



## Tax alert: Date of share allotment relevant for invoking section 56(2)(viib)

**26 October 2023**

The Delhi Bench of the Income-tax Appellate Tribunal has held that the provisions of section 56(2)(viib) of the Income-tax Act, 1961, would be invoked when the share allotment has been finalised and the subscriber gets allotted the shares i.e., date of share allotment and not date of receipt of share application money.

### In a nutshell



After a subscriber entity advances amount for allotment of shares, the subscriber entity has every right to withdraw or cancel its request for allotment.



A taxing provision cannot be invoked even before the completion of a transaction fully and finally.



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## Background:

- The taxpayer<sup>1</sup> is a company engaged in the business of construction activities.
- During the Financial Year (FY) 2014-15, corresponding to Assessment Year (AY) 2015-16, the taxpayer allotted optionally convertible preference shares at a premium to three investors.
- In the course of audit proceedings, the Assessing Officer (AO):
  - Observed that the share application money was received by the taxpayer in FY 2010-11, corresponding to AY 2011-12 and the shares in respect of the share application money were allotted to the investors during the year under consideration viz. FY 2014-15, corresponding to AY 2015-16.
  - Rejected the valuation (i.e., valuation of shares at premium) as the net worth of the taxpayer was negative.
  - Treated the premium on allotment of preference shares as income of the taxpayer under section 56(2)(viib) of the Income-tax Act, 1961 (ITA).
- Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeal) [CIT(A)] who deleted the addition holding that the taxpayer had received the consideration for issue of shares in FY 2010-11 and the shares were allotted in FY 2014-15, hence the provisions of section 56(2)(viib) which came into force from 1 April 2013 could not be applicable.
- Aggrieved by the CIT(A)'s order, the Revenue filed an appeal before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

## Relevant provisions in brief:

### Relevant extract of section 56(2)(viib) 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<sup>2</sup>, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares”

## Decision of the ITAT:

The ITAT noted that the issue under consideration, amongst others, was whether the provisions of section 56(2)(viib) are applicable for the year under consideration viz. FY 2014-15, corresponding to AY 2015-16 while the amounts were received in FY 2010-11, corresponding to AY 2011-12? In this regard, the ITAT noted / observed as follows:

- Section 56(2)(viib) of the ITA was inserted vide Finance Act, 2012 w.e.f. 1 April 2013 to provide that, where a closely held company receives in any previous year from any person being a resident, any consideration for issue of share that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares, will be charged to tax in the hands of the recipient company as income from other sources.
- After a subscriber entity advances amount for allotment of shares, the subscriber entity has every right to withdraw or cancel its request for allotment.

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<sup>1</sup> ITO vs Appealing Infrastructure (P.) Ltd. [2023] 152 taxmann.com 385 (Delhi - Trib.)

<sup>2</sup> The words 'being a resident' have been omitted by the Finance Act, 2023, w.e.f. 1 April 2024.

- Earlier, under the old Companies Act (i.e. Companies Act, 1956) regime, many companies accepted share application money under private placement and utilized the same for the business purpose even without allotment of shares. Only Schedule VI of the old Companies Act provided the manner to treat the same in the Balance Sheet of the company.

Now, section 42 of the Companies Act, 2013 puts prohibition over the said practice w.e.f. 1 April 2014, companies accepting share application money under private placement have to allot the securities against the share application money received within 60 days. If the securities are not allotted within a period of 60 days, the whole application money is required to be refunded within 15 days from the date of completion of 60 days. If the company fails to repay the application money within the said 60 days period, it shall be liable to repay that money with interest at the rate of 12% per annum from the expiry of the 60<sup>th</sup> day.

- In the case under consideration, the share application money was received in FY 2010-11, corresponding to AY 2011-12 and allotted in FY 2014-15, corresponding to AY 2015-16.

During the intervening period, the taxpayer had every right to get their monies refunded and opt out of the share allotment process. Hence, when the share allotment has been finalised, the subscriber gets allotted the shares, the provisions of section 56(2)(viib) need to be invoked. A taxing provision cannot be invoked even before the completion of a transaction fully and finally.

- The Delhi ITAT in an earlier ruling<sup>3</sup> had also held that share allotment date, not share application, is relevant date to trigger provisions of section 56(2)(viib) of the ITA.

In view of the above, the ITAT held that the provisions of section 56(2)(viib) would be invoked at the time of allotment of shares.

#### **Comments:**

This ruling has held that the provisions of section 56(2)(viib) of the ITA would be invoked when the share allotment has been finalised and the subscriber gets allotted the shares i.e., date of share allotment and not date of receipt of share application money.

While holding the same, the ITAT has considered the following:

- After a subscriber entity advances amount for allotment of shares, the subscriber entity has every right to withdraw or cancel its request for allotment.
- A taxing provision cannot be invoked even before the completion of a transaction fully and finally.

The Chennai ITAT in case of DCIT vs Archean Chemical Industries (P.) Ltd. [2023] 148 taxmann.com 16 (Chennai - Trib.) has also held that in order to apply provisions of section 56(2)(viib) of the ITA, for any previous year, there must be allotment of equity shares and such allotment should be over and above face value of such shares.

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

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<sup>3</sup> Cimex Land and Housing (P.) Ltd. v. ITO [2019] 104 taxmann.com 240 (Delhi ITAT)



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