



Tax alert: Excess share premium not taxable on shares issued to 100% holding company

28 June 2023

The Delhi Bench of the Income-tax Appellate Tribunal, based on facts, has rendered its decision that the provisions of section 56(2)(viib) of the Income-tax Act, 1961 are not applicable for allotment of shares at premium to a 100% holding company.

In a nutshell



The transaction of allotment of shares at a premium between a holding company and its subsidiary company when seen holistically, there is no benefit derived by the taxpayer by issue of shares at certain premium notwithstanding that the share premium exceeds the FMV.



The objective behind the provisions of section 56(2)(viib) of the ITA is to prevent unlawful gains by issuing company in the garb of capital receipts. The object of deeming an unjustified premium charged on issue of share as taxable income, under section 56(2)(viib), is wholly inapplicable for transactions between holding and its subsidiary company where no income can be said to accrue to the ultimate beneficiary, i.e., holding company.



The chargeability of deemed income arising from transactions between holding and subsidiary or vice versa, militates against the solemn object of section 56(2)(viib) of the ITA.



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Background:

- The taxpayer¹ is a company engaged in the business of generating and dealing in electricity and all forms of energy and power generated by wind and other conventional and non-conventional methods.
- During the Financial Year (FY) 2013-14, corresponding to Assessment Year (AY) 2014-15, the taxpayer issued certain shares at a premium (say shares having face value of INR 10 per share, were issued at INR 1,000/- per share) and thus, the taxpayer received share premium.
- The Assessing Officer (AO) during the course of audit proceedings was required to examine the justification of share premium with regard to the Fair Market Value (FMV) and the creditworthiness of the subscriber to whom the shares were allotted at premium. The AO accepted the income of the taxpayer without any modifications.

Thereafter, the Principal Commissioner of Income-tax (PCIT) invoked revisionary proceedings under section 263 [relating to revision of orders prejudicial to Revenue] of the Income-tax Act, 1961 (ITA) on the grounds that the AO failed to examine the genuineness of the transaction and creditworthiness of the persons from whom share premium was received, thus, rendering the audit proceedings erroneous and prejudicial to the interest of Revenue. The FMV adopted by the taxpayer at premium was apparently on a higher side in view of the financial statement of the taxpayer.

While the taxpayer submitted replies, the PCIT did not find them satisfactory and concluded that the AO's order was erroneous and prejudicial to the interest of the Revenue. The PCIT accordingly, set aside the AO's order and directed the AO to pass fresh order after making thorough and detailed inquiries on the particular issue of issuance of shares at huge premium.

- Aggrieved by the revisional order of PCIT, the taxpayer filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

The key contentions of the taxpayer before the ITAT were as follows:

- The taxpayer had issued shares to only one entity which was 100% holding company (Hold Co) of the taxpayer. The shares were not allotted to any third party investor.
- The investment amount was received by the taxpayer in the preceding financial year i.e., FY 2012-13, corresponding to AY 2013-14 in the form of share application money and the shares were issued against such receipts in subsequent year i.e. FY 2013-14, corresponding to AY 2014-15 to the Hold Co resulting in securities premium amount being accounted for in its books of account.
- In view of the above, there was no warrant to invoke the deeming fiction of section 56(2)(viib) of the ITA [relating to taxation of consideration received in excess of FMV of shares issued].

Relevant provisions in brief:

Relevant extract of section 56 of the ITA

“(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely...

...(viib) where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person [being a resident]², any consideration for issue of shares that exceeds the face value

¹ BLP Vayu (Project-1) (P.) Ltd. vs PCIT [2023] 151 taxmann.com 47 (Delhi - Trib.)

² The words 'being a resident' have been omitted by the Finance Act 2023 with effect from 1 April 2024.

of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the share”

Decision of the ITAT:

The ITAT noted /observed the following:

Applicability of section 56(2)(viib) of the ITA

- In the case under consideration, the shares had been allotted at a premium to its 100% holding company. Thus, applicability of section 56(2)(viib) of the ITA had to be seen in this perspective.
- The Ahmedabad Bench of ITAT in an earlier ruling³ had analysed the deeming provisions of section 56(2)(viib) of the ITA threadbare and, *inter alia*, observed that the deeming clause required to be given a schematic interpretation. The transaction of allotment of shares at a premium was between holding company and subsidiary company and thus when seen holistically, there was no benefit derived by the taxpayer by issue of shares at certain premium notwithstanding that the share premium exceeded FMV. It was a transaction between self.
- The objective behind the provisions of section 56(2)(viib) of the ITA was to prevent unlawful gains by issuing company in the garb of capital receipts.
- In the case under consideration, not only that the FMV was supported by independent valuer report, the allotment was also made to the existing shareholder holding 100% equity and therefore, there was no change in the interest or control over the money by issuance of shares.
- The object of deeming an unjustified premium charged on issue of share as taxable income under section 56(2)(viib) was wholly inapplicable for transactions between holding and subsidiary company where no income could be said to accrue to the ultimate beneficiary i.e. holding company. The chargeability of deemed income arising from transactions between holding and subsidiary or vice versa militated against the solemn object of section 56(2)(viib) of the ITA.
- In this backdrop, the extent of inquiry on the purported credibility of premium charged would not matter as no prejudice could possibly result from the outcome of such inquiry. Thus, the condition for applicability of section 263 for inquiry into the transactions between holding and subsidiary company was of no consequence.
- The Delhi Bench in an earlier ruling⁴ had held that section 56(2)(viib) of the ITA could not be applied in case of transaction between holding company and wholly owned subsidiary company in the absence of any benefit occurring to any outsider.

Thus, section 56(2)(viib) of the ITA was not applicable in the case under consideration.

In view of the above, the ITAT held that revisional action was unjustified and without the jurisdictional requirement of section 263 of the ITA. Thus, the revisional order of PCIT was cancelled and AO's order was restored.

³ DCIT vs. Ozone India Ltd. [2021] 126 taxmann.com 192 (Ahmedabad ITAT)

⁴ KBC India Pvt. Ltd. vs. ITO [ITA No.9710/Del/2019] (Delhi ITAT)

Comments:

This ruling has held / upheld the following:

- The transaction of allotment of shares at a premium between holding company and subsidiary company when seen holistically, there is no benefit derived by the taxpayer by issue of shares at certain premium notwithstanding that the share premium exceeds the FMV. It is a transaction between self.
- The objective behind the provisions of section 56(2)(viib) of the ITA is to prevent unlawful gains by issuing company in the garb of capital receipts.
- The object of deeming an unjustified premium charged on issue of share as taxable income under section 56(2)(viib) is wholly inapplicable for transactions between holding and its subsidiary company where no income can be said to accrue to the ultimate beneficiary i.e. holding company.
- The chargeability of deemed income arising from transactions between holding and subsidiary or vice versa militates against the solemn object of section 56(2)(viib) of the ITA.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.



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