. in the case of ***M/s LGW Limited vs. I.T.O. (ITA No. 267/Kol/2013)*** keeping in view the decision of the *Hyd. Trib. in ACIT vs. Suvarna Rekha*

Applicability

- Consideration received on sale of a capital asset by stamp duty valuation is **applicable only in case of a seller**
- Gujarat HC in the case of ***CIT vs. Sarjan Realities Ltd. (20 taxman 112)[2012]***

Important Principles

Section 50C of the ITA

Applicability to Indirect Transfers

- Transfer of immovable property held through shares of the company, cannot be regarded as indirect transfer of immovable property
- Section 50C would not be applicable to such transactions
- Mumbai Trib. in the case of ***Irfan Abdul Kader Fazlani v. ACIT (56 SOT 12)[2013]***

Whether Leasehold Rights covered?

- Transfer of leasehold rights in land or building will not be covered under the ambit of section 50C of the ITA
- Pune Trib. in the case of ***Kancast Pvt. Ltd. vs ITO (68 SOT 110)[2015]***
- Mumbai Trib. in the case of ***Kishori Sharad Gaitonde v. ITO (ITA No. 1561/M/09)***
- Kolkata Trib. in the case of ***DCIT vs. Tejinder Singh (50 SOT 391)[2012]***

Important Principles

Section 50C of the ITA

Exemptions Under Section 54

- While computing exemption under section 54, actual sale consideration is to be taken into consideration and not the stamp duty valuation under section 50C of the ITA
- Jaipur Trib. in the case of ***Nand Lal Sharma vs. ITO (61 taxmann.com 271)[2015]***

Applicability to FSI, TDR, etc

- Section 50C applicable to transfer of development rights in property
- Mumbai Trib. in the case of ***Arif Akhatar Hussain and Jaffar Akhatar Hussain v. ITO (ITA No.541/Mum/2010, ITA No. 706/Mum/2010)***
- Section 50C does not apply to transfer of FSI & TDR
- Mumbai Trib. in the case of ***ITO vs. Prem Rattan Gupta (31 CCH 384)***

Fair market value to be deemed as full value of consideration

Section 50D of the ITA

Substitution of fair market value as full value of consideration

- Section 50D provides that
 - Where the consideration received or accruing as a result of the transfer of a capital asset by an assessee **is not ascertainable or cannot be determined**,
 - then, for the purpose of computing income chargeable to tax as CG, the FMV of the said asset on the date of transfer shall be deemed to be the FVC received or accruing as a result of such transfer
- The said provision was introduced by the Finance Act, 2012 w.e.f. AY 2013-14, for cases where the mechanism for calculating CG (machinery provision) failed as consideration received for assets transferred was unascertainable. (largely real estate transactions)

Abbreviations

AO – Assessing officer
CBDT – Central Board of Direct Taxes
CG – Capital gains
CIT(A) – Commissioner of income-tax (Appeals)
COA – Cost of Acquisition
DTAA – Double Taxation Avoidance Agreement
DVO – Departmental valuation officer
FII – Foreign Institutional Investor
FMV – Fair market value
FVC – Full value of consideration
HUF – Hindu undivided family
ITA – Income-tax Act, 1961
ITAT – Income-tax Appellate Tribunal
ITO – Income-tax officer
LTCL – Long term capital loss
LTCL – Long term capital loss
SDV – Stamp duty value
SEBI – Securities and Exchange Board of India
STCG – Short term capital gain
STCL – Short term capital loss
UTI – Unit Trust of India

Thank You

The information contained in this document is intended to provide general information on a particular subject or subjects and is not exhaustive treatment of such subject(s). The contents of this document is for knowledge sharing and for general information and the presenter by means of this document is not rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your finances or your business. Before making any decision or taking any action that may affect your finances or business, you should consult as may be necessary. The presenter shall not be responsible for any loss whatsoever sustained by any person who relies on this document.

