Bonus shares and shares received as gift eligible for concessional rate of tax under section 115E

November 14, 2017

In brief

The Hyderabad bench of the Income-tax Appellate Tribunal (Tribunal) held[1] that bonus shares received by a Non-Resident Indian (NRI or taxpayer) by virtue of holding original shares being eligible foreign exchange asset as defined under section 115C of the Income-tax Act, 1961 (the Act), would partake the character of foreign exchange asset. Such bonus shares would hence be eligible for concessional tax rate of 10% under section 115E of the Act.

The Tribunal further held that shares received by the taxpayer as gift, i.e., without any consideration, would also be considered as foreign exchange asset if the previous owner originally bought the shares using convertible foreign exchange. Such shares would also be eligible for the concessional tax rate of 10% and the cost of acquisition of such shares would be the cost of acquisition to the previous owner.

In detail

Facts

- The taxpayer[1] had declared long-term capital gain on sale of shares in an Indian company and claimed the concessional rate of tax of 10% under section 115E of the Act.
- The shares transferred by the taxpayer comprised of:
  - Bonus shares received by virtue of holding original shares, which were acquired in convertible foreign exchange; and
  - Shares received from overseas investor, free of cost, which included original shares acquired in convertible foreign exchange by the overseas investor and bonus shares allotted thereon.
- The tax officer (TO) held that the taxpayer did not acquire the shares using convertible foreign exchange and therefore was not eligible for concessional rate of 10% under section 115E.

Issues before the Tribunal

Whether long-term capital gains arising to an NRI on transfer of shares received as bonus or gift would be eligible for claiming concessional rate of tax under section 115E of the Act if the original shares were acquired in convertible foreign exchange.

Taxpayer's contentions

With respect to bonus shares

- Bonus shares that rank *pari passu* with the original shares adopted the attributes of original shares. If the original shares were acquired in convertible foreign exchange, the same character should also have been attributed to the bonus shares.
- To support the above contentions, the taxpayer relied on rulings of the Supreme Court[2] and the Mumbai bench of the Tribunal.[3]

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[1] ITA No. 392/ Hyd/ 2017

[2] CIT *v.* Dalmia Investments Co. Ltd. (1964) 52 ITR 567 (SC)

[3] Sanjay Gala *v.* ITO (2011) 46 SOT 482 (Mumbai)

With respect to shares received as gift

The transaction of receipt of shares without any consideration was in the nature of gift. Thereby, the taxpayer had stepped into the shoes of the earlier owner for the purpose of computing the cost and period of holding of shares. Hence, the attributes and the cost of acquisition of original shares for the overseas investor should have been considered as the attributes and the cost of acquisition for the taxpayer also.

Revenue's contention

The taxpayer acquired shares from overseas investors without investing any convertible foreign exchange. The taxpayer had claimed benefit under section 115E of the Act, thereby, defeating the purpose of giving concession to NRI's, which was to encourage investments in convertible foreign exchange, and therefore, the taxpayer was not entitled to the concessional rate under section 115E of the Act.

Tribunal's ruling

- The bonus shares acquired the nature of the original shares. Therefore, the bonus shares would also be considered as foreign exchange assets under section 115E of the Act.
- With respect to the shares received as gift, the cost of acquisition of the previous owner was treated as the cost of such shares for the taxpayer. Applying the same analogy, the nature of shares would also remain the same for the taxpayer.
- Accordingly, the Tribunal concluded that, the taxpayer should have been eligible for concessional tax rate of 10% under section 115E with respect to bonus shares and shares received as gift where original shares were acquired in convertible foreign exchange.

The takeaways

This is an important ruling by the Tribunal in the context of capital gains taxation of NRIs with respect to shares acquired in convertible foreign exchange providing guidance on taxation of bonus shares and shares received as gift.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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