



Long term capital loss on off-market sale of listed shares is allowed to be set-off against long term capital gain on sale of unlisted shares

Background

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Asara Sales and Investments Private Limited¹ (the taxpayer) held that Long Term Capital Loss (LTCL) on sale of listed shares of a subsidiary company is allowed to be set-off against the Long Term Capital Gain (LTCG) on sale of unlisted shares. The taxpayer while selling the shares of a listed company opted to transact on off-market trade, since the said shares were of the group concern and the group did not want the shares to be picked up by any stranger, if traded on the stock exchange. Such business decision taken by the taxpayer cannot be doubted and called as colourable device to set-off profits arising on sale of unquoted shares.

Facts of the case

- The taxpayer is engaged in the activity of making investment in shares, mostly of group companies and derived income from capital gains, dividend income and some nominal interest.
- The Assessing Officer (AO) noted that the taxpayer has shown LTCG of INR4.53 crore on sale of shares of unlisted group companies and LTCL of INR8.39 crore on sale of shares of listed subsidiary company (GGDL).
- The taxpayer after set-off of LTCL against LTCG, computed the net LTCL at INR3.85 crore.
- Since GGDL is a listed company at the stock exchange and its sale and purchase was to be governed by the rules of stock exchange and liable for the Security Transaction Tax (STT), the taxpayer was asked to clarify how this loss on listed shares which fall under Section 10(38) of the Income-tax Act, 1961 (the Act) has been set off against the profit on sale of unlisted shares.
- In reply, the taxpayer furnished the details of sales of listed and unlisted securities and pointed out that with respect to LTCL on GGDL, no STT was paid as sale of GGDL was off market sale. The said transaction was outside the purview of Section 10(38) of the Act and therefore, forms part of computation of total income.
- However, AO observed that once the shares were otherwise eligible for exemption under Section 10(38) of the Act, then mere fact that the said shares were subsequently sold in off market, to a 100 per cent subsidiary, without paying any STT, would not take away or change the nature of shares, because the shares were listed at stock exchange and were otherwise eligible for levy of STT.
- The AO held that LTCL of INR8.39 crore on sale of shares of listed company would not be set off in the current year against the LTCG of sale of unlisted shares nor it would be allowed to carry forward to be set off in future. The LTCG of INR4.53 crore on sale of shares of unlisted group company would be chargeable to tax at 20 per cent.

¹Asara Sales and Investments Private Limited v. ITO (ITA No. 1345/Pun/2014) – Taxsutra.com

- The Commissioner of Income-tax (Appeal) [CIT(A)] upheld the order of the AO and also treated the transaction to be a colourable device where the transaction was made on the same day in respect of listed shares and sale of shares of unlisted group companies.

Tribunal's decision

- The transactions could be carried out through two different avenues i.e. by way of sale through the stock market or by way of sale through off-market transactions. Both the transactions are recognised transactions and any person is at liberty to undertake any of the transactions. In case the quoted shares of any company are sold through stock exchange, then the next step is that STT would become liable to be paid on such transactions. However, in case the shares are sold between two parties in off-market transaction, then there is no question of charging of STT.
- Once no STT is charged, the provisions of Section 10(38) of the Act would not be attracted.
- The taxpayer had not sold listed shares through stock exchange and had not paid any STT and consequently, the provisions of Section 10(38) of the Act are not applicable.
- The taxpayer had purchased the said shares through stock exchange and had paid STT. However, at the time of sale of said equity shares, the taxpayer took a decision not to trade it through stock exchange, in order to prevent any stranger from picking up the equity of group-company. The decision was taken in order to safeguard the acquisition of said shares by any stranger to the group concern.
- The group company to whom shares were sold was not 100 per cent subsidiary of the taxpayer, but the taxpayer was holding to the extent of 24 per cent shares in the said concern. The taxpayer pointed out that it was minority shareholder in said group company and even the board of directors of the taxpayer as well as of group-company were independent and there was no control/influence or interference in each other's activities.
- The decision was taken by the taxpayer to settle its dues i.e. repaying the loan raised from said group company by adjusting it against the value of quoted shares held by the taxpayer in GGD, and in this way retained the shareholding within family and not involved strangers by selling the said shares through stock exchange. It was a business decision taken by the shareholders of the taxpayer and no fault could be found with the said decision.

- There is no merit in the order of AO in holding that the transaction was a colourable device.
- The website of NSDL recognises the market trades and off-market trades. The module is provided on the NSDL platform under which any person while disposing of its security is given the option of trading the same in on market transaction and off-market transaction. So the existence and acceptance of off-market trades cannot be doubted.
- Further, the taxpayer sold the shares on the market price prevailing on the date of sale and no fault can be found with such transactions undertaken by the taxpayer. In case as against the market value, the other concern had purchased the shares at a higher value, then it would be questionable, but it is not so. There is no merit in the orders of authorities below in holding that the loss claimed by selling the shares of GGD below the book value should be ignored while setting it off against the other income, if any, in current year or for carry forward and set off in subsequent years.
- Accordingly, the Tribunal reversed the orders of AO and CIT(A).

Our comments

The question of substance over form has been a matter of debate before the courts. The Supreme Court in the case of McDowell & Co.² observed that tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid payment of tax by resorting to dubious method.

The Supreme Court in case of Vodafone International Holdings BV³ while reconciling the decisions of McDowell's and Azadi Bachao Andolan⁴ observed that that the ratio of McDowell's may need to be restricted to the cases of tax evasion which are through the uses of colorable devices and by resorting to dubious methods and subterfuges. It cannot be said that all tax planning is illegal/illegitimate/impermissible.

² McDowell & Co v. CIT [1985] 154 ITR 148 (SC)

³ Vodafone International Holdings BV v. UOI [2012] 341 ITR 1 (SC)

⁴ UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

In the instant case, the Pune Tribunal on the basis of facts of the case observed that the taxpayer has taken business decision of transfer of shares to a group company to repay its loan. It was not having control over such group company. Further the taxpayer had chosen the route of off-market transaction to avoid transferring its shares to strangers. Accordingly, the Tribunal rejected the tax department's plea that the transaction was a colourable device to avoid taxes.

The General Anti-Avoidance Rules (GAAR) provisions under the Act will come into effect from 1 April 2017 i.e. Assessment Year 2018-19. Under these provisions, it would be interesting to see whether AO can treat such transactions as 'impermissible avoidance arrangement' and whether it could be treated as entered into with the main purpose to obtain tax benefit.



Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2017 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.