

Dhruva M&A Alert

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Tribunal denies claim of long-term capital loss on reduction of shares without payment of consideration

In a recent decision¹, the Mumbai Bench of the Income Tax Appellate Tribunal ('Tribunal') rejected assessee's claim of long-term capital loss on reduction of shares of subsidiary without payment of consideration

Background

- Mahindra and Mahindra Limited ('the taxpayer'), an Indian company, held shares in Mahindra Shubhlabh Services Limited ('MSSL'). Such shares represented 83.05% of the capital of MSSL.
- Pursuant to a scheme of capital reduction approved by the Bombay High Court, shares held by the taxpayer in MSSL were cancelled without payment of any consideration.
- The loss arising out of the aforesaid capital reduction was determined by the taxpayer and a claim was made to carry forward the said loss.

- The Assessing Officer ('AO') as well as the Dispute Resolution Panel ('DRP') did not accept the claim of the taxpayer for determination and carry forward of long-term capital loss arising on reduction of shares held in MSSL.

Taxpayer's Contentions

- The taxpayer argued that reduction in share capital amounted to transfer of capital asset under section 2(47) of the Income-tax Act, 1961 ('the Act') and accordingly, capital loss arising therefrom should be allowed to be carried forward in the hands of the taxpayer.

¹ Mahindra and Mahindra Limited v. DCIT (ITA No. 1449/Mum/2016 and Other Appeals)



- The taxpayer relied on the decision of the Bangalore Bench of the Tribunal in the case of *Jupiter Capital Private Limited*², wherein it was held that reduction in share capital amounts to transfer of a capital asset under section 2(47) of the Act and consequently, capital loss arising on account of reduction in share capital is to be allowed for set-off against capital gains.
- In arriving at its decision, the Bangalore Bench of the Tribunal had relied upon the decision of the Supreme Court in the case of *Kartikeya V. Sarabhai*³. The Supreme Court, in the facts of the said decision, had held that though a shareholder continues to remain a shareholder of the company on capital reduction, there is an extinguishment of rights as a shareholder qua the company amounting to transfer under section 2(47) of the Act.
- Further, in arriving at its decision, the Special Bench had relied upon various judicial precedents⁵ to hold that even where a transfer may be said to have taken place on capital reduction, unless and until such transfer entailed a 'consideration', the computation provisions of the Act would not be workable. Accordingly, in absence of consideration and consequent failure of computation mechanism, the charging provisions could not be given effect and any loss arising on such transfers would not be allowed as a capital loss.

Tribunal's Ruling

Revenue's Contentions

- The Revenue denied the claim of capital loss relying upon the decision of Special Bench of the Mumbai Tribunal in the case of *Bennett Coleman & Co. Ltd.*⁴, wherein the assessee was denied capital loss on reduction in face value of shares held in its sister concern.
- The Special Bench had observed that as the reduction in face value of shares was without payment of any consideration, the value of assets of sister concern immediately before and after reduction of capital remained the same and the assessee's proportionate share in such assets also remained the same. Accordingly, the loss, if any, on capital reduction was merely a notional loss which cannot not be allowed for tax purposes.
- The Tribunal noted that the decision of the Supreme Court in *Kartikeya V. Sarabhai* which was further relied upon in the case of *Jupiter Capital Private Limited* was factually distinguishable since the facts of the said case involved payment of consideration to the shareholders on capital reduction.
- The Tribunal also observed that the facts in the case of *Bennett Coleman & Co. Ltd.* and that of the taxpayer are similar as in both the cases there was an absence of consideration.
- Further, in absence of any arguments being advanced to distinguish the Special Bench decision in the case of *Bennett Coleman & Co. Ltd.*, the same would squarely apply to the facts of the instant case.
- The Tribunal also noted that the Special Bench decision would have binding precedent over Division Bench decision.
- Accordingly, the Tribunal agreed to the order of the AO and DRP and rejected the

² M/s Jupiter Capital Private Limited v. ACIT (ITA No. 445 / Bang / 2018)

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

⁴ Bennett Coleman & Co. Ltd. v. ACIT [2011] 12 ITR(T) 97 (Mumbai)

⁵ CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC), CIT v. Mohanbhai and Pamabhai [1987] 165 ITR 166 (SC), Sunil Siddharthbhai v. CIT [1985] 156 ITR 509 (SC)



taxpayer's claim of long-term capital loss on reduction of shares held in MSSL.

Dhruva Comments

- This decision reiterates the position that a claim of capital loss cannot be allowed in absence of consideration in a scheme of capital reduction. The taxability of capital reduction in the hands of shareholders would need to be evaluated basis the facts such as the receipt of consideration, impact of the reduction on shareholders' rights, etc.
- It is also pertinent to note that several of the recent rulings⁶ have distinguished the Special Bench ruling in case of *Bennett Coleman & Co. Ltd.* basis the fact that the capital reduction in those cases did involve payment of consideration to the shareholders.

⁶ Carestream Health Inc. v. DCIT (ITA No. 826/Mum/2016) and M/s Jupiter Capital Private Limited v. ACIT (ITA No. 445/Bang/2018)



ADDRESSES

Mumbai

1101, One IndiaBulls Centre,
11th Floor, Tower 2B,
841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400 013
Tel: +91 22 6108 1000 / 1900

Ahmedabad

B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad - 380 015
Tel: +91-79-6134 3434

Bengaluru

Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560 001
Tel: +91-80-4660 2500

Delhi / NCR

101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana - 122 002
Tel: +91-124-668 7000

Pune

305, Pride Gateway, Near D-Mart, Baner,
Pune - 411 045
Tel: +91-20-6730 1000

Kolkata

4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal – 700016
Tel: +91-33-66371000

Singapore

Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai

WTS Dhruva Consultants
U-Bora Tower 2, 11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel: + 971 56 900 5849

New York

Dhruva Advisors USA, Inc.
340 Madison Avenue, 19th Floor, New York,
New York 10173 USA

KEY CONTACTS

Dinesh Kanabar

Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Vishal Gada (Mumbai/Ahmedabad)

vishal.gada@dhruvaadvisors.com

Ajay Rotti (Bengaluru/U.S.A)

ajay.rotti@dhruvaadvisors.com

Vaibhav Gupta (Delhi / NCR)

vaibhav.gupta@dhruvaadvisors.com

K. Venkatachalam (Pune)

k.venkatachalam@dhruvaadvisors.com

Aditya Hans (Kolkata)

aditya.hans@dhruvaadvisors.com

Mahip Gupta (Singapore)

mahip.gupta@dhruvaadvisors.com

Nimish Goel (Dubai)

nimish.goel@dhruvaadvisors.com

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