

TAX FLASH NEWS

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Section 56(2)(ix) of the Income-tax Act is not applicable to the forfeiture of application money on the issue of debentures

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of R. S. Triveni Foods P. Ltd.¹ (the taxpayer) dealt with the issue of taxability of forfeiture of application money received on account of issue of Fully Convertible Debentures (FCD). The Tribunal held that the forfeiture of application money on FCD is not on account of transfer of capital asset and hence it is not taxable as 'income from other sources' under Section 56(2)(ix) of the Income-tax Act, 1961 (the Act).

Facts of the case

The taxpayer floated FCDs of INR100 each, partly paid INR50 per debenture through private placement to two entities on 6 January 2014 and raised INR30 million. The FCD's were fully and compulsory convertible into 8 equity shares of INR10 each at par before the expiry of 15 months from the date of allotment. As per the terms and conditions, the board of directors had a right to forfeit FCD's in case the debenture holder fails to make the payment of remaining debenture call money within the stipulated time of 90 days from date of allotment. During the Assessment Year (AY) 2015-16, the call money received by the taxpayer of INR30 million was forfeited as the allottees companies despite various reminders and extension of time failed to submit the balance money. Accordingly, as per terms and conditions, the call money was forfeited. The amount of forfeiture money was transferred to the capital reserve.

The Assessing Officer (AO) disallowed the claim of the taxpayer and held that the said receipt was a revenue receipt and the forfeiture of the same does not change its characteristic as the capital receipt. The amount raised through allotment of debentures was utilised for acquisition of current assets and in view of the ratio of the decision of Logitronics Ltd.², the said receipt were held to be of revenue in nature.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that forfeiture of shares were taxable as income from other sources under Section 56(2)(ix) of the Act. The forfeiture of advance related to capital asset which includes shares and securities is taxable as income from other sources under Section 56(2)(ix) of the Act.

The taxpayer contended that the provision of Section 56(2)(ix) of the Act would not be applicable to the facts of the present case because the said section has come into effect from 1 April 2015 and taxpayer has not received any sum or advance in this year, therefore, this provision would not be applicable.

Tribunal's decision

The forfeiture of FCDs has taken place during AY 2015-16, therefore, taxability qua the forfeiture amount has to be seen in this year.

The deeming provision under Section 56(2)(ix) of the Act is attracted in the event when any sum is forfeited out of any sum and money received as advance or otherwise in the course of negotiations for the transfer of a capital assets. Therefore, sum received in the course of negotiation for transfer of a capital receipt is sine qua non for invoking the deeming provision. The negotiation has to be in relation to transfer of a capital asset in whose hands the deeming provision is attracted. In other words, the capital asset which is the subject matter of negotiation for transfer must belong to the taxpayer.

¹ R. S. Triveni Foods P. Ltd v. ADIT (ITA No. 739/Del/2019) – Taxsutra.com

² Logitronics Ltd. v. CIT [2011] 333 ITR 386 (Del)

The CIT(A) has referred to Explanation (d) to Section 56(2)(vii) of Act, which defines capital asset to include 'shares and securities'. On a perusal of the said Explanation it has been observed that it is only applicable for the purpose of Section 56(2)(vii) where an individual or HUF receives in any of the previous year from any person or persons any sum or money without consideration or any immovable property, etc. The said definition cannot be imported for purpose of interpreting a 'capital asset' in Section 56(2)(ix).

Debenture is a long term debt instrument used by the companies to borrow money at a fixed rate of interest. It is a type of debt instrument which is not secured by any collateral. The debenture cannot be treated as a capital asset of the issuer company because it is a kind of debt instrument with an obligation to acknowledge the debt and pay interest. It is a capital asset in the hands of the person subscribing to the debenture or the allottee of the debenture, who is entitled to get interest at a stipulated rate and may also get right to equity shares if conditions of subscription prescribes so.

In the present case, the debentures were duly allotted to the subscribing companies and the non-payment of further call money under the agreement had led to the termination of the debentures. Therefore, said sum paid by the debenture holder cannot be held to be on account of transfer of capital asset in the hands of the taxpayer. Accordingly, the forfeiture of the amount is not on account of failure of negotiation of transfer of capital asset of the taxpayer and thus, will not hit by Section 56(2)(ix) of the Act.

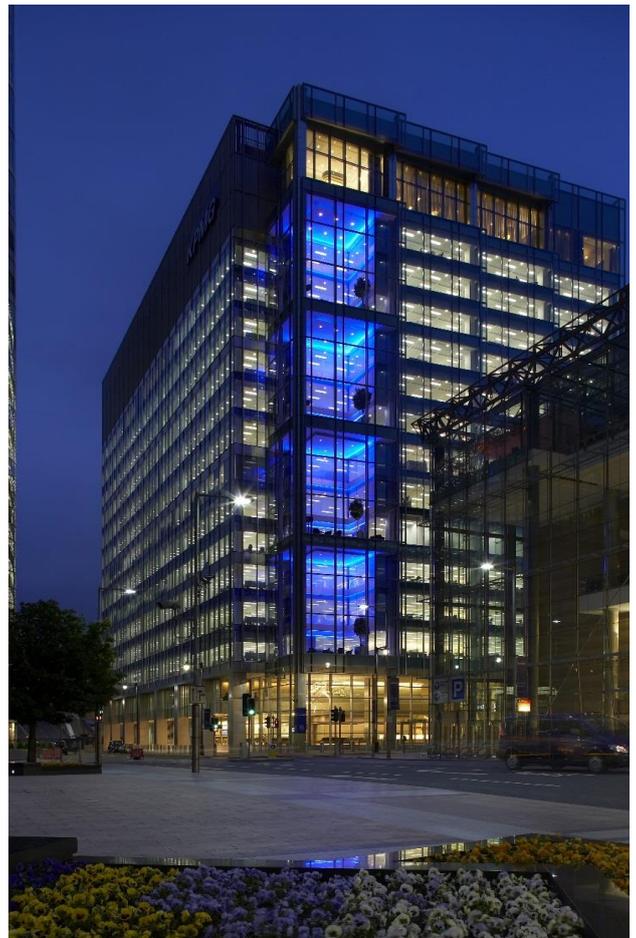
Our comments

Prior to the introduction of the provisions of Section 56(2)(ix) of the Act, the Courts/Tribunal in various cases³ have held that the amount of forfeited share application money was a capital receipt and cannot be taxed as income either under Section 28(iv) or under Section 41(1) of the Act.

The Finance Act, 2014 amended the provisions of Section 56(2)(ix) of the Act. It provides that any amount received as advance or otherwise in the course of negotiation for transfer of a capital asset which has been forfeited by a seller for non-compliance by a buyer would be taxable as 'income from other sources'.

The Tribunal in the present case has held that the forfeiture of application money on FCD is not on account of transfer of a capital asset and hence it is not taxable as 'income from other sources' under Section 56(2)(ix) of the Act.

³ Graviss Hospitality Ltd v. DCIT [2015] 67 SOT 184 (Mum), Prism Cement Ltd. v. JCIT [2006] 103 TTJ 63 (Mum), DCIT v. Brijlaxmi Leasing & Finance Ltd. [2009] 118 ITD 546 (Ahd), Deepak Fertilisers and Petrochemicals Corpn. Ltd. v. DCIT [2014] 116 ITD 372 (Pune)



home.kpmg/in

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Pralhad 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

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