



Sale of shares of the subsidiary to the second step down subsidiary is exempt under the provisions of Section 47(iv) of the Income-tax Act

Background

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Emami Infrastructure Limited¹ (the taxpayer) held that the sale of shares of the subsidiary to the second step down 100 per cent subsidiary of the taxpayer is not regarded as a transfer in view of the provisions under Section 47(iv)² of the Income-tax Act, 1961 (the Act). The Tribunal relied on the decision of the Bombay High Court in the case of Petrosil Oil Co. Ltd³ where it has been held that a sub-subsi-diary would be a subsidiary under the Act if the whole of its share capital has been held by the parent company or its nominees throughout the previous year. The meaning given to the term 'subsidiary company' under the Companies Act, 1956 can be imported into the Act.

Facts of the case

- During the year under consideration, the taxpayer sold 2,86,329 shares of Zandu Realty Ltd (a 100 per cent subsidiary) to its related entity, i.e., Emami Rainbow Niketan Pvt Ltd which is its 100 per cent step down subsidiary. Emami Realty Ltd is a 100 per cent subsidiary of the taxpayer. Emami Rainbow Niketan Pvt. Ltd is in turn a 100 per cent subsidiary of Emami Realty Ltd.
- The shares were sold in accordance with the valuation report of approved valuer duly approved by the Board of Directors (BoD).

- The taxpayer claimed Long Term Capital Loss (LTCL) on the sale of shares on which Securities Transaction Tax (STT) has not been paid. The taxpayer considered the Fair Market Value (FMV) of shares of INR2100/- per share as determined by an approved valuer as full value of consideration.
- The Assessing Officer (AO) has taken the cost of acquisition of Zandu shares at an average price of INR2975 share instead of the actual date wise purchase cost. The AO observed that there is a huge price variance between the quoted price in NSE and the off-market selling price shown by the taxpayer and held that when the shares are traded in its stock exchange the best way to determine the selling price of a share is the price quoted in the stock-exchange. Accordingly, Long Term Capital Gain is determined at INR290.58 million as against the claim of loss of INR 250.52 million shown by the taxpayer in the return of income.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Issues before the Tribunal

- Is the transaction regarded as a transfer within the provisions of Section 47(iv) of the Act?
- Whether or not the computation of capital gains as made by the lower authorities are correct and whether the AO can substitute the sale consideration of the shares sold with the FMV as determined by the taxpayer?

¹ Emami Infrastructure Limited v. ITO (ITA No. 880/Kol/2014) – Taxsutra.com

² The provisions of the Act states that the transaction cannot be regarded as transfer in the case of any transfer of a capital asset by a company to its subsidiary company where the parent company or its nominees hold the whole of the share capital of the subsidiary company, and the subsidiary company is an Indian company.

³ Petrosil Oil Co. Ltd v. CIT [2011] 236 ITR 220 (Bom)

Tribunal's decision

- Section 47 of the Act provides a certain category of transactions, which are not regarded as transfer for the purpose of Section 45 of the Act. In the present case, Emami Realty Ltd is a 100 per cent subsidiary of the taxpayer. Emami Rainbow Niketan Pvt. Ltd is, in turn, a 100 per cent subsidiary of Emami Realty Ltd. In other words, this is a second step down 100 per cent subsidiary of the taxpayer. The issue is whether the provisions of Section 47(iv)(a)(b) is applicable to a second step down subsidiary. However, there are divergent views on this issue.
- The Tribunal referred the decision of the Bombay High Court in the case of Petrosil Oil Co.Ltd wherein it has been held that:
 - The Act does not define 'subsidiary company'. There would be a dichotomy if the taxpayer were to be a subsidiary company of the U.S. company for the purposes of the Companies Act, but were deemed not to be a subsidiary of the U.S. company for the purposes of the Act.
 - The meaning given to the term 'subsidiary company' under the Companies Act must be imported into the Act. Thus, a sub-subsidiary would be a subsidiary under the Act if the whole of its share capital has been held by the parent company or its nominees throughout the previous year.
 - If that meaning is incorporated then it is very clear that the taxpayer is a subsidiary within the meaning of the Act.
 - The U.S. company is a company in which the public are substantially interested and falls within the definition provided under the Act, i.e., 100 per cent. The taxpayer fulfills the condition of the definition provided under the Act inasmuch as throughout the previous year it held 100 per cent shares.
 - Throughout the previous year, 100 per cent of the share capital of the U.K. Company was held by the U.S. Company. The U.K. Company is thus a nominee of the U.S. Company. The taxpayer would thus be a subsidiary within the meaning of the Act.
- Applying the above decision of the Bombay High Court, the Tribunal in the present has held that the transaction cannot be regarded as transfer in view of provisions of Section 47(iv) of the Act, as it is a transfer of capital asset by a company to its subsidiary company and as a second step down 100 per cent subsidiary company is also as subsidiary of the taxpayer under the Companies' Act 1956 as the term 'subsidiary company' has not been defined under the Act.
- The Gujarat High Court in the case of Kalindi Investments Pvt. Ltd⁴ held that the 'words' any transfer of a capital asset by a company to its subsidiary company would according to the ordinary grammatical construction, contemplate only the immediate subsidiary company of the holding company as the holding company holds the share capital only of its immediate subsidiary company. The wider definition of a holding company with an emphasis on 'control' as the guiding factor is not adopted in clauses (iv) and (v) of Section 47 of the Act. It is specifically provided that the parent company or its nominees must hold the whole of the share capital of the company.
- If the above proposition of law laid down by the Gujarat High Court is applied to the facts of the present case, then the Tribunal had to come to the conclusion that the transaction in question does not fall within the ambit of provisions of section 47(iv) of the Act.
- After going through the two decisions as aforesaid, the Tribunal prefer to follow the decision of the Bombay High Court in the case of Petrosil Oil Co. Ltd and held that a second step down 100 per cent subsidiary is also covered within the provision of Section 47(iv) of the Act, as this is the letter and spirit of the enactment.
- Hence, respectfully following the decision of the Bombay High Court, it has been held that the transaction of sale of shares of Zandu Realty by the taxpayer to Emami Rainbow Niketan Ltd is not regarded as a transfer within the provisions of Section 47(iv) of the Act. Hence, the question of computing either capital loss or capital gain does not arise. Thus, the taxpayer is not entitled to carry forward the capital loss of INR25 crores as claimed.

Our comments

The issue with respect to exemption under Section 47(iv) of the Act to the transfer of capital assets to step down subsidiary has been a matter of debate before the courts.

⁴ Kalindi Investments Pvt. Ltd v. CIT [2002] 256 ITR 713 (Guj)

The Gujarat High Court in the case of Kalindi Investments Pvt. Ltd held that the words 'any transfer of a capital asset by a company to its subsidiary company' would as per the ordinary grammatical construction indicate only the immediate subsidiary company of the holding company as the holding company holds the share capital of only its immediate subsidiary company. For the purposes of Section 47(iv) and (v), the Act has carved out a limited number of holdings and subsidiary companies. The wider definition of 'a holding company' with emphasis on 'control' as the guiding factor is not adopted in clauses (iv) and (v) of Section 47 of the Act.

In the present case, the Kolkata Tribunal did not follow the decision of the Gujarat High Court in the case of Kalindi Investments Pvt Ltd. However, the Tribunal followed the decision of the Bombay High Court in the case of Petrosil Oil Co. Ltd and held that the transfer of shares of the subsidiary to the second step down 100 per cent subsidiary of the taxpayer is not a transfer in view of provisions of Section 47(iv) of the Act.



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