

Share-sale to second step down 100% subsidiary not “transfer”

March 16, 2018

In brief

The Kolkata bench of the Income-tax Appellate Tribunal (Tribunal) held that the benefit of section 47(iv) of the Income-tax Act, 1961 (the Act) will be available on the transfer of capital asset to its second step down 100% subsidiary.

In detail

Facts

- The taxpayer¹, an Indian Company, sold shares of a listed company to its 100% second step down subsidiary and claimed long-term capital loss.
- The sale price of the shares was determined based on the valuation report obtained from an independent valuer.
- The claim was disallowed by the tax officer (TO), stating that the price of shares was required to be taken based on the price quoted at the stock exchange and not as per the valuation report.

Issues before the Tribunal

- Whether there is a transfer of shares as per section 47(iv) of the Act?
- If the answer to the above is negative, then whether computation of capital gains as made by the TO and confirmed by the

Commissioner of Income-tax (Appeal) [CIT(A)] was correct or not, and whether the TO could substitute the sale consideration of the shares sold with the fair market value determined by the TO?

Taxpayer's contentions

- The market price of listed shares was driven by various market forces, some of which could be calculated, while others could not. Therefore, there was a huge difference in the price determined by an independent valuer and that quoted at the stock exchange.
- The Act did not contain any provision for taxability of deemed capital gain in the hands of the seller on sale of property, except in case of an immovable property.
- The taxpayer, for the first time before the TO, also claimed that the sale of the capital asset to its subsidiary was exempt

under section 47(iv) of the Act. The claim was not made in the return of income filed by taxpayer. However, the claim was rejected by the TO on the ground that the second step down subsidiary was not covered under section 47(iv) of the Act.

- The CIT(A), upheld TO's order.

Revenue's contentions

- The price as quoted on the stock exchange should have been considered to determine the sale consideration.
- The capital gain exemption claimed by the taxpayer under section 4(iv) of the Act was rejected by relying on Goetze (India) Limited².
- Further, the provisions of section 47(iv) of the Act are not applicable on the taxpayer, as they do not include a second step down subsidiary, following the decision of Gujarat High

¹ I.T.A No. 880/Kol/2014

² Goetze (India) Limited v. CIT [2006] 284 ITR 323 (SC)

Court (HC) in the case of Kalindi Investment Private Limited³.

Tribunal's ruling

- The Tribunal accepted that there was divergent views on whether the benefit of section 47(iv) was available to the second step down subsidiary or not.
- The Bombay HC in the case of Petrosil Oil Company Limited⁴ had held that the term “subsidiary” was not defined in the Act. Thus, reference could be made to the definition of “subsidiary” provided under

the Companies Act, 1956.

- As per the Companies Act, the subsidiary of a company also includes a sub-subsidiary of the company.
- The shares of the second step down subsidiary were held by its 100% subsidiary throughout the previous year, thereby, fulfilling the conditions of Companies Act.
- Thus, the transaction of sale of capital asset, being shares of a listed company, by taxpayer to its second step down subsidiary, was not regarded as transfer under section

47(iv) of the Act.

- Therefore, the question of computing either capital gain or loss does not arise in the case of the taxpayer.

The takeaway

A sale by a holding company to its second step down 100% subsidiary company, will not be regarded as “transfer.”

Let's talk

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

³ Kalindi Investment Private Limited v. CIT [2002] 256 ITR 713 (Gujarat)

⁴ Petrosil Oil Company Limited v. CIT [1999] 236 ITR 220 (Bombay)

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