



## Sale of shares of the group concern to related parties treated as a sham transaction, hence capital loss on such transaction was disallowed

### Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of AAA Portfolios Pvt. Ltd.<sup>1</sup> (the taxpayer), held that sale of shares of the group company during the lock-in period to related parties cannot be accepted as genuine and, therefore, the transaction was a sham transaction. The taxpayer had submitted misleading facts and explanation before the tax authorities, and this conduct of the taxpayer cannot be held as a conduct of sincere and innocent taxpayers. Therefore, the capital loss resulting from such transaction was disallowed.

### Facts of the case

- The taxpayer is a private limited company, and in relation to the relevant year, the taxpayer filed the income-tax return, declaring a loss.
- In March 2006, a preferential allotment of shares of Escort Ltd. was made to Harparshad & Company Pvt. Ltd. (HPC), as per the SEBI guidelines. The taxpayer purchased the shares of Escort Ltd. from HPC at INR83.79 per share on 27 September 2007 under a tripartite agreement.
- HPC had the option to convert each share warrant on equity share at a conversion price on or before 29 September 2007. There was a lock-in period of three years, which was to expire on 31 March 2009, and these shares were not transferable during this period.
- The shares were sold back to HPC on 30 September 2008 at INR53.96 per share. Accordingly, during the year under consideration, the taxpayer claimed the capital loss on this transaction of sale of share.
- The Assessing Officer (AO) disallowed the claim of the taxpayer by holding that the transaction entered into by the taxpayer with its related parties, in respect of shares of the same group concern resulting in substantial loss to the taxpayer, cannot be taken and accepted to be genuine.
- The AO also held that the taxpayer has claimed to have bought and then sold the rights in the shares of listed company Escort Ltd., which is also a group concern, outside the share market in the form of a private bulk deal. The transaction has taken place at a rate, which was lower than the market rate on that date, and therefore, the transaction was completely a sham transaction to book artificial losses and to

<sup>1</sup> AAA Portfolios Pvt. Ltd. v. DCIT [ITA No. 2483/Del./2014: AY 2009-10] – Taxsutra.com

evade legally payable taxes. Consequently, the AO made disallowance, *inter alia*, on the account of sale of investment and completed the assessment at taxable income.

- The Commissioner of Income-tax Appeals [CIT(A)] upheld the order of the AO.

### Tribunal's ruling

- In the case of Biraj Investment Pvt. Ltd.<sup>2</sup>, the taxpayer sold the shares and booked capital loss therefrom, which were pledged with the Industrial Development Bank of India, and the Gujarat High Court held that the transaction could not be a device for reducing tax effect.
- In the case of Biraj Investment Pvt. Ltd., there was no lock-in period for transfer of shares, as exists in the present case. In the present case, there was no transaction of pledging shares before the sale, resulting in a capital loss, and therefore, facts and circumstances of the present case are quite dissimilar to that case.
- In the case of M. Ramaswamy<sup>3</sup>, there was a controversy regarding the shares pertaining to a sick mill. The Madras High Court held that the shares, being movable property, can be transferred as per the articles of the company, and the transferee gets the right of ownership even if the transaction of sale is not entered in the share register of the company. Accordingly, the taxpayer is entitled to claim adjustment of a capital loss on such transfer. In the present case, it is not the case that since the name of the assessee was not entered into the shareholders register or share-roll register of the company, the taxpayer is not entitled to claim the loss on such transfer of share.
- The transactions entered into by the taxpayer with its related parties in respect of the shares of the same group concern resulting in a substantial loss to the taxpayer cannot be accepted as genuine, and therefore, it was a sham transaction.

- Since the transaction was not permissible and was legally prohibited during the lock-in period, the purchase and sale of shares without any legally permissible physical transfer of shares are considered as a sham transaction. Consequently, the claim of the taxpayer is not acceptable, which was advanced with an intention to evade taxes.
- The taxpayer had submitted that shares were sold back to HPC in September 2009, whereas before the AO, the taxpayer had mentioned the date of transaction as 30 September 2008. The taxpayer had submitted misleading facts and explanation before the authorities below, and this conduct of the taxpayer cannot be held as that of sincere and innocent taxpayers.
- If the shares were sold in September 2009, the same could not be considered as sold within the lock-in period, which was only up to 30 March 2009, and there would be no controversy about the loss claimed by the assessee. However, the shares were sold in the month of September 2008 and therefore, the controversy arose, and the claim of the taxpayer was dismissed.
- The taxpayer had contended the urgency and requirement of selling shares before the lock-in period and stated that in the AY 2009-10, the taxpayer was faced with huge tax demands, for which it had to liquidate its investment in these shares. However, there was no document before the High Court showing the tax demand pertaining to AY 2009-10, and the proof to show the tax payment to the exchequer on or after 30 September 2008, or even up to and of the relevant calendar year of 2008.
- Per contra, from the copies of the four challans placed before the Tribunal, it was apparent that the taxpayer made payment of tax for AY 2006-07 in four installments, starting during the calendar year 2009 and 2010. In the light of these documents, urgency and necessity showed by the taxpayer in September 2008 or nearby time cannot be held as acceptable or sustainable in the view of contradictory incorrect and baseless facts narrated by the taxpayer.

<sup>2</sup> ACIT v. Biraj Investment (P) Ltd. [2012] 210 Taxman 418 (Guj)

<sup>3</sup> CIT Madurai v. M. Ramaswamy [1984] 151 ITR 122 (Mad)

- Relying on the Delhi High Court decision in the case of Friends Overseas<sup>4</sup> and the Kolkata High Court decision in the case of Amal Kumar<sup>5</sup>, the Tribunal rejected the explanations of the taxpayer that the taxpayer sold back the shares to HPC due to huge tax demand in AY 2009-10.
- This baseless and factually incorrect contradictory version and explanation of the taxpayer deserves to be treated as a desperate measure to evade the responsibility cast by the taxing provisions of the Act and the law.
- Also, the said explanation of the taxpayer in this regard is nothing but an ill-contrived fictional story which is baseless and not acceptable. The taxpayer had no bonafide reason in September 2008, which forced the taxpayer to sell shares during the lock-in period, which resulted in huge loss to the taxpayer.
- In view of above, it was held that the transaction of sale of shares undertaken by the taxpayer during the relevant financial period with the group company was a sham transaction, and the loss booked under the said transaction cannot be held as allowable as the short-term capital loss for the taxpayer.

## Our comments

The Tribunal in the present case has held that the sale of shares of the same group company by the taxpayer to its related party during the lock-in period cannot be treated as a genuine transaction. There was no good cause for the taxpayer to sell these shares back to the group company. The transaction of sale of shares undertaken by the taxpayer company was a sham transaction, and therefore, the capital loss booked under the said transaction was disallowed.

The Delhi High Court in the case of Vishishth Chay Vyapar Ltd.<sup>6</sup> disallowed losses on the account of transactions of sale and purchase of shares and diminution in the value of stock, since such transactions were a sham. There were only book entries, and no payment was made for the transactions of shares amongst inter-related parties.

The General Anti-Avoidance Rule (GAAR) comes into effect from the financial year 2017-18. As per GAAR provisions, the AO may treat the transaction, as an 'impermissible avoidance arrangement' if the main purpose of the transaction is to obtain a tax benefit. Accordingly, the AO may, *inter alia*, disregard, combine or recharacterise whole or part of the arrangement.



<sup>4</sup> Friends Overseas Pvt. Ltd. v. CIT [2004] 136 Taxman 94 (Del)

<sup>5</sup> Amal Kumar Chakraborty vs. CIT [1994] 207 ITR 376 (Kol)

<sup>6</sup> CIT v. Vishishth Chay Vyapar Ltd (ITA 1105/2010) (Del)

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