cutting through complexity

16 June 2015

Gift received by a company is a capital receipt not taxable under the Income-tax Act

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of KDA Enterprises Pvt Ltd.[1] (the taxpayer) held that a gift received by a company is a capital receipt and cannot be charged to tax under the Income-tax Act, 1961 (the Act) since there is no specific provision for taxability of such receipts in the statute.

The Tribunal observed that companies are competent to make and receive gifts, and natural love and affection are not a necessary requirement. Under the Act, only the income of the taxpayer is subject to tax and not each and every receipt of the taxpayer, where the other receipts are not in the nature of income.

With regards to the provisions of Minimum Alternate Tax (MAT), the Tribunal held that the provisions are applicable only if the item of expense or income is debited or credited to the Profit and Loss Account. However, when the item of expense or income is not debited or credited to the Profit and Loss Account, Explanation to Section 115JB of the Act cannot apply and hence no adjustment is required while computing book profits under the provisions of MAT.

Facts of the case

- The taxpayer is a private limited company engaged in the business of investment. During the year under consideration (financial year 2008-09), the taxpayer received a gift of INR1618.6 million from four private companies which were shareholders of Reliance Industries Ltd. (RIL). The taxpayer claimed that the amounts have been received directly from RIL on account of the dividend receivable by the said four concerns against their shareholding in RIL.
- All the four concerns passed resolutions in the meeting of Board of Directors for making the said gifts and similarly the taxpayer also passed a resolution by the Board of Directors for receiving the gifts.
- It is on the directions of the four concerns that their dividend were directly credited to the bank account of the taxpayer. All the four donor concerns are also authorised by the Memorandum of Association (MoA) and Articles of Association (AoA) for making such gifts, and the taxpayer is authorised as well for receiving such gifts.
- Since the identity of the donor companies, their source of funds for gifts and the nature of transaction are clearly established, the taxpayer claimed that these receipts are not taxable because these are capital receipts and any such gift is not taxable.
- The Assessing Officer (AO) held that these receipts cannot be categorised as gifts or transactions which are specifically exempt from taxation and further held that these cannot be categorised as dividend income in the hands of the taxpayer. The AO held that a gift received by the taxpayer is chargeable to tax as income from other source in the hands of the taxpayer. The AO further held that amount of gift should be added to the book profit under Section 115JB of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] passed an order in favour of the taxpayer.

[1] DCIT v. KDA Enterprises Pvt. Ltd. (ITA No. 2662/M/2013) (Mum) – Taxsutra.com

Tribunal's ruling

- Under the Act, each and every receipt is not taxable. Where other receipts which not in the nature of income are intended to be taxed, the legislature has to specifically make provisions for taxability of such receipts in the statute itself.

- The gift received by the taxpayer are a voluntary payment made by the donors to the taxpayer. Neither the taxpayer has any legal right to claim the gift from the donor nor do the donors have any legal or contractual obligations to give a gift to the taxpayer. The gift received has nothing to do with the business of the taxpayer so as to constitute its income from business or a revenue receipt in the nature of income.

- As per Section 14[2] of the Act, the income of the taxpayer shall be chargeable to tax only if it falls under any of the heads of income specified therein. A gift received is neither in the nature of salary nor in the nature of income from house property. It cannot be said that the taxpayer is engaged in the business of receiving gifts from corporate bodies. As the gift has no relation to any capital asset, the same can also not be considered as capital gain in the hands of the taxpayer. With respect to income from other source, what is subjected to tax under the provisions of Section 56 of the Act is income of revenue nature. In the present case the gift was treated as non-taxable capital receipt in the hands of the recipient.

- The provisions of Section 56(2)(v)(vi), (vii) and (viia) of the Act specifically covers the instances of gift which are taxable under the provisions of Act. However, all other gifts received by the taxpayer other than those covered in these sections are not chargeable to tax being capital receipt in nature. In various decisions[3], it has been held that gifts are capital receipts when consideration is not in the nature of income and hence, it cannot be charged to tax under the provisions of Act.

- In the present case, the identity of all the four concerns, which have made gifts to the taxpayer, was given along with their name, PAN, address and other details. Therefore, the identity of these concerns was proved.

- The suspicion of the AO that the transaction of gift is dubious and to bring into books any unaccounted money is contrary to the facts on record. The gifts have been received on account of dividend by the donor companies from RIL. Further, RIL has also paid dividend distribution tax and therefore, such money received by the taxpayer is not unaccounted money.

- Relying on the decision of D.P. World Pvt. Ltd.[4] and Redington (India) Limited[5] it has been held that companies are competent to make and receive gifts, and natural love and affection are not a necessary requirement. Only requirement for a company is to make gifts as per the respective MOA and AOA, which authorise the company for the same.

- In the present case, the taxpayer and the donor companies are authorised for receiving and making gifts respectively by their MoA and AoA. The position regarding the competency of corporate entities to make and receive gifts has also been upheld in various cases[6].

- It is also clear from the Transfer of Property Act that companies can receive and make gifts and there is no requirement of any natural love and affection for making or receiving a gift by companies. Even the Act by way of Section 56(2)(viia) and 56(2)(viib) of the Act provides that gifts of certain kind of shares are taxable in the hands of certain category of companies.

- Section 122 of the Transfer of Property Act provides for making of a gift and permits transfer of moveable or immovable property but without any consideration. Further, the term living person includes a company or association or body of individuals, whether incorporated or not.

- In various decisions[7] it has been held that gifting of amounts in the nature of capital receipts without considerations does not result into income and hence the same cannot be charged to tax under the provisions of the Act.

[2] Classification of heads of income
[3] Padmaraje R. Kadambande v. CIT [1992] 195 ITR 877 (SC)
Mehboob Productions Private Ltd. v. CIT, [1977] 106 ITR 758 (Bom)
H.H.Maharani Shri Vijaykuverba Saheb of Morvi & Anr. v. CIT [1963] 49 ITR 594 (Bom)

[4] D.P. World Pvt. Ltd. v. DCIT [2013] 140 ITD 694 (Mum)
[5] Redington (India) Limited v. JCIT [2014] 49 taxmann.com 146 (Chennai)
[6] CIT v. Groz-Beckert Saboo Ltd [1979] 116 ITR 125 (SC), ACIT v. SET India Private Limited [2010] 3 ITR(T) 454 (Mum), Essar Technologies [ITA No 179/Mum/2005], CIT v. Stewarts & Lloyds of India Ltd. [1987] 165 ITR 416 (Cal), Deere & Co.[2011] 337 ITR 277 (AAR), Goodyear Tire and Rubber Company [2011] 334 ITR 69 (AAR), Dana Corporation [2010] 321 ITR 178 (AAR), Amiantit International Hondings Ltd. [2010] 322 ITR 678 (AAR), Vodafone Essar [2011-TII-01-HC-(Del)]
[7] HH Maharani Shri Vijaykuverba Saheb of Morvi & Anr v. CIT [1963] 49 ITR 594 (Bom)
CIT v. Pran Jiban Jaitha [1964] 52 ITR 108 (Cal), Lachit Films v. CIT [1992] 195 ITR 402 (Gauhati),
Padmaraje R. Kadambande v. CIT [1992] 195 ITR 877 (SC), CIT v. Ramdeo Samadhi [1986] 160 ITR 179 (Raj)

- The provisions of Gift tax Act, even though repealed, clearly recognised the company, a juridical person as a donor and made it an assessable entity under the Act. The legislature wherever thought fit has provided by even through taxing statutes that a company can make/receive gift.

- Three elements are essential in determining whether or not a gift has been made i.e. a) delivery, b) donative intent, and c) acceptance by the donee. In the present case, all the three essentials have duly been fulfilled by the taxpayer as well as all the four donor of gifts. The dividend was actually received by the taxpayer in its bank account, all four donors had passed a resolution that they intend to transfer the dividend on shares of RIL held by them to the taxpayer as gift and the taxpayer had also passed a resolution for due acceptance of the gift.

- Thus in the instant case, the gift received by the taxpayer is in the nature of capital receipt duly supported by documentary evidence and hence cannot be deemed as revenue receipt liable to tax.

- Even the legislative history shows that gifts received by companies other than certain kind of shares by certain category of companies mentioned under Section 56(2)(viia) and (viib) are not taxable under the Act or any other Act.

Unexplained cash credit

- Provisions of Section 68[8] of the Act are applicable only if the taxpayer either offers no explanation or his/her explanation is unsatisfactory as to the nature and source of such cash credits. In such cases, it is for the taxpayer to prove the identity of the person from whom the money is received and his source of payment and the genuineness of the transaction. In the present case, the identity of the donors has been proved and the source/capacity has been provided. The suspicion of the AO that the transaction of gift is dubious and to bring into books any unaccounted money is contrary to the facts on record.

Taxability as deemed dividend

- With regard to the taxability of gift under Section 2(22)(e)[9] of the Act, it has been observed that since there was no common shareholding between the taxpayer and the other four companies who have made gifts, the addition cannot be made under Section 2(22)(e) of the Act.

[8] Unexplained cash credit
[9] Deemed dividend

Taxability under the MAT provisions

- The Supreme Court in the case of Apollo Tyres[10] had observed that while looking into accounts of the company, the AO has to accept the authenticity of the accounts with respect to the provisions of the Companies Act. This obligates the company to maintain its accounts in a manner provided by the Companies Act, scrutinised and certified by the statutory auditors, approved by the shareholders and filed before the Registrar of the Companies.

- The Tribunal followed the decision of the Supreme Court in the case of Apollo Tyres and held that while computing income under Section 115J of the Act the only power the AO has is to examine whether the books of accounts are satisfied by the authorities under the Companies Act as having been maintained in accordance with the Companies Act. Thus, the AO has limited power of making an increase or reduction as provided in the Explanation to the said Section.

- The Explanation to Section 115JB of the Act is applicable only if the item of expense or income is debited or credited to the Profit and Loss Account. However, when the item of expense or income is not debited or credited to the Profit and Loss Account, Explanation to Section 115JB of the Act cannot apply and hence no adjustment is required while computing books profits under the provisions of MAT.

- In the present case the gift received from corporate bodies were not credited to the Profit and Loss Account and hence no adjustment is required to the book profit declared by the taxpayer under Section 115JB of the Act.

- Accordingly, the amount of gift received by the taxpayer is not taxable as income from other sources or capital gain or deemed dividend. Further, it is not taxable under the provisions of MAT.

Our comments

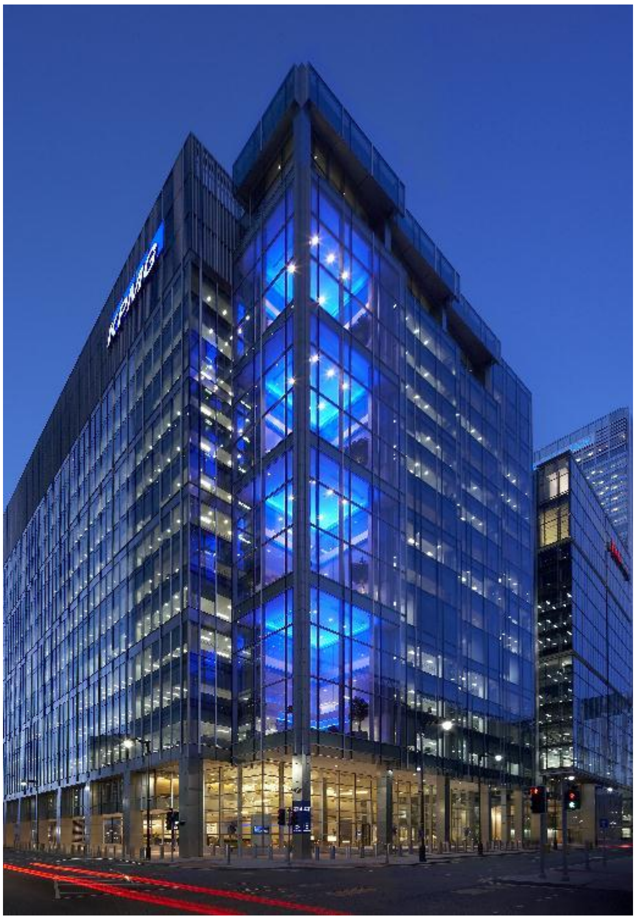
This is a welcome ruling of the Mumbai Tribunal where it has been held that companies are competent to make and receive gifts, and natural love and affection are not a necessary requirement. The

[10] Apollo Tyres Ltd. v. CIT [2002] 255 ITR 273 (SC)

amount of gift is a capital receipt and it cannot be charged to tax under the Act except in case of specified transactions under specific provisions of Section 56(2)(viia) and (viib) of the Act.

The Tribunal relied on various decisions where it has been held that a gift cannot be charged to tax since gifts are capital receipts and the consideration is not in the nature of income. This ruling is in line with the decision of the Chennai Tribunal in the case Redington (India) Limited where it was held that a corporate gift is valid in law, and love and affection is not a necessary criteria for a valid gift.

The Tribunal relied on the Supreme Court's decision in the case of Apollo Tyres Ltd. and held that when the item of expense or income is not debited or credited to the Profit and Loss Account, Explanation to Section 115JB of the Act cannot apply and hence no adjustment is required while computing book profits under the provisions of MAT.



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