Tax Insights

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Tribunal rejects Revenue's contention that the arrangement made pursuant to the scheme of amalgamation approved by the High Court is a colourable device and holds no double taxation is permissible

In brief

The Bangalore bench of the Income-tax Appellate Tribunal (Tribunal)[1] held that, considering that the arrangement in question had been made pursuant to the composite scheme of amalgamation sanctioned by the Madras High Court during FY 2010-11 (scheme), no infirmity was found in the arrangement which makes it a colourable device. The Tribunal also held that double taxation is not permissible.

In detail

Facts

- The taxpayer is a limited company engaged in the business of manufacture and sale of beer.
- As a part of the scheme, the taxpayer's group company (transferor company 1) and the wholly owned subsidiary of the transferor company 1 (transferor company 2) were amalgamated with the taxpayer. The taxpayer held 50% of the equity share capital of the transferor company 1. Pursuant to the scheme, out of the 100% equity shares held by transferor company 1 in transferor company 2, 50% equity shares in transferor company 2 were vested in a trust settled by the taxpayer for own benefit.
- As a part of the scheme, the taxpayer issued 60,07,413 equity shares to the trust in lieu of shares held in transferor company 2.
- During the year under consideration, the trust sold the aforesaid 60,07,413 equity shares in the open market, resulting in a gain, and remitted the net proceeds to the taxpayer as disbursement to the beneficiary. The trust offered the capital gains and claimed exemption under section 10(38) of the Income-tax Act, 1961 (the Act). The taxpayer credited the receipt to the general reserve.
- The Tax Officer (TO) contended that the taxpayer had used a colourable device in the form of trust to avoid payment of capital gains tax arising out of the sale of the taxpayer's shares and made an addition as 'long-term capital gain' in the hands of the taxpayer.

[1] ITA No.481/Bang/2018

Issue before the Tribunal

Whether the Commissioner of Income-tax (Appeals) [CIT(A)] has erred in confirming the action of the TO in making an addition of the proceeds to the income of the taxpayer, towards alleged capital gains, totally disregarding the facts of the case and the legal principles?

Taxpayer's contentions

- As per the Companies Act, 1956, a company cannot hold its own shares, and it either has to cancel such shares after allotment, in which case its capital base gets eroded, or the shares are parcelled out to any other entity (the trust in the present case) so that the value of the shares of the resultant company can be capitalised. The shares were issued to the trust, without cancelling the same, to protect the capital base of the taxpayer (combined entity).
- The trust had reported the capital gains arising out of the sale of the shares in its return of income, and the same had been accepted by the income-tax authorities. The mere fact that the trust was eligible and claimed the exemption under section 10(38) of the Act does not make the income taxable in the hands of the taxpayer. Having accepted the capital gains in the hands of the trust, the income-tax authorities could not tax the same income in the hands of the taxpayer, leading to double taxation.
- The Revenue has accepted a similar transaction in case of another group company of the taxpayer in an earlier year.
- In case the shares of the transferor company 2 were cancelled without any allotment to the trust, no capital gains would have accrued to the taxpayer.

Tribunal's ruling

- It was undisputed that the capital gains arising from the sale of shares were offered to tax in the hands of the trust, and the same were accepted by the income-tax authorities.
- When the income has already been offered to tax by the trust and exemptions have been claimed, the TO has failed to establish the reason why the same income has to be once again considered in the hands of a different taxpayer.
- Alleging that the taxpayer used a colourable device to avoid the payment of capital gains and by applying the provisions of GAAR and taxing the same income once again in the hands of the taxpayer would lead to double taxation, which is not permissible.
- The trust was a separate taxpayer under the provisions of the Act and considering that the above arrangement has been made pursuant to the scheme granted by the High Court, there was no infirmity in the arrangement which makes it a colourable device.
- The taxpayer's contention that if the shares were cancelled in the first instance, instead of creating the trust to hold the same, it would not have resulted in capital gains.
- Even if it were to be held that the income of the trust is the income of the taxpayer, there is no reason why the benefit of the exemption under section 10(38) of the Act cannot be extended to the taxpayer as well.
- Since under both the above arrangements, there are no resultant capital gains that will be liable to tax, there is no question of claiming the arrangement to be a colourable device.

The takeaways

The Tribunal deleted the addition of long-term capital gains made by the TO in the hands of the taxpayer. Where the arrangement of a trust was made pursuant to the scheme approved by the High Court, the Tribunal held that it did not find infirmity in such arrangement leading to the conclusion of the colourable device. Moreover, the ruling specifically noted that the lower authorities failed to establish why the income was to be once again included in the hands of the taxpayer when the same was already concluded in the hands of the trust.

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