

# What's New

## Tax News Alert



August 2018

### ***Provisions of section 56(2)(viib) can apply to excess consideration despite satisfactory explanation provided under section 68 of the Act***

#### ***In Brief***

In a recent decision, the Kerala High Court (HC), *inter alia*, has held that whether the amount received by the taxpayer in the form of share premium has been correctly offered to tax, is an issue to be examined with reference to section 56(2)(viib) of the Income-tax Act, 1961 (the Act) and if it is found that the share premium has not been correctly offered to tax as provided therein, the taxpayer has to be assessed in accordance with the said provision.

#### ***In detail***

##### ***Facts of the case***

- The taxpayer for the year under consideration has received share premium on allotment of shares of face value INR 100 each at a premium of INR 291 per share;
- Subsequently, the Tax Officer (TO) issued a notice under section 143(2) of the Act, enquiring whether the amount received by the taxpayer in the form of “share premium” is from disclosed sources and whether the same have been correctly offered to tax.
- In response to the notice issued, the taxpayer disclosed the genuineness of the persons who purchased the shares on premium and stated that the same has been correctly offered to tax.
- However, the TO completed the assessment by making addition in respect of share premium received under section 56(2)(viib) of the Act, i.e., under the head Income from Other sources.
- Subsequently, the taxpayer filed a writ petition before the HC challenging the order of the TO.

##### ***Taxpayer's contentions***

- There was no scope for further assessment of share premium received where the source of funds has been disclosed.
- Further, the provision of section 56(2)(viib) would not be applicable unless the test under section 68 of the Act is satisfied.

##### ***Revenue's contentions***

- The provisions of section 68 of the Act cannot be taken as governing by section 56(2)(viib) of the Act.
- Further, the provisions of section 56 of the Act falls under the chapter “Computation of Income,” whereas section 68 comes under “Aggregation of Income and Set-off or Carry Forward of Loss”.
- The provisions for computation was amended to bring within the ambit of taxable income any premium paid for purchase of shares.

##### ***Issue before the High Court***

Whether the excess share premium received by the taxpayer, despite satisfactory explanation on source of funds and proving its genuineness, would be taxable under the head income from other sources?

##### ***High Court's decision***

- The HC noted that any premium received by the closely held company (in which the public are not substantially interested) on the sale of shares in excess of their face value, would be treated as Income from Other Sources.
- Further, the HC observed that the provisions of section 56(2) of the Act, are triggered at the stage of computation of income itself, when the share application money received is above the face value. Accordingly, the aggregate consideration received in excess of fair market value will be taxable as Income from Other Sources.

- The HC further noted that any credit in the books of accounts for which a satisfactory explanation (i.e. the nature and source of the amount credited) is not offered, the whole amount would be taxable by virtue of proviso to section 68 of the Act.
- Further, the HC observed that if an explanation is offered and is satisfactory to the TO, then the amount exceeding the fair market value as determined would be liable to be taxed, which anyways would be taxable under the provisions of section 56(2)(viib) of the Act.
- The HC held that if the provisions of section 68 are applicable, and the proviso to section 68 is not satisfied, then the entire amount credited to the books of account would be treated as income. If a satisfactory explanation is offered as to the source, then the excess premium received will be brought to tax as income from other sources.
- It was also held that provisions of section 56(2)(viib) of the Act cannot be governed by the provisions of section 68 of the Act.

### ***The takeaways***

This ruling reinforces the principle that a satisfactory explanation under section 68 of the Act would not rescue taxpayers from taxability under section 56(2)(viib) of the Act in relation to the excess share premium received by a closely held company, regardless of a satisfactory explanation of the nature and source of funds and proving the genuineness of the persons purchasing the shares.

<sup>1</sup> WA No. 1297 of 2018 in WP (C) No. 3485/ 2018

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