Tax Flash News

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Capital reduction results in transfer of a capital asset

Executive summary

There has been a tax dispute regarding whether capital reduction could result in a ‘transfer’ of a capital asset (shares or right in shares), and whether it could result in capital gain/loss in the hands of the shareholders under the Income Tax Act, 1961 (the Act).

The Supreme Court in the case of *Jupiter Capital*[1] held that the reduction in share capital of the company would be covered within the ambit of the expression ‘sale, exchange or relinquishment of the asset’ used in the definition of ‘transfer’ under the Act.

The decision was rendered in the context of the capital reduction through share cancellation and where the shareholders received consideration for the reduction.

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[1] *PCIT* v. *Jupiter Capital Pvt Ltd* (SLP No. 63 of 2025). Source: Taxsutra

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Facts of the case

The taxpayer held shares in another company, ANNPL.

Due to accumulated losses, ANNPL's net worth eroded, prompting it to file a petition for a reduction in share capital with the Bombay High Court.

The Court approved the reduction, resulting in decrease in the number of shares issued by ANNPL, though the face value per share remained unchanged at INR10.

The shareholders were paid some consideration for the capital reduction.

The number of shares held by the taxpayer was also proportionately reduced.

The taxpayer claimed a long-term capital loss arising from this reduction.

The tax officer disallowed the loss arguing that no transfer of capital assets occurred under Act pursuant to the capital reduction.

The Act[2] defines the term 'transfer' to include (a) the sale, exchange or relinquishment of the asset; (b) the extinguishment of any right therein.

Revenue's Contentions

The reduction in share capital did not constitute a 'transfer' under the Act.

It was only reduction of shares by way of extinguishing the number of shares and not extinguishing the rights of the shareholder which involved selling the shares to another entity.

The face value per share and the percentage of shareholding remained the same post-reduction of number of shares.

Decision

The reduction in share capital of the company and subsequent proportionate reduction in the shareholding of the taxpayer would be squarely covered within the ambit of the expression 'sale, exchange or relinquishment of the asset' used in the definition of 'transfer' under the Act.

[2] Section 2(47) of the Act

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The Supreme Court referred to its earlier decisions on this issue.

In the case of *Kartikeya V. Sarabhai*[3], the Supreme Court had held that while the taxpayer continued to remain a shareholder of the company even after the reduction of share capital, it could not be accepted that there was no extinguishment of any part of his right as a shareholder *qua* the company.

The Supreme Court in the case of *Anarkali Sarabhai*[4] had held that both reduction of share capital and redemption of shares involved the purchase of its own shares by the company and hence would be included within the meaning of transfer under the Act.

Our comments

This is a positive decision for the taxpayer claiming capital loss arising from the capital reduction. In the past, there have been contradictory decisions on this issue.

The Mumbai Special Bench of the Tribunal in *Bennett Coleman & Co.*[5] held that the replacement or substitution of earlier shares by the new shares did not amount to transfer. The majority judgment held that in case of capital reduction where no consideration was received, the loss arising on account of such reduction cannot be subject to the computational provisions. The said loss was not allowable as a capital loss and at best can be described as notional loss.

In the case of *Tata Sons Limited*[6], the Mumbai Bench of the Tribunal held that a reduction of capital was the extinguishment of the right in the shares, and it amounted to a transfer under the Act. The loss on reduction of share capital was an allowable capital loss and not a notional loss.

It may be noted that the captioned Supreme Court decision has been rendered in the context of the capital reduction by way of cancellation of shares and the shareholders received some consideration for the capital reduction.

It would be interesting to see whether the same conclusion will apply in case where the capital reduction is by way of reduction in the face value of shares (without the cancellation of shares) or where the shareholders do not receive any consideration.

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

[4] *Anarkali Sarabhai* v. *CIT* [1997] 224 ITR 422 (SC)

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

[6] *Tata Sons Limited* v. *CIT* (ITA No. 3468/Mum/2016)

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