

Tax Alert | Delivering Clarity

31 December 2020

Share application money constitutes capital asset

The Mumbai Bench of Income-tax Appellate Tribunal gave its decision that share application money constitutes capital asset under section 2(14) of the Indian Income-tax Act, 1961.

Background:

- As part of a corporate restructuring a taxpayer¹ transferred its investments (held in the form of equity shares, preference shares and rights to apply for shares i.e. share application money) to other companies within the group.
- The taxpayer suffered losses (viz. long-term and short-term capital losses) on transfer of investment and claimed the same in its income-tax return filed for the Financial Year (FY) 2003-04, corresponding to Assessment Year (AY) 2004-05.
- The Assessing Officer (AO) denied the claim of losses in the audit proceedings for the year under consideration.
- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] allowed the taxpayers claim of losses.
- Aggrieved by the CIT(A)'s order, the Revenue filed an appeal before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT). The ITAT in its initial order allowed the loss claimed on transfer of shares, but denied the loss incurred on share application money on the basis that share application money could not be considered as a capital asset under section 2(14) of the Income-tax Act, 1961 (ITA).

Section 2(14) of the ITA, defines capital asset to mean property of any kind held by a taxpayer, whether or not connected with his business or profession, except those specifically excluded.

- Aggrieved by the ITAT's order, the taxpayer filed a miscellaneous application for re-adjudication by the ITAT on the ground that the issue involved was squarely covered by the decision of the jurisdictional Bombay High Court (HC) in another case².

Decision of the ITAT:

- The ITAT noted that the only issue which required re-adjudication was whether share application money (as transferred by the taxpayer) would constitute capital asset or not. Further, the answer to the same would determine taxpayer's eligibility to claim set-off of these losses as arising out of transfer of share application money to the other entities.

¹ DCIT v. Morarjee Realities Ltd (ITA no 2343/Mum/2009) (Mumbai ITAT)

² CIT v. Siemens Nixdorf Information Systems GmbH [2019] 111 taxmann.com 413 (Bombay HC)

- The ITAT noted the following:
 - Jurisdictional HC in the earlier decision² had refused to admit the question of law raised by the Revenue with regard to the decision given by the ITAT that debt was a capital asset (inter alia, after considering the meaning of term 'property').
 - The Bombay HC in earlier decisions³ had held that:
 - The term 'capital asset' as defined under section 2(14) of the ITA would mean property of any kind held by a taxpayer, whether or not connected with his business or profession, except those which were specifically excluded in the said section. The only exclusion is for stock-in-trade, consumables or raw materials held for purposes of business. Therefore, the word property would have wide connotation to include interest of any kind.
 - The word property would be of widest import and signified every possible interest which a person could hold or enjoy. The term should be given a liberal or wide connotation.
 - The provisions of the Indian Companies Act provide for refund of share application money with interest under certain circumstances.
- In view of the above, the ITAT held that:
 - Loans and share application money as advanced by the taxpayer would stand on same footing since both were advances in nature. Share application money was nothing but mere advances till the time the shares were allotted and share application money converted into share capital.
 - The ratio of the cited decisions was applicable to the facts of the case under consideration.

Accordingly, the ITAT held that, share application money as transferred by the taxpayer constituted a 'capital asset' within the meaning of section 2(14) of the ITA.

Comment:

This ruling lays down an important principle that share application money constitutes a capital asset under section 2(14) of the ITA. Taxpayers transferring share application money may want to evaluate the impact of this ruling to the facts of their specific cases.

³ PCIT v. Reliance Natural Resources Ltd. [2019] 111 taxmann.com 413 (Bombay HC); CWT v. Vidur V. Patel [1995] 215 ITR 30 (Bombay HC); Bafna Charitable Trust v. CIT [1998] 230 ITR 864 (Bombay HC)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material and the information contained herein prepared by Deloitte Touche Tohmatsu India LLP (DTTI LLP) is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This material contains information sourced from third party sites (external sites).

DTTI LLP is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such external sites. None of DTTI LLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this material, rendering professional advice or services. This information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this material.

©2020 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited