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Transfer of shares to parent company at book value cannot be treated as a sham

In brief

The Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal), in a recent ruling in the case of Euro RSCG Advertising Pvt. Ltd.¹ (the assessee) has held that actual acquisition price/cost of shares cannot be substituted with (lower) fair value of shares for computing capital gains on share transfer. It was held that acquisition of shares from related parties at a price higher than the fair value cannot be held as a make-believe arrangement or colourable transaction.

Facts

- The assessee was engaged in the business of rendering communication services, including advertising, sales promotion, direct marketing, corporate communications and public relations.
- During AY 2007-08, the assessee transferred 10,400 shares held in Euro RSCG Target Media Pvt. Ltd (Euro TM) to its parent company, Havas International ‘**at cost**’ of INR 24.2 million.
 - 2,400 shares in Euro TM were purchased in 2002; and

¹ Euro RSCG Advertising Pvt. Ltd [TS-496-ITAT-2012 (Mum)]

- 8,000 shares were allotted at premium, towards discharge of consideration for sale of media business in 2006.
 - o The price at which the allotment was made was greater than the fair market value determined by an independent valuer.
- The assessee computed short-term capital gains at 'Nil' for 8,000 shares and long-term capital loss (due to indexation) for the balance 2,400 shares.

Issues

Based on these facts, whether the cost of acquisition of shares to be taken as per books, i.e. actual cost or (lower) fair market value as on the date acquisition for the purpose of determining capital gains ?

Revenue's contentions

- The cost of acquisition of 8,000 shares, being the allotment price, was higher than the net asset value on the date of allotment.
- The allotment of shares to the assessee at high premium was unreasonable, given that the transaction was between related parties.
- The share purchase agreement was only a "*self serving document*" to suit the needs of the parties and was designed to reduce the tax incidence.
- Reliance was placed on the decision in the case of McDowell & Co.² and the capital gains were recomputed by substituting the cost of acquisition of shares with a lower value. This consequently resulted in increase of short-term capital gains.

- The Commissioner of Income-tax (Appeals) (CIT(A)) upheld the decision of the assessing officer (AO) and considered the transaction to be a colourable device.

Assessee's contentions

- The 8,000 shares in Euro TM had been allotted for a total consideration of INR 16 million, pursuant to the agreement and the same was recorded as investment in the books of account.
 - The terms of agreement between the assessee and Euro TM, specifically provided for allotment of shares at a premium.
- The AO had accepted the cost of acquisition during the assessment proceedings for AY 2006-07. Once the cost of acquisition as appearing in the earlier year's balance sheet had been accepted by the AO, the same cannot be disputed in later years.
- The transaction cannot be treated as sham as the shares were transferred at the cost as per books, as disclosed in the agreement.

Tribunal Ruling

The Tribunal held that:

- Once the cost of acquisition as shown in the books of account had been accepted earlier by the AO and also evidenced by the terms of agreement between the parties, it cannot be held that the cost shown by the assessee is fictitious.
- The cost of acquisition has to be taken as per the books for the purpose of computation of capital gains.

² McDowell & Co v. CTO [1985] 154 ITR 148 (SC)

- The transaction cannot be treated as a sham as the shares have been transferred purely on the basis of value recorded in the books, as disclosed earlier.
- In view of this fact, it was held that the addition made on account of short-term capital gains by reducing the cost of acquisition of shares was uncalled for.

Conclusion

- The Tribunal held the historical cost of acquisition of shares cannot be substituted with lower fair value for computing capital gains on share transfer and the transaction cannot be treated as a sham or colourable device merely on the basis that it was carried between group companies.
- This case mainly surrounds around the genuineness of the historical cost of acquisition. The consideration/transaction value for the current transfer of shares was not challenged by the AO.

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