#KPMGjosh

# TAX FLASH NEWS

18 February 2019

## Property held by a Not Ordinarily Resident outside India not to be included for determining the eligibility for deduction under Section 54F of the Income-tax Act

### Background

For a taxpayer qualifying to be Not Ordinarily Resident (NOR) in India, income which accrues or arises outside India shall not be included in the computation of total income.

Separately, the exemption under Section 54F of the Act is available to individual taxpayers if the capital gains are utilised for investment in new residential property as per the due dates specified therein, and where the taxpayer holds only one residential house other than the new house as on date of transfer.

In this context, the Bangalore bench of the Income-tax Appellate Tribunal (the Tribunal) has recently *inter-alia* held[1] the following:

- For an individual qualifying to be a NOR in India, income from a house property held outside India cannot be assessable to tax under head 'income from house property', and accordingly the same cannot be regarded as house property held for the purpose of determining eligibility under Section 54F of the Act
- Expenses incurred on investment in a new residential house property, one year before the transfer of the old asset is entitled for benefit under Section 54F.

### Facts of the case

The taxpayer, an individual, had received equity shares of Nephrolife valued at INR28 lakh in 2011, as a gift from ROI Capital Advisors Pvt Ltd (ROI); ROI had acquired such shares in the year 2009

- In the same year, the taxpayer sold a portion of such shares amounting to INR17 lakh, and on such sale, the taxpayer computed Long Term Capital Gains (LTCG) by including the period[2] for which such shares were held by the previous owner (ROI in this case).
- The taxpayer invested money for the construction of a new residential house in India prior to the date of sale of such shares and the entire construction of the new residential house was completed within two years after the date of sale of shares.
- Separately, the taxpayer sold a painting in the U.K. and such sale incurred a long term capital loss.
- The taxpayer while filing India tax return for the Financial year (FY) 2011-12 had offered the following:
  - The aggregate fair market value of shares received as gift[3]
  - LTCG after considering deduction[4] on account of an investment in a residential house within two years after the date of transfer
  - Long term capital loss on sale of a painting in the U.K. was set off against the LTCG.
- During the scrutiny assessment, the Assessing officer (AO) had *inter-alia* held the following:

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[1] Dev Kumar Roy vs ITO (ITA No.2350/Bang/2018 dated 08 February 2019) – Taxsutra.com

[2] Explanation 1(b) of Section 2(42A) read with sub-section (1) of Section 49 of the Act

[3] Section 56(2)(vii)(c) of the Act

[4] Section 54F of the Act

- Gain on sale of shares as short term capital gains instead of LTCG, by disregarding the gift, as the AO noticed that the taxpayer held 99.9 per cent of the shares of ROI; the Articles of Association of ROI did not have any clause to make gifts; interest free loan given by the taxpayer to ROI was used for acquiring the shares of Nephrolife; the gift by ROI to the taxpayer was not voluntary; ROI being an artificial person cannot make gift out of love and affection

- Denied the deduction[4] claimed by the taxpayer from LTCG, as the capital gains was in the nature of short terms capital gains, and as the taxpayer owned more than one residential house (one in Bengaluru and one in the U.K.).

- Denied the claim for set-off of long term capital loss against the LTCG, as such loss did not accrue or arise in India.

- Aggrieved by the order passed by the AO, the taxpayer had filed an appeal with the Commissioner of Income-tax (Appeals) [CIT(A)], who upheld the order of the AO

- Further, aggrieved by the order of the CIT(A), the taxpayer had filed an appeal with the Tribunal (the Tribunal).

## Tax department's contentions

- The Revenue contented that the transfer of shares by ROI to the taxpayer is not a gift as the taxpayer with 99.9 per cent shareholding in ROI would have influenced ROI for transfer of shares; the transfer was not made to the taxpayer voluntarily by ROI; ROI being an artificial person cannot make gift out of love and affection. Consequently, since there was no gift, the period of holding by ROI cannot be considered for computing capital and hence the capital gains would qualify to be short term capital gains

- In addition, the Revenue also contended that the taxpayer has had held more than one residential house, one in Bengaluru and one in the U.K., other than the new residential house, and accordingly, deduction should not be allowed. Further, part of capital gains invested in acquiring the new residential house before the sale of shares would not qualify for deduction.

- With respect to set-off of long term capital loss on the sale of painting in the U.K. against the LTCG, the Revenue contended that the loss should be ignored as the same did not accrue or arise in India.

## Taxpayer's contentions

- The taxpayer contended that ROI's Memorandum of Association had a clause to alienate its properties in any manner; ROI had valid reasons to gift the shares to the taxpayer owing to some regulatory issues independently evaluated by ROI; the interest free loan given by the taxpayer to ROI was not squared off with the gift of shares. Accordingly, it was argued that since the shares were acquired by ROI in 2009 and gifted to the taxpayer, the period of holding by ROI was also to be considered for computing the capital gains

- The taxpayer had qualified to be a NOR in India during the relevant FY and accordingly the income from property held outside India in the U.K. cannot be held to be income accrued or arisen in India. Consequently, the said property cannot be considered as property owned by the taxpayer for the purpose of determining eligibility for the deduction[4].

- Further, part of capital gains invested in acquiring the new residential house before the sale of shares would also qualify for deduction[4], as the Act does not stipulate that the construction of new house must begin after the date of sale of shares.

- With respect to long term capital loss the taxpayer contended that the amount on sale of painting was received in India and hence the same was included in the taxable income in India.

## Tribunal's decision

- The Tribunal observed that the Articles of Association of ROI had a clause to alienate its properties in any manner; the loan given by taxpayer to ROI was not squared off with the gifts in its books of account. Further, the Tribunal placed reliance on certain judicial precedents[5] to hold that love and affection were not a necessary qualification for a gift, and held that the shares of Nephrolife were given as gifts to the taxpayer by ROI. Accordingly, the gains were to be regarded as LTCG by considering the period held by ROI

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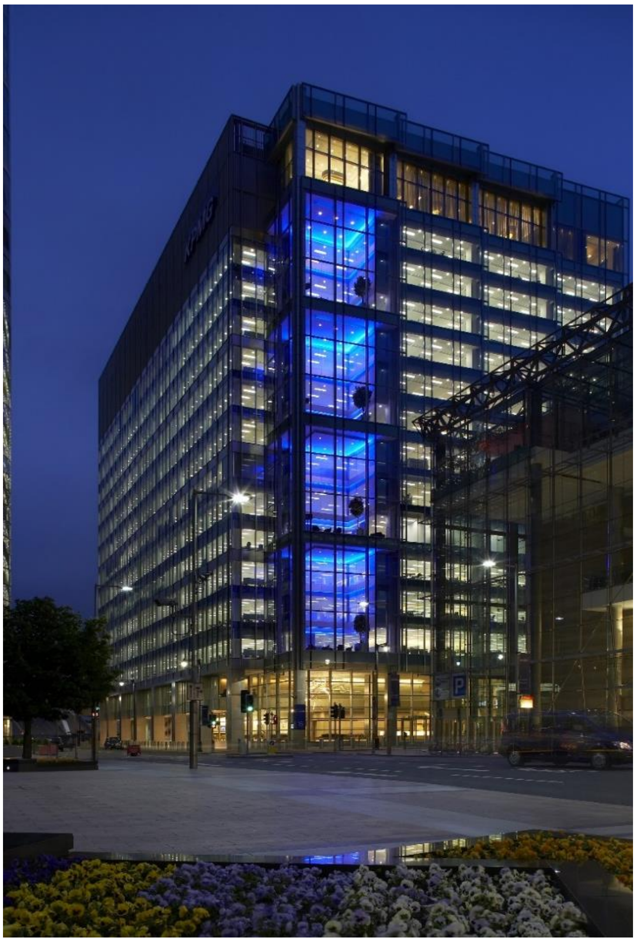
[5] Redington (India) Ltd., vs JCIT [2014] 49 taxmnn.com 146; CIT vs Nadatur Holdings and Investments Pvt. Ltd. [2012] 26 taxmann.com 224 (Kar)

- With respect to the deduction claimed by the taxpayer on the LTCG, the Tribunal inter-alia held the following:

    - Since the taxpayer had qualified to be a NOR in India, the income from property held outside India in the U.K. cannot be the taxed as income under the head, 'income from house property'. Consequently, the said house property cannot be included for the number of properties owned by the taxpayer

    - The taxpayer had incurred a part of the expenses for the construction of the new house one year before the sale of shares. Further, the construction of the new house was also completed within two years of the sale of shares. Accordingly, based on a judicial precedent[6], the Tribunal held that the taxpayer is entitled to deduction.

- With respect to long term capital loss, the Tribunal held that since the loss accrued or arose to the taxpayer (who had qualified to be NOR) outside India, the same should not be included in the total income.



## Our comments

This decision provides clarity on the conditions that need to be satisfied for grant of deduction under Section 54F of the Act. Further, the Tribunal provides that for a NOR, property located outside India should not to be included for determining the eligibility for deduction under Section 54F of the Act.

Considering this is a fact specific case and a ruling of the Tribunal, adoption of the same in other jurisdictions/set of facts could be evaluated on a case-to-case basis.

[6] CIT v. J.R.Subramanya Bhat, [1987]165 ITR 571 (Kar).

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