CHAPTER 7

Capital Gains

Some Key Points : Recent Amendments

Cost of acquisition of the capital asset transferred by a sole proprietorship or firm to a company on succession, to be taken as cost to the previous owner i.e. the predecessor proprietor or firm, where such succession is not regarded as transfer under section 47 [Section 49]

In case the asset becomes the property of the company on account of succession of a sole proprietorship concern or firm by the company, then, in order to determine the period of holding of such asset in the hands of the company, the period for which such asset was held by the sole proprietorship concern or the firm, as the case may be, shall also be considered.

Therefore, when the capital asset is sold or transferred by the successor company, for computing capital gains on such transfer –

Cost of acquisition to company	=	Cost of the asset to the predecessor firm or sole proprietorship concern		
Period of holding (for determining whether capital gains is LTCG or STCG)	=	Period of holding of the predecessor firm or sole proprietorship concern	+	Period of holding of the company

Fair market value of the capital asset on the date of transfer to be taken as sale consideration, in cases where the consideration is not determinable [Section 50D]

(i) Recently, some of the courts have ruled that, in case of transfer of a capital asset for which the sale consideration is not determinable, the gain arising from transfer of such asset shall not be taxable, due to failure of the machinery provision.

(ii) Consequently, a new section 50D has been inserted by the Finance Act, 2012 providing that, in case where the consideration received or accruing as a result of the transfer of a capital asset by an assessee is not ascertainable or cannot be determined, then, for the purpose of computing income chargeable to tax as capital gains, the **fair market value of the said asset on the date of transfer** shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

Extension of capital gain exemption under section 54B to a HUF [Section 54B]

(i) Under section 54B, the capital gain arising on the transfer of land which was used for agricultural purposes by an individual or his parents during the 2 years immediately preceding the date of transfer shall not be charged to tax to the extent of cost of acquisition of new agricultural land acquired within a period of 2 years after the date of transfer.

(ii) The aforesaid exemption was so far available only to an individual assessee. Section 54B is now amended to extend the benefit of such an exemption to a Hindu Undivided Family also.

(iii) Therefore, the capital gain arising on the transfer of land used for agricultural purposes, for 2 years immediately preceding the date of transfer by an assessee, *being an individual or his parent, or a Hindu Undivided Family* shall not be charged to tax if such assessee purchases a new agricultural land within a period of 2 years after the date of transfer. The capital gain would be exempt to the extent of cost of acquisition of new agricultural land acquired.

Exemption of long-term capital gains on transfer of residential property if the sale consideration is used for subscription in equity of a new start-up manufacturing SME company to be used for purchase of new plant and machinery [New Section 54GB]

(i) The National Manufacturing Policy (NMP) was announced by the Government in 2011 to encourage investment in the SME segment (Small and Medium Enterprises) in the manufacturing sector.

(ii) Section 54GB has been inserted to exempt long term capital gains on sale of a residential property (house or plot of land) owned by an individual or a HUF in case of re-investment of sale consideration in the equity shares of an eligible company being a newly incorporated SME company engaged in the manufacturing sector, which is utilized by the company for the purchase of new plant and machinery.

(iii) **Quantum of exemption under section 54GB**

- If cost of new plant and machinery ≥ Net consideration of residential house, entire capital gains is exempt.
- If cost of new plant and machinery < Net consideration of residential house, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new plant and machinery}}{\text{Net consideration}}$$

Assessing Officer enabled to make a reference to the Valuation Officer in case the assessee has taken the fair market value as the cost of acquisition of the asset in accordance with the estimate made by the Registered Valuer [Section 55A]

The Assessing Officer can, with effect from 1.7.2012, make a reference to the Valuation Officer even in a case where the fair market value of the asset as on 01.04.1981 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.1981 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

Non-residents and foreign companies to be subject to tax at a concessional rate of 10% (without indexation benefit or currency fluctuation) on long-term capital gains arising from transfer of unlisted securities [Section 112]

In order to bring parity in tax rate on long-term capital gains (arising on sale of unlisted securities) applicable to non-residents and FIIs, section 112 has been amended to provide that, in the case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of unlisted securities would be subject to tax@10% without giving effect to indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

Question 1

Often controversies arise between the assessee and the department on the issue of treatment of gain arising out of transactions of sale and purchase of shares and securities.

Based on the judicial decisions, narrate the significant points of distinction in order to judge the purpose and motive of the assessee for its different treatment as income from business or income from capital gain.

Answer

The profit arising to an assessee from the transaction of sale and purchase of shares and securities, can be treated either as business income or capital gains.

The profit would be treated as business income if shares and securities constitute a trading asset and the assessee is a trader of shares and securities. However, the profit would be taxable under the head “Capital Gains”, if the shares and securities are held as an investment i.e., a capital asset.

The original purpose or intention is crucial. If the original intention was to hold the shares as investment, the gains resulting from the sale of such shares will be capital gains. On the other hand, if the original intention was to carry on the activities of purchase and sale as a systematic activity and hold the shares as stock-in-trade, the gains resulting from the sale of such shares will be assessable as business income.

It is open to the assessee to maintain two portfolios, one for investments and another for dealing in shares. It was so observed by the Bombay High Court, in *Gopal Purohit vs. CIT (2011) 336 ITR 287,* where it was held that there should be uniformity in treatment and consistency in treating transactions in shares as investment or stock-in-trade, when facts and circumstances were identical. Further, the High Court also held that entries in the books of account alone are not conclusive in determining the nature of income.

In case the purchase and sale of the shares and securities is undertaken with a motive of earning profit out of the transaction, then the same would result in a trading transaction and will give rise to business income whereas if the motive of investment in the shares and securities is to earn income by way of dividend or interest, as the case may be, then the profit arising from the transaction of sale and purchase of such shares and securities will give rise to capital gain and not business income.

The magnitude of purchase and sale, the ratio between the purchase and sale of the shares and securities and holding period of the same can be considered for determining the purpose and the motive of the assessee for undertaking such transaction.

Question 2

What are the consequences if the amount deposited in Capital Gains Account Scheme to avail exemption from capital gains is not utilised within the stipulated time? Is there any difference in the tax treatment in the event of death of the assessee before the stipulated time?

Answer

Where the amount deposited in Capital Gains Accounts Scheme is not utilized for the specified purpose mentioned under the respective section providing for exemption (like say, section 54, 54B, 54G, etc.) within the specified period of two years or three years, as the case may be, mentioned therein, then the unutilized amount shall be charged under section 45 as capital gain of the previous year in which the specified period of two years or three years, as the case may be, expires.

The tax treatment will be different where before the stipulated time, the assessee expires and the amount is received by his legal heirs.

The CBDT has, in *Circular No.743 dated 6.5.1996*, clarified that in the event of death of an individual before the stipulated period, the unutilized amount would not be chargeable to tax in the hands of the legal heirs of the deceased individual, since such unutilized amount is not income but is a part of the estate devolving upon them.

Question 3

"Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of share or shares held in a company by a shareholder on conversion of a company into a LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45 subject to fulfillment of certain conditions". Explain in the context of the provisions contained in the Act.

Answer

Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or any transfer of a share or shares held in a company by a shareholder on conversion of a company into a LLP shall not be regarded as a transfer for a purpose of levy of capital gains tax under section 45 on fulfillment of the following conditions:-

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lacs in any of the three preceding previous years;

(2) all the shareholders of the company immediately before the conversion become partners of the LLP and their capital contribution and profit sharing ratio in the LLP are also in the same proportion as their shareholding in the company on the date of conversion;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders of the company;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of at least 5 years from the date of conversion;

(5) all assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP; and

(6) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company standing in the accounts on the date of conversion, for a period of 3 years from the date of conversion.

Question 4

Hari has acquired a residential house property in Delhi on 1st April, 2001 for ₹ 10,00,000 and decided to sell the same on 3rd May, 2004 to Ms. Pari and an advance of ₹ 25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2013, he has sold this house to Mr. Suri for ₹ 35,00,000. In the meantime, on 4th April, 2013, he had purchased a residential house in Delhi for ₹ 8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2014, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2013 from Mr. X, an Indian resident, by paying ₹ 5,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2014 -15.

Cost inflation Index - 2001-02: 426; 2004-05: 480; 2013-14: 939.

Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2014-15

Particulars	₹
Sale proceeds	35,00,000
Less: Indexed cost of acquisition (See Note 1)	21,49,120
Long Term Capital Gain	13,50,880
Less: Exemption under section 54 in respect of investment in house at Delhi (See Note 2)	8,00,000
Taxable long-term capital gain	5,50,880

Notes:

1. Computation of indexed cost of acquisition

Particulars	₹
Cost of acquisition	10,00,000
Less: Advance taken and forfeited	25,000
Cost for the purpose of Indexation	9,75,000
Indexed cost of acquisition (₹ 9,75,000 x 939/426)	21,49,120

2. In order to avail exemption of capital gains under section 54, a new residential house should be purchased within 1 year before or 2 years after the date of transfer or constructed within a period of 3 years after the date of transfer. In this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2014 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in *Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).*

3 Exemption under section 54 can be availed only in respect of one house. The Bombay High Court, in *K.C. Kanshik v. P.B. Rane, ITO (1990) 185 ITR 499,* held that where the assessee purchases more than one house, then the assessee can claim exemption in respect of only one house. It would be more beneficial for Mr. Hari to claim exemption in respect of the Delhi house since the cost of the same is higher than the cost of the Chennai house.

   Note – The decision of the Karnataka High Court in *CIT v. D.Ananda Basappa (2009)309 ITR 329* allowing exemption under section 54 in respect of investment in two houses was owing to the reason that the two flats were adjacent to each other and were suitably modified to be used as a single residential unit. However, in this case, one house is in Delhi and the other is in Chennai. Obviously, they cannot be used as a single residential unit. Therefore, the ruling of the Karnataka High Court would not apply in this case.

Question 5

A resident woman individual sold a house property on 16.01.2014. On the said transaction, she earned a long-term capital gain of ₹ 1,01,50,000. She invested a sum of ₹ 50,00,000 in capital gains bonds specified in section 54EC on 05.03.2014. She further invested a sum of ₹ 50,00,000 in the same bonds on 05.05.2014. Her other income for the financial year 2013-14 was ₹ 56,000. Compute the tax payable by her for the A.Y. 2014-15.

Answer

Computation of taxable income for the A.Y. 2014-15

	Particulars	₹
A	Long term capital gains	1,01,50,000
	Less: Deduction under section 54EC [See Notes 1 & 2 below]	1,00,00,000
	Long term capital gain	1,50,000
B	Other income	56,000
	Total Income	2,06,000

As per section 112, in case of an individual, being a resident where her total income includes long-term capital gain and other income, the tax payable on the total income is the aggregate of the amount of income tax on long-term capital gains@ 20% and the amount of income tax on the total income as reduced by the amount of long term capital gain, had the total income so reduced been her total income.

However, the unexhausted basic exemption limit can be exhausted against long-term capital gains, and tax would be leviable on the balance long-term capital gains @ 20%. Therefore, the basic exemption limit of ₹ 2,00,000 should be first adjusted against other income of ₹ 56,000 and the unexhausted basic exemption limit of ₹ 1,44,000 should be adjusted against the long-term capital gains of ₹ 1,50,000. The balance long-term capital gains of ₹ 6,000 would be taxable@20% plus education cess@2% and secondary and higher education cess@1%. Therefore, the tax payable by the assessee would be ₹ 1,236.

Notes:

(1) In order to claim exemption under section 54EC, the assessee has to invest in specified bonds of RECL or NHAI within a period of 6 months from the date of transfer of the asset.

(2) However, investments made on or after 1.04.2007 in such bonds by an assessee during any financial year cannot exceed ₹ 50 lacs.

In this case, the assessee has invested ₹ 50 lacs in the F.Y.2013-14 and ₹ 50 lacs in the F.Y.2014-15, both within six months from the date of transfer. She has, therefore, fulfilled both the conditions and hence, she is eligible to claim exemption of ₹ 100 lacs under section 54EC.

Question 6

Richie Rich Real Estates, a partnership firm engaged in real estate business, sold a land for ₹ 50 lacs on 01-06-2013. The buyer was a stranger to the assessee firm. The valuation adopted by the stamp valuation authority was ₹ 60 lacs. The Assessing Officer wants to adopt the value of ₹ 60 lacs for computing the profit arising from the sale of land, by invoking the provisions of section 50C. Is the same justified?

Answer

Section 50C(1) enjoins that where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by the "stamp valuation authority" for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall for the purposes of section 48, be deemed to be the full value of the consideration received or accruing as a result of such transfer.

In *CIT v. Thiruvengadam Investments Private Limited (2010) 320 ITR 345 (Mad.)*, the issue under consideration was whether the provisions of section 50C are applicable where the property is held as a business asset.

The High Court pointed out that it was not in dispute that the assessee was engaged in real estate business. As the property in the hands of the assessee was treated as a business asset and not as a capital asset, there is no question of invoking the provisions of section 50C. Section 50C pertains to determining the full value of consideration of a capital asset.

However, the Assessing Officer can invoke the provisions of new section 43CA, which provides that where the consideration for transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable (i.e., the stamp duty value) shall be deemed to be the full value of the consideration for the purposes of computing income under the head 'Profits and gains of business or profession.

Therefore, the Assessing officer can invoke the provisions of new section 43CA to adopt the value of ₹ 60 lacs for computing the profit arising on sale of land.

Question 7

Kala purchased a residential flat from her friend Bala at ₹ 10 lacs in the city of Jaipur on 3rd October, 2013. The value determined by the Stamp Valuation Authority for stamp duty purpose amounted to ₹ 15 lacs. Bala had purchased the flat on 1st January, 2011 at a cost of ₹ 3.50 lacs. Kala sold the flat for ₹ 20 lacs on 30th March, 2014.

Determine the effect of the above transactions on the assessments of Bala and Kala for assessment year 2014-15, assuming that value for stamp duty purpose in case of the second sale was not more than the sale consideration.

Answer

Tax treatment in the hands of the seller, Mr. Bala

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

In the instant case, Bala sold the residential flat at Jaipur to his friend Kala for ₹ 10 lacs, whereas the stamp duty value was ₹ 15 lacs. Therefore, stamp duty value shall be deemed to be the full value of consideration for sale of the property. Therefore, short-term capital gain arising to Bala for assessment year 2014-15 will be ₹ 11.50 lacs (i.e. ₹ 15 lacs - ₹ 3.50 lacs).

Tax treatment in the hands of the buyer, Ms. Kala

The taxability provisions under section 56(2)(vii), w.e.f. A.Y.2014-15 includes within its scope, any immovable property, being land or building or both, received for inadequate consideration by an individual or HUF.

As per section 56(2)(vii), where any immovable property is received for a consideration which is less than the stamp duty by an amount exceeding ₹ 50,000, the difference between the stamp duty value and the consideration shall be chargeable to tax in the hands of the recipient (Individual/HUF) as the income from other sources. The provisions of section 56(2)(vii) would be attracted in this case, since the difference exceeds ₹ 50,000. Therefore, ₹ 5 lacs, being the difference between the stamp duty value of the property (i.e., ₹ 15 lacs) and the actual consideration (i.e., ₹ 10 lacs) would be taxable in the hands of Ms. Kala, under the head 'Income from Other Sources'.

As per section 49(4), the cost of acquisition of such property for computing capital gains would be the value which has been taken into account for section 56(2)(vii). Accordingly ₹ 15 lacs would be taken as the cost of acquisition of the flat. Therefore, on sale of the flat by Ms. Kala, ₹ 5 lacs (i.e. ₹ 20 lacs – ₹ 15 lacs) would be chargeable to tax as short-term capital gains in her hands for A.Y. 2014-15.

Question 8

On 15.11.2013, Ram gave power of attorney and possession to Rahim in respect of a vacant land acquired 10 years ago. The sale deed was executed in April, 2014. In which assessment year, the capital gain is chargeable to tax?

Answer

Section 50C provides that where the consideration received or accruing as a result of transfer of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by an authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed or assessable shall be deemed to be the full value of the consideration received or accruing as a result of such transfer for computing capital gain.

Explanation 2 below section 50C(2) define the term 'assessable' to mean the price which the stamp valuation authority would have, notwithstanding anything to the contrary contained in any other law for the time being in force, adopted or assessed, if it were referred to such authority for the purposes of the payment of stamp duty.

The term "assessable" brings transfers executed through power of attorney within the scope of section 50C.

Thus, when the power of attorney is executed by Ram and possession is given in favour of Rahim, the transfer is chargeable to capital gains. The capital gains is, therefore, chargeable to tax in the A.Y.2014-15.

Question 9

Can reference be made to the Valuation Officer under section 55A of the Income-tax Act, 1961 where the Assessing Officer is of the view that in the context of computation of capital gains, the value of the asset as on 1.4.1981 adopted by the assessee is more than the fair market value?

Answer

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to the valuation officer with a view to ascertain the fair market value of the capital asset for the purpose of computation of income under the head capital gain, in a case where the value of asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, and the Assessing Officer is of the opinion that the value so claimed is at variance with the fair market value of the asset.

Therefore, the Assessing Officer can make a reference to the Valuation Officer for valuation of the capital asset in a case where the fair market value of the asset as on 1.04.1981 is taken as the cost of the asset and he is of the view that there is a variance between the value as on 1.04.1981 claimed by the assessee in accordance with the estimate made by a registered valuer and the fair market value of the asset on that date.

Question 10

Discuss whether the benefit of exemption under section 54EC would be available in the following cases –

(a) Capital gains on transfer of depreciable assets; and

(b) Deemed capital gains on amount received on liquidation of a company.

Answer

(a) Section 54EC provides exemption of capital gains arising from the transfer of a long-term capital asset, if such capital gains are invested, within a period of 6 months after the date of such transfer, in bonds of National Highways Authority of India or Rural Electrification Corporation Ltd., redeemable after 3 years. It may be noted that section 54EC provides for exemption of capital gains arising from the transfer of long-term capital asset.

By virtue of section 50, capital gain on transfer of a depreciable asset shall be treated as capital gain on transfer of short-term capital asset for the purpose of sections 48 and 49. Section 50 nowhere says that, for the purpose of section 54EC, the depreciable asset would be a short-term capital asset. Further, section 54EC is an independent section and section 50 does not have an overriding effect over section 54EC. Section 54EC has an application where a long-term capital asset is transferred. Therefore, capital gains on transfer of a depreciable asset held for more than 36 months would be eligible for benefit of exemption under section 54EC, if the conditions stipulated therein are fulfilled.

This view was upheld by the Bombay High Court in *CIT v. ACE Builders (P.) Ltd. (2006) 281 ITR 210* and the Gauhati High Court in *CIT v. Assam Petroleum Industries (P.) Ltd. (2003) 262 ITR 587* in relation to erstwhile section 54E. The Courts held that the deeming fiction created under section 50 is restricted only to the mode of computation of capital gains contained in sections 48 and 49 and does not extend to the exemption provisions.

Thus, exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50 and shall be available on depreciable asset in case they are held for more than 36 months.

(b) The primary condition to be satisfied for claim of benefit under section 54EC is that there should be transfer of a capital asset. Section 46(1) clearly states that when assets are transferred by way of distribution to the shareholders of a company on account of liquidation, such distribution shall not be regarded as transfer in the case of a company. However, capital gains would be chargeable to tax in the hands of the shareholders under section 46(2). Since there is no transfer in respect of cases covered by section 46, the assessee would not be entitled to the benefit of section 54EC. This was held by the Rajasthan High Court in *CIT v. Ruby Trading Co. (P) Ltd. (2003) 259 ITR 54*, in relation to erstwhile section 54E. The rationale of the decision can be extended to section 54EC and consequently, the assessee would not be entitled to benefit of section 54EC since there is no transfer in respect of cases covered by section 46.

Note: However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47), in which case, exemption under section 54EC in respect of the capital gain arising from the said transaction would be available.

Question 11

Anish owns a residential house which is self-occupied and also a house plot. He sells the house on 28.2.2014 and the house plot on 4.3.2014 for ₹ 11 lacs and ₹ 9 lacs, respectively. The house was purchased on 17.10.2000 for ₹ 4.5 lacs and the plot on 26.12.1999 for ₹ 3 lacs. Anish has purchased a new residential house on 3.5.2014 for ₹ 5 lacs. Compute the income chargeable under the head "Capital Gain" for the A.Y. 2014-15. Cost inflation indices for the financial year 1999-2000, 2000-2001 and 2013-14 are 389, 406 and 939, respectively.

Answer

Computation of Capital Gains of Anish for the A.Y.2014-15

Particulars	₹
Sale of house on 28.2.2014	
Sale consideration received	11,00,000

Less: Indexed cost of acquisition ₹ 4,50,000 x 939/406	10,40,764
Long term capital gain	59,236
Less: Exemption under section 54 (lower of capital gains or amount invested)	59,236
Taxable capital gain	Nil
Sale of house plot on 4.3.2014	
Sale consideration received	9,00,000
Less: Indexed cost of acquisition ₹ 3,00,000 x 939/389	7,24,165
Long term capital gain	1,75,835
Less: Exemption under section 54F	
Investment for the purpose of section 54F is ₹ 4,40,764 (i.e. ₹ 5,00,000 – ₹ 59,236), which is less than the net consideration on sale of plot. Therefore, only proportionate capital gain would be exempt under section 54F. [Capital gain × Amount invested / Net sale consideration] i.e., [₹ 1,75,835 × ₹ 4,40,764 / ₹ 9,00,000]	86,113
Taxable capital gain	89,722

Question 12

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase of one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

Discuss the correctness of the contention of the Assessing Officer.

Answer

This issue came up before the Karnataka High Court in *CIT v. D.Ananda Basappa (2009) 309 ITR 329*. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential unit.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form one apartment. Therefore, the contention of the Assessing Officer is not correct.

Question 13

3 Star & Company, a partnership firm, entered into a contract to purchase an immovable property. The agreement was not honoured by the seller. Therefore, the firm filed a suit for specific performance of contract against the owner of the property. Ultimately, a compromise was arrived at. In terms of the compromise, the owner agreed to pay 3-Star & Company ₹ 15 lacs as consideration. State with reasons whether the receipt should be treated to be in the nature of capital gain in the hands of the firm.

Answer

The assessee, 3-Star & Company, entered into a contract to buy an immovable property. On failure on the part of the seller, the assessee filed a suit for specific performance of the contract. Subsequently, the assessee received ₹ 15 lacs from owner in terms of a compromise agreed to by the parties.

In the case of *CIT v. Smt. Laxmidevi Ratani (2008) 296 ITR 363 (MP),* the High Court, on identical facts, held that the receipt is exigible to capital gains tax as it involved transfer of property within the meaning of section 2(47). The action on the part of the assessee in giving up its right to claim the property and instead accepting money compensation is a clear case of extinguishment of right in the property resulting in transfer as defined in section 2(47).

Question 14

Aerochem, a partnership firm, transfers a piece of land situated in Thane district on 17.8.2013 for ₹ 60 lacs. The land, purchased on 6.3.1980 for ₹ 1 lac, was registered on 3.4.1984 on payment of stamp duty of ₹ 20,000. Expenses on land development and construction of boundary wall incurred in August, 1984 were of ₹ 1,50,000. The charges for the transfer of land paid to the broker were 2½% of the sale consideration. Fair market value of the land as on 1.4.1981 was ₹ 1,50,000.

The firm invested ₹ 30 lacs on 1.12.2013 in the bonds issued by National Highways Authority of India redeemable after 3 years. Compute the amount of capital gain chargeable to tax for Assessment Year 2014-15 with the help of cost inflation index for F.Y. 1984-85 and 2013-14 of 125 and 939, respectively. Also, give in brief, the reasons and the applicable provisions for each of the items dealt with.

Answer

Computation of Capital Gains chargeable to tax for A.Y.2014-15

Particulars	₹	₹
Gross sale consideration of the land		60,00,000

Less: Expenses on transfer of land paid to a broker @ 2.5% of the sale value [See Note 1]		1,50,000
Net Sale Consideration		58,50,000
Less: Indexed cost of acquisition and improvement		
A) ₹ 1,50,000 x 939/100 [See Notes 2 & 4]	14,08,500	
B) ₹ 1,70,000 x 939/125 [See Notes 3 & 4]	12,77,040	26,85,540
		31,64,460
Less: Investment in bonds of NHAI eligible for exemption under section 54EC [See Note 5]		30,00,000
Capital Gain		1,64,460

Notes:

(1) Brokerage paid is allowable as deduction under section 48(i) as held by Rajasthan High Court in the case of *Sah Roop Narain vs. CIT (1987) 32 Taxman 453*.

(2) Cost of acquisition of the capital asset can be claimed as deduction under section 48 while computing capital gains. As per section 55(2)(b)(i), the cost of acquisition in case of a capital asset acquired before 1.4.1981 shall be the actual cost of acquisition or the fair market value as on 1.4.1981, at the option of assessee. Accordingly, in this case, the cost of acquisition would be the fair market value of the land on 1.04.1981, as the same is more beneficial to the assessee.

(3) Cost of improvement of the capital asset can also be claimed as deduction under section 48. The cost of improvement, in this case, would include the expenditure of ₹ 1,50,000 on land development and construction of boundary wall and expenditure of ₹ 20,000 on payment of stamp duty. Therefore, the total cost of improvement would be ₹ 1,70,000.

(4) Since the asset transferred is a long-term capital asset, indexation benefit would be available and the indexed cost of acquisition and indexed cost of improvement are allowable as deduction while computing capital gains.

(5) Under section 54EC, exemption is available for investment, made within a period of 6 months from the date of transfer, in bonds of NHAI or RECL, redeemable after 3 years. In this case, the transfer took place on 17.8.2013 and the investment was made in bonds of NHAI, redeemable after 3 years, on 1.12.2013, which is within the 6 month period. Therefore, the investment of ₹ 30 lacs qualify for exemption under section 54EC.

Question 15

(a) *Discuss whether the following can be treated as transfer of capital asset for the purpose of levy of capital gains tax:*

(i) Transfer of house property in a transaction of reverse mortgage.

(ii) Conversion of foreign currency bonds into shares.

(b) *Examine the correctness of the following statement:*

Section 2(14) of the Act excludes all items of movable property which are held for personal use of the assessee or any member of his family.

Answer

(a) (i) Clause (xvi) of section 47 provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government would not amount to a transfer for the purpose of capital gains. Therefore, transfer of house property in a transaction of reverse mortgage will not be treated as a transfer of capital asset for the purpose of capital gains.

(ii) Clause (x) of section 47 provides that conversion of, *inter alia,* bonds of a company into shares of that company would not amount to a transfer for levy of capital gains tax. Foreign Currency Convertible Bonds (FCCBs) fall within the ambit of this clause. Clause (xa) of section 47 provides that the conversion of Foreign Currency Exchangeable Bonds (FCEBs) into shares or debentures of any company shall not be treated as a 'transfer'. The difference between FCCBs and FCEBs is that whereas FCCBs can only be converted into shares of the issuing company, FCEBs can also be converted into or exchanged for the shares of a group company.

(b) Sub-clause (ii) of section 2(14) provides that personal effects, that is, movable property including wearing apparel and furniture held for the personal use by the assessee or any member of his family dependent on him are not capital assets. However, the following movable property held for the personal use by the assessee or any member of his family dependent on him are capital assets -

(a) jewellery; (b) archaeological collections; (c) drawings; (d) paintings;

(e) sculptures, or (f) any work of art

Hence, the statement "Section 2(14) of the Act excludes all items of movable property which are held for personal use of the assessee or any member of his family" is incorrect.

Question 16

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961 for A.Y. 2014-15:

A farmer (resident of Jaipur) sold his rural agricultural land situated in Nepal and received Indian Rupees 2 lacs over the cost of acquisition of this land.

Answer

The definition of capital assets under section 2(14) specifically excludes rural agricultural land in India. Therefore, it follows that if such land is situated outside India, it would fall within the definition of capital asset under section 2(14). Accordingly, capital gains on sale of rural agricultural land situated in Nepal would be subject to tax in the hands of the farmer, since he is a resident in India.

Question 17

A shareholder of a demerged Indian company received shares from the resulting company in the scheme of demerger. The shareholder wants to transfer the said shares received subsequent to the demerger for consideration. Your advice is sought on the tax consequences as to the shares received on demerger and sought to be transferred.

Answer

As per the provisions of section 47(vid), any transfer or issue of shares by the resulting company to the shareholders of the demerged company in a scheme of demerger is not regarded as a transfer for the purposes of capital gains under section 45, if the transfer or issue is made in consideration of the demerger of the undertaking.

As a consequence of the demerger, the existing shareholders of the demerged company will receive shares in a resulting company. When the shareholder subsequently intends to transfer the said shares, the cost of such shares will have to be arrived at as per the provisions of section 49(2C). According to the said provision, the cost of acquisition of shares in the resulting company will be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged company, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

As per the provisions of section 2(42A)(g), for determining the period of holding of such shares, the period for which the shares of the demerged company were held by the assessee would also be considered.

If the shares are held for more than one year, and transferred through a recognized stock exchange and securities transaction tax has been paid on such sale, the long-term capital gain arising therefrom would be exempt under section 10(38). If the total holding period does not exceed one year, then the short-term capital gains arising on sale of such shares would be taxable @15% under section 111A.

Question 18

Sri Sajjan converted the capital asset, acquired by him in the year 1989, into stock-in- trade at the fair market value on 1st March, 2013. Sri Sajjan sold the entire stock-in-trade so converted, on 25th November, 2013. Sri Sajjan seeks your advice as to the tax implications of the transaction with reference to the provisions of Income-tax Act, 1961 for the assessment year 2014-15.

Answer

Conversion of a capital asset into stock-in-trade falls within the definition of transfer under section 2(47). Therefore, in this case, transfer has taken place during the previous year 2012-13.

However, as per section 45(2), the capital gains liability arises only in the year in which the stock-in-trade is sold i.e. previous year 2013-14, in this case. It is a long-term capital gain since the asset was acquired in 1989. The fair market value (FMV) on the date of conversion i.e. on 1.3.2013 is deemed to be the full value of consideration accruing as a result of transfer of the capital asset.

Therefore, in the year of sale of stock-in-trade (i.e. P.Y. 2013-14), both business income and capital gains would arise. Where,

Business income = Sale consideration of stock-in-trade – FMV on the date of conversion

Capital gains = FMV on the date of conversion – Indexed cost of acquisition / improvement

Question 19

A piece of land owned by Mr. Mishra located on Jaipur-Delhi highway was acquired by NHAI in the F.Y.2008-09, but the award ordered in F.Y. 2009-10 was paid in the F.Y. 2013-14. This land was purchased by him on 2.4.1978 for ₹ 10,000. The fair market value of the land as on 1.4.1981 was ₹ 9,000. Compensation paid was ₹ 15 lacs.

The other piece of land located in Chennai purchased in April, 2004 for ₹ 25 lacs was also sold by him in February, 2014 for ₹ 35 lacs, but sale deed thereof could not be executed by 31.3.2014. The value for the purpose of stamp duty to be applied by the stamp valuation authority was ₹ 40 lacs.

Compute the income chargeable to tax arising as a result of these transactions in the A.Y.2014-15. The CIIs for the F.Y: 2004-05, 2008-09, 2009-10 and 2013-14 are 480, 582, 632 and 939 respectively.

Answer

Computation of taxable income of Mr. Mishra for A.Y.2014-15

Particulars	₹
Capital Gains	
(A) Long-term capital gain derived from transfer of land on Jaipur-Delhi highway acquired by NHAI in F.Y. 2008-09 for which award was paid in F.Y. 2013-14 is chargeable to tax in A.Y.2014-15 [See Note (i) below]	
Sale consideration i.e. compensation paid	15,00,000
Less: Indexed cost of acquisition [See Note (ii) below]	
$\frac{(10000 \times 582)}{100}$	58,200
Long Term Capital Gains (A)	14,41,800
(B) Sale of land at Chennai in February 2014 [See Note (iii) below]	
Full value of consideration as per section 50C [See Note (iv) below]	40,00,000
Less: Indexed cost of acquisition	
(₹ 25,00,000 × 939/480)	48,90,625
Long Term Capital Loss (B)	(8,90,625)
Long Term Capital Gains (A - B)	5,51,175

Total income chargeable to tax arising as a result of these transactions in the A.Y.2014-15 is equal to ₹ 5,51,175 (i.e. ₹ 14,41,800 - ₹ 8,90,625). Long term capital loss can be set-off from the long term capital gain.

Notes:

(i) The capital gains arising on compulsory acquisition shall be charged to tax in the year in which the compensation is first received as per section 45(5)(a).

(ii) The option of fair market value as on 1.4.1981 is not exercised by the assessee since the fair market value is lower than the cost.

582 is the cost inflation index of F.Y.2008-09 i.e. the year in which the property was compulsorily acquired.

(iii) The execution of sale deed is not compulsory for the purpose of charge of capital gain because the transfer of right enabling enjoyment of immovable property gives rise to charge of capital gains as held by the Kerala High Court in the case of *CIT v. C.F. Thomas (2006) 284 ITR 557.*

(iv) As per section 50C, the value applied by the stamp valuation authority is deemed to be the full value of consideration received or accruing as a result of such transfer, since such value is higher than the sale consideration of ₹ 35 lacs. 939 is the cost inflation index of F.Y.2013-14 i.e. the year in which the property at Chennai was sold.

Question 20

Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2014-15. Within a month from the date of such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Vijay for a monetary consideration.

Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2014-15 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non-use of the new house for his own residential purposes disentitle him to exemption?

Answer

The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, *inter alia*, for purchase of a new residential house within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to "purchase" by Vijay for the purpose of claiming exemption under section 54 *[CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)].* Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head house property. This requirement would be satisfied even when the new house is let out for residential purposes.

Question 21

Sanjay, an individual, purchased a site on 21.4.2003 for ₹ 2,00,000. He completed construction of a building thereon on 14.2.2011 at a cost of ₹ 10,00,000. He sold the property consisting of site and building on 7.12.2013 for ₹ 20,00,000. Sanjay seeks your opinion on the nature of capital gain arising to him from the sale of the property for the A.Y.2014-15.

Computation of capital gain is not necessary.

Answer

Site and building are separate capital assets for the purpose of capital gains. This distinction is clear from the scheme of the Income-tax Act, 1961. For the purpose of section 32, a building which is entitled to depreciation means only the superstructure and does not include the site on which it is built. This was held by the Apex Court in *CIT v. Alps Theatre (1967) 65 ITR 377*.

In this case, the site is a long-term capital asset since it is held by Sanjay for more than 36 months and the building is a short-term capital asset since it is held by Sanjay for less than 36 months. The site is an independent capital asset and continues to be so even after the construction of the building thereon. Even though the property consisting of site and building was sold as a single asset for a consolidated price of ₹ 20,00,000, such price can be attributed to the site and building separately.

Therefore, in the case of Sanjay, the capital gain attributable to the site is assessable as long-term capital gain and the capital gain attributable to the building is assessable as short-term capital gain for the assessment year 2014-15. On identical facts, the Rajasthan High Court in *CIT v. Vimal Chand Golecha (1993) 201 ITR 442,* the Madras High Court in *CIT v. Dr. D. L. Ramachandra Rao (1999) 236 ITR 51* and the Karnataka High Court in *CIT v. C.R. Subramanian (2000) 242 ITR 342* have taken this view.

Question 22

(i) *John inherits a house property from his father, who had mortgaged it. John discharges the mortgage debt. John later sells the property. Can he claim the amount paid to the mortgagee as cost of improvement in computing the capital gain?*

(ii) *Laxman mortgaged his house property and utilized the mortgage amount to perform the marriage of his son. He paid the amount to the mortgagee later. Upon sale of the said property thereafter, he claims the mortgage debt discharged as forming part of the cost of acquisition. Can capital gain be computed accepting his claim?*

Answer

(i) John inherited the house property with the liability to discharge the mortgage debt. He can, therefore, claim the amount paid to the mortgagee as cost of improvement/acquisition while computing the capital gain on sale of the said property. The decision of the Supreme Court in *RM. Arunchalam v. CIT (1997) 227 ITR 222* supports this view.

(ii) Laxman has himself created the mortgage in respect of his house property. It is a self-created mortgage. Therefore, the debt discharged by Laxman on the property under mortgage created by him does not form part of cost of acquisition. The decision of the Supreme Court in *V.S.M.R. Jagadish Chandran v. CIT (1997) 227 ITR 240* supports this view. Therefore, capital gain on sale of the property cannot be computed on the basis of the claim made by him.

Note – *This question can also be answered with reference to the Bombay High Court ruling in CIT v. Roshanbabu Mohammed Hussein Merchant (2005) 144 Taxman 720 / 275 ITR 231. This case highlights the difference in tax treatment in respect of allowability of the expenditure incurred on removing an encumbrance in two different cases, namely –*

(i) In a case where the mortgage is created by the previous owner and

(ii) In a case where the mortgage is created by the assessee himself.

The Bombay High Court pointed out that there is a distinction between the obligation to discharge the mortgage debt created by the previous owner and the obligation to discharge the mortgage debt created by the assessee himself. Where the property acquired by the assessee is subject to the mortgage created by the previous owner, the assessee acquires absolute interest in that property only after the discharge of mortgage debt. In such a case, the expenditure incurred by the assessee to discharge the mortgage debt created by the previous owner to acquire absolute interest in the property is treated as 'cost of acquisition' and is deductible from the full value of consideration received by the assessee on transfer of that property. However, where the assessee acquires property which is unencumbered, the assessee gets absolute interest in that property on acquisition. When the assessee transfers that property, he is liable for capital gains tax on the full value realized, even if he has himself created an encumbrance on that property. The assessee is under an obligation to remove that encumbrance for effectively transferring the property. In other words, the expenditure incurred by the assessee to remove the encumbrance created by the assessee himself on the property (which was acquired by him without any encumbrance) is not an allowable deduction under section 48.

Question 23

State the cases where the benefit of indexation of costs is not available for determination of capital gains.

Answer

In the following cases, the benefit of indexation of cost is not available for determination of capital gains on transfer of capital assets –

1. Transfer of capital assets held for not more than 36 months (12 months in the case of listed securities, etc), since capital gains arising therefrom would be a short term capital gains.
2. Transfer of depreciable assets where computation is governed by section 50, since capital gains arising therefrom would always be short term capital gains, even if they are held for more than 36 months.
3. Transfer of undertaking or division in a slump sale under section 50B.
4. Transfer of bonds/debentures other than capital indexed bonds issued by the Government *(Third proviso to section 48)*.
5. Transfer of shares in or debentures of an Indian company, acquired by a non-resident in foreign currency *(First and second proviso to section 48)*.
6. Transfer of a foreign exchange asset by a non-resident Indian, who opts to be governed by the provisions of Chapter XII-A *(Section 115D)*.
7. Transfer of Global Depository Receipts purchased in foreign currency by an individual resident in India and employee of an Indian company or its subsidiary engaged in specified knowledge based industry or service *(Section 115ACA)*.
8. Transfer of units of Unit Trust of India or a Mutual Fund specified under section 10(23D) purchased in foreign currency by an overseas financial organisation referred to as Offshore Fund *(Section 115AB)*.
9. Transfer of securities by Foreign Institutional Investors *(Section 115AD)*.

Question 24

Redemption of preference shares amounts to "transfer" within the meaning of Section 2(47) of the Income Tax Act, 1961 in the hands of the shareholder. Discuss.

Answer

The definition of the term "transfer" under section 2(47) is not an exhaustive definition but an inclusive one. "Transfer" in relation to capital asset includes, *inter alia*, sale, exchange or relinquishment of capital asset.

When shares are redeemed by a company, it only means that the concerned shareholder is giving up his or her ownership or claim with reference to the shares in favour of the company. The consideration received by the shareholder from the company is certainly for sale/relinquishment of the interest in the shares and therefore, the redemption of preference shares amounts to "transfer" and the gain arising therefrom, being the excess realization over the cost of acquisition, shall be charged to tax under the head "Capital Gains". This was upheld by the Supreme Court in *Anarkali Sarabhai vs CIT (1997) 224 ITR 422*. If the redemption is after a period of 12 months from the date of acquisition of shares by the shareholder, the long term capital gain shall be computed by deducting the indexed cost of acquisition. The resultant long term capital gain shall be charged to tax in accordance with the provisions of section 112.

Question 25

Aries Tubes Private Ltd. went into liquidation on 01.06.2013. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	₹
Share Capital (issued on 01.04.2011)	*5,00,000*
Reserves prior to 1.6.2013	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	*13,00,000*

There are 5 shareholders, each of whom received ₹ 2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

Answer

Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head “capital gains”, in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes any distribution made to the shareholders of a company on its liquidation, to the extent to which the distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not.

In this case, the accumulated profits immediately before liquidation is ₹ 3,00,000. The share of each shareholder is ₹ 60,000 (being one-fifth of ₹ 3,00,000). An amount of ₹ 60,000, is therefore, taxable under section 2(22)(c) in the hands of each shareholder.

Therefore, ₹ 2,00,000 [i.e. ₹ 2,60,000 minus ₹ 60,000 taxed as deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of ₹ 1,00,000 by each shareholder is to be deducted to arrive at the capital gains of ₹ 1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 12 months and hence long-term capital asset), but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for Securities Transaction Tax and hence the capital gain (long term) is not exempt under section 10(38). Also, the rate of tax on such long term capital gain would be 20% and subject to the provisions of section 112.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of *CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj).* Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer.

Note: However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47) and the exemption under section 54EC in respect of the capital gain arising from the said transaction shall be available.

Question 26

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.03.1981 for ₹ 5 lacs. The said property was inherited by his son Abraham in financial year 2008-09 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2009 of ₹ 15 lacs. The said house property was sold by Abraham on 16.03.2013 for ₹ 50 lacs. State with reasons the amount chargeable to capital gains for A.Y. 2014-15

(Cost Inflation Index 2008-09: 582 and 2013-14: 939).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, ₹ 5 lacs, being the cost to his father (amount paid by his father on 26.3.1981 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of *RM. Arunachalam v. CIT [1997] 227 ITR 222.*

Computation of Taxable Capital Gain for the A.Y. 2013-14

Particulars	₹
Sale consideration of house property	50,00,000

Less: Indexed cost of acquisition (see Note below)		
(i) Cost to previous owner (₹ 5,00,000 × 939 / 582)	8,06,701	
(ii) Loan amount paid by Mr. Abraham (Benefit of CII is available since the loan amount was paid in the financial year 2008-09) (₹ 15,00,000 × 939 /582)	24,20,103	32,26,804
Capital gains		17,73,196

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

As per the definition of indexation cost of acquisition under clause (iii) of *Explanation* below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2008-09.

However, as per the view expressed by Bombay High court, in the case of *CIT v. Manjula J. Shah (2012) 204 Taxman 691,* in case the cost of acquisition of the capital asset in the hands of the assessee is taken to be cost of such asset in the hands of the previous owner, the indexation benefit would be available from the year in which the capital asset is acquired by the previous owner. If this view is considered, the indexation cost of acquisition would be ₹ 71,15,103 and long term capital loss would be ₹ 21,15,103.

Question 27

'X', purchased on 18.6.2003, house property for ₹ 22,00,000 which was sold to A on 18.10.2013 for ₹ 38,75,000. The sub-registrar, at the time of registration of sale deed, charged stamp duty on ₹ 50,00,000 which was paid by the buyer.

The Assessing Officer while assessing for capital gain referred the matter to the valuation officer as per the request of vendor. The Valuation Officer determined the value of property at ₹ 45,00,000 on the date of transfer. X seeks your advice on the following:

(i) On what value the Assessing Officer could compute capital gain chargeable to tax?

(ii) The amount of capital gain on which 'X' is required to pay capital gains tax. (The CII for F.Y. 2003-04 is 463 and of F.Y. 2013-14 is 939).

Answer

(i) According to section 50C, the Assessing Officer can refer the property to the valuation officer, only when the following two conditions are satisfied:

(a) The value fixed by the stamp valuation authority is not disputed in appeal or revision etc.

(b) The assessee claims before the Assessing Officer that the value adopted or assessed by the stamp valuation authority exceeds the fair market value (FMV) of the property as on the date of transfer.

In the instant case, though the assessee paid the stamp duty as fixed by the stamp valuation authorities, he had requested the Assessing Officer to refer the property to the valuation officer for valuation. The value determined by the Valuation Officer is less than the value adopted by the stamp valuation authority. Therefore, such value only could be adopted for computing chargeable capital gains.

(ii) The amount on which the assessee is required to pay capital gains tax will be as under:-

Sale consideration of the house property under section 50C(1)	₹ 45,00,000
Less: Indexed cost of acquisition ₹ 22,20,000 × 939/463	₹ 44,61,771
Long term capital gain	₹ 38,229

Question 28

Specify the items of capital assets in respect of which the cost of acquisition shall be taken as 'nil' under the provisions of the Income-tax Act, 1961 while computing capital gains.

Answer

According to section 55 of the Income-tax Act, 1961, the cost of acquisition shall be taken to be 'nil' in the case of the following capital assets:

1. Self generated goodwill of a business
2. Bonus shares
3. Right to subscribe to rights issues
4. Tenancy rights
5. Stage carriage permits
6. Loom hours
7. Any right to manufacture, produce or process any article or thing; and
8. A trademark or brand name associated with the business.

Question 29

Dalal entered into an agreement with Shroff for the sale of his property and received earnest money of ₹ 1,00,000 on 1.4.2013. The balance of ₹ 4,00,000 was to be paid within 3 months, failing which Dalal was entitled to a compensation of ₹ 50,000. The earnest money was also liable to be forfeited. Shroff defaulted in the payment of the balance within the time specified and therefore the earnest money was forfeited. A suit was also filed for breach of contract and ₹ 50,000 was awarded, which was received on 28.3.2014. Discuss the nature of the two receipts from the point of view of liability to tax.

Answer

Forfeiture of earnest money: The matter relating to the liability to tax of earnest money and compensation has arisen for consideration by the Apex Court in *Travancore Rubber and Tea Co. Ltd v. CIT (2000) 243 ITR 158.* The quality and nature of receipt for income-tax purposes are fixed once and for all when the subject of the receipt is received and subsequent operations do not change that nature. Section 51 preserves this rule enunciated in *Morley (Inspector of Taxes) v. Tattersall 7 ITR 316.* There is a distinction between earnest money and compensation, but it loses its significance in the context of section 51 which includes "other moneys" in addition to earnest money. Accordingly, the amount received by way of earnest money is not taxable but would go to reduce the cost of acquisition of asset at the time of its ultimate sale.

Compensation for breach of contract: The compensation received for breach of contract is also not chargeable to tax at the time of receipt but would go to reduce the cost of acquisition of the asset while reckoning capital gain at the time of its ultimate sale.

Question 30

(i) *Chand Ltd. decided to effect buy-back of share capital by purchase of listed shares in open market. During the year ended 31.3.2014, Chand Ltd. purchased its own 10,000 shares, listed in BSE. Discuss the tax implications in the hands of Chand Ltd. and shareholders.*

(ii) *Discuss the tax treatment of surplus arising out of deep discount bonds:*

   (a) *On sale of such bonds*

   (b) *On realization of such bonds on maturity.*

Answer

(i) Section 46A provides for the taxability of capital gains in the hands of shareholders, when the shares are purchased by the company in the open market by way of buy-back of its own listed shares. In the hands of Chand Ltd, there shall be no liability to tax as the payment is on capital account.

In the case of shareholders, the difference between the consideration received by the shareholders and the cost of acquisition will be chargeable to tax as capital gains. Any payment made by a company on purchase of its own shares in accordance with section 77A of the Companies Act, 1956 will not constitute dividend under section 2(22). Hence, there is no liability on the part of the company to deduct tax at source.

(ii) The CBDT has clarified vide *Circular No.2/2002 dated 15.02.2002*, that the difference between the cost of acquisition and market value as on 31st March immediately succeeding shall be taxable as interest income. In respect of subsequent assessment years, the difference in market values as on the closing dates of the respective previous years shall be taken as interest income.

Where the bonds are sold before maturity, the sale price less the market value as on the closing date of the immediately preceding financial year shall be taken as the capital gain/loss. If the bonds are transferred within 12 months from the date of acquisition, the resultant gain/loss will be short term capital gain/loss. Where it is transferred after 12 months, it will be a long term capital gain/loss.

In the year of redemption, the redemption price and the market value as on 31st March immediately preceding the date of redemption will be compared and the difference will be treated as interest income.

If the bonds are kept as trading asset instead of interest income, the income will obtain the character of business income.

Circular No.2/2002 dated 15/02/2002 has stated that small non-corporate investors having deep discount bonds upto an aggregate face value of ₹ 1 lac can continue to offer income for tax in accordance with the earlier *Circular F.No.225/45/96 dated 03.12.1996*, which clarifies that the difference between purchase price and redemption price is taxable as interest income. If the bonds are transferred before maturity, the sale consideration less cost of acquisition is taxable as capital gain (where the bonds are held as investment) and as business income (where the bonds are held as trading assets). On final redemption, however, no capital gains will arise.

Question 31

A Manufacturing company was transporting two of its machines from unit 'A' to unit 'B' (which is at a distance of 100 miles) on 1st September, 2013 by a truck. On account of a civil disturbance, both the machines were damaged. The insurance company paid ₹ 5 lacs for the damaged machines. On these facts, for submitting the return of income for the previous year ending 31st March, 2014, your advice is sought as to:

(i) Whether the damage of machines results in any transfer?

(ii) How the amounts received from the insurance company are to be treated for taxability?

(iii) Would there be any impact on the written down value of the block of plant and machinery as at 31st March 2014?

Answer

As per section 45(1A), receipt of insurance compensation in the form of money or any asset is to be treated as consideration and capital gain is accordingly to be charged to tax. The two qualifying conditions prescribed are (a) the compensation should have been received because of damage or destruction of capital asset and (b) the damage or destruction is as a result of circumstances mentioned therein.

In the facts of the case, both the conditions are satisfied and therefore, the compensation is to be treated as consideration. Applying section 45(1A) the answers to the issues are:

(i) in the case of damage or destruction, there is no actual transfer;

(ii) the receipt of insurance compensation of ₹ 5 lacs has to be treated as consideration in accordance with the provisions of section 45(1A).

(iii) in the instant case, as per the provisions of section 43(6)(c) the receipt of compensation of ₹ 5 lacs calls for adjustment in the written down value of the block of assets. If the written down value is more than ₹ 5 lacs, then ₹ 5 lacs should be deducted from written down value. On the other hand, if the written down value is less than ₹ 5,00,000, the difference would be treated as short term capital gain.

Question 32

Gama Ltd, located within the corporation limits decided in December, 2013 to shift its industrial undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows: (₹ in lacs)

	Particulars	*Land*	*Building*	*Plant & Machinery*	*Furniture*
(i)	*Sale proceeds (sale effected in March, 2014)*	*8*	*18*	*16*	*3*
(ii)	*Indexed cost of acquisition*	*4*	*10*	*12*	*2*
(iii)	*Cost of acquisition in terms of section 50*	*--*	*4*	*5*	*2*
(iv)	*Cost of new assets purchased in July, 2013 for the purpose of business in the new place*	*4*	*7*	*17*	*2*

Compute the capital gains of Gama Ltd for the assessment year 2014-15.

Answer

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.
2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of ₹ 2 lacs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter apply the provisions of section 54G.

	Particulars	₹
(a)	**Land** – Sale proceeds (Non depreciable)	8,00,000
	Less: Indexed cost	4,00,000
	Long term capital gain	4,00,000
	Less: Cost of new assets purchased within one year before the transfer (under section 54G)	3,00,000
	Taxable Long term capital gain	1,00,000
(b)	**Building** – sale proceeds (depreciable assets)	18,00,000
	Less : W.D.V. is deemed as cost of acquisition under section 50	4,00,000
	Short term capital gain	14,00,000
(c)	**Plant & machinery-** sale proceeds (depreciable asset)	16,00,000
	Less: WDV is deemed cost under section 50	5,00,000
	Short term capital gain	11,00,000
(d)	**Furniture -** sale proceeds (depreciable asset)	3,00,000
	Less: WDV is deemed cost under section 50	2,00,000
	Short term capital gain (A)	1,00,000

Summary	
Short term capital gain : Building	14,00,000
Short term capital gain : Plant & machinery	11,00,000
	25,00,000
Less: New assets purchased under section 54G (See Note below)	25,00,000
Net short term capital gain (B)	Nil
Total short term capital gain (A)+(B) = ₹ 1 lac	

Note – Total exemption available under section 54G is ₹ 28 lacs (₹ 4 lacs + ₹ 7 lacs + ₹ 17 lacs). The exemption should first be exhausted against short tem capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, ₹ 25 lacs is exhausted against short term capital gain and the balance of ₹ 3 lacs against long term capital gain.

Question 33

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth ₹ 4 lacs on 1.5.2007 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2013 was ₹ 2,08,800. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of *destruction of loss. A fire broke out in August, 2013 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of ₹ 6 lacs from the insurance company on 15th March, 2014. Discuss the issues arising on account on the transactions and their tax treatment.*

(Cost inflation index for financial year 2007-08 and 2013-14 are 551 and 939 respectively)

Answer

As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset, then, any profits and gains arising form the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (assuming it was the only asset in the block).

The computation of capital gain and tax implication is given below:

Full value of the consideration	₹ 6,00,000
Less: Written down value as on April 1st, 2013	₹ 2,08,800
Short term capital gains	₹ 3,91,200

Question 34

Tani purchased a land at acost of ₹ 10 lakhs in the financial year 1982-83 and held the same as her capital asset till 31st March, 2010. Tani started her real estate business on 1st April, 2010 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was ₹ 150 lakhs.

She constructed 20 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 8 lakhs. Construction was completed in December, 2013. She sold 15 flats at ₹ 20 lakhs per flat between January, 2014 and March, 2014. The remaining 5 flats were held in stock as on 31st March, 2014.

She invested ₹ 50 lakhs in bonds issued by Rural Electrification Corporation Ltd. on 31st March, 2014.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2014-15 indicating clearly the reasons for treatment for each item.

Cost Inflation Index: FY 1982-83: 109; FY 2010-11: 711; FY 2013-14: 939.

Answer

Computation of capital gains and business income of Tani for A.Y.2014-15

Particulars	₹
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	1,50,00,000
Less: Indexed cost of acquisition [₹ 10,00,000 × 711/109]	65,22,936
	84,77,064
Proportionate capital gains arising during A.Y.2014-15 [₹ 84,77,064 × ¾]	63,57,798
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2014-15	13,57,798
Business Income	
Sale price of flats [15 × ₹ 20 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [₹ 150 lacs × ¾]	1,12,50,000
Cost of construction of flats [15 × ₹ 8 lakhs]	1,20,00,000
Business income chargeable to tax for A.Y.2014-15	67,50,000

Alternate presentation for computation of capital gains

	₹
Proportionate Fair Market Value as on 1st April 2010 - the date of conversion – to be taken as deemed consideration (₹ 150 lakhs × 15 /20)	1,12,50,000
Less: Proportionate Indexed Cost of Acquisition of Land (Note1) (₹ 10,00,000 × 711/109 × 15/20)	48,92,202
Long term capital gain	63,57,798
Less: Exemption under section 54EC	
Investment in bonds issued by Rural Electrification Corporation Ltd	50,00,000
Taxable long-term capital gain	13,57,798

Notes:

(1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock-in-trade.

(2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock-in-trade is sold.

(3) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.

(4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 75% of the stock-in-trade (15 flats out of 20 flats) is sold in the P.Y.2013-14, only proportionate capital gains (i.e., 75%) would be chargeable in the A.Y.2014-15.

(5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be the difference between the price at which the stock-in-trade is sold and the fair market value on the date of conversion of the capital asset into stock-in-trade.

(6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [*CBDT Circular No.791 dated 2.6.2000]*. In this case, since the investment in bonds of RECL has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC.

Question 35

Mr. Shakti purchased a residential house in March, 2002 for ₹ 22 lakhs. He sold the house on 1st December, 2013 for ₹ 100 lakhs. He paid brokerage at 2% on sale price. He invested ₹ 80 lakhs in April, 2014 in equity shares of Shakti Manufacturing Private Limited, a newly formed manufacturing company which qualifies to be a small enterprise under the Micro, Small and Medium Enterprises Development Act, 2006. Mr. Shakti holds 80% of share capital of the company.

The company utilised the sum of ₹ 80 lakhs in the following manner:

(i) Purchase of new machinery during April, 2014 ₹ 70 lakhs (including ₹ 10 lakhs for purchase of computers).

(ii) Deposit in specified bank on 25th September, 2014 ₹ 10 lakhs.

The due date for filing return of income for Mr. Shakti for Assessment Year 2014-15 is 30th September, 2014. Assume that he files the return on 28th September, 2014.

Compute the taxable capital gain arising from the above transaction for Assessment Year 2014-15. (Cost Inflation Index: FY 2001-02: 426; FY 2013-14: 939.)

Answer

Computation of taxable capital gains of Mr. Shakti for A.Y.2014-15

Particulars	₹
Gross sale consideration	1,00,00,000
Less: Expenses on transfer (2% of the gross sale consideration)	2,00,000
Net sale consideration	98,00,000
Less: Indexed cost of acquisition (₹ 22,00,000 × 939/426)	48,49,296
Long term capital gains	49,50,704
Less: Exemption under section 54GB (See Note below) (₹ 49,50,704 × ₹ 70,00,000 / ₹ 98,00,000)	35,36,217
Taxable capital gains	14,14,487

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	₹
(1)	Purchase cost of new plant and machinery acquired in April, 2014	70,00,000
	Less: Cost of office appliances, i.e., computers (which have been specifically excluded from the meaning of new plant and machinery)	10,00,000
		60,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return	10,00,000
Deemed cost of new plant and machinery for exemption u/s 54GB		70,00,000

Note:

Exemption under section 54GB can be availed on long-term capital gains on transfer of a residential house, since all the conditions given below are fulfilled by Mr. Shakti :

(i) The sale proceeds are used for subscription in the equity shares of an eligible company, being a newly incorporated manufacturing company which qualifies to be a small enterprise under the Micro, Small and Medium Enterprises Act, 2006.

(ii) Mr. Shakti holds more than 50% of the share capital in the said company.

(iii) Further, the amount of subscription as share capital has been utilized by the eligible company for purchase of new plant and machinery within a period of one year from the date of subscription.

Question 36

X. Limited has transferred its Unit N to Y. Limited by way of slump sale on November 30, 2013. The summarised Balance Sheet of X. Limited as on that date is given below:

Liabilities	*₹ (in lakhs)*	*Assets*	*₹ (in lakhs)*
Paid up capital	*1,700*	*Fixed Assets :*	
Reserve & surplus	*620*	*Unit L*	*150*
Liabilities:		*Unit M*	*150*
Unit L	*40*	*Unit N*	*550*
Unit M	*110*	*Other Assets:*	
Unit N	*90*	*Unit L*	*520*
		Unit M	*800*
		Unit N	*390*
Total	*2,560*	*Total*	*2,560*

Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.

(i) Cost inflation index for financial year 2006-07 and financial year 2013-14 are 519 and 939, respectively.

(ii) Lump sum consideration on transfer of Unit N is ₹ 880 lakhs.

(iii) Fixed assets of Unit N includes land which was purchased at ₹ 60 lakhs in August 2006 and revalued at ₹ 90 lakhs as on March 31, 2013.

(iv) Other fixed assets are reflected at ₹ 460 lakhs (i.e. ₹ 550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 410 lakhs.

(v) Unit N was set up by X. Limited in July, 2006.

Answer

Computation of capital gain on slump sale of Unit N under section 50B

Particulars	₹ (in lacs)
Sale consideration for the slump sale of Unit N	880
Less: Net worth of Unit N (Refer Note 1 below)	770
Long term capital gain arising on slump sale	110

Computation of tax liability of X Ltd. on slump sale of Unit N

Particulars	₹ (in lacs)
Tax on capital gains@20%	22.00

Add: Surcharge@5%	1.10
	23.10
Add: Education cess@2% and Secondary and higher education cess@1%	0.69
Total tax liability on capital gain arising on slump sale of Unit N	23.79

Notes:

1. The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	₹ (in lacs)
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	60
(ii) Other assets	390
(B) Written down value of depreciable assets under section 43(6)	410
Aggregate value of total assets	860
Less: Value of liabilities of Unit N	90
Net worth of Unit N	770

2. Since Unit N is held for more than 36 months, the capital gains of ₹ 110 lacs arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

Self-examination Questions

1. Discuss the conditions to be satisfied for claiming exemption of tax in respect of -

   (a) Capital gains on compulsory acquisition of agricultural land situated within specified urban limits

   (b) Capital gains on sale of listed equity shares/units of an equity oriented fund.

2. Write short notes on -

   (i) Capital gains in the case of slump sale under section 50B

   (ii) Reference to Valuation Officer under section 55A

3. Ganesh, a resident individual, bought 1,000 equity shares of ₹ 10 each of XYZ Ltd. at ₹ 50 per share on 3.4.2013. He sold 700 equity shares at ₹ 35 per share on 31.8.2013 and the remaining 300 shares at ₹ 25 per share on 1.11.2013. XYZ Ltd. declared a dividend of 50%, the record date being 30.6.2013. Ganesh sold on 5.1.2014, a house from which he derived a long-term capital gain of ₹ 75,000. Compute the amount of capital gain arising to Ganesh for the A.Y. 2014-15.

4. Where a holding company receives assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, would the value of assets received by the holding company on the date of distribution be liable to tax?

5. The word 'otherwise' used in section 45(4) takes into its fold not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner. Discuss.

6. What is the cost of acquisition in a case where the previous owner himself acquired the asset by any of the modes set out in section 49(1)?

Answers

4. This question was answered by the Gujarat High Court in *CIT v. Brahmi Investments (P.) Ltd. (2006) 286 ITR 66*. In this case, the High Court held that if a holding company had received assets on voluntary liquidation of its subsidiary company by virtue of being a shareholder of the subsidiary company, the value of assets received by the holding company on the date of distribution was liable to tax under section 46(2). Section 47(v), which provides that transfer of a capital asset by a subsidiary company to its 100% holding company (being an Indian company) would not be regarded as a transfer for the purpose of charge of capital gains tax, would not be applicable in this case.

5. The Bombay High Court made a landmark judgment in deciding this issue in *Commissioner of Income-tax v. A.N. Naik Associates (2004) 136 Taxman 107.* The Court applied the "mischief rule" about interpretation of statutes and pointed out that the idea behind the introduction of sub-section (4) in section 45 was to plug in a loophole and block the escape route through the medium of the firm.

   The High Court observed that the expression 'otherwise' has not to be read *ejusdem generis* with the expression 'dissolution of a firm or body of individuals or association of persons'. The expression 'otherwise' has to be read with the words 'transfer of capital assets by way of distribution of capital assets. If so read, it becomes clear that even when a firm is in existence and there is a transfer of capital asset, it comes within the expression 'otherwise' since the object of the amendment was to remove the loophole which existed, whereby capital gains tax was not chargeable. Therefore, the word 'otherwise' takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of retiring partners.

6. The Madras High Court, in *CIT v. Theatre Sri Rangaraja (2004) 135 Taxman 269,* observed that the *Explanation* to section 49(1) makes it clear that where the previous owner of an asset which was sold had himself acquired it by any of the modes set out in section 49(1)(i) to (iv), it is the cost incurred by the owner who had owned the asset prior to the previous owner that is required to be taken into account and not the cost incurred by the previous owner at the time he received the asset in any of the modes set out in sub-clauses (i) to (iv) of section 49(1).