Tax Flash News

3 May 2023

Long-term capital gains on the sale of unlisted shares by the non-resident are taxable under a special provision of the Income-tax Act without giving effect to foreign exchange fluctuation

Executive Summary

A non-resident is eligible for the concessional tax rate of 10 per cent on the long-term capital gains arising from the transfer of unlisted securities or shares of a company under Section 112(1)(c)(iii) of the Income-tax Act, 1961 (the Act). The tax on such capital gain is to be calculated without giving effect to foreign exchange fluctuation and indexation benefit available under the first and second proviso to Section 48. However, the non-resident taxpayers have been claiming that the computation of long-term capital gains on the sale of unlisted shares can be done under the general provisions of Section 48 after giving effect of foreign exchange fluctuation.

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Legatum Ventures Limited[1] (the taxpayer) dealt with the issue whether the UAE company has an option to compute long-term capital gains on the sale of unlisted shares of an Indian company under the general provisions of Section 48 over a special provision of Section 112(1)(c)(iii). The Tribunal held that Section 112(1)(c)(iii) is a special provision, therefore, the long-term capital gains on the sale of unlisted shares by the UAE company have to be computed under Section 112(1)(c)(iii) without giving the effect of foreign exchange fluctuation under the first proviso to Section 48.

Facts of the case

- The taxpayer, an UAE company, is mainly engaged in investment activities. The taxpayer sold shares of an unlisted Indian company and declared long-term capital loss after giving effect to foreign exchange fluctuation under proviso 1 to Section 48.
- The taxpayer contended that Section 112(1)(c)(iii) merely provides the rate of tax and does not provide a mechanism for the computation of capital gains. Therefore the loss should be allowed to be carried forward to the subsequent year. Since after considering the first proviso to Section 48, the taxpayer has a loss, Section 112(1)(c)(iii) would not apply since there was no income for the applicability of such provisions.
- The AO relied on the Supreme Court decision in the case of Gold Coin Health Food Private Limited[2] and observed that the term 'income' also includes loss. The AO held that provisions of Section 112(1)(c)(iii) supplement the provision of Section 48, which is a special provision applicable in certain specific circumstances. Therefore, the taxpayer was not given any option to choose the provision as per its convenience. Once the special provisions are in place, they need to be acted upon. Therefore, capital gains must be computed under Section 112(1)(c)(iii) without giving effect of foreign exchange fluctuation. Accordingly, the AO computed the long-term capital gains applying the provisions of Section 112(1)(c)(iii) taxable at the rate of 10 per cent.

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[1] Legatum Ventures Limited v. ACIT (ITA No. 1627/Mum/2022) – Taxsutra.com

[2] CIT v. Gold Coin Health Food Private Limited [2008] 304 ITR 308 (SC)

Tribunal’s decision

- Section 112(1)(c)(iii) is a special provision for the computation of capital gains in case of a non-resident arising from the transfer of unlisted shares and securities. While Section 48 is a general provision which deals with the mode of computation of capital gains in all cases of transfer of capital assets. Further, Section 112(1)(c)(iii) does not provide for ‘re-computation’ of capital gains for levying tax rate of 10 per cent.

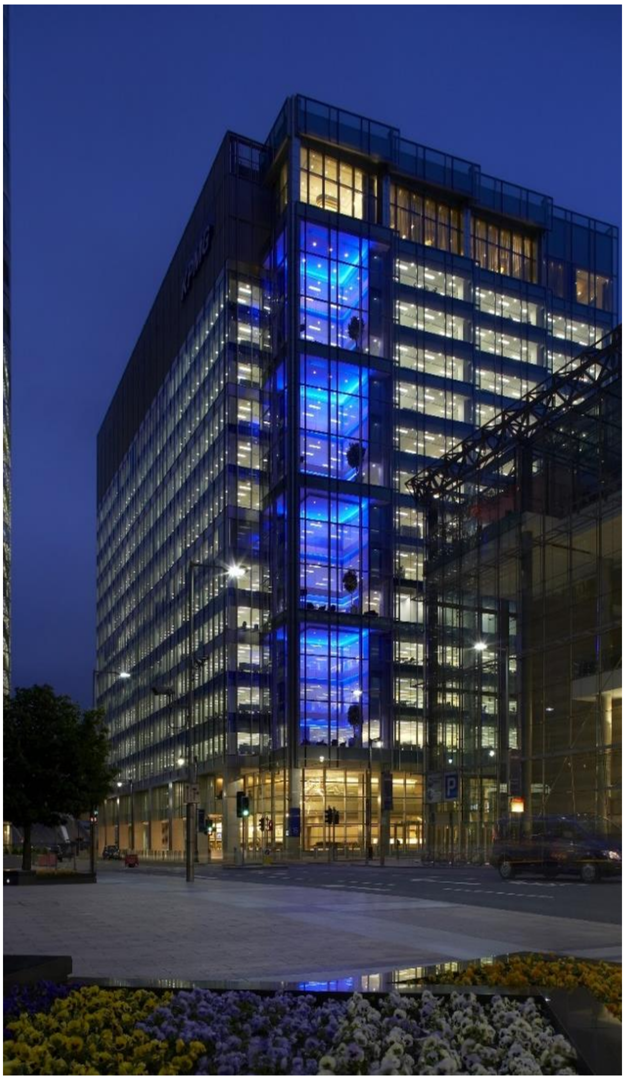
- Once the conditions under Section 112(1)(c)(iii) are fulfilled, capital gains are required to be computed as per the manner provided under the said section. It is a well-settled rule of interpretation that if a special provision is made with respect to a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim ‘*Generallia specialibus non derogant’*.

- Further, it is also a well-settled rule of construction that when, in an enactment, two provisions exist, which cannot be reconciled with each other, they should be so interpreted that the effect should be given to both.

- Therefore, if the submission of the taxpayer that the income chargeable under the head ‘capital gains’ was to be computed only as per Section 48 was accepted, then the same would render the computation mechanism provided in Section 112(1)(c)(iii) completely otiose and redundant.

- In view of above, there was no merit in the taxpayer’s contentions that if the case of the taxpayer is governed under two provisions of the Act, then it has the right to choose to be taxed under the provision which leaves him with a lesser tax burden.

- In the present case, the capital gains have to be computed only by reference to provisions of Section 112(1)(c)(iii).



Our comments

The Mumbai Tribunal relying on the well-settled principle that the special provisions will override the general provisions, observed that the long-term capital gains on the sale of unlisted shares by a non-resident company are taxable under Section 112(1)(c)(iii) being a special provision. As a result of this decision, in the instant case, the non-resident company could not give effect of foreign exchange fluctuation. It would be interesting to see how the Courts and other benches of the Tribunal will deal with this matter.

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