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TAX FLASH NEWS

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No capital gains on transfer under the scheme of demerger, in absence of consideration the computation mechanism fails

Background

The Mumbai Income-Tax Appellate Tribunal (the Tribunal) in the case of Aditya Birla Telecom Limited[1] (the taxpayer) held that no capital gain tax to be levied in absence of consideration received/ accrued to the taxpayer for transfer of undertaking under a scheme of demerger. The Tribunal observed that, in absence of nexus between transfer of the undertaking and the revaluation of investment, the same can neither be considered as arising on account of such demerger nor considered as the full value of consideration. Wherever the legislature has considered appropriate, it has introduced specific provisions for the assumption of sale consideration. As the current case clearly falls outside the ambit of such specified provisions it is unjust to impute a consideration.

Facts of the case

- The taxpayer is a wholly owned subsidiary of Idea Cellular Limited (ICL).
- As per the scheme of demerger, all the assets and liabilities of the telecom unit of the taxpayer was transferred to ICL without any consideration. The scheme of demerger was also approved by the High courts of Gujarat and Bombay without modifications.
- Pursuant to the scheme of demerger, the taxpayer also revalued its investment in Indus, an asset distinct from the demerged undertaking and the difference arising on revaluation thereof was credited to business restructuring reserve.
- The Assessing Officer (the AO) held that demerger was a slump sale under Section 50B of the Income-tax Act, 1961 (the Act) and computed the short-term capital gain considering the revaluation of the investment in Indus as full value of the consideration. Further, the AO disallowed unamortised license fees claimed by the taxpayer under Section 35ABB(2) of the Act on the ground that it was already considered in computing the short-term capital gain.
- The taxpayer contended that in absence of any sale consideration, no notional gain can be imputed in the hands of the seller to tax such transfer. The taxpayer while relying on the decision of the Supreme Court, in the case of K P Varghese[2] contended that, unless there is material evidencing that something more was received, over and above what was stated, no higher price can be taken to be the basis of computation of capital gains. In the instant case, there being no understatement of income by the taxpayer nothing is permitted to be imputed in its hands.
- The AO held that there is no demerger as per the Act and the taxpayer is not eligible for any exemption of capital gains under Section 47(iii), (v) and (vi) of the Act and that the transfer of undertaking to ICL was taxable to capital gains. Further, the AO took the revalued assets as accrued consideration and computed the capital gain.

[1] Aditya Birla Telecom Limited v. DCIT (ITA No.341/Mum/2014) - Taxsutra.com

[2] K P Varghese v ITO [1981] 131 ITR 597 (SC)

- The Commissioner of Income-Tax (Appeals) CIT(A) confirmed the AO's order and observed that revalued assets amounted to full value of consideration for transfer of undertaking to ICL.

- The taxpayer preferred an appeal before the Tribunal challenging the order of the CIT(A).

Tribunal's decision

- Under the scheme of Arrangement, the taxpayer transferred all the assets and liabilities of the telecom undertaking to ICL without consideration. The Gujarat and Bombay High courts have approved the said scheme without any modifications. As a part of the arrangement, the existing investment in Indus, which continued to remain vested in the taxpayer post demerger was revalued at its fair value and the difference was recognised in business restructuring reserve.

- The creation of the reserve was merely an accounting entry passed in the books of account and was a unilateral action by the taxpayer. For any transaction to be termed as 'consideration' it must involve two or more parties. The reserve created by unilateral action of the taxpayer cannot be treated as consideration received from ICL.

- Further, consideration must have nexus to the transfer and must not arise out of independent transactions wherefrom independent rights emanate. The transfer of undertaking and revaluation of investment in Indus both are independent transactions arising from the same scheme of arrangement and there exists no nexus between the two transactions. Thus no consideration has accrued to the taxpayer on account of demerger.

- In absence of any sale consideration for transfer, the capital gains computation mechanism fails and thus no capital gains tax can be levied on such transfer. The Tribunal followed the principle laid down by the Supreme Court in the case of B C Srinivasa Setty1where it was held that the charging section and the computation provisions together constitute an integrated code and when there is a case where one of the ingredients for computation of capital gains is absent, no capital gains could be levied due to failure of computation mechanism.

- Following the co-ordinate bench decision in the case of Avaya Global Connect Ltd1, the Tribunal held that in absence of any sale consideration, capital gains computation mechanism fails and thus no capital gains tax can be levied on such transfer.

- The Tribunal drew reference to the decision of the Mumbai Tribunal in case of Rupee Finance & Management Ltd1 where it was held that in absence of specific enabling provisions in the Act, there can be no notional taxation of a transaction with reference to the fair market value. Thus what can be taxed in the hands of the transferor is the real or actual gain that arises/accrues from transfer and in absence of any sale consideration, no notional gain can be imputed in hands of seller.

- Wherever the legislature had considered appropriate, it had inserted specific provisions for assumption of sale consideration. Section 50C and 50D of the Act provide for imputing the consideration are also not applicable to the instant case on account of the following:

  - The instant case is of transfer of undertaking and not of any land/building of the taxpayer, therefore provisions of Section 50C of the Act may not be applicable.

  - Since the instant case pertains to AY 2010-11, the provision of Section 50D of the Act which was introduced with effect from the assessment year 2013-14 may not be applicable.

  Thus it is unjust and unwarranted to impute/assume consideration in cases which clearly do not fall within the ambit of such specific provisions.

- Since no consideration can be said to accrue to the taxpayer on demerger, capital gain charge would fail.

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[2] CIT v. B C Srinivasa Setty [1981] 128 ITR 294 (SC)
[4] Avaya Global Connect Ltd v. ACIT [2009] 122 TTJ 300 (Mum)
[5] Rupee Finance & Management Ltd v. ACIT [2008] 22 SOT 174 (Mum)

Our comments

The issue with respect to levy of capital gain tax vis-à-vis transfer of assets without consideration has been a subject matter of debate before the courts. While the courts have been guided by the principle that if no right has been conferred under any specific provision of the Act to assume or impute a value to the transaction, then the gains are to be computed having reference to the actual transaction value unless the facts demonstrate that additional consideration has flown in other form leading to lower declaration of value of consideration. This principle has also been discussed in the instant case where the Tribunal examined whether any value can be imputed by the AO as full value of consideration for the purposes of computing capital gains of the transfer of undertaking.

Whether any consideration can be further attributed to a transaction or whether the case falls under the purview of specific provisions where by the law permits imputation of value for the purposes of computing gains, is a matter of fact. Also, the consideration mentioned along with other terms of the arrangement, as approved by the High Courts, assumes significance in determining the consideration for computing capital gains in such cases of organisational restructuring.

In the instant case, the Tribunal observed that revaluation of investment was a distinct transaction and had no nexus to the transfer of undertaking. Hence, the same could not be considered in determining full value of consideration. Also provisions of Section 50C and 50D of the Act which empowered the AO to impute an artificially computed value as consideration, were not applicable to the given case. The actual transaction value had to be considered as full value of consideration for the purposes of computing gains. As the demerger was carried out for no consideration, the computational provisions have failed and therefore the taxpayer is not chargeable to tax under the head ‘capital gains’.

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