KPMG

#KPMG josh

TAX FLASH NEWS

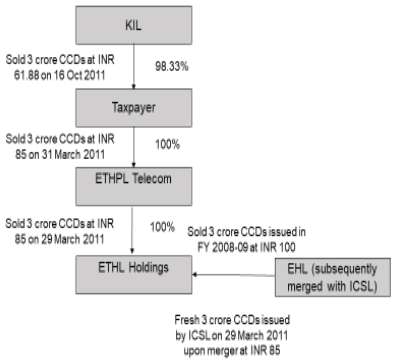
27 June 2019

Transaction of sale of CCDs to a related concern which resulted in a loss cannot be construed as colourable device

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Essar Teleholdings Ltd[1] (the taxpayer) held that the transactions carried out by the taxpayer in respect of sale of Compulsory Convertible Debentures (CCDs) to a related concern which resulted in a short term capital loss cannot be construed as a colourable device.

Facts of the case

The taxpayer is a public limited company engaged in the business of investment in shares and securities of other companies. During the Financial Year 2008-09, Essar Holdings Ltd (EHL) issued three crore CCDs at INR100 per debenture to ETHL Communications Holdings Ltd (ETHL Holdings). Pursuant to merger of EHL with Imperial Consultants and Securities Pvt. Ltd (ICSL), fresh three crore CCDs were issued by ICSL to ETHL Holdings on 29 March 2011 at INR85 per debenture. The issue price of INR85 was determined by an independent valuer and it was duly approved by the High Court in the scheme of merger. The 100 per cent shares of ETHL Holdings were held by ETHPL Telecom Holdings Pvt. Ltd (ETHPL Telecom). ETHL Holdings sold three crore CCDs to ETHPL Telecom on 29 March 2011 at INR85 per debenture. The 100 per cent shares of ETHPL Telecom were held by the taxpayer. ETHPL Telecom sold three crore CCDs to the taxpayer on 31 March 2011 at INR85 per debenture. The diagram representing the structure is as under:



During the Assessment Year 2012-13, the taxpayer in turn sold three crore CCDs on 16 October 2011 at INR61.88 to Kroner Investment Ltd. (KIL), which was holding 99.83 per cent shareholding in taxpayer. This transaction resulted in a short term capital loss of INR69.36 crore. The fair value of CCD of INR85 has been denoted at INR61.88 by taking 15 per cent for illiquid nature of CCD by valuer.

The Assessing Officer (AO) observed that CCDs were purchased from a related party on 31 March 2011 and sold within a short span of seven months with a loss of around 30 per cent. Therefore, it was a colourable device to offset the huge capital gains with capital loss. The AO observed that this transaction was hit by provisions of Section 47(v) of the Act and it cannot be treated as transfer. Therefore, the short term capital loss of INR69.36 crore was to be disallowed under Section 47(v) of the Act as well as being a colourable device to defraud the revenue. The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

[1] Essar Teleholdings Ltd v. ACIT (ITA No. 1958/Mum/2018) – Taxsutra.com

Tribunal's decision

The independent chartered accountant based on the assets and liabilities of ICSL as per the balance sheet as on 31 March 2011, determined the value of CCDs at INR72.80 per debenture and later a discount of 15 per cent was applied on the same on account of illiquid nature of CCD to arrive at the FMV of CCD at INR61.88 per debenture. Hence, the sale price of CCDs at INR61.88 per debenture to a related concern was duly supported by an independent valuation report of a chartered accountant which was having strong basis and rationale. Moreover, from the Balance Sheet of ICSL as on 31 March 2012, it has been observed that there was a loss of INR894.81 crore and this loss was there throughout the period from 1 April 2011 to 31 March 2012 in view of the fact that the major portion of the loss was contributed by finance cost which was a period cost. Hence, the loss for the relevant period i.e. from 1 April 2011 to 16 October 2011 (being the date of sale) should also be considered by the valuer while determining the fair market value.

It has been observed that the tax department had not disputed the determination of FMV of INR72.80 per debenture as it is based on the audited balance sheet of ICSL as on 31 March 2011. Hence, applying the broken period loss for the period upto the date of sale of debentures (i.e. 16 October 2011) of INR23.02 per debenture and reducing the same from the value determined by valuer as on 31 March 2011 of INR72.80 per debenture, the revised Fair Market Value (FMV) per debenture would be INR49.78 (72.80 – 23.02). The taxpayer had sold the debentures at INR61.88 per debenture which was higher than the revised FMV of INR49.78 per debenture. Hence, it cannot be said the transactions had been carried out by the taxpayer as a colourable device.

The taxpayer had purchased the three crore CCDs at INR85 per debenture from its subsidiary company ETHL. From the diagram it is evident that the said subsidiary company had also purchased at the very same rate of INR85 per debenture from its subsidiary company. That step down subsidiary was originally holding three crore CCDs from FY 2008-09 which were issued to it at the rate of INR100 per debenture, but pursuant to merger of Essar Holdings Ltd with ICSL and pursuant to the order of the High Courts, the said step down subsidiary was issued fresh three crore CCDs by ICSL on 29 March 2011 at the rate of INR85 per debenture. Hence, effectively the purchase price (i.e. cost price) of INR85 per debenture was made by the taxpayer to ensure that its subsidiary company and step down subsidiary company does not incur any loss on their investments and it is for commercial reasons. Hence, the purchase price of INR85 per debenture cannot be construed as a colourable device. In order to support its case, the Tribunal relied on various decisions[2].

The Tribunal observed that the transactions had been carried out independently. The sale of shares resulting in long term capital gain had happened subsequent to the sale of CCDs resulting in loss and it cannot be viewed with a jaundiced eye, merely because the loss had arose out of transactions with a related concern and the same being carried out by coinciding to a nearer date. The Tribunal held that it is for the taxpayer to decide when to sell the CCDs and similarly when to sell the equity shares and the tax department cannot step into the shoes of the taxpayer in this regard. The Tribunal relied on the decision of the Delhi High Court in the case of Gillette Diversified Operations P Ltd[3].

The Tribunal observed that the taxpayer could sell the CCDs of ICSL at INR61.88 per debenture due to losses incurred by ICSL. When there was a loss in an investee company, the same would get automatically reflected in the shares or debentures held by an outsider or a related concern when the said investments are sold. The loss of ICSL had contributed to the loss to the taxpayer on sale of CCDs to KIL. In order to support its case the Tribunal relied on the decision of PKS Holdings[4].

The documentary evidences for the purchase and sale of CCDs were not doubted by the tax department. The transactions of purchase of CCDs from related concern and sale of CCDs to related concerns were also not doubted by the tax department. Only the pricing was doubted by the tax department on the ground that it was carried out with related concerns and it had resulted in a loss. The professed intention and the real intention of the taxpayer was proved in the instant case in the various documents filed before the lower authorities. If the same were to be treated as different, then the onus was on the tax department to prove it, which in the instant case, had not been proved by the tax department.

From the details of the computation of capital gains, it has been observed that the taxpayer derived long term capital gain on sale of shares and a meager amount of short capital loss of INR69.36 crore (on sale of CCD) which was sought to be set off by the taxpayer. Even after set off there was a substantial capital gain left and it was sought to be adjusted against the brought forward losses of the taxpayer from the earlier years. Even if the impugned short term capital loss of INR69.36 crore on sale of CCDs of ICSL to related concern was not available to the taxpayer, then also the net long term capital gains of INR1007.40 crore would be set off with the brought forward long term and short term capital losses from earlier years. Therefore, it could be safely concluded

[2] CIT v. Pitty Bros Private Limited [1979] 120 ITR 709, CIT v. Mehta (P) Ltd [2008] 220 CTR 148 (Bom)

[3] CIT v. Gillette Diversified Operations P Ltd [2010] 324 ITR 226 (Del)

[4] ITO v. PKS Holdings [2016] 71 taxmann.com 345 (Kol)

that there was no intention on the part of the taxpayer to evade taxes by booking bogus short term capital loss on sale of CCDs to related concern. Hence, the transactions carried out by the taxpayer cannot be construed as a colourable device.

Accordingly, the Tribunal held that the transactions carried out by the taxpayer in respect of sale of CCDs to related concern which had resulted in a short term capital loss of INR69.36 crore was to be construed as a genuine loss and cannot be construed as a colourable device.

Our comments

The issue with respect to tax planning v. tax evasion has been a subject matter of debate before the courts. Determination of whether a transaction or series of transactions amounts to a colourable device or sham for avoidance of tax depends on the facts and circumstances of each case.

In the case of Consolidated Finvest & Holdings Limited[5], the Delhi Tribunal examined a series of transactions between two related entities which resulted in capital loss in the hands of one entity and determined that there was no tax avoidance. The Tribunal observed that there was no sham transaction and the same were considered genuine by the Indian tax authorities in earlier assessment years. It was observed that the AO could not provide any reasoning or evidence for holding it to be a sham except the fact that the transaction resulted in long term capital loss.

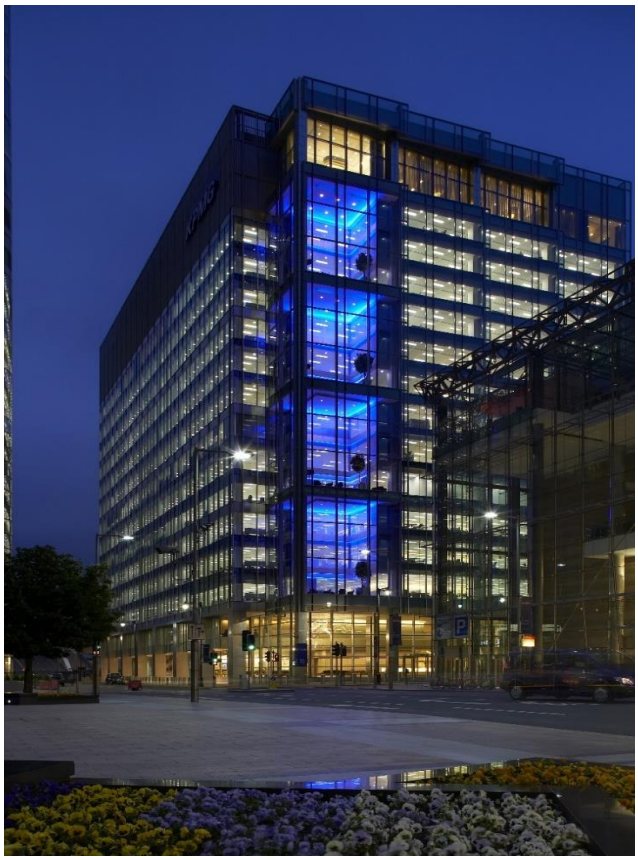
Similarly, in Copal Research Limited[6], the primary issue before the Delhi High Court was whether the taxpayer's transaction amounted to a prima facie avoidance of tax. The Delhi High Court held that the taxpayer's transaction was not structured primarily for the purpose of tax avoidance. This was on the basis that the taxpayer had sufficient commercial reasons for carrying out the transaction in that manner.

However, various Courts/Tribunal[7] had disregarded the transaction and held that the transaction is a colourable device and it is not a transaction in the eyes of the law.

In the case of Vodafone[8], the Supreme Court has after referring to several foreign jurisprudence, McDowell's[9] case and Azadi Bachao Andolan's[10] case, observed that it is only when colourable artificial devices are used to evade taxes, the transaction should be ignored. It does not disregard legitimate tax planning. Thus, where a holding structure has a definite and strong business rationale, it has been in existence for a long period of time and there is generation of taxable revenues of the business per se in India, there is very little room to characterise it as a colourable device.

The Tribunal in the present case held that the transactions carried out by the taxpayer in respect of sale of CCDs to a related concern which resulted in a short term capital loss was to be construed as a genuine loss and cannot be construed as a colourable device.

It would be interesting to see how Courts/Tribunal will deal with such transactions under the provisions of GAAR.



[5] ITA No.494/Del/2011
[6] W.P.(C) 2033/2013
[7] A Ltd. (A.A.R. No. P of 2010 dated 22 March 2012), Z (A.A.R. No. 1048 of 2011)
[8] Vodafone International Holdings B.V. [2012] 341 ITR 1 (SC)
[9] McDowell & Co. Ltd. v. CTI [1985] 154 ITR 148 (SC)
[10] Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

home.kpmg/in

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

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000