CNK & Associates LLP
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Quarterly Insights
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Domestic Tax

INDEX

Judicial Decisions

Sales tax subsidy received under incentive scheme was capital receipt

Commissioner of Income-tax vs. Indo Rama Textiles Ltd. (158 taxmann.com 685) (Delhi)
In favour of revenue

Facts

The assessee company had set up new industrial units in underdeveloped and developing areas in the state of Maharashtra. Under the eligibility certificates issued by the State Industrial and Investment Corporation of Maharashtra (SICOM), the assessee was entitled to avail sales tax subsidy over a certain period and the maximum entitlement of the subsidy was linked to the capital investment in setting up the industrial unit under the Package Scheme of Incentives of 1993 issued by the Govt. of Maharashtra. The assessee claimed the subsidy as a capital receipt and exempt from tax whereas the tax authorities sought to treat the subsidy received as revenue receipt, liable to tax.

Held

The High Court referred to the preamble of the incentive scheme as well as other clauses of the incentive scheme to determine that the objective of the scheme was to incentivize capital investment in the industrial units in specific areas. As the eligibility criteria to claim the benefits of the scheme was capital investment, the High Court held that the fact that the subsidy was a sales tax subsidy would not make it a revenue receipt and the nature of receipt would be a capital receipt, not taxable under the Act.

CNK Comments

The decision along with a plethora of earlier judgments uphold the settled view that while deciding the nature of the subsidy, the purpose and the object of the scheme is to be given importance and not the source of the grant of subsidy. While the law has been amended from 2015 to now bring all incentives received except those received towards the cost of the asset, to tax, the principles laid down may still be relevant to determine if the incentive is received towards the capital asset or is revenue in nature.

Benefit of foreign exchange fluctuation as well as cost inflation index- both cannot be claimed together

ICICI Bank Ltd. vs. Deputy Commissioner of Income-tax (159 taxmann.com 747) (Mumbai – Trib.)
In favour of revenue

Facts

The assessee had invested in subsidiaries formed outside India. The investments were made in foreign currency. During the year, the investments were transferred either by way of sale or capital reduction or buyback in the respective foreign jurisdiction. The capital loss on transfer of such investments was computed after converting the cost and sale consideration in foreign currency and applied the cost inflation index to the cost of acquisition in foreign currency, thereby availing the benefit of both forex fluctuation and cost inflation index. The tax authorities sought to argue that the cost inflation index is only in respect of the Indian economy and Indian cost and therefore, the cost of acquisition and the sales consideration ought to have been computed in INR and not foreign currency.

Held

The ITAT held that the method applied by the assessee claiming both the foreign exchange fluctuation benefit as well as application of cost inflation index is incorrect. The said benefit is not in accordance with the provisions of the Act. Therefore, the sales consideration as well as the cost of acquisition were to be independently computed in INR on the dates on which the respective sale or purchase took place and the cost of acquisition in INR would be eligible for indexation.

CNK Comments

In this case, the investment as well as the sale was in foreign currency (albeit the ITAT seems to have wrongly concluded that the investment was in INR as the funds were remitted to and *from India). Therefore, the rules relating to the computation of income expressed in foreign currency are clear that the capital gains are to be computed in the respective foreign currency and the resultant gains are to be converted in INR. Further, the language of section 48, which provides for indexation of the cost of acquisition does not seem to restrict application to only income expressed in INR. The ITAT seems to not have considered the language of the section and the rules while arriving at its conclusion.*

Date of fulfillment of conditions precedent and not the date of agreement would be considered as the date of transfer

Citicorp International Finance Corporation vs. Addl. DIT, Mumbai (159 taxmann.com 574) (Mumbai – Trib.)
In favour of Revenue

Facts

The assessee, a US tax resident, entered into a share purchase agreement **(SPA)** for sale of shares of an Indian company on 20/04/2006. However, the transfer of shares from the demat account was undertaken and the payment was received only on 30/06/2006, on fulfilment of certain conditions precedent **(CP)**, as mentioned in the SPA. The shares under consideration were originally held as Compulsorily Convertible Preference Shares (CCPS) which were converted into equity on 30/06/2005. The assessee treated the date of sale of the shares as 30/06/2006 i.e. the date of fulfillment of the CP and hence the gains arising from the transaction as long-term capital gains. The tax authorities on the other hand treated the date of the agreement, i.e. 20/04/2006 as the date of the transfer and consequentially, treated the gains arising from the sale to be short-term capital gains.

Held

The ITAT went through the SPA and the clauses related to CP and appreciated that the non-fulfillment of CP after a certain period gave the parties to the agreement a right to rescind the contract. Therefore, the ITAT held that the effective date of transfer in case of an agreement where certain conditions are to be fulfilled would be the date on which the said conditions are fulfilled and not the date of entering into the agreement. Accordingly, the shares were treated as long term capital assets and the gains were treated as long term capital gains.

CNK Comments

The ITAT has distinguished the above ruling with a situation where the agreement does not have any conditions to be fulfilled and in such a situation the date of the agreement would be considered as the date of transfer. This ruling follows earlier judgements of the ITAT and would be useful in determining the timing of the date of transfer in case of agreements where the parties to the agreement are required to satisfy certain CPs before closing.

Transfer of undertaking without transfer of immovable property not be to be treated as a slump sale even if right to use property is given

PCIT vs. Manipal Health Systems Ltd. (158 taxmann.com 285) (Karnataka)
In favour of Assessee

Facts

The assessee entered into a business transfer agreement and transferred its hospital business on a going concern basis for a lump sum consideration. While the business was transferred, the land and building, through which the hospital business was undertaken was not transferred. Instead, the agreement allowed the buyer the right to use the said immovable property under a separate lease deed. The assessee sought to argue that the transaction would not constitute as slump sale as the immovable property was not transferred whereas the tax authorities claimed that the transaction, being transfer of an undertaking for a lump sum consideration, constituted slump sale.

Held

The High Court relied on the definition of 'slump sale' under the Act which requires transfer of an undertaking and held that in a situation where the 'whole' undertaking was not transferred the transaction would not constitute slump sale. In the present case as the assessee had transferred only 'right to use immovable properties' and not the immovable property itself, the essential condition of transferring the 'whole' undertaking was not fulfilled and therefore, the transaction would not be characterized as a slump sale.

CNK Comments

Interestingly, the ITAT in this case, while reaching a similar conclusion that the transaction would not be characterized as a slump sale, had concluded on the basis that all the significant assets requiring the acquirer to undertake the business were not transferred. While concluding, the ITAT did not take into consideration the fact that while the immovable property was not transferred, the right to use the immovable property was given to the acquirer in the business transfer agreement itself along with a separate lease deed. The High Court, while arriving at the same conclusion, did not consider whether the asset not transferred was significant or not, but relied on the definition of 'slump sale' to conclude that the entire undertaking including all assets and liabilities ought to be transferred to constitute slump sale. The High Court did not take into consideration the definition of undertaking, which includes a part of the undertaking. The High Court also did not consider various other decisions of other High Courts wherein cases where all assets and liabilities were not transferred were held as slump sale so long as one was able to substantiate that the acquirer could undertake the business on the basis of the assets and liabilities transferred.

Purchase of new residential property in the name of spouse would be eligible for claim of deduction under section 54

Simran Bagga vs. ACIT (158 taxmann.com 265) (Delhi – Trib.)
In favour of Assessee

Facts

The assessee, a non-resident individual, had sold her property in India. She acquired a new residential property in India out of the sale proceeds. However, for the sake of convenience, the registration of the new property was completed in the name of assessee's spouse. The tax authorities disallowed the claim of the assessee under section 54 on the ground that the new residential property was registered in the name of the spouse of the assessee and not in the name of the assessee.

Held

As the assessee was able to demonstrate that the funds for the investment were provided by the assessee out of the sale of the old property, the ITAT held that the fact that the registration of the new property was done in the name of the spouse would not disentitle the assessee to claim the benefit of section 54 against the capital gains arising on the sale of the old property.

CNK Comments

The view of the ITAT, following various other judgements of the Tribunals and High Courts, is in line with the principle that the person paying for the property would be considered as the economic owner of the property. Further, the ITAT also held that for the purpose of exemption under sections such as sections 54 and 54F, one should take a liberal interpretation in favour of the exemption (although in this case, the ITAT stated that even if one takes a literal interpretation, the conclusion would not change).

Assessee eligible to claim long term capital loss in case of 'Nil' consideration received on cancellation of shares held by assessee under capital reduction scheme

Tata Sons Ltd. vs. CIT (158 taxmann.com 601) (Mumbai – Trib.)
In favour of Assessee

Facts

The assessee was an equity shareholder in Tata Teleservices Limited **(TTSL)**. Due to losses incurred by TTSL, the paid-up capital was reduced by way of reduction of the number of equity shares, through a scheme of arrangement and re-structuring. Under the scheme, while the shares held by the shareholders (including the assessee) were cancelled, no consideration was paid for such cancellation. The assessee claimed capital loss arising on account of capital reduction which led to cancellation of shares held by the assessee. The tax authorities sought to disallow the assessee's claim of loss on the ground that there was no consideration received and therefore, the computation mechanism of capital gains fails.

Held

Reduction of capital by way of cancellation of shares is extinguishment of right in shares and it amounts to transfer within meaning and scope of section 2(47). Further, the loss on reduction of shares is a capital loss and not a notional loss. The ITAT further distinguished between a scenario where consideration cannot be determined and where consideration is 'Zero' or 'Nil'. The former may result in the computation mechanism failing whereas one cannot take a similar view for the latter as there is a consideration. Therefore, where the assessee had not received any consideration on reduction of capital, the ITAT held that its investment resulted in capital loss which was to be allowed or set off against any other capital gain.

CNK Comments

This would be a welcome ruling, especially the distinction drawn by the ITAT where the consideration cannot be determined vis-à-vis the consideration is Nil, which would have an impact on various transactions and not just capital reduction. While the ruling is provided in the case of a capital reduction scheme, it may not necessarily apply in all types of capital reduction, and one may need to analyse if the shares have been cancelled in order to constitute a transfer under the Act. Some forms of capital reduction may not result in a transfer, as has been held by various courts such the Mumbai ITAT in the case of Bennett Coleman & Co. Ltd and has also been distinguished in this ruling.

Notification

No TDS for receipts by IFSC units availing deduction under section 80LA

[Notification No. 28/2024/F. No. 275/21/2023-IT(B)]

The Central Government has notified a list of payments made by any payer to certain specified International Financial Services Centres **(IFSC)** units from which no TDS is required.

Accordingly, certain types of payments to IFSC units such as Banking unit, Finance Company, IFSC Insurance Intermediary office, etc. would not be subject to TDS. The payer and payee are however required to fulfill certain conditions and furnish the details as prescribed, to make / receive the payments without TDS.

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