

Management rights of mutual fund schemes are capital asset – gains on transfer taxable as capital gains

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In brief

In a recent ruling,¹ the Delhi bench of the Income-tax Appellate Tribunal (Tribunal) held that consideration received by the taxpayer (an Asset Management Company) on transfer of management rights of schemes of a mutual fund is taxable as capital gains. Further, to compute capital gains, the cost of acquisition of management rights should have been the actual purchase price in case the rights were acquired, and nil in any other case.

In detail

Facts

- The taxpayer was an investment manager managing 14 schemes of a mutual fund, of which two were acquired earlier from another mutual fund.
- The consideration paid for the acquisition of the aforesaid two mutual fund schemes was capitalised as intangible assets in the books of accounts, and depreciation at 25% was claimed on the same as per the provisions of the Income-tax Act, 1961 (the Act).
- In the year under consideration, the taxpayer transferred the management rights of the 14 schemes of the mutual fund. The consideration received by the taxpayer

was termed as “retirement fees.” The taxpayer treated the said receipt as capital receipt, not chargeable to tax.

- The tax officer (TO) held that the consideration received on transfer of management rights should have been taxable as capital gains, as the taxpayer had itself accepted that the management rights acquired were capital assets, which were capitalised in its books.
- The Commissioner of Income-tax (Appeals) [CIT(A)] had granted relief to the taxpayer by holding that since the cost of acquisition and cost of improvement for certain mutual fund schemes could not be ascertained, the capital gains

computation mechanism failed. Therefore, no capital gains was leviable on the consideration received in respect of transfer of such schemes. To conclude the aforesaid, the CIT(A) relied on the Supreme Court's (SC) decision in the case of B.C. Shrinivasa Shetty².

Issues before the Tribunal

- Whether the management rights could be regarded as “capital asset,” and if so, whether the cost of acquisition thereof shall be taken as nil, if no cost was incurred for its acquisition as per provisions contained under section 55(2)(a) of the Act?
- Alternatively, whether the consideration received by the taxpayer on transfer of management rights should

¹ ITA No. 4782/DEL/2013

² CIT v. B. C. Shrinivasa Shetty [1981] 128 ITR 294 (SC)

have been considered as business income as per section 28(va)(a) of the Act, as it was received for not carrying out business?

Revenue's contentions

- The Revenue contended that the consideration received by the taxpayer should have either been taxable under the head "capital gains" or under the head "income from business or profession."
- A right to manage the schemes is akin to the "right to carry any business." For the purpose of computing capital gains, the cost of acquisition of the right to manage schemes should have been arrived at by applying the provisions of section 55(2)(a) of the Act pertaining to "right to carry on business."
- Further, if the above transfer of management rights could not have been said to be covered under the head "capital gains", then it should have been taxed under section 28(va)(a) of the Act as the consideration was received for not carrying out a business.

Taxpayer's contentions

- The consideration received for the right to manage the

schemes was in the nature of capital receipt and thereby not chargeable to tax.

- Further, the taxpayer contended that out of the total 14 schemes of mutual fund, 12 were floated by it and no cost of acquisition could be attributable for such schemes. Relying on the decision of B. C. Shrinivasa Shetty², the taxpayer contended that since the capital gains could not be determined, it could not be chargeable to tax.
- The provisions of section 55(2)(a) and section 28(va)(a) was not applicable in the taxpayer's case.

Tribunal's decision

- The Tribunal held that the consideration received by the taxpayer on transfer of the management rights of a mutual fund could not be treated as "Retiring Fees." The taxpayer itself had earlier treated the consideration paid for acquiring the management rights of two schemes as a capital asset (intangible asset) and thereon claimed depreciation. Accordingly, the taxpayer could not adopt a different stance for the other 12 schemes floated by it. The management rights was to be

treated as a capital asset.

- Accordingly, the consideration received by the taxpayer should have been taxable under the head "capital gains."
- For the cost of acquisition of management rights, amended provisions of section 55(2)(a)³ of the Act [applicable with effect from 01 April, 2003] which provides the mechanism for cost of acquisition for "right to carry on business" was to be applied. The ratio laid down by the SC decision in the case of B.C. Shrinivasa Shetty² was not applicable to the facts and circumstances of this case.

The takeaways

Management rights of mutual fund schemes are to be treated as capital assets and the consideration on transfer thereof, taxable under the head "capital gains." If the management rights are purchased from a previous owner, the cost of acquisition of such asset is the amount of purchase price, else the cost of acquisition is to be considered as nil.

Let's talk

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

³ For computation of capital gains, the cost of acquisition of "right to carry on any business" is (a) in case of acquisition of

such right by purchase from a previous owner, the amount of purchase price; or

(b) in any other case (barring a few exceptions) to be taken as nil.

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