KPMG

#KPMG josh

TAX FLASH NEWS

22 April 2021

Provisions of Section 56(2)(viib) are not applicable when shares are issued at face value pursuant to the scheme of amalgamation

Executive summary

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Ozone India Ltd.[1] (the taxpayer) dealt with the applicability of provisions of Section 56(2)(viib) of the Income-tax Act, 1961 (the Act) where the shares are issued pursuant to a scheme of amalgamation. The Tribunal held that such anti-abuse provisions under Section 56(2)(viib) are not appliable where the issue of shares are at 'face value' by the amalgamated company (the taxpayer) to the shareholders of the amalgamating company pursuant to the Scheme approved by the Court.

Facts of the case

During the financial year 2012-13, Kalavir Estate Pvt. Ltd. (KEPL) was amalgamated with the taxpayer. The said amalgamation was approved by the Gujarat High Court whereby all the assets and liabilities of KEPL were vested with the taxpayer against issue of shares by the taxpayer as the consideration and the shares being issued at par value.

The transaction of amalgamation was accounted under the 'pooling of interest' method as prescribed by the Accounting Statndard (AS) -14 issued by the Institute of Chartered Accountants of India (ICAI) consequent upon which the difference between net assets of KEPL vested with the taxpayer and value of shares of the taxpayer correspondingly issued was accounted for as capital receipts and treated as capital reserve. All the assets of KEPL were transferred at book value to the taxpayer, except land, which was transferred at a revalued amount. The land asset was taken in as stock-in-trade by the taxpayer at the revalued amount.

The Assessing Officer (AO) held that the excess value of net assets so received by taxpayer over issue of its shares was liable for taxation in the hands of the taxpayer being excess consideration for issue of its share under the head 'income from other sources' in terms of Section 56(2)(viib).

Tribunal's decision

Provisions of Section 56(2)(viib) are not applicable where no premium is charged on issue of shares

The Budget Speech of the Finance Minister while introducing Section 56(2)(viib) also provided the object behind the insertion. The CBDT Circular[2] of the being a contemporaneous exposition may also serve as useful guide to understand the true intent of Section 56(2)(viib). When the clause in Section 56(2)(viib) is read with CBDT Circular, Finance Ministers' speech in Parliament disclosing his intentions behind such insertion and also Memorandum explaining the Finance Bill, it appears that whole thrust for such insertion is to bring measures to tax hefty or excessive share premium received unjustifiably by private companies on issue of shares without carrying underlying value to support such uncalled for premium and thereby enriching itself without paying taxes legitimately due to them.

As per plain reading of Section 56(2)(viib), taxable consideration is the one which exceeds face value of shares issued. In the event of shares issued at consideration above face value, the same need to be compared with fair market value to determined excess consideration. The taxpayer in the present case, is not found to have issued shares at value more than face value at the first instance as repeatedly exhorted on behalf of the taxpayer.

[1] DCIT v. Ozone India Ltd. (I.T.A. Nos. 2081/Ahd/2018) – Taxsutra.com

[2] CBDT Circular No. 3/2012, dated 12 June 2012

Section 56(2)(viib) creates a deeming fiction to imagine and fictionally convert a capital receipt into revenue income. It is well entrenched by various case laws that while giving effect to such legal fictions, Section 56(2)(viib) creates a deeming fiction to imagine and fictionally convert a capital receipt into revenue income. It is well entrenched by various case laws that while giving effect to such legal fictions, all facts and circumstances thereto and inevitable corollaries thereof have to be assumed. A deeming fiction cannot be stretched beyond its purpose and import another fiction in it.

In the light of the object and the purpose of the deeming clause, the provisions of Section 56(2)(viib), would not come to motion where the taxpayer as admittedly not charged any premium at all and the shares were issued at face value.

Provisions of Section 56(2)(viib) do not cover a share issue made pursuant to a scheme of amalgamation

Firstly, Section 56(2)(viib) does not oust its applicability in the event of shares issued pursuant to amalgamation. The issue of shares is to give effect to the amalgamation, as per the mutual agreement and the Court order. In other words, it may be argued that the issue of shares does not trigger any consideration and in converse, the obligation to give consideration, triggers issue of shares. Secondly, the clause contemplates 'receipt' of the consideration for the shares from a resident person. In other words, it contemplates a transaction between a resident person and the company issuing shares. In the case of an amalgamation, the consideration, which would be undertaking along with all its assets and liabilities is in the form of vesting by the amalgamating company, whereas the shares are issued to its shareholders. Thus, it is, in effect, a tripartite arrangement between (i) amalgamated co. (ii) amalgamating co. (iii) the shareholders of amalgamating co. Such tripartite arrangements in amalgamation cases are not contemplated in the deeming clause in question.

Secondly, as per the proviso to the clause, it does not apply 'to the consideration for issue of shares by a venture capital undertaking (VCU) from a venture capital company (VCC) or a venture capital fund (VCF)'. The proviso implies that there should be issue of shares directly by the company to the subscriber. In other words, it contemplates a bilateral transaction. Further, it also contemplates a transaction in the nature of issue of shares at the instance of the company on its own and it does not contemplate a transaction in the nature of issue of shares for discharging the consideration or issue of shares obligated pursuant amalgamation etc.

Thirdly, as per the provisions of the Act , the consideration for issue of shares by the amalgamated company, in so far as the shareholder is concerned, is the shares held in the amalgamated company by way of transfer (except for the saving clause in Section 47(vii)). A bare issue of shares contemplated in Section 56(2)(viib) thus cannot be equated with a situation of transfer gathered from an intent implicit in Section 47(vii). Thus, the consideration and the issue of shares envisaged by Section 56(2)(viib) is not found compatible with scheme enacted, when seen from the perspective of revenue.

Accordingly, it was held that the issue of shares at 'face value' by the amalgamated company (the taxpayer) to the shareholders of amalgamating company in pursuance of the scheme of amalgamation legally recognised in the Court of Law does not fall with scope and ambit of Section 56(2)(viib).

Our comments

This is an important decision on the applicability of provision of Section 56(2)(viib) because the Tribunal dealt with various aspects of these provisions in detail. The Tribunal held that the provisions of Section 56(2)(viib) are not applicable when shares are issued pursuant to a scheme of amalgamation, especially when the same are issued at par value. This ratio laid down by the Tribunal may equally apply to demerger cases as well.

This decision provides clarity on various aspects for example non-applicability of Section 56(2)(viib) to tripartite transactions, cases where shares are issued to discharge an obligation, etc.

The Tribunal while purposively construing the provisions of Section 56(2)(viib) observed that such provisions restrictively apply to tax avoidance cases of private companies where they charge unjustified premium on issue of shares and cases of money-laundering and such provsions should not apply to the genuine amalgamation like transaction which are approved by the Court.

Provisions of Section 56(2)(viib) were introduced as an anti-abusive provisions, which seems to have achieved its objective of reducing tax evasive practices by infusion of funds at excessively high premiums. However, given the wide-ranging issues and contradictory views, one would need to wait and watch how the provisions of Section 56(2)(viib) will be interpreted if this decision will be challenged before the High Court.

KPMG in India addresses:

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

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

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

---

home.kpmg/in

#KPMG josh

home.kpmg/in/socialmedia

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000