Sale of shares to a JV Partner at a loss is not a colourable transaction

August 8, 2014

In brief

Recently, the Delhi High Court in the case of **SIEL Limited** (the taxpayer) dismissed the appeal of the revenue authorities, wherein it held that loss resulting from the sale of shares to a Joint Venture (JV) partner would not be a colourable transaction. The price paid for acquiring rights shares could not be equated with the price paid to acquire shares from the shareholders. A different price could not be a ground or reason to disregard and hold that sale of shares at Indian Rupees (INR) 2.02 per share did not represent the true and correct picture. It was further held that the valuation report obtained in accordance with the specific regulation of the statute should be relied upon.

In detail

Facts

The taxpayer[1] and Plansee Tizit Aktiengesellschaft (Plansee) entered into a JV agreement for setting up a company, Siel Tizit Limited (STL), for carrying on the business of hard metals. The two JV partners each had 50% shareholding. The total paid-up equity capital was 15,000,000 equity shares of INR 10 each. STL made two rights issues at par, viz. at INR 10 per share, of 3 million and 10 million shares respectively. The taxpayer, due to financial difficulties, did not subscribe to the rights issues and renounced them in favour of Plansee.

Separately, the taxpayer, in an agreement dated March 31, 1999, sold 12.7 million equity shares for consideration of USD 600,000 which, on conversion, came to INR 2.02 per share of face value of INR 10 each. This resulted in book loss of INR 101.2 million/ indexed loss of INR 136.2 million on capital account. The taxpayer has the shares valued (date of valuation report: April 22, 1999) and also obtained approval from the Reserve Bank of India (RBI), which was received on April 29, 1999. The Assessing Officer did not accept the said capital loss for the following reasons:

- There was a close connection between the two JV partners;
- The rights were issued at par, viz., at INR 10 per share, and the sale of shares was made at INR 2.02 per share;
- Consideration of USD 600,000 was arrived at before the valuation report. The valuation report was merely a ploy to get RBI's approval;
- Rights renunciation and the sale of shares which had been done by SIEL Limited in favour of Plansee had taken place in such a span of time where the rates could not have varied much. Rights renounced at INR 10 was the ideal rate which would have formed the basis for the sale of shares to Plansee;
- Since the shares were held only by two JV partners, the valuation was not guided by market factors;
- The rationale behind infusing additional funds at low prices defied logic. If the company's funds crunch was to be met by this sale, it should have been done at higher prices, or at least at par with the price at which the rights had been renounced;
- Through this arrangement the taxpayer has been able to pass off capital losses without parting with its funds.

[1] CIT *v.* Siel Limited [TS 470-HC-2014(Del)]

Thus, the Assessing Officer held that the taxpayer had sold the shares at a price deliberately lower than prices at which the rights renunciation was offered. The sale should have been made at INR 10 per share, the price at which the rights were renounced. If this was the case, the taxpayer would not have incurred any loss on the sale of shares of STL to Plansee.

The Assessing Officer also placed reliance on the decision of Mcdowell[2] wherein it was held that colourable devices could not be part of tax planning, and that it was wrong to encourage or entertain the belief that it was honourable to avoid the payment of tax by resorting to dubious methods.

The taxpayer did not succeed at the first appellate level, but succeeded on further appeal before the Tribunal. Aggrieved by the Tribunal's order, the revenue authorities preferred an appeal before the High Court.

Issue before the High Court

Whether the sale of shares of STL by the taxpayer to Plansee at a loss was a cover-up, a device whereas the *de facto* or real transaction was different?

High Court's ruling

The High Court held that the revenue authorities had not questioned the following aspects of the transaction:

- If the transaction relating to sale of shares in question was a bogus transaction having no commercial or business reasons;
- If there was a transfer of shares by the taxpayer to Plansee;
- If the sale transaction was a cover up, a device and the *de facto* or real transaction was different.

Therefore, the issue in this regard was whether the sale price received by the respondent taxpayer was the true and correct price, or whether there was some undeclared consideration paid, which was not brought into the books.

A mere difference in the price of the shares could not be a ground or reason to disregard and hold that sale of shares at INR 2.02 per share did not represent the true and correct price. The price paid for acquiring rights shares could not be equated with the price paid to acquire shares from the shareholders, as in the present case.

The High Court also considered the approvals given by the Department of Industrial Policy and Promotion (DIPP) and RBI, for acquiring the shares in STL by Plansee.

Further, the High Court also held that merely because STL was not a listed company and the market price of the shares was not readily available, it did not mean that the consideration declared and paid was sham and not the correct amount that was paid. There was no secondary or additional evidence to demonstrate the finding that the sale consideration was not genuine or true. It was open to the Assessing Officer to make his own valuation, based on the information available to him. The Assessing Officer had also not questioned the information and data used for the purpose of valuation.

Based on the above, the High Court concluded that the sale consideration for sale of shares was not underhand or undeclared, and therefore the appeal of the revenue authorities was dismissed.

The takeaway

The High Court relied on the approvals given by the RBI and DIPP and the valuation report, to rule that the transaction was not a colourable transaction.

Mere reliance on judicial precedents would not sway a Court to agree with a litigant when facts hd not been contradicted.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Direct Tax

Shyamal Mukherjee, *Gurgaon*
+91-124 330 6536
shyamal.mukherjee@in.pwc.com

Ketan Dalal, *Mumbai*
+91-22 6689 1422
ketan.dalal@in.pwc.com

Rahul Garg, *Gurgaon*
+91-124 330 6515
rahul.garg@in.pwc.com

[2] Mcdowell and Co. Ltd. *v.* Commercial Tax Officer [1985] 154 ITR 148 (SC)

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cy ber City, Gurgaon
Haryana -122002
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
+91-20 4100 4444

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in Assurance, Tax and Advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Tell us what matters to you and find out more by visiting us at www.pwc.in