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Cost of underlying shares on redemption of GDR and long-term capital loss on STT paid shares not to be ignored

On conversion of GDRs into shares, weighted average price cannot be adopted as cost of shares and LTCL on sale of shares subject to STT can be carried forward without setting off against LTCG on sale of shares subject to STT and claim exempt u/s 10(38).

The Mumbai Tribunal, in the case of a non-resident taxpayer, held that weighted average price of the share prevailing on the stock exchange should not be considered for cost of acquisition of shares on redemption of Global Depository Receipts (GDRs). Further the Tribunal held that long-term capital loss (LTCL) on sale of shares subjected to Securities Transaction Tax (STT) can be carried forward and is not to be set-off against long-term capital gains exempt from tax under section 10(38) of the Income tax Act, 1961.

Facts of the case:

Nomura India Investment Fund Mother Fund[1] (taxpayer or Nomura) is an approved sub-account of the Master Trust Bank of Japan Limited, a Foreign Institutional Investor (FII) registered with the Securities and Exchange Board of India (SEBI). During financial year 1 April 2006 to 31 March 2007, relevant to the assessment year 2007-08, the taxpayer redeemed Global Depository receipts (GDRs) into the underlying equity shares. As per para 7(3) of the Issue of Foreign Currency Convertible Bonds And Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993, on redemption, the cost of acquisition of the shares underlying the GDR shall be reckoned as the cost on the date on which the Overseas Depositary Bank advises the Domestic Custodian Bank for redemption. The price of the ordinary shares of the issuing company prevailing on the Bombay Stock Exchange or on the National Stock Exchange on the date of the advice of redemption shall be taken as the cost of acquisition of the underlying ordinary shares. In the instant case, the date of cancellation of the GDR and release of the underlying equity shares was a public holiday and so the taxpayer took the opening share price prevailing on the stock exchange on the immediately next working day.

Due to fluctuating prices on the next working day, the Assessing Officer considered the weighted average price of shares as cost of acquisition and accordingly the short-term capital loss was reduced substantially.

Further taxpayer had earned long-term capital gain (LTCG) on sale of shares subject to STT and claimed exemption under Section 10(38) of the Income tax Act, 1961, without setting off long-term capital loss on sale of shares subject to STT. However, the Assessing Officer considered the term income as used in Section 10(38) of the Act, as entire receipt arising from transfer of long-term capital asset which includes loss and did not allow carry forward of long-term capital loss.

An appeal was preferred by the taxpayer before the CIT(A). However they did not succeed.

Decision of ITAT:

Cost of Acquisition of Shares on redemption of GDRs

[1] ITA 8140/Mum/2010

The ITAT observed that there is no specific provision in the Act providing for determination of cost of acquisition of underlying shares on redemption of GDRs. Sec.55(2)(ac) provided some insight on the matter. Provision to Section 55(2)(ac) provides that where the capital assets are listed on any recognised stock exchange as on January 31, 2018, the highest price of the share quoted on the said date should be considered as fair market value and where there is no trading of capital asset on the said date, the highest price of such asset on said exchange on a date immediately preceding the date shall be considered as the fair market value.

ITAT observed that ideally the closing price prevailing on the stock exchange on the date immediately preceding the date of advice (being a public holiday) should have been considered for the purpose of calculating the cost of acquisition of the shares. However as the dispute was only with regard to the price of shares and not the date, the ITAT did not indulge in that issue.

ITAT held that in absence of any specific mandate either in the statute or in the Scheme, weighted average price towards cost of shares cannot be adopted. Accordingly based on the facts and circumstances, opening price of the share on next working day, which is close to the closing price on the day prior to the holiday, is the most appropriate price.

Setting off of LTCL on sale of shares subject to STT against LTCG on sale of shares subject to STT

ITAT observed that on reading section 10(38) of the Act, the exemption is in respect of income derived from sale of shares where STT has been paid. Therefore, it cannot be said that capital gain on sale of shares is generally exempt. Only on fulfillment of certain conditions, gains derived from sale of shares is exempt u/s 10(38) of the Act. Thus, the income derived from sale of shares is not exempt itself.

ITAT has relied on co-ordinate bench ruling in Raptakos Brett & Co. Ltd[2], United Investments[3], Somnath Vaijanath Sakre[4] and Raptakos Brett & Co. Ltd (HC)[5] and held that long-term capital loss arising on sale of shares cannot be set off against long-term capital gains on sale of shares subjected to STT and claimed exempted under Section 10(38) of the Act. The ITAT also held that the said loss was allowed to be carried forward to subsequent years.

Observation:

The Mumbai Tribunal in The Master Trust Bank of Japan Ltd., as trustee of Black Rock India Equity Fund[6] has held that, "Therefore, the average market price adopted as the "prevailing price" on the date of conversion of GDRs into equity shares as the 'cost of acquisition' is reasonable and justifiable in the absence of any other circular/Rule vis-à-vis Scheme under which GDRs are issued and redeemed into ordinary shares of the company." This decision of the Tribunal was followed by the Mumbai Tribunal in M/s. LG Asian Plus Ltd[7] .

Apparently from the Tribunal order in Nomura, it appears that these decisions of the Mumbai Tribunal have not been referred.

The Mumbai ITAT has been consistent with recent judicial precedents that long-term capital loss arising on sale of shares subject to STT, cannot be ignored or set-off against long-term capital

[2] [2015] 58 taxmann.com 115 (Mumbai - Trib.)
[3] ITA No. 511/Kol/2017 for A.Y. 2013-14 order dated 01.07.2019
[4] ITA No.2986/Pun/2016 for A.Y. 2012-13, order dated 08.03.2019
[5] [Income Tax Appeal no. 357 of 2016 dated 09.10.2018
[6] I.T.A. No.7793/M/2011 (2013) for the AY 2008-09 vide order dated 10 May 2013
[7] ITA No. 7921/M/2010) for the A.Y. 2007-08 vide order dated 31 July 2015

gains on sale of shares subject to STT, which are exempt under Section 10(38) of the Act. However, the Central Board of Direct Taxes *vide* the FAQ (F. No. 370149/20/2018-TPL) dated 4 February 2018 on the Finance Bill 2018 had clarified as under:

*"**Q 23.** What will be the treatment of long-term capital loss arising from transfer made between 1st February, 2018 and 31st March, 2018?*

***Ans 23.** As the exemption from long-term capital gains under clause (38) of section 10 will be available for transfer made between 1st February, 2018 and 31st March, 2018, the long-term capital loss arising during this period will not be allowed to be set-off or carried forward.*

***Q 24.** What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?*

***Ans 24.** Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.".*