

# *Premium received on issue of shares and where proved would be on capital account*

May 14, 2018

## *In brief*

The Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) in its recent ruling,<sup>1</sup> relied on the Bombay High Court (HC) decision<sup>2</sup> to hold that the premium on share issue was a capital account transaction and did not give rise to income within the charging sections of the Income-tax Act, 1961 (the Act).

## *In detail*

### **Facts**

- During financial year 2011-12, the taxpayer had raised funds from its non-resident shareholders by issue of equity shares of face value at a premium.
- The tax authorities added the amount of share premium as income under section 56(1) and without prejudice as unexplained income under section 68 of the Act.
- The Commissioner of Income-tax (Appeal) had rejected the addition under sections 56(1) and 68.
- The tax authorities filed an appeal in relation to deletion under section 68.

### **Issues before the Tribunal**

- Whether the amount received as share premium

could be characterised as income chargeable under section 68 of the Act?

### **Taxpayer's contentions**

- Issue of shares was a capital account transaction and did not give rise to income. The taxpayer relied on the Bombay HC decision<sup>2</sup> and the Central Board of Direct Taxes instruction.<sup>3</sup>
- The share capital was raised after obtaining Reserve Bank of India's approval, which was issued after considering the valuations under discounted cash flow method.

### **Revenue's contentions**

- The taxpayer had not satisfactorily explained the "nature" of share premium.
- The valuation that sought to justify the share premium,

submitted by the taxpayer needed to be rejected.

- The Bombay HC decision<sup>2</sup> related to transfer pricing additions and not to additions made under section 68 of the Act.

### **Tribunal's ruling**

- The Tribunal rejected tax authorities contention regarding non-applicability of the Bombay HC's decision<sup>2</sup> and re-iterated the finding of the HC that transfer pricing provisions, as contained in Chapter X, are machinery provisions, and there had to be firstly an income chargeable to tax and only then could the machinery provisions be applied.
- The tax authorities had accepted the genuineness of the funds raised through equity shares to the tune of

<sup>1</sup> ITA No. 4860/ Mumbai/ 2016

<sup>2</sup> Vodafone India Services Private Limited v. Union of India [2014] 368 ITR 1 (Bombay) and [2014] 369 ITR 511 (Bombay)

<sup>3</sup> CBDT instruction No. 2 /2015 dated 29 January, 2015

the face value of shares in the same year.

- The incriminating information used by the Revenue to discredit the valuation was based on perverse fact finding which was already rejected by the Tribunal.
- As far as the deeming fiction of section 68 of the Act was concerned, no reliable incriminating fact finding was available on record to tax the said amount within the provisions of section 68 of the Act.

- Therefore, no addition was warranted towards share premium in view of the factual matrix of the case.

### ***The takeaways***

- The Tribunal has re-iterated the view that the provisions of section 68 do not apply to capital account transactions such as receipt of share premium on issue of shares which are not in the nature of income.
- It is pertinent to note that the amendment inserted *vide* the Finance Act, 2012 (with effect

from 01 April, 2013) has provided that the company receiving share premium or any such amount by whatever name called, and the person paying the same, need to provide explanation about the nature and source of such amount to the satisfaction of the tax officer for not falling into the ambit of section 68.

### ***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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