

Tribunal holds that provisions of section 56(2)(viib) not applicable where the company had only closely related shareholders and there was no possibility of unaccounted money being involved

September 21, 2018

In brief

The Chennai bench of the Income-tax Appellate Tribunal¹ (Tribunal) lifted the corporate veil in case of a company having shareholders who were relatives to hold that the provisions of section 56(2)(viib) of the Income-tax Act, 1961 (Act) are not attracted on subscription to shares by existing shareholders at a substantial premium, provided the genuineness of the source of investment is not in dispute.

In detail

Facts

- The taxpayer engaged in real estate business had two shareholders, i.e., Mrs. A and Ms. B (being mother and daughter, respectively) each holding 50% stake.
- Mrs. A subscribed to 10,100 shares of the taxpayer, at a premium.
- The revised shareholding of the taxpayer was 75% and 25%, held by Mrs. A and Ms. B, respectively.
- Subsequent to infusion of capital by Mrs. A, the taxpayer acquired a land.
- On assessment, the tax officer (TO) made additions under the provisions of

section 56(2)(viib) of the Act.

- The First Appellate Authority upheld the TO's order.

Taxpayer's contention

- Section 56(2)(viib) of the Act was introduced to deter the generation and use of unaccounted money through infusion of funds from **unconnected persons/ shareholders** at a substantial premium, which ultimately confers the benefit to existing shareholders by enhancing the value of their shareholding.
- The fair market value (FMV) of the taxpayer after acquisition of land was

equal to FMV computed in accordance with section 56(2)(viib) of the Act.

- In the instant case, Mrs. A undertook the infusion for the specific purpose of acquiring land.
- As the money was brought in by an existing shareholder for the specific use of the taxpayer (and not for the benefit of other shareholders), the provisions of section 56(2)(viib) of the Act could not be attracted.
- Even if, the introduction of funds at a very high premium had benefitted Ms. B, the transaction would not be subject to tax in view of the relative

¹ ITA No. 1352/Chny/2018 dated 27 August, 2018

exemption under section 56(2)(x) of the Act.

Revenue's contention

- Section 56(2)(viib) of the Act is absolute in its wording and does not provide for any exemptions other than the ones specifically provided.
- Section 56(2)(viib) of the Act provides a specific mechanism to determine the FMV.
- In addition, the exclusion of "relatives" from the liability of taxation is provided only under sections 56(2)(v), 56(2)(vi) and 56(2)(vii) of the Act, and not under 56(2)(viib) of the Act.
- The FMV arrived at by the taxpayer was subsequent to the receipt of share application money and acquisition of land, and thus, could not be considered for the purpose of section 56(2)(viib) of the Act.
- Considering the mechanism prescribed, the infusion by Mrs. A attracted taxation under section 56(2)(viib) of the Act.

Tribunal's ruling

- Section 56(2)(viib) of the Act is a deeming fiction introduced to curb the generation and use of unaccounted money.
- Mrs. A's source of investment was genuine and not disputed.
- Legal fictions should be carried to their logical conclusion within the framework of the purpose for which it is created.
- In case of the taxpayer, the corporate veil is required to be lifted, and thereafter, the transaction has to be viewed in light of relevant provisions.
- On lifting the taxpayer's corporate veil, it was evident that a benefit of approximately 25% (revised shareholding) arose to the daughter due to infusion by her mother (i.e. prescribed relatives).
- The current infusion would not benefit the other shareholders inducted in future, as the subsequent shares would have to be allotted on the basis of

intrinsic value computed based on the mechanism provided under section 56(2)(viib) of the Act.

- Thus, on a harmonious reading of section 56(2)(vi), (vii) & (x) of the Act, with the intention of introducing section 56(2)(viib) of the Act and lifting the corporate veil, it was clear that the provisions of section 56(2)(viib) of the Act was not attracted.
- Thus, the Tribunal deleted the addition made under section 56(2)(viib) of the Act.

The takeaways

This ruling will ease implementation of group restructuring/ restructuring of capital of companies having shareholders who are relatives, unless there is a question about the genuineness of source of investment.

Let's talk

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

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Hyderabad

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

Gurgaon

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

Bengaluru

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

Kolkata

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

Pune

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

Chennai

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

Mumbai

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

For more information

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

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with more than 236,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com

In India, PwC has offices in these cities: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Jamshedpur, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

©2018 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2018 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.