

Reduction in share capital amounts to ‘transfer’ and therefore capital losses are allowed to be set-off

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Jupiter Capital Pvt Ltd¹ (the taxpayer) dealt with the issue whether a reduction in share capital amounts to transfer and the capital loss on the same is allowed for set-off against capital gains. The Tribunal held that reduction in the share capital of the company amounts to ‘transfer’ of a capital asset under Section 2(47) of the Income-tax Act, 1961 (the Act). Accordingly, the capital loss arising on account of reduction in the share capital of the Indian company is allowed for set-off against capital gains.

Background

The taxpayer had made an investment in the Indian company engaged in the business of telecasting news. The total number of shares of the company were 153.50 million out of which the taxpayer’s share was 99.89 per cent. The said company had incurred losses, and net worth of the company was totally eroded. Subsequently, the company filed a petition before the Bombay High Court for reduction of share capital to set off the loss against the paid-up equity share capital. The High Court held that there was a reduction in the share capital of a subsidiary company, however, the face value of shares remained the same at INR10 even after the reduction. The Court also ordered for payment of INR31.78 million as a consideration. During the year the taxpayer claimed long term capital loss accrued on the reduction in share capital from the sale of shares of such company. However, the Assessing Officer (AO) while disagreeing with the taxpayer’s claim held that reduction in shares of the subsidiary company did not result in the transfer of a capital asset as envisaged in Section 2(47) of the Act. Even though the number of shares have reduced, the face value as well as shareholding pattern remained the same.

The Supreme Court in the Kartikeya Sarabhai² case has laid down the principle that Section 2(47) of the Act provides an inclusive definition of ‘transfer’ which, *inter alia*, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. It is not necessary that for a capital gain to arise, there must be a sale of a capital asset. The sale is only one of the modes of transfer envisaged by Section 2(47) of the Act.

The taxpayer relying on the decision of Kartikeya Sarabhai argued that reduction in share capital was a real transfer of asset, and the scheme resulted in extinguishment/relinquishment of part of the taxpayer’s rights, in the shares of the Indian subsidiary and therefore the transaction fell within the definition of Section 2(47) of the Act.

The Commissioner of Income-tax (Appeals) [CIT(A)] while distinguishing the decision of Kartikeya Sarabhai held that any extinguishment of rights would involve parting the sale of a percentage of shares to another party or divesting rights therein. The taxpayer in the present case had neither parted with nor sold the shares, as there was no change in the overall percentage of total shareholding which remained at 99.88 per cent. There was no extinguishment of rights in as much as the reduction was only in the number of shares and not the face value. Accordingly, there was no real transfer as envisaged under Section 2(47) of the Act.

² Kartikeya V. Sarabhai v. CIT [1997] 228 ITR 163 (SC)

¹ Jupiter Capital Pvt Ltd v. ACIT (ITA No. 445/Bang/2018) – Taxsutra.com

The Tribunal held that in the case of Kartikeya Sarabhai the Supreme Court observed that the taxpayer continues to remain a shareholder of the company even after the reduction of share capital, but it cannot be accepted that there has been no extinguishment of any part of his right as a shareholder qua the company. Therefore, reduction of a share capital amounts to transfer in view of the provisions of Section 2(47) of the Act.

In the present case, the face value per share remains the same before the reduction of share capital and after the reduction of share capital. However, the total number of shares have been reduced from 153.50 million to 10,000, and out of this, the taxpayer was holding prior to reduction 153.34 million shares and after reduction 9988 shares. On account of reduction in the number of shares held by the taxpayer in the Indian company, the taxpayer has extinguished its right of 153.34 million shares, and in lieu thereof, the taxpayer received 9988 shares at INR10 each along with an amount of INR31.78 million. The Supreme Court in the case of Kartikeya Sarabhai does not make reference to the percentage of shareholding prior to reduction of share capital and after reduction of share capital. Hence, the basis adopted by the CIT(A) to hold that the decision of the Supreme Court was not applicable in the present case was not proper. The decision of the Supreme Court is applicable to the facts of the present case. Accordingly, the Tribunal held that the capital loss arising on account of the reduction in share capital is allowed to be set off against capital gains.

Our comments

The applicability of transfer provisions to the reduction of share capital has been a matter of debate before the Courts/Tribunal.

The Supreme Court in the case of Kartikeya Sarabhai observed that reduction of right in a capital asset would amount to 'transfer' under Section 2(47) of the Act. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. Relinquishment of the asset or the extinguishment of any rights in it, which may not amount to sale, can also be considered as transfer and any profit or gain which arises from the transfer of such capital asset is taxable under Section 45 of the Act.

The Special Bench of the Mumbai Tribunal in the case of Bennett Coleman & Co. Ltd³ held that the capital loss arising on account of reduction in share capital could not be subject to the charging provisions under Section 45 of the Act read with Section 48 of the Act and therefore such loss was not allowable as capital loss. The Special Bench observed that unless and until some consideration is received, the transfer of asset would not attract the charging provisions of Section 45 of the Act. The taxpayer had not received any consideration for reduction of share capital and hence 'computation' of capital gain or loss as contemplated by Section 45 and 48 of the Act failed. While the number of shares held by the taxpayer had reduced to 50 per cent, nothing had moved from the company to the taxpayer.

The Bangalore Tribunal in the present case relying on the decision in the case of Kartikeya Sarabhai held that reduction in share capital amounts to 'transfer' of a capital asset under the provisions of Section 2(47) of the Act. Consequently, the capital loss arising on account of reduction in the share capital of the Indian company is allowed for set-off against capital gains.



³ Bennett Coleman & Co. Ltd v. CIT [2011] 12 ITR (T) ITR 97 (Mum) (SB)

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