

Regulatory Alert Stay Ahead...

Mumbai Tribunal reiterates its view that there is no impediment on companies to make and receive gifts

Issue no: M&A/1/2015

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Executive Summary

Income Tax Appellate Tribunal, Mumbai ('the Tribunal'), based on the facts of the case, has held that:

- There are no impediments on companies to make and receive gifts provided the same is specifically provided under Memorandum of Association and Articles of Association.
- 'Natural love and affection' are not necessary requirements for determining the ability to make and receive gift.
- Gift received by the assessee from corporate bodies are in the nature of capital receipts not liable to tax in the absence of specific charging provisions. The Tribunal has denied the chargeability of such income to tax as capital gains (section 45 of the Income tax Act, 1961 ('the Act')), income from other sources (section 56), deemed dividend {section 2(22)(e)} and unexplained cash credits {section 68}.
- No adjustment was required while computing book profits under section 115JB of the Act in respect of the said capital receipts.

Facts

- KDA Enterprises Pvt. Ltd. ('the Assessee') received gifts aggregating to INR 161.87 crores from four companies ('the donors') in Assessment Year 2009-10. Further, these companies did not have any common shareholders.
- The said gifts were made by the donors by passing board resolutions to the effect that dividend income receivable from shares held in Reliance Industries Limited were to be irrevocably credited to the bank account of the assessee and to the effect of accepting such gift. Further, the said act of making and receiving gift was duly authorised under the Memorandum and Articles of Association of all the companies.
- In the books of accounts of the assessee the said gifts were treated as capital receipts and credited to capital reserve.
- During the course of the assessment proceedings the Assessing Officer made additions by holding that the receipts are neither gifts nor in the form of exempt dividend and accordingly taxed the entire receipt as "income from other sources". Further, adjustments were also made to book profits under section 115JB of the Act while assessing the income of the assessee.
- The Commissioner of Income-tax (Appeals), passed an Order thereby deleting the additions. The tax department challenged the Order by filing an appeal before the Tribunal.

Issues before the Tribunal

- Whether the receipt in the nature of gift from one corporate body to another corporate body are in the nature of 'income' under section 2(24) of the Act?
- Whether the said receipts are taxable as "income from other sources" under section 56(1) of the Act? Alternately, if the receipts are not taxable under section 56(1) of the Act, whether the same are taxable as "benefits" under section 28(iv) of the Act?
- Whether a company can make and accept gifts? Whether 'natural love and affection' is a crucial element for any transaction to qualify as gift?
- Whether the receipts are required to be adjusted while computing book profits in terms of section 115JB of the Act?

Tribunal Ruling

Issue 1:

- In order to bring the receipt under the ambit of taxation under the provisions of the Act, either it has to be in the nature of income, or its taxability has to be specifically provided under the provisions of the Act.
- The gift was voluntary, without consideration and further, neither the Assessee nor the donors were under any legal or contractual obligation to receive/give gifts, respectively. Further, the receipts had nothing to do with business of the Assessee. Accordingly it would not constitute "income" as defined under section 2(24) of the Act.

Issue 2:

- The Assessing Officer has recorded no specific reason for assessing the income under the head "income from other sources" under section 56(1) of the Act but has only done so because the said receipt was found not taxable under other heads of income.
- The legislature has specifically brought to tax, receipts in the nature of gifts wherever the same was intended. Further, reliance was also placed on the case of DP World Pvt. Ltd.¹ and it was held that gifts being capital receipts are neither taxable under section 56(1) of the Act as "income from other sources" nor as benefits under section 28(iv) of the Act.

¹ (2013) 140 ITD 694 (Mumbai-Trib.)

Issue 3:

- The Tribunal after placing reliance on the observation made by the Tribunal in the case of DP World Pvt. Ltd and further placing reliance on the judgement rendered by the Chennai Bench of the Tribunal in the case of Redington (India) Limited² held that there are no impediments casted under legislation upon companies from making and accepting gifts.
- Further, after considering the provisions of Transfer of Properties Act, 1882, the Indian Contract Act, 1872 and the Gift Tax Act, 1958 (repealed) the Tribunal arrived at a conclusion that companies can make and accept gifts.
- The Tribunal further held that “natural love and affection” is not essential characteristic for determining as to whether a particular transaction is in the nature of gift. However, the companies making and accepting gifts should be specifically authorised to do the same by the Memorandum and Articles of Association.
- The Tribunal also observed that intention of the legislation was to tax certain gifts received by individuals and HUFs. Further, the Tribunal also observed that the legislation was amended by insertion of sections 56(2)(vii-a) and (vii-b) to tax gift of shares of companies in which public are substantially interested received by companies, but any other gifts received by the companies or any other person other than individual and HUF are still not taxable under the Act.

Issue 4:

- The Tribunal after placing reliance on the decision of the Apex Court in the case of Apollo Tyres³ and the Bombay High Court in the case of Akshay Textiles & Agencies Pvt. Ltd.⁴ and Kinetic Motor Co. Ltd.⁵ held that
 - once the accounts are prepared in terms of the Companies Act, scrutinized and certified by the statutory auditors, approved by the shareholders and accepted by the Registrar of Companies the Assessing Officer has to accept the authenticity of the accounts.
 - the Assessing Officer has only limited power to make adjustments as provided in Explanation to section 115JB of the Act. Since, the receipt in the nature of gift was rightly credited to capital reserve, no adjustment was required to be made to the profit and loss account of the Assessee.

² (2014) 49 taxmann.com 146 (Chennai - Trib.)

³ (2002) 255 ITR 273 (SC)

⁴ (2008) 304 ITR 401 (Bom.)

⁵ (2003) 262 ITR 330 (Bom.)

Comments

- The said decision of the Tribunal reiterates the well-recognized position that companies can make and receive gifts. The Tribunal has also laid down the following three elements for classification of the transaction as 'gift':
 - Delivery;
 - Donative intent; and
 - Acceptance by donee.
- The Tribunal also observed that companies, if authorized by the MoA & AoA, are competent to make and receive gifts. Further, natural love and affection is a not necessary requirement for a gift.

Way forward

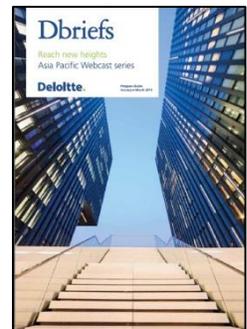
- In light of the aforesaid ruling, the Tribunal has once again recognized the concept of corporate gifts. Further, it is essential for taxpayers to analyze the implications of the aforesaid ruling in similar transactions undertaken/ proposed to be undertaken.

Source: DCIT v/s. KDA Enterprise Pvt. Ltd. (ITA No.2662/Mum./2013)

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