



CAPITAL GAINS



LEARNING OUTCOMES

After studying this chapter, you would be able to -

- appreciate** the scope of income chargeable under this head;
- examine** the provisions of section 2(42A), relating to period of holding, for classification of a capital asset as short-term capital asset and long-term capital asset;
- analyse and apply** the provisions of section 47 to determine whether a particular transaction would be considered/ not be considered as transfer for the purpose of capital gains taxation;
- determine** the cost of acquisition/ improvement and indexed cost of acquisition/ improvement, in case of a short-term capital asset and long-term capital asset, respectively for the purpose of computing the capital gains;
- compute** capital gains on transfer of depreciable assets;
- compute** capital gains in case of slump sale;
- determine** the quantum of exemption available on investment of capital gains/ net consideration arising on transfer of certain assets and appreciate the conditions to be satisfied to avail such exemption;
- compute** the capital gains chargeable to tax applying the charging and deeming provisions and giving effect to the exemptions available in respect of capital gains;
- identify** the cases where an Assessing Officer can make a reference to the Valuation Officer;
- appreciate** the concessional tax treatment available for short-term capital gains and for long term capital gains on transfer of listed equity shares/ units of an equity oriented fund/ units of a business trust;
- compute** the tax liability applying the special rates of tax on long-term capital gains and short-term capital gains arising on transfer of listed equity shares/ units of an equity oriented fund and the normal rates of tax on capital gains arising on transfer of other short-term capital assets and other long-term capital assets.



7.1 INTRODUCTION

In this chapter on capital gains, we begin our discussion with the definition of “capital asset” and “transfer”. Thereafter, we will proceed to discuss the various circumstances under which capital gains tax is levied. There are certain transactions which are not to be regarded as transfer for the purposes of capital gains. These transactions have also been discussed in this chapter. For computing long-term capital gains, knowledge of cost inflation index is necessary. Again, there is a separate method of computation of capital gains in respect of depreciable assets. Also, there are exemptions in cases where capital gains/net sales consideration are invested in specified assets. All these aspects are being discussed in this chapter.

Section 45 provides that any profits or gains arising from the **transfer** of a **capital asset** effected in the previous year will be chargeable to income-tax under the head ‘Capital Gains’. Such capital gains will be deemed to be the income of the previous year in which the transfer took place. In this charging section, two terms are important. One is “capital asset” and the other is “transfer”.



7.2 CAPITAL ASSET

Definition: According to section 2(14), a capital asset means –

- (a) property of any kind held by an assessee, whether or not connected with his business or profession;
- (b) any securities held by a Foreign Institutional Investor which has invested in such securities in accordance with the SEBI regulations.

However, it **does not include**—

- (i) **Stock-in trade:** Any stock-in-trade [other than securities referred to in (b) above, consumable stores or raw materials held for the purpose of the business or profession of the assessee;

The exclusion of stock-in-trade from the definition of capital asset is only in respect of sub-clause (a) above and not sub-clause (b). This implies that even if the nature of such security in the hands of the Foreign Portfolio Investor is stock in trade, the same would be treated as a capital asset and the profit on transfer would be taxable as capital gains.

Further, the Explanatory Memorandum to the Finance (No.2) Bill, 2014 clarifies that the income arising from transfer of such security by a Foreign Portfolio Investor (FPI) would be in the nature of capital gain, irrespective of the presence or otherwise in India, of the Fund manager managing the investments of the assessee.

- (ii) **Personal effects:** Personal effects, that is to say, movable property (including wearing apparel and furniture) held for personal use by the assessee or any member of his family dependent on him.

EXCLUSIONS:

- (a) jewellery;
- (b) archaeological collections;
- (c) drawings;
- (d) paintings;
- (e) sculptures; or
- (f) any work of art.

Definition of Jewellery - Jewellery is a capital asset and the profits or gains arising from the transfer of jewellery held for personal use are chargeable to tax under the head "capital gains". For this purpose, the expression 'jewellery' includes the following:

- (i) Ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones and whether or not worked or sewn into any wearing apparel;
- (ii) Precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel.

- (iii) **Rural agricultural land** in India i.e., agricultural land in India which is not situated in any specified area.

As per the definition that only rural agricultural lands in India are excluded from the purview of the term 'capital asset'. Hence urban agricultural lands constitute capital assets. Accordingly, the agricultural land described in (a) and (b) below, being land situated within the specified urban limits, would fall within the definition of "capital asset", and transfer of such land would attract capital gains tax -

- (a) agricultural land situated in any area within the jurisdiction of a municipality or cantonment board having population of not less than ten thousand, or
- (b) agricultural land situated in any area within such distance, measured aerially, in relation to the range of population as shown hereunder -

| | Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a) | Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year. |
|-------|---|---|
| (i) | ≤ 2 kms | > 10,000 |
| (ii) | > 2 kms ≤ 6 kms | > 1,00,000 |
| (iii) | > 6 kms ≤ 8 kms | > 10,00,000 |

Example 1

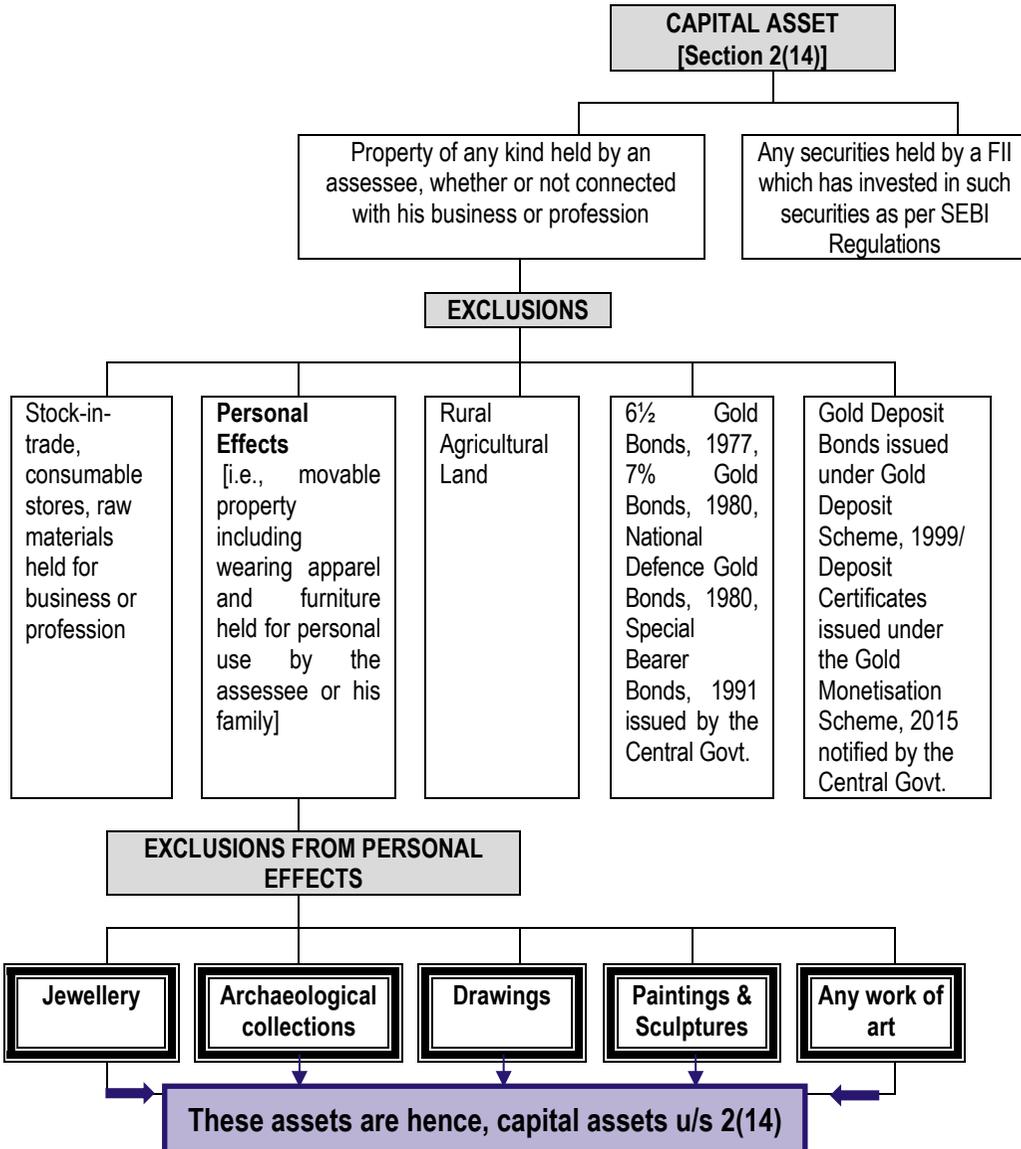
| | Area | Shortest aerial distance from the local limits of a municipality or cantonment board referred to in item (a) | Population according to the last preceding census of which the relevant figures have been published before the first day of the previous year. | Is the land situated in this area a capital asset? |
|--------|------|--|--|--|
| (i) | A | 1 km | 9,000 | No |
| (ii) | B | 1.5 kms | 12,000 | Yes |
| (iii) | C | 2 kms | 11,00,000 | Yes |
| (iv) | D | 3 kms | 80,000 | No |
| (v) | E | 4 kms | 3,00,000 | Yes |
| (vi) | F | 5 kms | 12,00,000 | Yes |
| (vii) | G | 6 kms | 8,000 | No |
| (viii) | H | 7 kms | 4,00,000 | No |
| (ix) | I | 8 kms | 10,50,000 | Yes |
| (x) | J | 9 kms | 15,00,000 | No |

Explanation regarding gains arising on the transfer of urban agricultural land - *Explanation 1* to section 2(1A) clarifies that capital gains arising from transfer of any agricultural land situated in any non-rural area (as explained above) will not constitute agricultural revenue within the meaning of section 2(1A).

In other words, the capital gains arising from the transfer of such urban agricultural lands would not be treated as agricultural income for the purpose of exemption under section 10(1). Hence, such gains would be exigible to tax under section 45.

- (iv) **Specified Gold Bonds:** 6½% Gold Bonds, 1977, or 7% Gold Bonds, 1980, or National Defence Gold Bonds, 1980, issued by the Central Government;
- (v) **Special Bearer Bonds, 1991** issued by the Central Government;
- (vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 or deposit certificates issued under the Gold Monetisation Scheme, 2015 notified by the Central Government.

Note – ‘Property’ includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.



7.3 SHORT TERM AND LONG TERM CAPITAL ASSETS

- **Definition** – As per section 2(42A), short-term capital asset means a capital asset held by an assessee for not more than 36 months immediately preceding the date of its transfer.

As per section 2(29A), long-term capital asset means a capital asset which is not a short-term capital asset.

Thus, a capital asset held by an assessee for more than 36 months immediately preceding the date of its transfer is a long-term capital asset.

- **Exception** - A security (other than a unit) listed in a recognized stock exchange, or a unit of an equity oriented fund or a unit of the Unit Trust of India or a Zero Coupon Bond will, however, be considered as a long-term capital asset if the same is held for **more than 12 months** immediately preceding the date of its transfer.

Further, a share of a company (not being a share listed in a recognized stock exchange in India) or an immovable property, being land or building or both would be treated as a short-term capital asset if it was held by an assessee for not more than 24 months immediately preceding the date of its transfer.

Thus, the period of holding of unlisted shares or an immovable property, being land or building or both, for being treated as a long-term capital asset would be “more than 24 months” instead of “more than 36 months”.

- **Meaning of certain terms:**

| Term | Meaning |
|--|--|
| Equity oriented fund [Clause (a) of Explanation to section 112A] | <p>a fund set up under a scheme of a mutual fund specified under section 10(23D) and</p> <p>(i) in a case where the fund invested in the units of another fund which is traded on a recognised stock exchange –</p> <p>I. a minimum of 90% of the total proceeds of such fund is invested in the units of such other fund; and</p> <p>II. such other fund also invests a minimum of 90% of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and</p> <p>(ii) in any other case, a minimum of 65% of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange.</p> <p>However, the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.</p> |
| Zero Coupon Bond [Section 2(48)] | <p>a bond</p> <ul style="list-style-type: none"> - issued by any infrastructure capital company or infrastructure capital fund or a public sector company or a scheduled bank on or after 1st June, 2005, - in respect of which no payment and benefit is received or receivable before maturity or redemption from such issuing entity and - which the Central Government may notify in this behalf. |

Note: The income from transfer of a Zero coupon bond (not being held as stock-in-trade) is to be treated as capital gains. Section 2(47)(iva) provides that maturity or redemption of a Zero coupon bond shall be treated as a transfer for the purposes of capital gains tax.

The definitions of the terms “infrastructure capital company” and “infrastructure capital fund” have already been discussed in Chapter 6 – “Profits and gains from business and profession”.

Period of holding: A summary

| | | |
|---|---|---|
| STCA, if held for ≤ 12 month | } | <ul style="list-style-type: none"> • Security (other than unit) listed in a recognized stock exchange • Unit of equity oriented fund/ unit of UTI • Zero Coupon bond |
| LTCA, if held for > 12 months | | |
| STCA, if held for ≤ 24 month | } | <ul style="list-style-type: none"> • Unlisted shares • Land or building or both |
| LTCA, if held for > 24 months | | |
| STCA, if held for ≤ 36 month | } | <ul style="list-style-type: none"> • Unit of debt oriented fund • Unlisted securities other than shares • Other capital assets |
| LTCA, if held for > 36 months | | |

Applicability of tax on capital gains in the hands of the unit holders where the term of the units of Mutual Funds under the Fixed Maturity Plans has been extended [Circular No. 6/2015, dated 09-04-2015]

Fixed Maturity Plans (FMPs) are closed ended funds having a fixed maturity date wherein the duration of investment is decided upfront. Prior to amendment by the Finance (No. 2) Act, 2014, units of a mutual fund under the FMPs held for a period of more than twelve months qualified as long-term capital asset. The amendment in sub-section (42A) of section 2 by the Finance (No. 2) Act, 2014 required the period of holding in case of units of a mutual fund [other than an equity oriented fund] to be more than thirty-six months to qualify as long term capital asset.

As a result, gains arising out of any investment in the units of FMPs made earlier and sold/ redeemed after 10.07.2014 would be taxed as short-term capital gains if the unit was held for a period of thirty-six months or less. To enable the FMPs to qualify as a long-term capital asset, some Asset Management Companies (AMCs) administering mutual funds have offered extension of the duration of the FMPs to a date beyond thirty-six months from the date of the original investment by providing to the investor an option of roll-over of FMPs in accordance with the provisions of Regulation 33(4) of the SEBI (Mutual Funds) Regulation, 1996.

The CBDT has, vide this Circular, clarified that the roll over in accordance with the aforesaid regulation will not amount to transfer as the scheme remains the same.

Accordingly, no capital gains will arise at the time of exercise of the option by the investor to continue in the same scheme. The capital gains will, however, arise at the time of redemption of the units or opting out of the scheme, as the case may be.

- **Determination of period of holding [Clause (i) of *Explanation 1* to section 2(42A)]:** In determining period of holding of any capital asset by the assessee in the circumstances stated in column (1), the period shall be determined by considering the period specified in Column (2).

Determination of period of holding

| S. No. | Circumstances (Column 1) | Period to be reckoned/ included/ excluded, as the case may be (Column 2) |
|--------|---|---|
| 1 | Where shares held in a company in liquidation | The period subsequent to the date of liquidation of company shall be excluded . |
| 2 | Where asset becomes the property of an assessee by virtue of section 49(1) | The period for which the capital asset was held by the previous owner shall be included . |
| 3 | Where inventory of business is converted into or treated as a capital asset by the assessee | Period from the date of conversion or treatment as a capital asset shall be considered . |
| 4 | Where share(s) in the Indian company (amalgamated company) , becomes the property of an assessee in lieu of share(s) held by him in the amalgamating company at the time of transfer referred under section 47(vii). | The period for which the share(s) was held by the assessee in the amalgamating company shall be included . |
| 5 | Where the share or any other security is subscribed by the assessee on the basis of right to subscribe to any share or security or by the person in whose favour such right is renounced by the assessee | Period from the date of allotment of such share or security shall be reckoned . |
| 6 | Where the right to subscribe to any share or security, which is renounced in favour of any other person | Period from the date of offer of such right by the company or institution shall be reckoned . |
| 7 | Where any financial asset is allotted without any payment and on the basis of holding of any other financial asset | Period from the date of allotment of such financial asset shall be reckoned . |

| | | |
|----|---|---|
| 8 | Where share(s) in the Indian company being a resulting company becomes the property of an assessee in consideration of demerger | The period for which the share/s were held by the assessee in demerged company shall be included . |
| 9 | Where trading or clearing rights of a recognised stock exchange in India is acquired by a person pursuant to demutualisation or corporation of a recognised stock exchange in India as referred to in section 47(xiii) | The period for which the person was a member of the recognised stock exchange immediately prior to such demutualisation or corporatisation shall be included . |
| 10 | Where equity share(s) in a company allotted pursuant to demutualisation or corporation of a recognised stock exchange in India as referred to in section 47(xiii) | The period for which the person was a member of the recognised stock exchange immediately prior to such demutualisation or corporatisation shall be included . |
| 11 | Where unit of a business trust , allotted pursuant to transfer of share(s) as referred to in section 47(xvii) | The holding period for which the share(s) held by the assessee shall be included . |
| 12 | Where unit(s) becomes the property of the assessee in consideration of transfer of unit(s) in the consolidated scheme of the mutual fund referred to in section 47(xviii) | The period for which the unit(s) in the consolidating scheme of the mutual fund were held by the assessee shall be included . |
| 13 | Where share(s) of a company is acquired by the non-resident assessee on redemption of Global Depository Receipts referred to in section 115AC(1)(b) held by such assessee | Period from the date on which a request for such redemption was made shall be reckoned . |
| 14 | Where equity share of a company becomes the property of the assessee by way of conversion of preference | The period for which the preference shares were held by the assessee shall be included . |

| | | |
|-----------|---|--|
| | shares into equity shares referred under section 47(xb) | |
| 15 | Where unit(s) becomes the property of the assessee in consideration of transfer of unit(s) in the consolidated plan of a mutual fund scheme as referred to in section 47(xix) | The period for which the unit(s) in the consolidating plan of a mutual fund scheme was held by the assessee shall be included . |
| 16 | Where any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employees) | Period from the date of allotment or transfer of such specified security or sweat equity shares shall be reckoned . |
| | <p>“Specified security” means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees’ stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.</p> <p>“Sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.</p> | |
| 17 | Where a unit or units in a segregated portfolio referred under section 49(2AG) | Period for which the original unit or units in the main portfolio were held by the assessee shall also be reckoned. |

- **Period of holding in respect of other capital assets** - The period for which any capital asset is held by the assessee shall be determined in accordance with any rules made by the CBDT in this behalf.

Accordingly, the CBDT has inserted Rule 8AA in the Income-tax Rules, 1962 to provide for method of determination of period of holding of capital assets, other than the capital assets mentioned in clause (i) of *Explanation 1* to section 2(42A).

- In the case of a capital asset, **being a share or debenture of a company**, which **becomes the property** of the assessee in the circumstances mentioned in **section 47(x)**, there shall be **included the period** for which the bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the assessee **prior to the conversion**.

Note: Section 47(x) provides that any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company shall not be regarded as transfer for the purposes of levy of capital gains tax.

- In case of a capital asset, declared under the Income Declaration Scheme, 2016
 - o **being an immovable property**, the period for which such property is held shall be reckoned **from the date on which such property is acquired** if the date of acquisition is evidenced by a deed registered with any authority of a State Government.
 - o **in any other case**, the period for which such asset is held shall be reckoned **from 1st June, 2016**.

Income Declaration Scheme, 2016: Significant Features

- (1) The Income Declaration Scheme, 2016 is contained in the Finance Act, 2016, which received the assent of the President on 14th May 2016. The Scheme provides an opportunity to persons who have paid not full taxes in the past to come forward and declare the undisclosed income and pay tax, surcharge and penalty totalling in all to 45% of such undisclosed income declared.
- (2) A declaration under the aforesaid Scheme may be made in respect of any income or income in the form of investment in any asset located in India and acquired from income chargeable to tax under the Income-tax Act, 1961 for any assessment year prior to the assessment year 2017-18 for which the declarant had failed to furnish a return under section 139; or failed to disclose such income in a return furnished before the date of commencement of the Scheme or such income had escaped assessment by reason of the omission or failure on the part of such person to make a return under the Income-tax Act or to disclose fully and truly all material facts necessary for the assessment or otherwise. Where the income chargeable to tax is declared in the form of investment in any asset, the fair market value of such asset as on 1st June, 2016 computed in accordance with Rule 3 of the Income Declaration Scheme Rules, 2016 shall be deemed to be the undisclosed income.
- (3) The person making a declaration under the Scheme would be liable to pay tax at the rate of 30% of the value of such undisclosed income as increased by surcharge at the rate of 25% of such tax. In addition, he would also be liable to pay penalty at the rate of 25% of such tax. Therefore, the declarant would be liable to pay a total of 45% of the value of the undisclosed income declared by him. This special rate of tax, surcharge and penalty specified in the Scheme will override any rate or rates specified under the provisions of the Income-tax Act or the annual Finance Acts.

- (4) A declaration under the Scheme could be made anytime on or after 1st June, 2016 but before 30th September, 2016, being the last date for making a declaration under the Scheme, as notified by the Central Government.



7.4 TRANSFER: WHAT IT MEANS? [SECTION 2(47)]

The Act contains an inclusive definition of the term 'transfer'. Accordingly, transfer in relation to a capital asset includes the following types of transactions:—

- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- (iii) the compulsory acquisition thereof under any law; or
- (iv) the owner of a capital asset may convert/treated the same into/as the stock-in-trade of a business carried on by him. Such conversion/treatment is treated as transfer; or
- (v) the maturity or redemption of a zero coupon bond; or
- (vi) possession of an immovable property in consideration of part-performance of a contract referred to in section 53A of the Transfer of Property Act, 1882.
- (vii) transactions which have the effect of transferring or enabling the enjoyment of an immovable property.

Example 2:

A person may become a member of a co-operative society, company or other association of persons which may be building houses/ flats. When he pays an agreed amount, the society etc. hands over possession of the house to the person concerned. No conveyance deed is registered. For the purpose of income-tax, the above transaction is a transfer.

Note – Section 2(47) provides an inclusive definition of “transfer”, in relation to a capital asset. *Explanation 2* to section 2(47) clarifies that ‘transfer’ includes and shall be deemed to have always included –

- | | | |
|---|---|--------------------------------|
| (1) disposing of or parting with an asset or any interest therein, or | } | - directly or indirectly, |
| | | - absolutely or conditionally, |
| (2) creating any interest in any asset in any manner whatsoever | } | - voluntarily or involuntarily |

by way of an agreement (whether entered into in India or outside India) or otherwise.

The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.



7.5 SCOPE AND YEAR OF CHARGEABILITY [SECTION 45]

(1) General Provision [Section 45(1)]

Any profits or gains arising from the transfer of a capital asset effected in the previous year (other than exemptions covered under this chapter) shall be chargeable to income-tax under this head **in the previous year in which the transfer took place.**

Year of chargeability- Capital gains are chargeable as the income of the previous year in which the sale or transfer takes place. In other words, for determining the year of chargeability, the relevant date of transfer is not the date of the agreement to sell, but the actual date of sale *i.e.*, the date on which the effect of transfer of title to the property as contemplated by the parties has taken place [*Alapati Venkataramiah v. CIT [1965] 57 ITR 185 (SC)*].

However, as already noted, Income-tax Act has recognised certain transactions as transfer in spite of the fact that conveyance deed might not have been executed and registered. Power of Attorney sales as explained above or co-operative society transactions for acquisition of house are examples in this regard.

(2) Insurance receipts [Section 45(1A)]

Where any person receives any money or other assets under any insurance from an insurer on account of damage to or destruction of any capital asset, as a result of -

- ◆ flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature; or
- ◆ riot or civil disturbance; or
- ◆ accidental fire or explosion; or
- ◆ action by an enemy or action taken in combating an enemy (whether with or without declaration of war), then,

any profits or gains arising from 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 the **such person for the previous year in which such money or other asset was received.**

Full value of consideration: In order to compute capital gains, the value of any money or the fair market value of other assets on the date of such receipt shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of such capital assets.

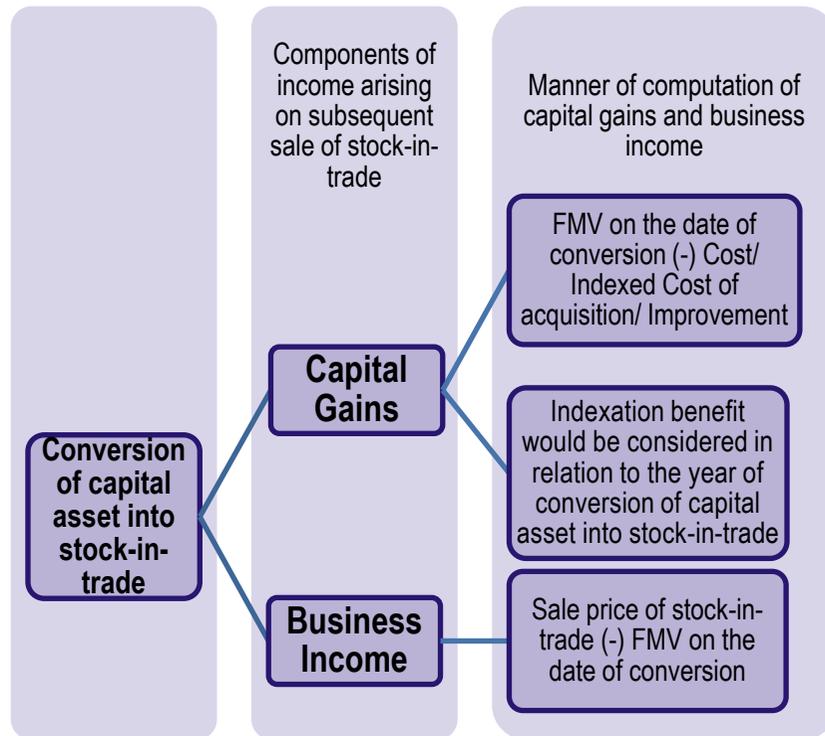
(3) Conversion or treatment of a capital asset as stock-in-trade [Section 45(2)]

A person who is the owner of a capital asset may convert the same or treat it as stock-in-trade of the business carried on by him. As noted above, the conversion/treatment is a transfer.

As per section 45(2), notwithstanding anything contained in section 45(1), being the charging section, the profits or gains arising from the above conversion or treatment will be chargeable to

income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him.

Full value of consideration: In order to compute the capital gains, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received as a result of the transfer of the capital asset.



Note – Both Capital Gains and Business income are chargeable to tax in the year in which stock-in-trade is sold or otherwise transferred.

ILLUSTRATION 1

X converts his capital asset (acquired on June 10, 2003 for ₹ 60,000) into stock-in-trade on March 10, 2020. The fair market value on the date of the above conversion was ₹ 5,50,000. He subsequently sells the stock-in-trade so converted for ₹ 6,00,000 on June 10, 2020. Examine the tax implication.

Cost Inflation Index - F.Y. 2003-04: 109; F.Y. 2019-20: 289; F.Y. 2020-21: 301.

SOLUTION

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2020-21, it will be a transfer under section 2(47) during the P.Y. 2019-20. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2021-22, since the stock-in-trade has been sold only on June 10, 2020. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2020) will be the full value of consideration.

The capital gains will be computed after deducting the indexed cost of acquisition from the full value of consideration. The cost inflation index for 2003-04 *i.e.*, the year of acquisition is 109 and the index for the year of transfer *i.e.*, 2019-20 is 289. The indexed cost of acquisition is $60,000 \times 289/109 = ₹ 1,59,083$. Hence, ₹ 3,90,917 (*i.e.* ₹ 5,50,000 – ₹ 1,59,083) will be treated as long-term capital gains chargeable to tax during the A.Y.2021-22. During the same assessment year, ₹ 50,000 (₹ 6,00,000 - ₹ 5,50,000) will be chargeable to tax as business profits.

(4) Transfer of beneficial interest in securities [Section 45(2A)]

As per section 45(2A), where any person has had at any time during the previous year any beneficial interest in any securities, then, any profits or gains arising from the transfer made by the depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which such transfer took place and shall not be regarded as income of the depository who is deemed to be the registered owner of the securities by virtue of section 10(1) of the Depositories Act, 1996.

Full value of consideration and period of holding: For the purposes of section 48 and proviso to section 2(42A), the cost of acquisition and the period of holding of securities shall be determined on the basis of the first-in-first-out (FIFO) method.

When the securities are transacted through stock exchanges, it is the established procedure that the brokers first enter into contracts for purchase/ sale of securities and thereafter, follow it up with delivery of shares, accompanied by transfer deeds duly signed by the registered holders.

- ◆ The seller is entitled to receive the consideration agreed to as on the date of contract.
- ◆ Thus, it is the date of broker's note that should be treated as the date of transfer in case of sale transactions of securities provided such transactions are followed up by delivery of shares and also the transfer deeds.
- ◆ Similarly, in respect of the purchasers of the securities, the holding period shall be reckoned to take place directly between the parties and not through stock exchanges.
- ◆ The date of contract of sale as declared by the parties shall be treated as the date of transfer provided it is followed up by actual delivery of shares and the transfer deeds.

Where securities are acquired in several lots at different points of time, the First-In-First-Out (FIFO) method shall be adopted to reckon the period of the holding of the security, in cases where the dates of purchase and sale could not be correlated through specific numbers of the scrips.

In other words, the assets acquired last will be taken to be remaining with the assessee while assets acquired first will be treated as sold. Indexation, wherever applicable, for long-term assets will be regulated on the basis of the holding period determined in this manner - *CBDT Circular No. 704, dated 28.4.1995*.

Meaning of certain terms:

| Term | Meaning |
|-------------------------|---|
| Beneficial owner | A person whose name is recorded as such with a depository. |
| Depository | A company formed and registered under the Companies Act, 1956 ¹ and which has been granted a certificate of registration under section 12(1A) of the Securities and Exchange Board of India Act, 1992. |
| Security | Such security as may be specified by SEBI. |

(5) Introduction of capital asset as capital contribution [Section 45(3)]

Where a person transfers a capital asset to a firm, AOP or BOI in which he is already a partner/ member or is to become a partner/ member by way of capital contribution or otherwise, the profits or gains arising from such transfer will be **chargeable to tax as income of the previous year in which such transfer takes place.**

Full value of consideration: For this purpose, the full value of the consideration will be deemed to be the amount recorded in the books of account of the firm, AOP or BOI as the value of the capital asset.

(6) Distribution of capital assets on dissolution of firm/AOP or BOI [Section 45(4)]

The profits or gains arising from the transfer of capital assets by way of

- distribution of capital assets on the dissolution of a firm or AOP or BOI or
- otherwise

shall be chargeable to tax as the income of the firm etc. of the previous year in which such transfer takes place.

Full value of consideration: For this purpose, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of consideration.

The Bombay High Court made a landmark judgment 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

¹ Now Companies Act, 2013

'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.

Note - *Since the tax treatment accorded to a LLP and a general partnership is the same, the conversion from a general partnership firm to an LLP will have no tax implications if the rights and obligations of the partners remain the same after conversion and if there is no transfer of any asset or liability after conversion. However, if there is a change in rights and obligations of partners or there is a transfer of asset or liability after conversion, then the provisions of section 45 would get attracted.*

(7) Compensation on compulsory acquisition [Section 45(5)]

Sometimes, a building or some other capital asset belonging to a person is taken over by the Central Government by way of compulsory acquisition. In that case, the consideration for the transfer is determined by the Central Government or RBI. When the Central Government pays the above compensation, capital gains may arise. Such capital gains are **chargeable as income of the previous year in which such compensation or part thereof, was first received.**

Enhanced Compensation- Many times, persons whose capital assets have been taken over by the Central Government and who get compensation from the government go to the court of law for enhancement of compensation. If the court awards a compensation which is higher than the original compensation, the difference thereof will be chargeable to capital gains in the year in which the same is received from the government.

Cost of acquisition in case of enhanced compensation - For this purpose, the cost of acquisition and cost of improvement shall be taken to be *nil*.

Compensation received in pursuance of an interim order deemed as income chargeable to tax in the year of final order - In order to remove the uncertainty regarding the year in which the amount of compensation received in pursuance of an interim order of the court is to be charged to tax, a proviso has been inserted after clause (b) to provide that such compensation shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such court, Tribunal or other authority is made.

Reduction of enhanced compensation - Where capital gain has been charged on the compensation received by the assessee for the compulsory acquisition of any capital asset or enhanced compensation received by the assessee and subsequently such compensation is reduced by any court, tribunal or any authority, the assessed capital gain of that year shall be recomputed by taking into consideration the reduced amount. This re-computation shall be done by way of rectification under section 155.

Death of the transferor- It is possible that the transferor may die before he receives the enhanced compensation. In that case, the enhanced compensation or consideration will be chargeable to tax in the hands of the person who receives the same.

(8) Taxability of capital gains in case of Specified Agreement [Section 45(5A)]

Genuine hardship on account of taxability of capital gains in the year of transfer of property to developer: The definition of 'transfer', *inter alia*, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred.

Applying the definition of transfer, under these development agreements, the transfer took place in the year in which the owner of the immovable property, being land or building or both handed over the immovable property to the developer.

Consequently, the capital gains tax liability in the hands of the owner would arise in the year in which the possession of immovable property is handed over to the developer for development of a project, in spite of the fact that the consideration thereof (i.e. the actual constructed property) will be received only after a couple of years.

Deferment of taxability of capital gains: With a view to minimise the genuine hardship which the owner of land or building may face in paying capital gains tax in the year of transfer, section 45(5A) provides that

- in case of an assessee **being individual or Hindu undivided family**,
- who enters into a specified agreement for development of a project,
- the capital gain arises from such transfer shall be chargeable to income-tax as income of the **previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority**.

Meaning of Specified Agreement: Specified agreement means the registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.

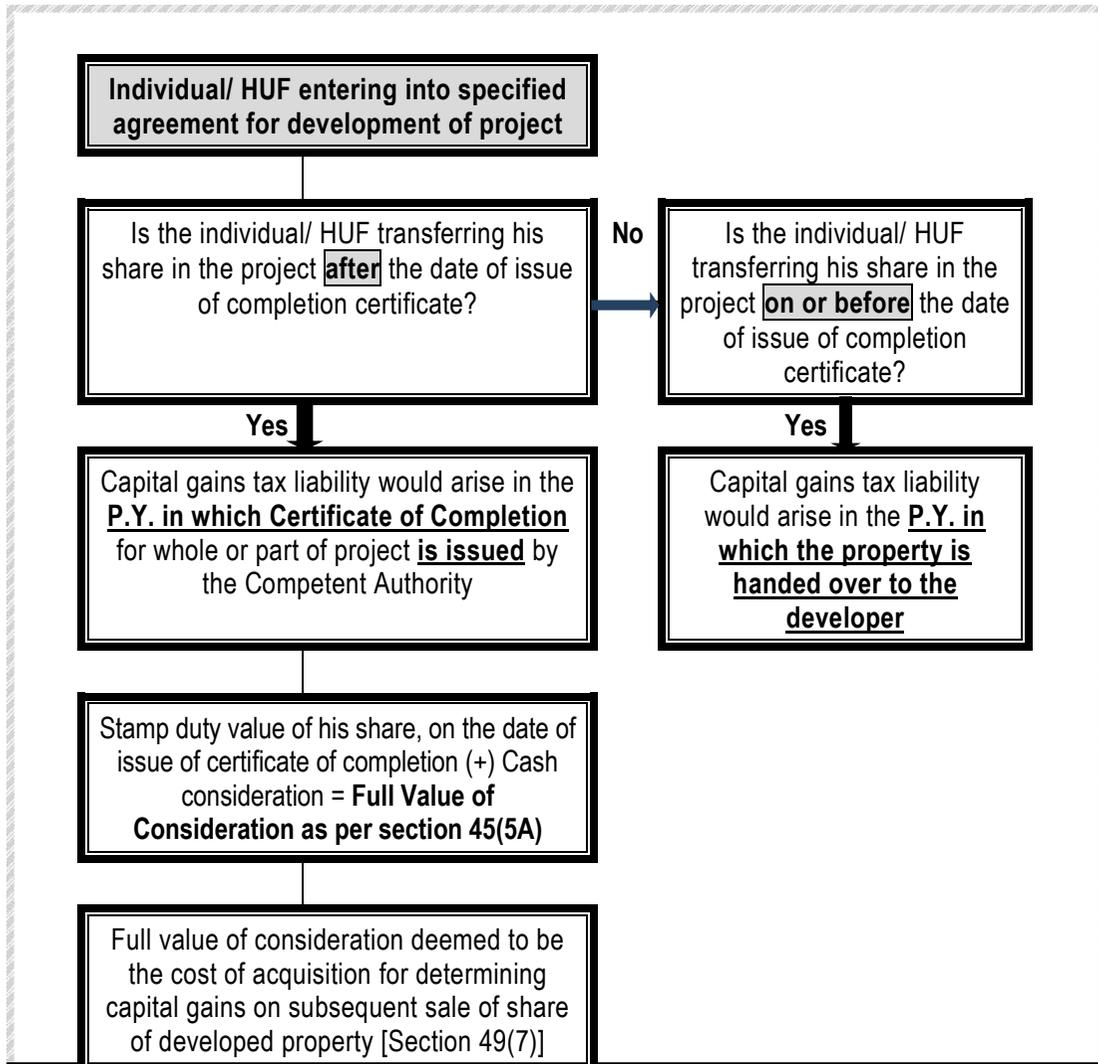
Full value of consideration: For the purpose of section 48, the stamp duty value of his share, being land or building or both, in the project on the date of issuing of said certificate of completion as increased by any consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

Non-applicability of the beneficial provision: It may, however, be noted these beneficial provisions would not apply, where the assessee transfers his share in the project on or before the date of issue of said completion certificate and the capital gain tax liability would be deemed to arise in the previous year in which such transfer took place. In such a case, full value of consideration received or accruing shall be determined by the general provisions of the Act. [Proviso to section 45(5A)]

Meaning of certain terms:

| Term | Meaning |
|----------------------------|---|
| Competent authority | The authority empowered to approve the building plan by or under any law for the time being in force |
| Stamp duty value | The value adopted or assessed or reassessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both. |

Taxability of capital gains in case of Specified Agreement: At a Glance



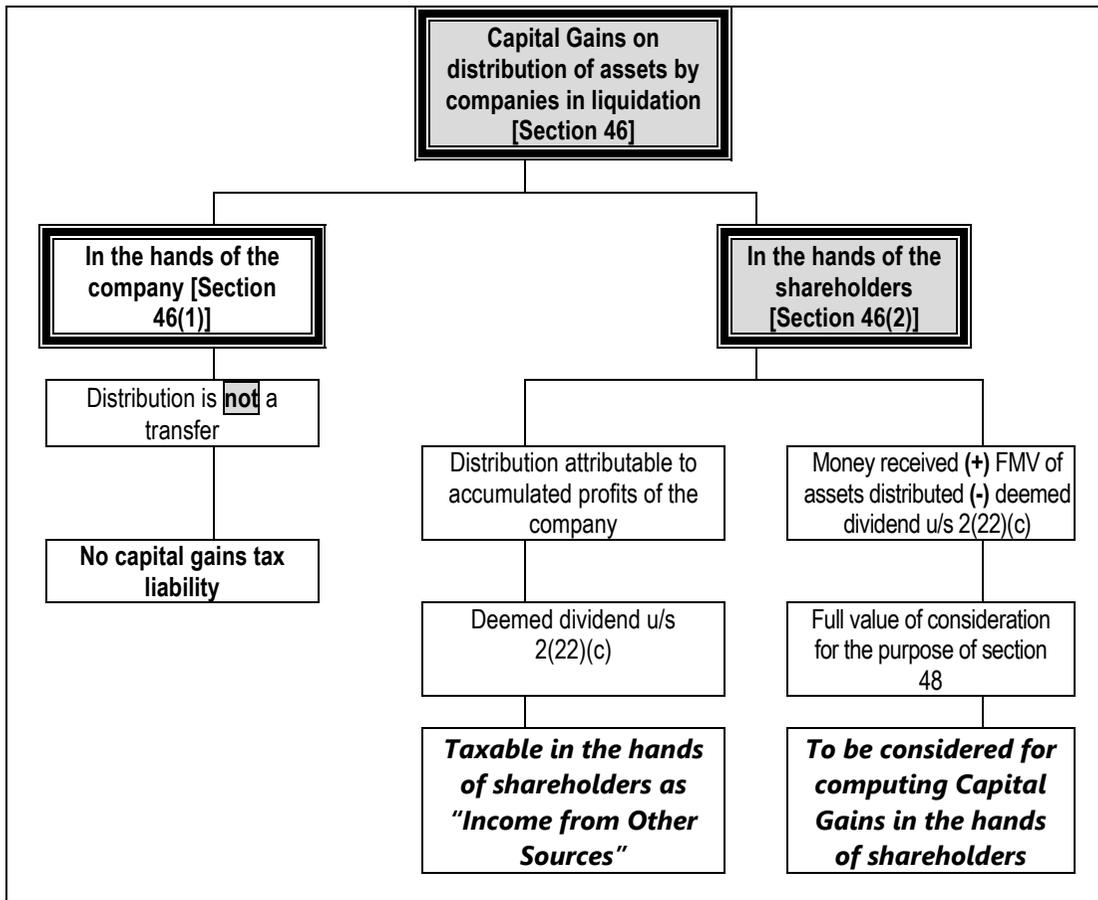


7.6 CAPITAL GAINS ON DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION [SECTION 46]

- (1) **In the hands of liquidated company:** Where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall **not** be regarded as a transfer by the company for the purposes of section 45 [Section 46(1)].

The above section is restricted in its application to the circumstances mentioned therein *i.e.*, the assets of the company must be distributed to shareholders on the liquidation of the company. If, however, the liquidator sells the assets of the company resulting in a capital gain and distributes the funds so collected, the company will be liable to pay tax on such gains.

- (2) **In the hands of shareholders:** Shareholders receive money or other assets from the company on its liquidation. They will be chargeable to income-tax under the head 'capital gains' in respect of the market value of the assets received on the date of distribution, or the moneys so received by them. The portion of the distribution which is attributable to the accumulated profits of the company is to be treated as dividend income of the shareholder under section 2(22)(c), which would be taxable in the hands of shareholders under the head "Income from other sources". The same will be deducted from the amount received/ fair market value for the purpose of determining the full value of consideration for computation of capital gains.
- (3) **Capital gains tax on subsequent sale by the shareholders:** If the shareholder, after receipt of any such asset on liquidation of the company, transfers it, then Fair Market Value on the date of distribution would be treated as cost of acquisition of such asset.



7.7 CAPITAL GAINS ON BUYBACK OF SHARES OR OTHER SECURITIES [SECTION 46A]

- (1) **In case of specified securities other than shares:** Any consideration received by a holder of specified securities (other than shares) from any company on purchase of its specified securities is chargeable to tax in the hands of the holder of specified securities. The difference between the cost of acquisition and the value of consideration received by the holder of securities is chargeable to tax as capital gains in his hands. The computation of capital gains shall be made in accordance with the provisions of section 48.

Such capital gains shall be chargeable in the year in which such securities were purchased by the company. For this purpose, “specified securities” shall have the same meaning as given in *Explanation* to section 77A of the Companies Act, 1956².

² Now section 68 of the Companies Act, 2013

As per Section 68 of the Companies Act, 2013, "specified securities" includes employees' stock option or other securities as may be notified by the Central Government from time to time.

Note – As far as shares are concerned, this provision would be attracted in the hands of the shareholder only if the shares are bought back by a company, other than a domestic company.

- (2) **In case of shares (whether listed or unlisted):** In case of buyback of shares (whether listed or unlisted) by domestic companies, additional income-tax @20% (plus surcharge@12% and cess@4%) is leviable in the hands of the company under section 115QA.

Consequently, the income arising to the shareholders in respect of such buyback of shares by the domestic company would be exempt under section 10(34A), since the domestic company is liable to pay additional income-tax on the buyback of shares.

Taxation provisions in respect of buyback

| (1) | (2) | (3) | (4) |
|--|---|--|--|
| Taxability in the hands of | Buyback of shares by domestic companies | Buyback of shares by a company, other than a domestic company | Buyback of specified securities by any company |
| Company | Subject to additional income-tax@23.296%. | Not subject to tax in the hands of the company. | Not subject to tax in the hands of the company. |
| Shareholder/holder of specified securities | Income arising to shareholders exempt under section 10(34A) | Income arising to shareholder taxable as capital gains u/s 46A. | Income arising to holder of specified securities taxable as capital gains u/s 46A. |



7.8 IMPORTANT DEFINITIONS

- (a) **Amalgamation [Section 2(1B)]** - "Amalgamation", in relation to companies, means

- the merger of one or more companies with another company or
- the merger of two or more companies to form one company

(the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that -

- (i) all the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;

- (ii) all the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) shareholders holding not less than three-fourth in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by, or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation,

otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

(b) Demerger [Section 2(19AA)] - "Demerger", in relation to companies, means the transfer, pursuant to a scheme of arrangement under sections 230 to 232 of the Companies Act, 2013, by a demerged company of its one or more undertaking to any resulting company in such a manner that -

- (i) all the property of the undertaking, being transferred by the demerged company, immediately before the demerger, becomes the property of the resulting company by virtue of the demerger;
- (ii) all the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, become the liabilities of the resulting company by virtue of the demerger;
- (iii) the property and the liabilities of the undertaking or undertakings being transferred by the demerged company are transferred at values appearing in its books of account immediately before the demerger;

However, this provision does not apply where, in compliance to the Indian Accounting Standards specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the resulting company records the value of the property and the liabilities of the undertaking or undertakings at a value different from the value appearing in the books of account of the demerged company, immediately before the demerger.

- (iv) the resulting company issues, in consideration of the demerger, its shares to the shareholders of the demerged company on a proportionate basis except where the resulting company itself is a shareholder of the demerged company;

Note - *If the resulting company is a shareholder of the demerged company, it cannot issue shares to itself. However, the resulting company has to issue shares to the other shareholders of the demerged company.*

- (v) the shareholders holding not less than three-fourths in value of the shares in the demerged company (other than shares already held therein immediately before the demerger, or by a nominee for, the resulting company or, its subsidiary) become shareholders of the resulting company or companies by virtue of the demerger, otherwise than as a result of the acquisition of the property or assets of the demerged company or any undertaking thereof by the resulting company;
- (vi) the transfer of the undertaking is on a going concern basis;
- (vii) the demerger is in accordance with the conditions, if any, notified under section 72A(5) by the Central Government in this behalf.

Explanation in respect of Certain Terms:

| Explanation | Term | Particulars |
|-------------|---------------------------------------|---|
| 1 | Undertaking | Includes <ul style="list-style-type: none"> - any part of an undertaking or a unit or division of an undertaking or - a business activity taken as a whole, However, it does not include individual assets or liabilities or any combination thereof not constituting a business activity. |
| 2 | Liabilities | Includes <ul style="list-style-type: none"> (a) the liabilities which arise out of the activities or operations of the undertaking; (b) the specific loans or borrowings (including debentures) raised, incurred and utilised solely for the activities or operations of the undertaking; and (c) in cases, other than those referred to in clause (a) or clause (b), so much of the amounts of general or multipurpose borrowings, if any, of the demerged company as stand in the same proportion which the value of the assets transferred in a demerger bears to the total value of the assets of such demerged company immediately before the demerger. |
| 3 | Property | For the purpose of determining the value of the property, any change in the value of assets consequent to their revaluation shall be ignored. |
| 4 & 5 | Splitting up or reconstruction | (i) Splitting up or the reconstruction of <ul style="list-style-type: none"> - any authority or - a body constituted or established under a |

| | | |
|--|--|--|
| | | <p>Central, State or Provincial Act, or</p> <ul style="list-style-type: none"> - a local authority or - a public sector company, <p>into separate authorities or bodies or local authorities or companies, as the case may be, shall be deemed to be a demerger if such split up or reconstruction fulfils such conditions as may be notified by the Central Government in the Official Gazette.</p> <p>(ii) The reconstruction or splitting up of a company, which ceased to be a public sector company as a result of transfer of its shares by the Central Government, into separate companies, shall be deemed to be a demerger, if such reconstruction or splitting up has been made to give effect to any condition attached to the said transfer of shares and also fulfils such other conditions as may be notified by the Central Government.</p> |
|--|--|--|

- (c) **Demerged company [Section 2(19AAA)]** - Demerged company means the company whose undertaking is transferred, pursuant to a demerger, to a resulting company.
- (d) **Resulting company [Section 2(41A)]** - Resulting company means one or more companies (including a wholly owned subsidiary thereof) to which the undertaking of the demerged company is transferred in a demerger and, the resulting company in consideration of such transfer of undertaking, issues shares to the shareholders of the demerged company and includes any authority or body or local authority or public sector company or a company established, constituted or formed as a result of demerger.



7.9 TRANSACTIONS NOT REGARDED AS TRANSFER [SECTION 47]

Section 47 specifies certain transactions which will not be regarded as transfer for the purpose of capital gains tax:

- (1) **Total or partial partition of a HUF:** Any distribution of capital assets on the total or partial partition of a HUF [Section 47(i)];
- (2) **A gift or will or an irrevocable trust:** Any transfer of a capital asset under a gift or will or an irrevocable trust [Section 47(iii)];

However, this clause shall not include transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its

employees under the Employees' Stock Option Plan or Scheme offered to its employees in accordance with the guidelines issued in this behalf by the Central Government.

- (3) **Transfer of capital asset by holding company to its wholly owned Indian subsidiary company:** Any transfer of capital asset by a company to its subsidiary company [Section 47(iv)]

Conditions –

- (i) The parent company or its nominees must hold the whole of the shares of the subsidiary company; and
- (ii) The subsidiary company must be an Indian company.

- (4) **Transfer of capital asset by a subsidiary company to its 100% holding company, being an Indian company:** Any transfer of capital asset by a subsidiary company to the holding company [Section 47(v)]

Conditions –

- (i) The whole of shares of the subsidiary company must be held by the holding company; and
- (ii) The holding company must be an Indian company.

Exception - The exemption mentioned in 3 or 4 above will not apply if a capital asset is transferred as stock-in-trade.

- (5) **Transfer of capital asset by amalgamating company to amalgamated Indian company, in a scheme of amalgamation:** Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company [Section 47(vi)].

- (6) **Transfer of share(s) held in an Indian company by amalgamating foreign company to amalgamated foreign company, in a scheme of amalgamation:** Any transfer, in a scheme of amalgamation, of shares held in an Indian company by the amalgamating foreign company to the amalgamated foreign company [Section 47(via)].

Conditions –

- (i) At least 25 percent of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; and
- (ii) Such transfer should not attract tax on capital gains in the country in which the amalgamating company is incorporated.

- (7) **Transfer of capital asset by banking company to banking institution, in a scheme of amalgamation:** Any transfer of a capital asset by banking company to banking institution in a scheme of amalgamation of a banking company with a banking institution sanctioned and

brought into force by the Central Government under section 45(7) of the Banking Regulation Act, 1949 [Section 47(viaa)].

- (8) **Transfer of share(s) of foreign company by amalgamating foreign company to amalgamated foreign company, in a scheme of amalgamation:** Any transfer, in a scheme of amalgamation, of a capital asset, being a share of a foreign company referred to in *Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company [Section 47(viab)]

Conditions –

- (i) At least 25% of the shareholders of the amalgamating foreign company must continue to remain shareholders of the amalgamated foreign company; and
 - (ii) Such transfer should not attract tax on capital gains in the country in which the amalgamating company is incorporated.
- (9) **Transfer of capital asset by the demerged company to the resulting Indian company, in a scheme of demerger:** Any transfer in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company [Section 47(vib)].
- (10) **Transfer of share(s) held in an Indian company by demerged foreign company to resulting foreign company, in a scheme of demerger:** Any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company [Section 47(vic)].

Conditions –

- (i) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- (ii) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, the provisions of sections 391 to 394 of the Companies Act, 1956³, shall not apply in case of demergers referred to in this clause.

- (11) **Transfer of capital asset by the predecessor co-operative bank to successor co-operative bank in business reorganization:** Any transfer in a business reorganisation, of a capital asset by the predecessor co-operative bank to the successor co-operative bank [Section 47(vica)].

³ Sections 230 to 232 of the Companies Act, 2013

- (12) **Transfer of share(s) in predecessor co-operative bank by a shareholder in a business reorganization:** Any transfer by a shareholder, in a business reorganisation, of a capital asset being a share or shares held by him in the predecessor co-operative bank if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank [Section 47(vicb)].

Note – Refer to section 44DB for the meanings of “business reorganisation”, “predecessor co-operative bank” and “successor co-operative bank”.

- (13) **Transfer of share(s) of foreign company by demerged foreign company to resulting foreign company, in a scheme of demerger:** Any transfer, in a scheme of demerger, of a capital asset, being a share of a foreign company referred to in *Explanation 5* to section 9(1)(i), which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company [Section 47(vicc)].

Conditions –

- (i) The shareholders holding at least three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
- (ii) Such transfer does not attract tax on capital gains in the country, in which the demerged foreign company is incorporated.

However, the provisions of sections 391 to 394 of the Companies Act, 1956⁴, shall not apply in case of demergers referred to in this clause.

- (14) **Transfer or issue of shares by the resulting company to the shareholder of demerged company, in a scheme of demerger:** Any transfer or issue of shares by the resulting company, in a scheme of demerger to the shareholders of the demerged company, if the transfer or issue is made in consideration of demerger of the undertaking [Section 47(vid)].
- (15) **Transfer of share(s) held in the amalgamating company by a shareholder, in a scheme of amalgamation:** Any transfer by a shareholder, in a scheme of amalgamation, of shares held by him in the amalgamating company [Section 47(vii)].

Conditions –

- (i) The transfer is made in consideration of the allotment to him of any share in the amalgamated company, except where the shareholder itself is the amalgamated company; and
- (ii) The amalgamated company is an Indian company.

⁴ Sections 230 to 232 of the Companies Act, 2013

Example 3:

Let us take a case where A Ltd., an Indian company, holds 60% of shares in B Ltd. B Ltd. amalgamates with A Ltd. Since A Ltd. itself is the shareholder of B Ltd., A Ltd., being the amalgamated company, cannot issue shares to itself. However, A Ltd. has to issue shares to the other shareholders of B Ltd.

ILLUSTRATION 2

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2021. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by ₹ 50,000 than the value of holding in ABC Ltd.

The Assessing Officer proposes to treat the transaction as an exchange and to tax ₹ 50,000 as capital gain. Is he justified?

SOLUTION

In the above example, assuming that the amalgamated company is an Indian company, the transaction is squarely covered by the exemption explained above and the proposal of the Assessing Officer to treat the transaction as an exchange is not justified.

- (16) **Transfer of bond or Global Depository Receipts by a non-resident to another non-resident outside India:** Any transfer of bonds or Global Depository Receipts referred to in section 115AC(1), by a non-resident to another non-resident outside India [Section 47(viia)].
- (17) **Transfer of Rupee Denominated bond of an Indian company by a non-resident to another non-resident outside India:** Any transfer, made outside India, of a capital asset being rupee denominated bond of an Indian company issued outside India, by a non-resident to another non-resident [Section 47(viiaa)].
- (18) **Transfer of specified capital asset by a non-resident on a recognised stock exchange in any IFSC [Section 47(viiab)]** – Transfer of the following capital assets by a non-resident on a recognised stock exchange located in any International Financial Services Centre (IFSC) shall not be regarded as transfer, where the consideration for such transaction is paid or payable in foreign currency:
- bond or GDR referred to in section 115AC(1); or
 - rupee denominated bond of an Indian company; or
 - derivative; or
 - other securities notified by the Central Government

Accordingly, the Central Government has, vide Notification No. 16/2020, dated 5.3.2020, specified the following securities:

- (i) *foreign currency denominated bond;*
- (ii) *unit of a Mutual Fund;*
- (iii) *unit of a business trust;*
- (iv) *foreign currency denominated equity share of a company;*
- (v) *unit of Alternative Investment Fund,*

which are listed on a recognised stock exchange located in any International Financial Services Centre in accordance with the regulations made by the SEBI under the Securities and Exchange Board of India Act 1992 or the International Financial Services Centres Authority under the International Financial Services Centres Authority Act 2019, as the case may be.

(19) Transfer of Government Security by a non-resident to another non-resident outside India through an intermediary: Any transfer of a capital asset, -

- (i) being a Government Security carrying a periodic payment of interest,
- (ii) made outside India through an intermediary dealing in settlement of securities,
- (iii) by a non-resident to another non-resident [Section 47(viib)]

(20) Redemption of Sovereign Gold Bonds by an Individual: Redemption by an individual of Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015 [Section 47(viic)]

Sovereign Gold Bond Scheme, 2015

This scheme has been introduced by the Government of India to reduce the demand for physical gold and consequently, reduce the foreign exchange outflow due to import of gold. The two-fold benefits of this scheme are:

- (1) The gold bond would serve as a substitute for physical gold; and
- (2) The gold bond would provide security to the individual investor investing in gold for meeting their social obligation.

(21) Transfer of specified capital asset to the Government or university etc.: Any transfer of any of the following capital asset to the Government or to a University or the National Museum, National Art Gallery, National Archives or any other public museum or institution notified by the Central Government to be of national importance or to be of renown throughout any State [Section 47(ix)]:

- (i) work of art
- (ii) archaeological, scientific or art collection
- (iii) book

- (iv) manuscript
 - (v) drawing
 - (vi) painting
 - (vii) photograph or
 - (viii) print.
- (22) **Transfer on conversion of bonds or debentures etc. into shares or debentures:** Any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company [Section 47(x)].
- (23) **Conversion of Foreign Currency Exchangeable Bonds into shares or debentures:** Any transfer by way of conversion of Foreign Currency Exchangeable Bonds referred to in clause (a) of section 115AC(1) into shares or debentures of a company [Section 47(xa)].
- (24) **Conversion of preference shares into equity shares:** Any transfer by way of conversion of preference shares of a company into equity shares of that company [Section 47(xb)].
- (25) **Transfer of land by a sick industrial company:** Any transfer of a capital asset, being land of a sick industrial company, made under a scheme prepared and sanctioned under section 18 of the Sick Industrial Companies (Special Provisions) Act, 1985, by a sick industrial company which is managed by its workers' co-operative [Section 47(xii)].

Condition –

Such transfer is made in the period commencing from the previous year in which the said company has become a sick industrial company and ending with the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.

- (26) **Transfer of capital asset or intangible asset on succession of the firm by a company or by AOP/ BOI to company consequent to demutualisation or corporatisation of a recognised stock exchange:** Any transfer of a capital asset or intangible asset (in the case of a firm) –
- (i) by a firm to a company where such firm is succeeded by that company; or
 - (ii) to a company in the course of demutualisation or corporatisation of a recognised stock exchange in India as a result of which an AOP or BOI is succeeded by that company [Section 47(xiii)].

Conditions –

- (i) All assets and liabilities of the firm or AOP or BOI relating to the business immediately before the succession become the assets and liabilities of the company;

- (ii) All the partners of the firm immediately before the succession become the shareholders of the company in the same the proportion in which their capital accounts stood in the books of the firm on the date of succession;
- (iii) The partners of the firm do not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company;
- (iv) The partners of the firm together hold not less than 50% of the total voting power in the company, and their shareholding continues in such manner for a period of 5 years from the date of succession;
- (v) The demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for demutualisation or corporatisation approved by SEBI.

(27) Transfer of a membership right of recognised stock exchange in a scheme for demutualisation or corporatisation approved by SEBI: Any transfer of a membership right by a member of recognised stock exchange in India

- for acquisition of shares and
- trading or clearing rights

acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation approved by SEBI [Section 47(xiiia)].

(28) Transfer of capital asset or intangible asset by private company and share held by shareholder to LLP in a conversion of private company into a LLP:

- (i) Any transfer of a capital asset or intangible asset by a private company or unlisted public company to a LLP or
- (ii) Any transfer of a 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 [Section 47(xiiib)].

Conditions –

- (i) All assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP;
- (ii) 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 in the same proportion as their shareholding in the company on the date of conversion;
- (iii) No consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

- (iv) 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 5 years from the date of conversion;
- (v) The total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakh in any of the three preceding previous years;
- (vi) The total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crore; and
- (vii) No amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(29) Transfer of capital asset or intangible asset by sole proprietary concern to a company in a succession of sole proprietary concern by a company: Where a sole proprietary concern is succeeded by a company in the business carried out by it, as a result of which the sole proprietary concern transfers or sells any capital asset or intangible asset to such company [Section 47(xiv)].

Conditions –

- (i) All assets and liabilities of the sole proprietary concern relating to the business immediately before the succession become the assets and liabilities of the company;
- (ii) The sole proprietor holds not less than 50% of the total voting power in the company, and his shareholding continues in such manner for a period of 5 years from the date of succession;
- (iii) The sole proprietor does not receive any consideration or benefit in any form, directly or indirectly, other than by way of allotment of shares in the company.

(30) Transfer in a scheme for lending of any securities: Any transfer in a scheme for lending of any securities under an agreement or arrangement which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by SEBI or the RBI [Section 47(xv)]

Example 4:

The Securities Lending and Borrowing (SLB) Scheme for all market participants in the Indian securities market under the overall framework of Securities Lending Scheme, 1997 of SEBI

(31) Transfer of capital asset under Reverse Mortgage: Any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government [Section 47(xvi)].

The Reverse Mortgage scheme is for the benefit of senior citizens, who own a residential house property. In order to supplement their existing income, they can mortgage their house property with a scheduled bank or housing finance company, in return for a lump-sum amount

or for a regular monthly/ quarterly/ annual income. The senior citizens can continue to live in the house and receive regular income, without the botheration of having to pay back the loan.

The loan will be given up to, say, 60% of the value of residential house property mortgaged. Also, the bank/housing finance company would undertake a revaluation of the property once every 5 years. The borrower can use the loan amount for renovation and extension of residential property, family's medical and emergency expenditure etc., amongst others. However, he cannot use the amount for speculative or trading purposes.

The Reverse Mortgage Scheme, 2008, includes within its scope, disbursement of loan by an approved lending institution, in part or in full, to the annuity sourcing institution, for the purposes of periodic payments by way of annuity to the reverse mortgagor. This would be an additional mode of disbursement i.e., in addition to direct disbursements by the approved lending institution to the Reverse Mortgagor by way of periodic payments or lump sum payment in one or more tranches.

An annuity sourcing institution has been defined to mean Life Insurance Corporation of India or any other insurer registered with the Insurance Regulatory and Development Authority.

Maximum Period of Reverse Mortgage Loan:

| | Mode of disbursement | Maximum period of loan |
|-----|---|--|
| (a) | Where the loan is disbursed directly to the Reverse Mortgagor | 20 years from the date of signing the agreement by the reverse mortgagor and the approved lending institution. |
| (b) | Where the loan is disbursed, in part or in full, to the annuity sourcing institution for the purposes of periodic payments by way of annuity to the Reverse Mortgagor | The residual life time of the borrower. |

The bank will recover the loan along with the accumulated interest by selling the house after the death of the borrower. The excess amount will be given to the legal heirs. However, before resorting to sale of the house, preference will be given to the legal heirs to repay the loan and interest and get the mortgaged property released.

Therefore, section 47(xvi) clarifies 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.

Exemption of income received in a transaction of reverse mortgage [Section 10(43)]: Section 10(43), further, provides that the amount received by the senior citizen as a loan, either in lump sum or in instalments, in a transaction of reverse mortgage would be exempt from income-tax.

Capital gains tax liability would be attracted only at the stage of alienation of the mortgaged property by the bank/ housing finance company for the purposes of recovering the loan.

- (32) **Transfer of shares of a special purpose vehicle to a business trust:** Any transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust to the transferor [Section 47(xvii)]

Meaning of business trust and special purpose vehicle will be discussed in *Chapter 12: "Assessment of Various Entities"*.

- (33) **Transfer of unit(s) by a unit holder under consolidating scheme of Mutual Fund:** Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating scheme of a mutual fund, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated scheme of the mutual fund [Section 47(xviii)].

However, this exemption would be available only if, the consolidation takes place of two or more schemes of equity oriented fund or of two or more schemes of a fund other than equity oriented fund.

- (34) **Transfer of unit(s) by a unit holder under consolidating plan of Mutual Fund scheme:** Any transfer by a unit holder of a capital asset, being a unit or units, held by him in the consolidating plan of a mutual fund scheme, made in consideration of the allotment to him of a capital asset, being a unit or units, in the consolidated plan of that scheme of the mutual fund [Section 47(xix)].

Meaning of the following terms:

| Term | Meaning |
|-----------------------------|--|
| Consolidating scheme | The scheme of a mutual fund which merges under the process of consolidation of the schemes of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under SEBI Act, 1992. |
| Consolidated scheme | The scheme with which the consolidating scheme merges or which is formed as a result of such merger. |
| Consolidating plan | The plan within a scheme of a mutual fund which merges under the process of consolidation of the plans within a scheme of mutual fund in accordance with the SEBI (Mutual Funds) Regulations, 1996 made under SEBI Act, 1992. |
| Consolidated plan | The plan with which the consolidating plan merges or which is formed as a result of such merger. |
| Mutual Fund | A mutual fund specified under section 10(23D), i.e., (i) a Mutual Fund registered under the SEBI Act, 1992 or regulations made thereunder; (ii) such other Mutual Fund set up by a public sector bank or a public financial institution or authorised by the Reserve Bank of India and subject to conditions notified by the Central Government. |

ILLUSTRATION 3

In which of the following situations capital gains tax liability does not arise?

- (i) *Mr. A purchased gold in 1970 for ₹ 25,000. In the P.Y. 2020-21, he gifted it to his son at the time of marriage. Fair market value (FMV) of the gold on the day the gift was made was ₹ 1,00,000.*
- (ii) *A house property is purchased by a Hindu undivided family in 1945 for ₹ 20,000. It is given to one of the family members in the P.Y. 2020-21 at the time of partition of the family. FMV on the day of partition was ₹ 12,00,000.*
- (iii) *Mr. B purchased 50 convertible debentures for ₹ 40,000 in 1995 which are converted in to 500 shares worth ₹ 85,000 in November 2020 by the company.*

SOLUTION

We know that capital gains arise only when we transfer a capital asset. The liability of capital gains tax in the situations given above is discussed as follows:

- (i) As per the provisions of section 47(iii), transfer of a capital asset under a gift is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.
- (ii) As per the provisions of section 47(i), transfer of a capital asset (being in kind) on the total or partial partition of Hindu undivided family is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.
- (iii) As per the provisions of section 47(x), transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form of a company into shares or debentures of that company is not regarded as transfer for the purpose of capital gains. Therefore, capital gains tax liability does not arise in the given situation.

ILLUSTRATION 4

Mr. Abhishek a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

SOLUTION

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

Accordingly, the mortgaging of residential house with bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in instalment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly instalment amounts received by Mr. Abhishek would not be taxable.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.



7.10 WITHDRAWAL OF EXEMPTION IN CERTAIN CASES

Section 47A provides for withdrawal of the benefit of exemption given by section 47 in certain cases.

- (1) **Conditions for transfer of capital asset by holding to its wholly owned subsidiary and vice versa [Section 47(iv) or 47(v)]:** As noted above, capital gains arising from the transfer of a capital asset by a company to its wholly owned subsidiary company is exempt from tax.

Similarly, capital gains arising from the transfer of a capital asset by the subsidiary company to its 100% holding company is also exempt from tax, provided under both circumstances the transferee is an Indian company.

Section 47A provides that the above exemption will be withdrawn if at any time before the expiry of 8 years from the date of transfer of a capital asset referred to above

- (1) such capital asset is converted by the transferee company or is treated by it as stock-in-trade of its business; or
- (2) the parent company or its nominees ceases to hold the whole of the share capital of the subsidiary company.

In the above two cases, the amount of capital gains exempt from tax by virtue of the provisions contained in section 47 will be deemed to be the income of the transferor company chargeable under the head 'capital gains' of the year in which such transfer took place.

- (2) **Transfer of membership of a recognised stock exchange for shares [Section 47(xi)]:** Capital gains not charged to tax under clause (xi) of section 47 shall be deemed to be the income chargeable under the head "capital gains" of the previous year in which such transfer took place if the shares of the company received in exchange for transfer of membership in a recognised stock exchange, are transferred at any time before the expiry of 3 years from the date of such transfer.
- (3) **Transfer of capital asset or intangible asset on succession of firm/ sole proprietary concern by a company [Section 47(xiii) or 47(xiv)]:** Where any of the conditions laid down in section 47(xiii) or (xvi), as the case may be, for succession of a firm or sole proprietary concern by a company are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset shall be deemed to be the profits and gains **chargeable to tax of the successor company** for the previous year in which the conditions are not complied with.

- (4) **Transfer of capital asset or intangible asset by private company or unlisted company and share held by shareholder to LLP in a conversion of private company or unlisted public company by a LLP [Section 47(xiiib)]:** If subsequent to the conversion of a private company or unlisted company into an LLP, any of the conditions laid down in section 47(xiiib) are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, **in the hands of the LLP or the shareholder of the predecessor company**, as the case may be.



7.11 MODE OF COMPUTATION OF CAPITAL GAINS (SECTION 48)

- (1) **Computation of capital gains:** The income chargeable under the head 'capital gains' shall be computed by deducting the following items from the full value of the consideration received or accruing as a result of the transfer of the capital asset:
- (i) Expenditure incurred wholly and exclusively in connection with such transfer.
 - (ii) The cost of acquisition and cost of any improvement thereto.
- (2) **No deduction in respect of STT paid:** However, no deduction shall be allowed in computing the income chargeable under the head "Capital Gains" in respect of any amount paid on account of securities transaction tax under Chapter VII of the Finance (No.2) Act, 2004.
- (3) **Cost inflation index:** As per second proviso to section 48, for computation of long term capital gains, the cost of acquisition and cost of improvement increased by applying the Cost Inflation Index (CII). Once the CII is applied to the cost of acquisition and cost of improvement, it becomes indexed cost of acquisition and indexed cost of improvement.

This means an amount which bears to the cost of acquisition, the same proportion as CII for the year in which the asset is transferred bears to the CII for the first year in which the asset was held by the assessee or for the year beginning on 1st April, 2001, whichever is later.

Similarly, indexed cost of any improvement means an amount which bears to the cost of improvement, the same proportion as CII for the year in which the asset is transferred bears to the CII for the year in which the improvement to the asset took place.

"Cost Inflation Index" in relation to a previous year means such index as may be notified by the Central Government having regard to 75% of average rise in the Consumer Price Index (Urban) for the immediately preceding previous year to such previous year.

Note - The benefit of indexation will not apply to the long-term capital gains arising from the transfer of bonds or debentures **other than** –

- (1) Capital indexed bonds issued by the Government; or
- (2) Sovereign Gold Bond issued by the RBI under the Sovereign Gold Bond Scheme, 2015.

In case of depreciable assets (discussed later), there will be no indexation and the capital gains will always be short-term capital gains.

The cost inflation indices for the financial years so far have been notified as under:

| Financial Year | Cost Inflation Index |
|----------------|----------------------|
| 2001-02 | 100 |
| 2002-03 | 105 |
| 2003-04 | 109 |
| 2004-05 | 113 |
| 2005-06 | 117 |
| 2006-07 | 122 |
| 2007-08 | 129 |
| 2008-09 | 137 |
| 2009-10 | 148 |
| 2010-11 | 167 |
| 2011-12 | 184 |
| 2012-13 | 200 |
| 2013-14 | 220 |
| 2014-15 | 240 |
| 2015-16 | 254 |
| 2016-17 | 264 |
| 2017-18 | 272 |
| 2018-19 | 280 |
| 2019-20 | 289 |
| 2020-21 | 301 |

- (4) **Full value of consideration of shares, debentures or warrants issued under ESOP in case of transfer under a gift etc.** - In case where shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme in accordance with the guidelines issued in this behalf by the Central Government are transferred under a gift or irrecoverable trust, then the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer of such asset.
- (5) **Special provision for non-residents** - In order to give protection to non-residents who invest foreign exchange to acquire capital assets, the first proviso to section 48 provides that, in the

case of non-residents, capital gains arising from the transfer of shares or debentures of an Indian company is to be computed as follows:

- The cost of acquisition, the expenditure incurred wholly and exclusively in connection with the transfer and the full value of the consideration are to be converted into the same foreign currency with which such shares were acquired.
- The resulting capital gains shall be reconverted into Indian currency.

The aforesaid manner of computation of capital gains shall be applied for every purchase and sale of shares or debentures of an Indian company. Rule 115A is relevant for this purpose. Benefit of indexation will not be applied in this case.

Note – Refer to Chapter 2: Non-resident Taxation of Module 4 where Rule 115A is detailed.

Non-corporate 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 or shares of a company in which public are not substantially interested [Section 112]

Rupee Denominated Bonds (RDBs)

As a measure to enable Indian companies to raise funds from outside India, the RBI has permitted them to issue rupee denominated bonds outside India. Accordingly, in case of non-resident assesseees, any gains arising on account of appreciation of rupee between the date of purchase and the date of redemption of rupee denominated bond of an Indian company held by him against foreign currency in which investment is made shall not be included in computation of full value of consideration. This would provide relief to the non-resident investor who bears the risk of currency fluctuation.

Note – The benefit of indexation and currency fluctuation would not be applicable to the long-term capital gains arising from the transfer of the following assets referred to in section 112A –

- (i) equity share in a company on which STT is paid both at the time of acquisition and transfer
- (ii) unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.



7.12 ASCERTAINMENT OF COST IN SPECIFIED CIRCUMSTANCES [SECTION 49]

A person becomes the owner of a capital asset not only by purchase but also by several other methods. Section 49 gives guidelines as to how to compute the cost under different circumstances.

- (1) **Cost to previous owner deemed as cost of acquisition of asset:** In the following cases, the cost of acquisition of the asset shall be deemed to be cost for which the previous owner

of the property acquired it. To this cost, the cost of improvement to the asset incurred or borne by the previous owner or the assessee must be added:

Where the capital asset became the property of the assessee:

- (i) on any distribution of assets on the total or partition of a HUF;
- (ii) under a gift or will;
- (iii) by succession, inheritance or devolution;
- (iv) on any distribution of assets on the liquidation of a company;
- (v) under a transfer to revocable or an irrevocable trust;
- (vi) under any transfer of capital asset by a holding company to its wholly owned subsidiary Indian company or by a subsidiary company to its 100% holding Indian company, referred to in section 47(iv) and 47(v) respectively;
- (vii) under any transfer referred to in section 47(vi) of a capital asset by amalgamating company to the amalgamated Indian company, in a scheme of amalgamation;
- (viii) under any transfer referred to in section 47(via) of shares held in an Indian company, in a scheme of amalgamation, by amalgamating foreign company to the amalgamated foreign company;
- (ix) under any transfer referred to in section 47(viaa) by a banking company to the banking institution, in a scheme of amalgamation of the banking company with a banking institution;
- (x) under any transfer of a capital asset, being a share of a foreign company, which derives directly or indirectly its value substantially from the share(s) of an Indian company, held by the amalgamating foreign company to the amalgamated foreign company, in the scheme of amalgamation referred to under section 47(viab);
- (xi) under any transfer referred to in section 47(vib), of a capital asset by the demerged company to the resulting Indian company, in a scheme of demerger;
- (xii) by any transfer of a capital asset, being share(s) held in an Indian company, by the demerged foreign company to the resulting foreign company, in a scheme of demerger referred to in section 47(vic);
- (xiii) by any transfer of a capital asset in a business reorganization under section 47(vica), by the predecessor co-operative bank to the successor co-operative bank;
- (xiv) by any transfer by a shareholder, in a business reorganisation referred to under section 47(vicb), of a capital asset being a share or shares held by him in the predecessor co-operative bank, if the transfer is made in consideration of the allotment to him of any share or shares in the successor co-operative bank;

- (xv) by transfer of a capital asset, being a share in a foreign company, which derives, directly or indirectly, its value substantially from the share or shares of an Indian company, held by the demerged foreign company to the resulting foreign company in the scheme of demerger referred under section 47(vicc);
- (xvi) by any transfer of capital asset or intangible asset on succession of a firm by a company in a business carried on by it or any transfer of a capital asset on succession of an AOP/BOI by a company on demutualisation or corporatisation of a recognized stock exchange referred to in section 47(xiii);
- (xvii) under any transfer under section 47(xiiib) of a capital asset or intangible asset by a private company or unlisted public company to a LLP;
- (xviii) by any transfer of capital asset or intangible asset on succession of a sole proprietorship concern by a company in a business carried on by it, fulfilling the conditions mentioned in section 47(xiv);
- (xix) by conversion by an individual of his separate property into a HUF property, by the mode referred to in section 64(2).

Accordingly, section 2(42A) provides that in all such cases, for determining the period for which the capital asset is held by the transferee, the period of holding of the asset by the previous owner shall also be considered.

Note: The issue as to whether indexation benefit in respect of a gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner was taken up by the Bombay High Court in *CIT v. Manjula J. Shah (2013) 355 ITR 474 (Bom.)*.

As per *Explanation 1* to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), *inter alia*, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration.

The indexed cost of acquisition means the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

The issue under consideration was whether, in a case where the assessee had acquired a capital asset by way of gift from the previous owner, the said asset can be treated as a long-

term capital asset considering the period of holding by the assessee as well as the previous owner.

The Bombay High Court held that the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

As per the plain reading of the provisions of section 48, however, the indexed cost of acquisition would be determined by taking CII for the year in which in which asset is first held by the assessee.

ILLUSTRATION 5

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 21.07.2020 the business of Neerja Textiles was succeeded by New Look Textile Private Limited and all the assets and liabilities of Neerja Textiles on that date became the assets and liabilities of New Look Textile Private Limited and Neerja was given 52% share in the share capital of the company. No other consideration was given to Neerja on account of this succession.

The assets and liabilities of Neerja Textiles transferred to the company include an urban land which was acquired by Neerja on 19.7.2013 for ₹ 9,80,000. The company sold the same on 30.03.2021 for ₹ 15,00,000.

Examine the tax implication of the above-mentioned transaction and compute the income chargeable to tax in such case(s).

Cost Inflation Index: F.Y. 2013-14: 220; F.Y. 2020-21: 301

SOLUTION

Taxability in case of succession of Neerja Textiles by New Look Textile Private Limited

As per provisions of section 47(xiv), in case a proprietorship concern is succeeded by a company in the business carried by it and as a result of which any capital asset or intangible asset is transferred to the company, then the same shall not be treated as transfer and will not be chargeable to capital gain tax in case the following conditions are satisfied:

- (1) all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.
- (2) the shareholding of the sole proprietor in the company is not less than 50% of the total voting power of the company and continues to remain as such for a period of 5 years from the date of succession.
- (3) the sole proprietor does not receive any consideration or benefit in any form from the company other than by way of allotment of shares in the company.

In the present case, all the conditions mentioned above are satisfied therefore, the transfer of capital asset by Neerja Textiles to New Look Textile Private Limited shall not attract capital gain tax provided Neerja continues to hold 50% or more of voting power of New Look Textiles Private Limited for a minimum period of 5 years.

Taxability in case of transfer of land by New Look Textile Private Limited

As per the provisions of section 49(1) and *Explanation 1* to section 2(42A), in case a capital asset is transferred in the circumstances mentioned in section 47(xiv), the cost of the asset in the hands of the company shall be the cost of the asset in the hands of the sole proprietor. Consequently, for the determining the period of holding of the asset, the period for which the asset is held by the sole proprietor shall also be considered.

Therefore, in the present case, the urban land shall be a long-term capital asset since it is held for more than 24 months by New Look Textile Private Limited and Neerja Textiles taken together. Cost of acquisition of land in the hands of the company shall be ₹ 9,80,000 i.e., the purchase cost of the land in the hands of Neerja.

Computation of capital gain chargeable to tax in the hands of New Look Textile Private Ltd.

| Particulars | ₹ |
|--|-----------|
| Net Sale Consideration | 15,00,000 |
| Less: Indexed cost of acquisition $9,80,000 \times 301/301$ (Refer Note below) | 9,80,000 |
| Long-term capital gain | 5,20,000 |

Note: *The year of transfer and the year in which the company first held the asset are the same in this case, which is the reason why the numerator and the denominator for calculating the indexed cost of acquisition would remain the same. Therefore, in effect, there is no benefit of indexation in this case. However, as per the view expressed by Bombay High Court in CIT v. Manjula J. Shah 16 Taxman 42, 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 indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2013-14 i.e., 220, being the year in which the capital asset was acquired by the previous owner, Neerja, as the denominator, in which case, the capital gains chargeable to tax would undergo a change. The long-term capital gains in such a case would be ₹ 1,59,182 [₹ 15,00,000 - ₹ 13,40,818 (9,80,000 x ₹ 301/220)].*

- (2) **Cost of acquisition of shares received under the scheme of amalgamation:** Where shares in an amalgamated company which is an Indian company become the property of the assessee in consideration of the transfer of shares referred to in section 47(vii) held by him in the amalgamating company under a scheme of amalgamation, the cost of acquisition to him

of the shares in the amalgamated company shall be taken as the cost of acquisition of the shares in the amalgamating company [Section 49(2)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB [Section 49(2E)] [discussed in point no. (13) below]

- (3) **Cost of acquisition of shares or debentures received during the process of conversion of bonds or debentures, debenture stock or deposit certificates:** It is possible that a person might have become the owner of shares or debentures in a company during the process of conversion of bonds or debentures, debenture stock or deposit certificates referred under section 47(x) or conversion of bonds [referred under section 115AC(1)(a)] referred to in section 47(xa).

In such a case, the cost of acquisition of such shares or debentures to the person shall be deemed to be that part of the cost of debentures, debenture stock, bond or deposit certificate in relation to which such asset is acquired by that person [Section 49(2A)].

- (4) **Cost of acquisition of specified security or sweat equity shares:** Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in section 17(2)(vi), the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for perquisite valuation [Section 49(2AA)].

- (5) **Cost of acquisition of rights of a partner received on conversion of private or unlisted public company into LLP:** Where a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP referred to in section 47(xiiib), then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

- (6) **Cost of acquisition of shares acquired on redemption of Global Depository Receipts:** The cost of acquisition of the capital asset, being share or shares of a company acquired by a non-resident assessee, consequent to redemption of GDRs [referred to in section 115AC(1)(b)] held by him would be the price of such share or shares prevailing on any recognised stock exchange on the date on which a request for such redemption was made [Section 49(2ABB)].

- (7) **Cost of acquisition of unit of business trust in consideration of shares of a special purpose vehicle:** Where the capital asset, being unit of a business trust, became the property of the assessee in consideration of transfer of shares of a special purpose vehicle as referred to in section 47(xvii), the cost of acquisition of the unit would be deemed to be the cost of acquisition of the shares to him [Section 49(2AC)].

- (8) **Cost of acquisition of units acquired under consolidated scheme of Mutual Fund:** The cost of acquisition of the units acquired by the assessee in consolidated scheme of mutual

fund in consideration of transfer referred in section 47(xviii) shall be deemed to be the cost of acquisition to him of the units in the consolidating scheme of mutual fund [Section 49(2AD)].

- (9) **Cost of acquisition of equity shares received at the time of conversion of preference shares:** Cost of acquisition of the equity share of a company, which became the property of the assessee in consideration of transfer by way of conversion of preference shares referred to in section 47(xb), shall be deemed to be that part of the cost of the preference share in relation to which such asset is acquired by the assessee [Section 49(2AE)].
- (10) **Cost of acquisition of units acquired under consolidated plan of Mutual Fund scheme:** Cost of acquisition of the unit or units in the consolidated plan of the scheme of the mutual fund in consideration of a transfer referred to in section 47(xix) shall be deemed to be the cost of acquisition to him of the unit or units in consolidating plan of the scheme of the mutual fund [Section 49(2AF)].
- (11) **Cost of acquisition of a unit or units in the segregated portfolio:** *The cost of acquisition of a unit or units in the segregated portfolio shall be the amount which bears, to the cost of acquisition of a unit or units held by the assessee in the total portfolio, the same proportion as the net asset value of the asset transferred to the segregated portfolio bears to the net asset value of the total portfolio immediately before the segregation of portfolios. [Section 49(2AG)]*
- (12) **Cost of the acquisition of the original units held by the unit holder in the main portfolio:** *The cost of the acquisition of the original units held by the unit holder in the main portfolio shall be deemed to have been reduced by the amount as so arrived at under sub-section (2AG). [Section 49(2AH)]*

Meaning of "main portfolio", "segregated portfolio" and "total portfolio"

| Term | Meaning |
|-----------------------------|--|
| Main portfolio | <i>the scheme portfolio excluding the segregated portfolio</i> |
| Segregated portfolio | <i>a portfolio, comprising of debt or money market instrument affected by a credit event, that has been segregated in a mutual fund scheme</i> |
| Total portfolio | <i>the scheme portfolio including the securities affected by the credit event</i> |

SEBI has, vide circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, permitted creation of segregated portfolio of debt and money market instruments by Mutual Fund schemes. As per the SEBI circular, all the existing unit holders in the affected scheme as on the day of the **credit event** i.e. downgrade in credit rating by a SEBI registered Credit Rating Agency (CRA), shall be allotted equal number of units in the segregated portfolio as held in the main portfolio. On segregation, the unit holders come to hold same number of units in two schemes – the main scheme and segregated scheme.

- (13) **Cost of acquisition of shares received in the resulting company in the scheme of demerger:** In the case of a demerger, the cost of acquisition of the shares in the resulting company shall 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 [Section 49(2C)].

$$\text{Cost of acquisition of shares in the resulting company} = A \times \frac{B}{C}$$

A = Cost of acquisition of shares held in the demerged company

B = Net book value of the assets transferred in a demerger

C = Net worth of the demerged company

“Net worth” means the aggregate of the paid up share capital and general reserves as appearing in the books of account of the demerged company immediately before the demerger.

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the shares in the resulting co-operative bank shall be the amount which bears to the cost of acquisition of shares held by the assessee in the demerged co-operative bank, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged co-operative bank immediately before demerger i.e.,

$$\text{Cost of acquisition of shares in the resulting co-operative bank} = A \times \frac{B}{C}$$

A = Cost of acquisition of shares held in the demerged co-operative bank

B = Net book value of the assets transferred in a demerger

C = Net worth of the demerged co-operative bank

- (14) **Cost of acquisition of the shares held in the demerged company:** Further, the cost of acquisition of the original shares held by the shareholder in the demerged company shall be deemed to have been reduced by the amount as so arrived under the sub-section (2C) [Section 49(2D)].

This also applies in relation to business reorganization of a co-operative bank as referred to in section 44DB. The cost of acquisition of the original shares held by the shareholder in the demerged co-operative bank shall be deemed to have been reduced by the amount so arrived at in (13) above.

- (15) **Cost of acquisition of capital asset transferred by holding to its wholly owned subsidiary Indian company or vice a versa, in case of attraction of section 47A:** The capital asset transferred by holding to its wholly owned subsidiary Indian company or by subsidiary to its 100% holding Indian company is not regarded as transfer. If the capital asset so transferred is converted into stock in trade or the parent company or its nominees ceases to hold the 100% share capital of the subsidiary company at any time before the expiry of 8 years from the date of transfer, then, the capital gain arising from such transfer shall become taxable by virtue of section 47A. In such case, the cost of acquisition of such asset to the transferee-company shall be the cost for which such asset was acquired by it [Section 49(3)].
- (16) **Cost of acquisition of property subject to tax under section 56(2)(x):** Where the capital gain arises from the transfer of such property which has been subject to tax under section 56(2)(x), the cost of acquisition of the property shall be deemed to be the value taken into account for the purposes of section 56(2)(x) [Section 49(4)].
- (17) **Cost of acquisition of capital asset declared under Income Declaration Scheme, 2016:** Where capital gain arises from the transfer of asset declared under the Income Declaration Scheme, 2016 and the tax, surcharge and penalty have been paid in accordance with the provisions of the Scheme on the fair market value of the asset as on the date of commencement of the Scheme, the cost of acquisition of the asset shall be deemed to be the fair market value of the asset which has been taken into account for the purposes of the said scheme [Section 49(5)].
- (18) **Cost of Acquisition of specified capital asset referred under clause (c) of the Explanation to section 10(37A):** Where the capital gain arises from the transfer of a reconstituted plot or land, (received by the assessee in lieu of land or building or both transferred under the Land Pooling Scheme of Andhra Pradesh) which has been transferred after the expiry of 2 years from the end of the financial year in which the possession of such plot or land was handed over to the assessee, the cost of acquisition of such reconstituted plot or land shall be deemed to be its stamp duty value as on the last day of the second financial year after the end of the financial year in which the possession of the said plot or land was handed over to the assessee. [Section 49(6)]

For the purpose, “stamp duty value” means the value adopted or assessed or assessable by the authority of the State Government for the purpose of payment of stamp duty in respect of an immovable property.

Exemption in respect of capital gains arising on transfer of Specified Capital Assets under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014 [Section 10(37A)]

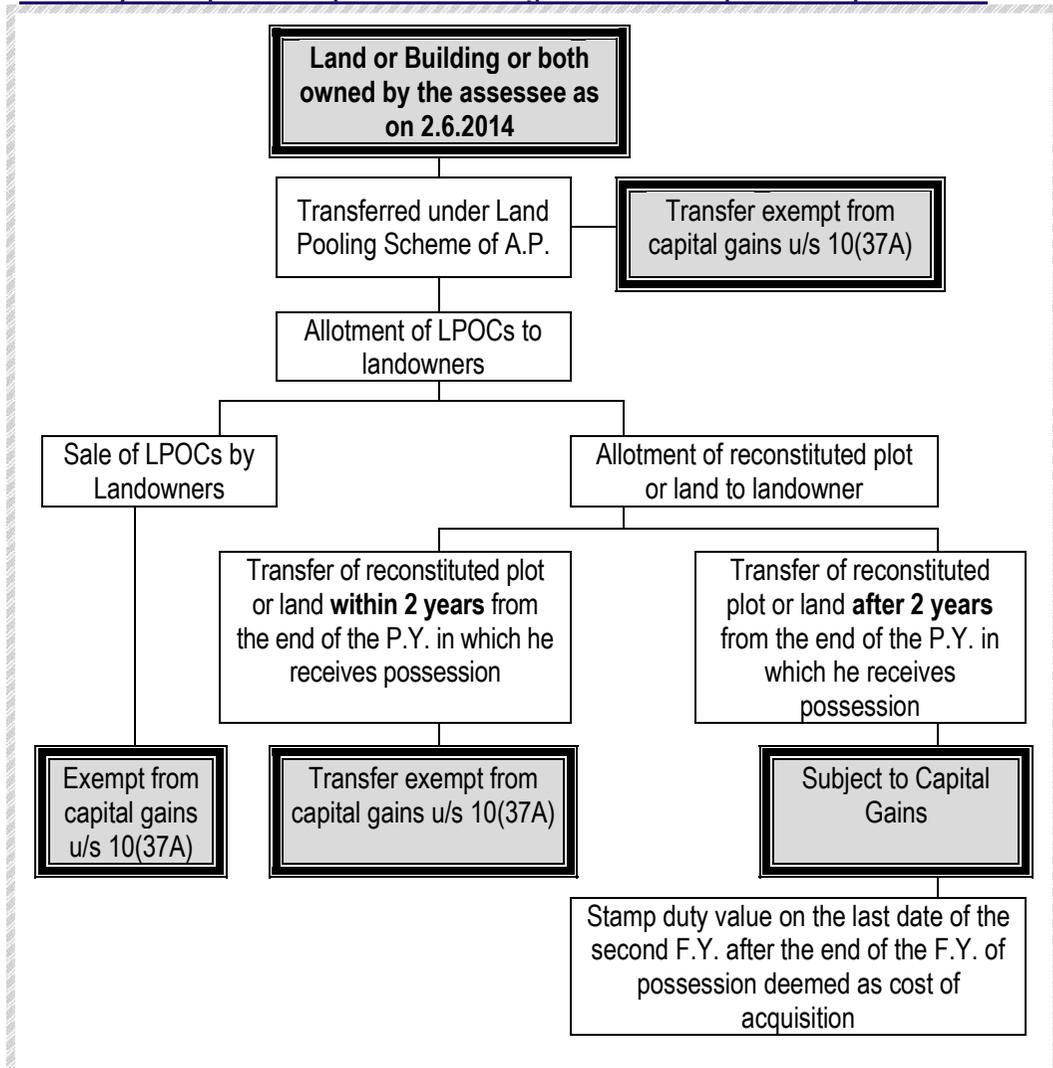
- ◆ As per section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2014, the specified compensation received by the landowner in lieu of acquisition of land is exempt from income tax. The Land Pooling Scheme is an alternative form of arrangement made by the Government of Andhra Pradesh for formation of new capital city of Amaravati to avoid land acquisition disputes and lessen the financial burden associated with payment of compensation under that Act.
- ◆ In Land Pooling Scheme, the compensation in the form of reconstituted plot or land is provided to land owners. However, the existing provisions of the Act do not provide for exemption from tax on transfer of land under the land pooling scheme as well as on transfer of Land Pooling Ownership Certificates (LPOCs) or reconstituted plot or land.
- ◆ With a view to provide relief to an individual or Hindu undivided family who was the owner of such land as on 2nd June, 2014, and has transferred their land under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014, clause (37A) of section 10 provides that in respect of said persons, capital gains arising from the transfer of the specified capital assets shall not be chargeable to tax under the Act:

Meaning of Specified Capital Asset:

Specified Capital Assets means

- the land or building or both owned by the assessee as on 2nd June, 2014 and which has been transferred under the land pooling scheme; or
- the land pooling ownership certificate (LPOC) issued to the assessee in lieu of transferred land or building or both or
- the reconstituted plot or land, as the case may be received by the assessee in lieu of land or building or both in accordance with the scheme, if such plot or land, as the case may be, so received is transferred within two years from the end of the financial year in which the possession of such plot or land was handed over to him.

Taxability/ Exemption of Capital Gains arising on transfer of Specified Capital Assets



- (19) **Cost of acquisition of capital asset, being share in the project referred under section 45(5A):** Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45(5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority), the cost of acquisition of such asset, shall be the amount which is deemed as full value of consideration in that sub-section i.e., stamp duty value on the date of issue of certificate of completion plus cash consideration.

However, this does not apply to a capital asset, being share in the project which is transferred on or before the date of issue of said completion certificate [Section 49(7)].

- (20) **Cost of Acquisition of capital assets of entities in case of levy of tax on accreted income under section 115TD:** Where the capital gain arises from the transfer of an asset, being the asset held by a trust or an institution in respect of which accreted income has been computed, and the tax has been paid thereon in accordance with the provisions relating to tax on accreted income of certain trusts and institutions under Chapter XII-EB, the cost of acquisition of such asset shall be deemed to be the fair market value of the asset which has been taken into account for computation of accreted income as on the specified date referred to in section 115TD(2) [Section 49(8)].

Note: Refer to Chapter 13 on “Assessment of Charitable or Religious Trusts or Institutions, Political Parties and Electoral Trusts” for understanding the concept of related income.

- (21) **Cost of acquisition of a capital asset which was used by the assessee as an inventory:** Where the capital gain arises from the transfer of a capital asset which was used by the assessee as inventory earlier before its conversion into capital asset, the cost of acquisition of such capital asset shall be the fair market value of the inventory as on the date of such conversion determined in the prescribed manner [Section 49(9)].



7.13 COST OF ACQUISITION [SECTION 55]

- (1) **Goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours**
- (i) **In case of acquisition from previous owner:** In the case of the above capital assets, if the assessee has purchased them from a previous owner, the cost of acquisition means the amount of the purchase price.
- (ii) **In case of self-generated assets** - There are circumstances where it is not possible to visualise cost of acquisition.

For example, suppose a doctor starts his profession. With the passage of time, the doctor acquires lot of reputation. He opens a clinic and runs it for 5 years. After 5 years he sells the clinic to another doctor for ₹ 10 lacs which includes ₹ 2 lacs for his reputation or goodwill.

Now a question arises as to how to find out the profit in respect of goodwill. It is obvious that the goodwill is self-generated and hence it is difficult to calculate the cost of its acquisition. However, it is certainly a capital asset.

The Supreme Court in *CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294 (SC)* held that in order to bring the gains on sale of capital assets to charge under section 45, it is necessary that the provisions dealing with the levy of capital gains tax must be read as a whole.

Section 48 deals with the mode of computing the capital gains. Unless the cost of acquisition is correctly ascertainable, it is not possible to apply the provisions of section 48. Self-generated goodwill is such a type of capital asset where it is not possible to visualise cost of acquisition. Once section 48 cannot be applied, the gains thereon cannot be brought to charge.

This decision of the Supreme Court was applicable not only to self-generated goodwill of a business but also to other self-generated assets like tenancy rights, stage carriage permits, loom hours etc.

In order to supersede the decision of the Supreme Court cited above, section 55 was amended. Accordingly, in case of self-generated assets namely, goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits, or loom hours, the cost of acquisition will be taken to be *nil*.

Note - It is significant to note that the above amendment does not cover **self-generated goodwill of a profession**. So, in respect of self-generated goodwill of a profession and other self-generated assets not specifically covered by the amended provisions of section 55, the decision of the Supreme Court in *B. C. Srinivasa Shetty's* case will still apply and hence, capital gains on transfer of such capital assets cannot be computed.

- (iii) **In case of other modes** - In the following cases, cost of acquisition of goodwill of a business or a trademark or brand name associated with a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, tenancy rights, stage carriage permits and loom hours shall not be *nil*, but will be deemed to be the cost for which the previous owner of the property acquired it: Where the capital asset became the property of the assessee —
- (a) On any distribution of assets on the total or partial partition of a Hindu undivided family.
 - (b) Under a gift or will.
 - (c) By succession, inheritance or devolution.
 - (d) On any distribution of assets on the liquidation of a company.
 - (e) Under a transfer to a revocable or an irrevocable trust.
 - (f) Under any transfer referred to in section 47(iv)/ (v)/ (vi)/ (via)/ (viaa)/ (viab)/ (vib)/ (vic)/ (vica)/ (vicb)/ (vicc)/ (xiii)/ (xiiib) or (xiv)
 - (g) Where the assessee is a Hindu undivided family, by the mode referred to in section 64(2).

- (2) **Financial assets** - Many times persons who own shares or other securities become entitled to subscribe to any additional shares or securities. Further, they are also allotted additional shares or securities without any payment. Such rights entitlement or shares or securities are referred to as financial assets in Income-tax Act. Section 55 provides the basis for ascertaining the cost of acquisition of such financial assets.
- (i) **Original shares (which form the basis of entitlement of rights shares):** In relation to the original financial asset on the basis of which the assessee becomes entitled to any additional financial assets, cost of acquisition means the amount actually paid for acquiring the original financial assets.
 - (ii) **Rights entitlement (which is renounced by the assessee in favour of a person):** In relation to any right to renounce the said entitlement to subscribe to the financial asset, when such a right is renounced by the assessee in favour of any person, cost of acquisition shall be taken to be *nil* in the case of such assessee.
 - (iii) **Rights shares acquired by the assessee:** In relation to the financial asset, to which the assessee has subscribed on the basis of the said entitlement, cost of acquisition means the amount actually paid by him for acquiring such asset.
 - (iv) **Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement:** In the case of any financial asset purchased by the person in whose favour the right to subscribe to such assets has been renounced, cost of acquisition means the aggregate of the amount of the purchase price paid by him to the person renouncing such right and the amount paid by him to the company or institution for acquiring such financial asset.
 - (v) **Bonus Shares:** In relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial assets, **cost of acquisition shall be taken to be nil in the case of such assessee.**
- In other words, where bonus shares are allotted without any payment on the basis of holding of original shares, the cost of such bonus shares will be nil in the hands of the original shareholder.
- Bonus shares allotted before 01.04.2001:** However, in respect of bonus shares allotted before 1.4.2001, although the cost of acquisition of the shares is nil, the assessee may opt for the fair market value as on 1.4.2001 as the cost of acquisition of such bonus shares.
- (3) **Equity shares received on demutualisation or corporatisation of a recognised stock exchange** – In relation to equity shares allotted to a shareholder of a recognised stock exchange in India under a scheme for demutualisation or corporatisation approved by SEBI, the cost of acquisition of such shares shall be the cost of acquiring his original membership of the exchange.

(4) **Clearing or trading right acquired on demutualisation or corporatisation of a recognised stock exchange** – The cost of a capital asset, being trading or clearing rights of a recognised stock exchange acquired by a shareholder (who has been allotted equity share or shares under such scheme of demutualisation or corporatisation), shall be deemed to be nil.

(5) **Long-term capital assets referred to in section 112A**

The cost of acquisition in relation to the long-term capital assets being,

- o equity shares in a company on which STT is paid both at the time of purchase and transfer or
- o unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer.

acquired before 1st February, 2018 shall be the higher of

- (i) cost of acquisition of such asset; and
- (ii) lower of
 - (a) the fair market value of such asset; and
 - (b) the full value of consideration received or accruing as a result of the transfer of the capital asset.

Meaning of Fair Market value

| S.No. | Circumstance | Fair Market Value |
|-------|---|---|
| (i) | In a case where the capital asset is listed on any recognised stock exchange as on 31.01.2018 | <p><u>If there is trading in such asset on such exchange on 31.01.2018</u> The highest price of the capital asset quoted on such exchange on the said date</p> <p><u>If there is no trading in such asset on such exchange on 31.01.2018</u> The highest price of such asset on such exchange on a date immediately preceding 31.01.2018 when such asset was traded on such exchange.</p> |
| (ii) | In a case where the capital asset is a unit which is not listed on any recognised stock exchange as on 31.01.2018 | The net asset value of such unit as on the said date |
| (iii) | In a case where the capital asset is an equity share in a company which is - not listed on a recognised stock | An amount which bears to the cost of acquisition the same proportion as CII for the financial year 2017-18 bears to |

| | | |
|--|---|---|
| | <p>exchange as on 31.01.2018 but listed on such exchange on the date of transfer</p> <p>- listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on 31.01.2018 by way of transaction not regarded as transfer under section 47</p> | <p>the CII for the first year in which the asset was held by the assessee or on 01.04.2001, whichever is later.</p> |
|--|---|---|

(6) Any other capital asset–

- (i) **Where the capital asset become the property of the assessee before 1-4-2001,** cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset on 1-4-2001 at the option of the assessee.
- (ii) **Where the capital asset became the property of the assessee by any of the modes specified in section 49(1):** The cost of acquisition to the assessee will be the cost of acquisition to the previous owner. Even in such cases, where the capital asset became the property of the previous owner before 1-4-2001, the assessee has got a right to opt for the fair market value as on 1-4-2001.

However, in case of capital asset referred in (i) and (ii) of (6) above, being land or building or both, the fair market value of such asset on 1-4-2001 shall not exceed the stamp duty value, wherever available, of such asset as on 1-4-2001.

Note: The provisions contained in (i) & (ii) of (6) above shall also apply to the financial assets mentioned in (i) to (v) of (2) and long term capital assets referred to in section 112A of (5) above.

- (iii) **Where the capital asset became the property of the assessee on the distribution of the capital assets of a company on its liquidation** and the assessee has been assessed to capital gains in respect of that asset under section 46, the cost of acquisition means the fair market value of the asset on the date of distribution.
- (iv) **A share or a stock of a company** may become the property of an assessee under the following circumstances:
- the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares.
 - the conversion of any shares of the company into stock,
 - the re-conversion of any stock of the company into shares,

- (d) the sub-division of any of the shares of the company into shares of smaller amount, or
- (e) the conversion of one kind of shares of the company into another kind.

In the above circumstances the cost of acquisition to the assessee will mean the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

- (7) **Where the cost for which the previous owner acquired the property cannot be ascertained**, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

Cost of Acquisition of assets: At a Glance

| Sl. No. | Nature of asset | Cost of acquisition |
|---------|---|---|
| 1 | Goodwill of business, trademark, brand name etc., - - Self generated - Acquired from previous owner | Nil Purchase price |
| 2 | Rights Shares: Original shares (which form the basis of entitlement of rights shares) Rights entitlement (which is renounced by the assessee in favour of a person) Rights shares acquired by the assessee Rights shares which are purchased by the person in whose favour the assessee has renounced the rights entitlement | Amount actually paid for acquiring the original shares Nil Amount actually paid for acquiring the rights shares Purchase price paid to the renouncer of rights entitlement as well as the amount paid to the company which has allotted the rights shares. |
| 3. | Equity shares received on demutualisation or corporatisation of a recognised stock exchange | Cost of acquisition of such shares shall be the cost of acquiring his original membership of the exchange. |
| 4. | Clearing or trading right acquired on demutualisation or corporatisation of a recognised stock exchange | NIL |
| 5. | Long term capital assets being, - equity shares in a company on | Cost of acquisition shall be the higher of |

| | | |
|----|---|---|
| | <p>which STT is paid both at the time of purchase and transfer or</p> <ul style="list-style-type: none"> - unit of equity oriented fund or unit of business trust on which STT is paid at the time of transfer, acquired before 1st February, 2018 | <p>(i) cost of acquisition of such asset; and</p> <p>(ii) lower of</p> <ul style="list-style-type: none"> - the fair market value of such asset; and - the full value of consideration received or accruing as a result of the transfer of the capital asset. |
| 6. | <p>Any other capital asset</p> <p>Where such capital asset became the property of the assessee before 1.4.2001</p> | <p>Cost of the asset to the assessee, or FMV as on 1.4.2001, at the option of the assessee.</p> <p>However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.</p> |
| | <p>Where capital assets became the property of the assessee by way of distribution of assets on total or partial partition of HUF, under a gift or will, by succession, inheritance, distribution of assets on liquidation of a company, etc.</p> | <p>Cost to the previous owner or FMV as on 1.4.2001, at the option of the assessee.</p> <p>However, in case of capital asset being land or building, FMV as on 1.4.2001 shall not exceed stamp duty value as on 1.4.2001.</p> |
| 7. | <p>Where cost of the property in the hands of previous owner cannot be ascertained</p> | <p>The FMV on the date on which the capital asset become the property of the previous owner would be considered as cost of acquisition.</p> |

ILLUSTRATION 6

ABC Ltd. converts its capital asset acquired for an amount of ₹ 50,000 in June, 2003 into stock-in-trade in the month of November, 2017. The fair market value of the asset on the date of conversion is ₹ 4,50,000. The stock-in-trade was sold for an amount of ₹ 6,50,000 in the month of September, 2020. What will be the tax treatment?

| Financial year | Cost Inflation Index |
|-----------------------|-----------------------------|
| 2003-04 | 109 |
| 2017-18 | 272 |
| 2020-21 | 301 |

SOLUTION

The capital gains on the sale of the capital asset converted to stock-in-trade is taxable in the given case. It arises in the year of conversion (i.e. P.Y. 2017-18) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2020-21). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2020-21).

The long-term capital gains and business income for the A.Y.2021-22 are calculated as under:

| Particulars | ₹ | ₹ |
|---|----------|----------|
| Profits and Gains from Business or Profession | | |
| Sale proceeds of the stock-in-trade | 6,50,000 | |
| Less: Cost of the stock-in-trade (FMV on the date of conversion) | 4,50,000 | 2,00,000 |
| Long Term Capital Gains | | |
| Full value of the consideration (FMV on the date of the conversion) | 4,50,000 | |
| Less: Indexed cost of acquisition (₹ 50,000 × 272/109) | 1,24,771 | 3,25,229 |

Note: For the purpose of indexation, the cost inflation index of the year in which the asset is converted into stock-in-trade should be considered.

ILLUSTRATION 7

Ms. Usha purchases 1,000 equity shares in X Ltd., an unlisted company, at a cost of ₹ 30 per share (brokerage 1%) in January 1996. She gets 100 bonus shares in August 2000. She again gets 1,100 bonus shares by virtue of her holding in February 2006. Fair market value of the shares of X Ltd. on April 1, 2001 is ₹ 80.

On 1st January 2021, she transfers all her shares @ ₹ 200 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2021-22

Cost Inflation Index for F.Y. 2001-02: 100, F.Y.2005-06: 117 & F.Y.2020-21: 301.

SOLUTION**Computation of capital gains for the A.Y. 2021-22**

| Particulars | ₹ |
|--|-----------------|
| 1000 Original shares | |
| Sale proceeds (1000 × ₹ 200) | 2,00,000 |
| Less : Brokerage paid (2% of ₹ 2,00,000) | 4,000 |
| Net sale consideration | 1,96,000 |
| Less : Indexed cost of acquisition [₹ 80 × 1000 × 301/100] | 2,40,800 |
| Long term capital loss (A) | (44,800) |
| 100 Bonus shares | |
| Sale proceeds (100 × ₹ 200) | 20,000 |

| | |
|---|-----------------|
| Less: Brokerage paid (2% of ₹ 20,000) | 400 |
| Net sale consideration | 19,600 |
| Less: Indexed cost of acquisition [₹ 80 × 100 × 301/100] [See Note below] | 24,080 |
| Long term capital loss (B) | (4,480) |
| 1100 Bonus shares | |
| Sale proceeds (1100 × ₹ 200) | 2,20,000 |
| Less: Brokerage paid (2% of ₹ 2,20,000) | 4,400 |
| Net sale consideration | 2,15,600 |
| Less: Cost of acquisition | NIL |
| Long term capital gain (C) | 2,15,600 |
| ∴ Long term capital gain (A+B+C) | 1,66,320 |

Note: Cost of acquisition of bonus shares acquired before 1.4.2001 is the FMV as on 1.4.2001 (being the higher of the cost or the FMV as on 1.4.2001).

ILLUSTRATION 8

On January 31, 2021, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of ₹ 70,000 and incurred expenses of ₹ 5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the A.Y. 2021-22.

SOLUTION

The transfer of self-generated goodwill of profession is not chargeable to tax. It is based upon the Supreme Court's ruling in *CIT vs. B.C. Srinivasa Shetty*.

ILLUSTRATION 9

Mr. R holds 1,000 shares in Star Minus Ltd., an unlisted company, acquired in the year 2001-02 at a cost of ₹ 75,000. He has been offered right shares by the company in the month of August, 2020 at ₹ 160 per share, in the ratio of 2 for every 5 held. He retains 50% of the rights and renounces the balance right shares in favour of Mr. Q for ₹ 30 per share in September 2020. All the shares are sold by Mr. R for ₹ 300 per share in January 2021 and Mr. Q sells his shares in December 2020 at ₹ 280 per share. What are the capital gains taxable in the hands of Mr. R and Mr. Q?

| Financial year | Cost Inflation Index |
|----------------|----------------------|
| 2001-02 | 100 |
| 2020-21 | 301 |

SOLUTION

Computation of capital gains in the hands of Mr. R for the A.Y.2021-22

| Particulars | ₹ |
|------------------------------|----------|
| 1000 Original shares | |
| Sale proceeds (1000 × ₹ 300) | 3,00,000 |

| | |
|---|-----------------|
| Less: Indexed cost of acquisition [$\text{₹ } 75,000 \times 301/100$] | 2,25,750 |
| Long-term capital gain (A) | 74,250 |
| 200 Right shares | |
| Sale proceeds ($200 \times \text{₹}300$) | 60,000 |
| Less : Cost of acquisition [$\text{₹}160 \times 200$] [Note 1] | 32,000 |
| Short-term capital gain (B) | 28,000 |
| Sale of Right Entitlement | |
| Sale proceeds ($200 \times \text{₹}30$) | 6,000 |
| Less : Cost of acquisition [Note 2] | NIL |
| Short-term capital gain (C) | 6,000 |
| Capital Gains (A+B+C) | 1,08,250 |

Note 1: Since the holding period of these shares is less than 24 months, they are short term capital assets and hence cost of acquisition will not be indexed.

Note 2: The cost of the rights renounced in favour of another person for a consideration is taken to be nil. The consideration so received is taxed as short-term capital gains in full. The period of holding is taken from the date of the rights offer to the date of the renouncement.

Computation of capital gains in the hands of Mr. Q for the A.Y.2021-22

| Particulars | ₹ |
|---|---------------|
| Sale proceeds (200 shares \times ₹ 280) | 56,000 |
| Less: Cost of acquisition [200 shares \times (₹ 30 + ₹ 160)] [See Note below] | 38,000 |
| Short-term capital gain | 18,000 |

Note: The cost of the rights is the amount paid to Mr. R as well as the amount paid to the company. Since the holding period of these shares is less than 24 months, they are short term capital assets.



7.14 COST OF IMPROVEMENT [SECTION 55]

- (1) **Goodwill of a business, etc.:** In relation to a capital asset being goodwill of a business or a right to manufacture, produce or process any article or thing, or right to carry on any business or profession, the cost of improvement shall be taken to be **Nil**.
- (2) **Any other capital asset:**
 - (i) Where the capital asset became the property of the previous owner or the assessee before 1-4-2001, cost of improvement means all expenditure of a capital nature

incurred in making any addition or alteration to the capital asset on or after the said date by the previous owner or the assessee.

- (ii) In any other case, cost of improvement means all expenditure of a capital nature incurred in making any additions or alterations to the capital assets by the assessee after it became his property.

However, there are cases where the capital asset might become the property of the assessee by any of the modes specified in section 49(1). In that case, cost of improvement means capital expenditure in making any addition or alterations to the capital assets incurred by the previous owner.

However, cost of improvement does not include any expenditure which is deductible in computing the income chargeable under the head "Income from house property", "Profits and gains of business or profession" or "Income from other sources".

ILLUSTRATION 10

X & sons, HUF, purchased a land for ₹ 1,20,000 in the P.Y. 2002-03. In the P.Y. 2006-07, a partition took place when Mr. A, a coparcener, is allotted this plot valued at ₹ 1,50,000. In P.Y. 2007-08, he had incurred expenses of ₹ 2,35,000 towards fencing of the plot. Mr. A sells this plot of land for ₹ 15,00,000 in P.Y. 2020-21 after incurring expenses to the extent of ₹ 20,000. You are required to compute the capital gain for the A.Y.2021-22.

| Financial year | Cost Inflation Index |
|----------------|----------------------|
| 2002-03 | 105 |
| 2006-07 | 122 |
| 2007-08 | 129 |
| 2020-21 | 301 |

SOLUTION

Computation of taxable capital gains for the A.Y.2021-22

| Particulars | ₹ | ₹ |
|--|----------|-----------------|
| Sale consideration | | 15,00,000 |
| Less: Expenses incurred for transfer | | 20,000 |
| | | 14,80,000 |
| Less: (i) Indexed cost of acquisition (₹ 1,20,000 × 301/122) | 2,96,066 | |
| (ii) Indexed cost of improvement (₹ 2,35,000 × 301/129) | 5,48,333 | 8,44,399 |
| Long term capital gains | | 6,35,601 |

Note - As per the view expressed by Bombay High Court in *CIT v. Manjula J. Shah* 16 Taxman 42, 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 indexed cost of acquisition would have to be calculated by considering the Cost Inflation Index of F.Y.2002-03.

ILLUSTRATION 11

Mr. C purchases a house property for ₹ 1,06,000 on May 15, 1975. The following expenses are incurred by him for making addition/alternation to the house property:

| | Particulars | ₹ |
|----|---|----------|
| a. | Cost of construction of first floor in 1982-83 | 3,10,000 |
| b. | Cost of construction of the second floor in 2002-03 | 7,35,000 |
| c. | Reconstruction of the property in 2012-13 | 5,50,000 |

Fair market value of the property on April 1, 2001 is ₹ 8,50,000 and stamp duty value on the said date was ₹ 8,10,000. The house property is sold by Mr. C on August 10, 2020 for ₹ 68,00,000 (expenses incurred on transfer: ₹ 50,000). Compute the capital gain for the assessment year 2021-22.

Cost Inflation Index: F.Y. 2001-02: 100, F.Y. 2002-03: 105, F.Y. 2012-13: 200, F.Y. 2020-21: 301

SOLUTION

Computation of capital gain of Mr. C for the A.Y.2021-22

| Particulars | ₹ | ₹ |
|--|-----------|------------------|
| Gross sale consideration | | 68,00,000 |
| Less: Expenses on transfer | | 50,000 |
| Net sale consideration | | 67,50,000 |
| Less: Indexed cost of acquisition (Note 1) | 24,38,100 | |
| Less: Indexed cost of improvement (Note 2) | 29,34,750 | 53,72,850 |
| Long-term capital gain | | 13,77,150 |

Notes:

Indexed cost of acquisition: ₹ 8,10,000 × 301/100 = ₹ 24,38,100

Fair market value on April 1, 2001 (actual cost of acquisition is ignored as it is lower than market value on April 1, 2001) however, it should not exceed ₹ 8,10,000, being the stamp duty value on 1.4.2001.

Indexed cost of improvement is determined as under:

| Particulars | ₹ |
|---|------------------|
| Construction of first floor in 1982-83 (expenses incurred prior to April 1, 2001 are not considered) | Nil |
| Construction of second floor in 2002-03 (i.e., ₹ 7,35,000 × 301/105) | 21,07,000 |
| Alternation/reconstruction in 2012-13 (i.e., ₹ 5,50,000 × 301/200) | 8,27,750 |
| Indexed cost of improvement | 29,34,750 |



7.15 COMPUTATION OF CAPITAL GAINS IN CASE OF DEPRECIABLE ASSETS [SECTIONS 50 & 50A]

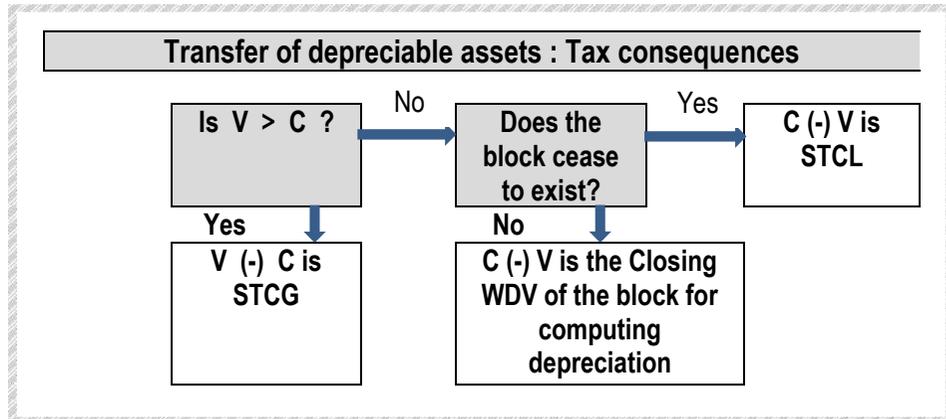
- (1) **Transfer of depreciable assets [Section 50]:** Section 50 provides for the computation of capital gains in case of depreciable assets. It may be noted that where the capital asset is a depreciable asset forming part of a block of assets, section 50 will have overriding effect in spite of anything contained in section 2(42A) which defines a short-term capital asset.

Accordingly, where the capital asset is an asset forming part of a block of assets in respect of which depreciation has been allowed, the provisions of sections 48 and 49 shall be subject to the following modifications:

- Where the full value of consideration received or accruing for the transfer of the asset **plus** the full value of such consideration for the transfer of any other capital asset falling with the block of assets during previous year exceeds the aggregate of the following amounts namely:
 - (1) expenditure incurred wholly and exclusively in connection with such transfer(s);
 - (2) WDV of the block of assets at the beginning of the previous year;
 - (3) the actual cost of any asset falling within the block of assets acquired during the previous year

such excess shall be deemed to be the capital gains arising from the transfer of short-term capital assets.

- Where all assets in a block are transferred during the previous year, the block itself will cease to exist. In such a situation, the difference between the sale value of the assets and the WDV of the block of assets at the beginning of the previous year together with the actual cost of any asset falling within that block of assets acquired by the assessee during the previous year will be deemed to be the capital gains arising from the transfer of short-term capital assets.



| Symbol | Description |
|-------------|---|
| V | Full value of consideration |
| C | Opening WDV of Block (+) Actual Cost of Asset acquired in the Block during the P.Y. (+) Expenses in connection with transfer of asset |
| STCG | Short Term Capital Gain |
| STCL | Short Term Capital Loss |
| WDV | Written Down Value |

- (2) **Cost of acquisition in case of power sector assets [Section 50A]:** With respect to the power sector, in case of depreciable assets referred to in section 32(1)(i), the provisions of sections 48 and 49 shall apply subject to the modification that the WDV of the asset (as defined in section 43(6)), as adjusted, shall be taken to be the cost of acquisition.

ILLUSTRATION 12

Rajawat & Co., a sole proprietorship owns six machines, put in use for business in March, 2020. The depreciation on these machines is charged @15%. The written down value of these machines as on 1st April, 2020 was ₹ 8,50,000. Three of the old machines were sold on 10th June, 2020 for ₹ 11,00,000. A second hand plant was bought for ₹ 8,50,000 on 30th November, 2020.

You are required to:

- (i) determine the claim of depreciation for Assessment Year 2021-22.
- (ii) compute the capital gains liable to tax for Assessment Year 2021-22.
- (iii) If Rajawat & Co. had sold the three machines in June, 2020 for ₹ 21,00,000, will there be any difference in your above workings? Examine.

SOLUTION**(i) Computation of depreciation for A.Y.2021-22**

| Particulars | ₹ |
|---|-----------------|
| W.D.V. of the block as on 1.4.2020 | 8,50,000 |
| Add: Purchase of second hand plant during the year | 8,50,000 |
| | 17,00,000 |
| Less: Sale consideration of old machinery during the year | 11,00,000 |
| W.D.V of the block as on 31.03.2021 | 6,00,000 |

Since the value of the block as on 31.3.2021 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is ₹ 45,000, being 7½% of ₹ 6,00,000.

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

- When one or some of the assets in the block are sold for consideration more than the value of the block.
- When all the assets are transferred for a consideration more than the value of the block.
- When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short-term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2020 for ₹ 21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

| Particulars | ₹ | ₹ |
|---|----------|-----------------|
| Sale consideration | | 21,00,000 |
| Less: W.D.V. of the machines as on 1.4.2020 | 8,50,000 | |
| Purchase of second hand plant during the year | 8,50,000 | 17,00,000 |
| Short term capital gains | | 4,00,000 |



7.16 CAPITAL GAINS IN RESPECT OF SLUMP SALE [SECTION 50B]

- (1) **Long term capital gains** - Any profits or gains arising from the slump sale of one or more undertakings held for more than 36 months, shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

Short term capital gains - Any profits and gains arising from such transfer of one or more undertakings held by the assessee for not more than thirty-six months shall be deemed to be short-term capital gains [Sub-section (1)].

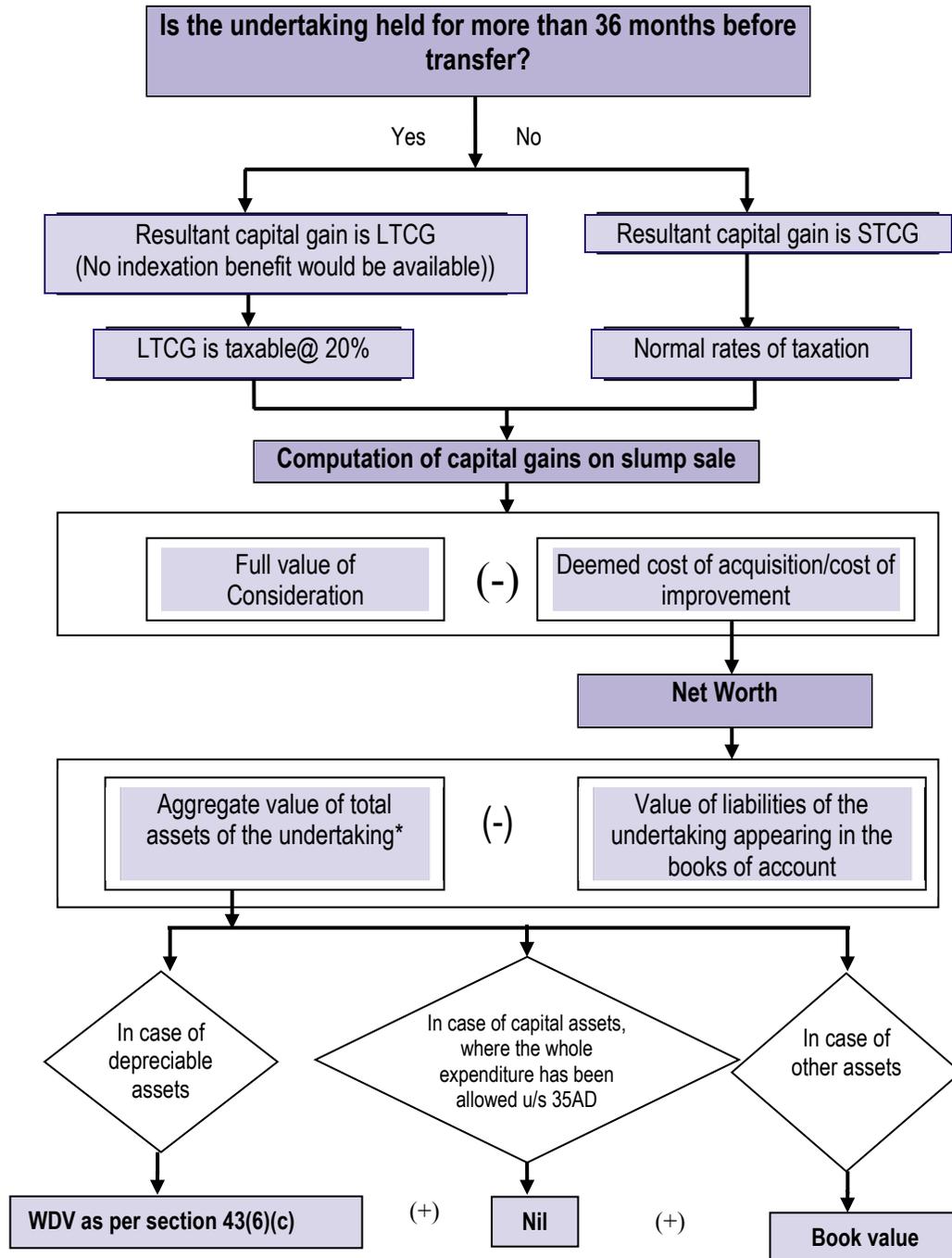
- (2) **Deemed cost of acquisition and cost of improvement** - The net worth of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement for the purposes of sections 48 and 49 in relation to capital assets of such undertaking or division transferred by way of such sale and the provisions contained in the second proviso to section 48 shall be ignored [Sub-section (2)]. It means no indexation benefit would be available

- (3) **Report of a Chartered Accountant** - Every assessee in the case of slump sale shall furnish in the prescribed form **on or before the specified date referred under section 44AB i.e., the date one month prior to the due date for filing return of income under section 139(1)**, a report of a chartered accountant indicating the computation of net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division has been correctly arrived at in accordance with the provisions of this section [Sub-section (3)].

Meaning of Certain Terms:

| Explanation | Term | Particulars |
|-------------|--|--|
| 1 | Net worth | Aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account. However, any change in the value of assets on account of revaluation of assets shall not be considered for this purpose. |
| 2 | Aggregate value of total assets of undertaking or division | In the case of depreciable assets: The written down value of block of assets determined in accordance with the provisions contained in sub-item (C) of item (i) of section 43(6)(c); Capital asset in respect of which 100% deduction is claimed: In case of capital assets in respect of which the whole of the expenditure has been allowed or is allowable as a deduction under section 35AD: Nil ; For all other assets: Book value |

Capital Gains on Slump Sale of an Undertaking [Section 50B]



* Ignore revaluation effect

ILLUSTRATION 13

M/s Sriram Enterprises, a proprietorship having 2 units. Unit 1 is transferred on 1.4.2020 by way of slump sale for a total consideration of ₹ 35 lacs. Unit 1 was started in the year 2005-06. The expenses incurred for this transfer were ₹ 38,000. Balance Sheet as on 31.3.2020 is as under:

| Liabilities | Total (₹) | Assets | Unit 1 (₹) | Unit 2 (₹) | Total (₹) |
|--|------------------|--------------|------------------|-----------------|------------------|
| Own Capital | 17,00,000 | Building | 13,00,000 | 3,00,000 | 16,00,000 |
| Revaluation Reserve (for building of unit 1) | 5,00,000 | Machinery | 4,00,000 | 2,00,000 | 6,00,000 |
| Bank loan (70% for unit 1) | 4,00,000 | Debtors | 2,00,000 | 1,40,000 | 3,40,000 |
| Trade creditors (25% for unit 1) | 3,50,000 | Other assets | 2,50,000 | 1,60,000 | 4,10,000 |
| Total | 29,50,000 | Total | 21,50,000 | 8,00,000 | 29,50,000 |

Other information:

- (i) Revaluation reserve is created by revising upward the value of the building of Unit 1.
- (ii) No individual value of any asset is considered in the transfer deed.
- (iii) Other assets of Unit 1 include patents acquired on 1.7.2018 for ₹ 50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2021-22.

SOLUTION

Computation of capital gains on slump sale of Unit 1

| Particulars | ₹ |
|------------------------------------|------------------|
| Sale value | 35,00,000 |
| Less: Expenses on sale | 38,000 |
| Net sale consideration | 34,62,000 |
| Less: Net worth (See Note 1 below) | 12,60,625 |
| Long-term capital gain | 22,01,375 |

Notes:

1. Computation of net worth of Unit 1 of Akash Enterprises

| Particulars | ₹ | ₹ |
|--|---|----------|
| Building (excluding ₹ 5 lakhs on account of revaluation) | | 8,00,000 |
| Machinery | | 4,00,000 |
| Debtors | | 2,00,000 |
| Patents (See Note 2 below) | | 28,125 |

| | | |
|--------------------------------------|----------|------------------|
| Other assets (₹ 2,50,000 – ₹ 50,000) | | 2,00,000 |
| Total assets | | 16,28,125 |
| Less: Creditors | 87,500 | |
| Bank Loan | 2,80,000 | 3,67,500 |
| Net worth | | 12,60,625 |

2. **Written down value of patents as on 1.4.2020**

| Value of patents | ₹ |
|---|---------------|
| Cost as on 1.7.2018 | 50,000 |
| Less: Depreciation @ 25% for Financial Year 2018-19 | 12,500 |
| WDV as on 1.4.2019 | 37,500 |
| Less: Depreciation for Financial Year 2019-20 | 9,375 |
| WDV as on 1.4.2020 | 28,125 |

For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of ₹ 4 lakh and ₹ 8 lakh (₹ 13 lakh – ₹ 5 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. Since the Unit is held for more than 36 months, capital gain arising would be long-term capital gain. However, indexation benefit is not available in case of slump sale.



7.17 DEEMED FULL VALUE OF CONSIDERATION FOR COMPUTING CAPITAL GAINS [SECTION 50C, 50CA & 50D]

| S. No. | Capital Asset | Section | Circumstance | | Deemed Full Value of consideration for computing Capital Gains |
|--------|--------------------------|---------|--------------|--|--|
| 1. | Land or Building or both | 50C | (1) | If Stamp Duty Value > 110% of consideration received or accruing as a result of transfer | Stamp Duty Value |
| | | | (a) | If date of agreement is different from the date of transfer and whole or part of the consideration is received by way of account payee cheque or bank draft or ECS or through such other prescribed electronic mode (IMPS, UPI, | Stamp Duty Value on the date of agreement |

| | | | | | |
|--|--|--|-----|--|--|
| | | | | RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement | |
| | | | (b) | If date of agreement is different from the date of transfer but the whole or part of the consideration has not been received by way of account payee cheque or bank draft or ECS or through such other prescribed electronic mode (IMPS, UPI, RTGS, NEFT, Net banking, debit card, credit card or BHIM Aadhar Pay) on or before the date of agreement | Stamp Duty Value on the date of transfer |
| | | | | However, if the stamp duty value on the date of agreement or the date of transfer, as the case may be $\leq 110\%$ of the sale consideration received | Actual consideration so received |
| | | | | <p>Example 5:</p> <p>Let us take a case where for transfer of building –</p> <ul style="list-style-type: none"> the actual consideration is ₹ 100 lakh; the stamp duty value on the date of agreement is ₹ 109 lakh; and the stamp duty value on the date of transfer is ₹ 112 lakh <p>(i) If any part of the consideration is paid by prescribed electronic mode on or before the date of agreement</p> <p>The actual consideration of ₹ 100 lakh would be the full value of consideration, since stamp duty value of ₹ 109 lakhs on the date of agreement does not exceed 110% of actual consideration of ₹ 100 lakhs.</p> <p>(ii) If no part of the consideration is paid by prescribed</p> | |

| | | | | | |
|--|--|---------|---|---|---|
| | | | <p>electronic mode on or before the date of agreement</p> <p>Stamp duty value of ₹ 112 lakhs on the date of transfer would be the full value of consideration, since the same exceeds 110% of actual consideration of ₹ 100 lakhs.</p> | | |
| | | | (2) | If the Assessing Officer refers the valuation to a Valuation Officer, on the assessee's claim that the stamp duty value exceeds the FMV of the property on the date of transfer | |
| | | | (a) | If Valuation by Valuation Officer > Stamp Duty Value | Stamp Duty Value |
| | | | (b) | If Valuation by Valuation Officer < Stamp Duty Value | Valuation by Valuation Officer |
| | | 155(14) | (3) | If stamp duty value has been adopted as full value of consideration, and subsequently the value is revised in any appeal or revision | Value so revised in such appeal or revision |
| 2. | Shares other than quoted shares | 50CA | <p>If consideration received or accruing as a result of transfer < FMV of such share determined in the prescribed manner</p> <p>The provisions of this section would not, however, be applicable to any consideration received or accruing as a result of transfer by such class of persons and subject to such conditions as may be prescribed.</p> | | FMV of such share determined in the prescribed manner |
| <p><u>Prescribed class of persons for the purpose of section 50CA</u></p> <p>Rule 11UAD provides that the provisions of section 50CA shall not apply to transfer of any movable property, being unquoted shares, of a company and its subsidiary and the subsidiary of such subsidiary by an assessee, where -</p> <p>(i) the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013, has suspended the Board of Directors of such company and has appointed new directors nominated by the Central Government under section 242 of the said Act; and</p> <p>(ii) share of such company and its subsidiary and the subsidiary of such subsidiary has been transferred pursuant to a resolution plan approved by the Tribunal under section 242 of the Companies Act, 2013 after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.</p> <p>Meaning of certain terms</p> <p>(1) A company shall be a subsidiary of another company, if such other company holds more than half in nominal value of the equity share capital of the company.</p> <p>(2) Tribunal shall have the same meaning assigned to it in section 2(90) of the Companies Act, 2013 i.e., National Company Law Tribunal constituted under section 408 of the said Act.</p> | | | | | |

Note: The fair market value of the shares other than quoted shares would be determined in the manner provided in sub-clause (b) or sub-clause (c), as the case may be, of Rule 11UA(1)(c) and for this purpose the reference to valuation date in the Rule 11U and 11UA shall mean the date on which the capital asset, being share other than quoted shares of a company is transferred (Rule 11UAA) ⁵.

| | | | | |
|----|--------------------------|-----|---|---|
| 3. | Any Capital asset | 50D | 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 | FMV of the said asset on the date of transfer |
|----|--------------------------|-----|---|---|

Meaning of certain terms:

| S. No. | Term | Section | Meaning |
|--------|------------------|---------|---|
| (i) | Stamp Duty Value | 50C | The value adopted or assessed or assessable by any authority of a State Government (Stamp Valuation Authority) for the purpose of payment of stamp duty |
| (ii) | Assessable | 50C | The term 'assessable' has been defined 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" has been added to cover transfers executed through power of attorney. |
| (iii) | Quoted Shares | 50CA | The share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business. |



7.18 ADVANCE MONEY RECEIVED [SECTION 51]

It is possible for an assessee to receive some advance in regard to the transfer of capital asset. Due to the break-down of the negotiation, the assessee may have retained the advance.

Section 51 provides that while calculating capital gains, the above advance retained by the assessee must go to reduce the cost of acquisition. However, if advance has been received and retained by the previous owner and not the assessee himself, then the same will not go to reduce the cost of acquisition of the assessee.

Section 56(2)(ix) provides for the taxability of any sum of money, received as an advance or otherwise in the course of negotiations for transfer of a capital asset. Consequently, such sum shall be chargeable to income-tax under the head 'Income from other sources', if such sum is forfeited on or after 1st April, 2014 and the negotiations do not result in transfer of such capital asset.

⁵ For detailed reading of Rule 11U to 11UAA of the Income-tax Rules, 1962, students may visit <https://www.incometaxindia.gov.in/Pages/default.aspx>

In order to avoid double taxation of the advance received and retained, section 51 provides that where any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset has been included in the total income of the assessee for any previous year in accordance with section 56(2)(ix), then, such amount shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition.

However, any such sum of money forfeited before 1st April, 2014, will be deducted from the cost of acquisition before applying indexation, if any, for computing capital gains.

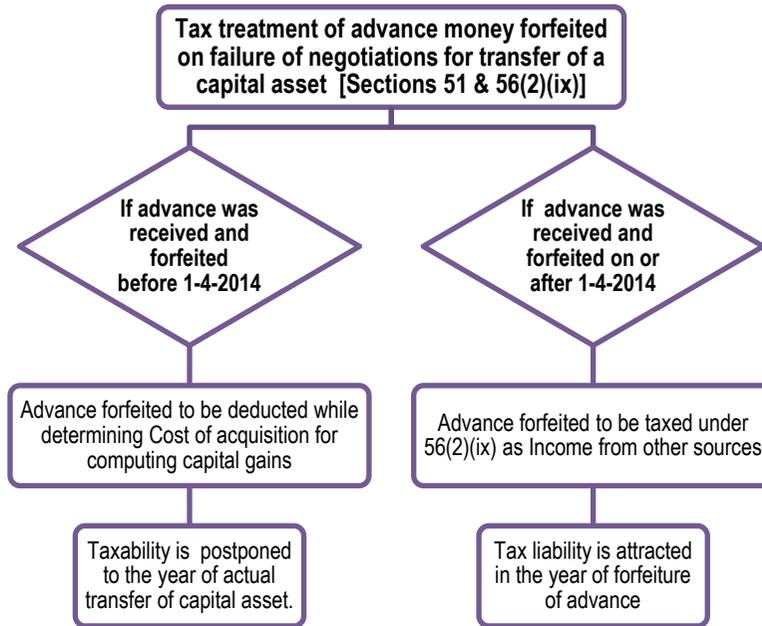


ILLUSTRATION 14

Mr. Kay purchases a house property on April 10, 1992 for ₹ 65,000. The fair market value of the house property on April 1, 2001 was ₹ 2,70,000 and Stamp duty value was ₹ 2,20,000. On August 31, 2004, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for ₹ 3,70,000 and received an amount of ₹ 60,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 2008, Mr. Kay constructed the first floor by incurring a cost of ₹ 2,35,000. Subsequently, in January 2009, Mr. Kay gifted the house to his brother Mr. Dee. On February 10, 2021, Mr. Dee sold the house for ₹ 12,00,000.

CII for F.Y.2001-02: 100; 2004-05: 113; 2008-09: 137; 2020-21: 301.

Compute the capital gains in the hands of Mr. Dee for A.Y.2021-22.

SOLUTION

Computation of taxable capital gains of Mr. Dee for A.Y.2021-22

| Particulars | ₹ | ₹ |
|--|----------|-----------------|
| Sale consideration | | 12,00,000 |
| Less: Indexed cost of acquisition (See Note below) | 4,83,358 | |
| Indexed cost of improvement (See Note below) | 5,16,314 | 9,99,672 |
| Long-term capital gain | | 2,00,328 |

Note: For the purpose of capital gains, holding period is considered from the date on which the house was purchased by Mr. Kay, till the date of sale. However, indexation of cost of acquisition is considered from the date on which the house was gifted by Mr. Kay to Mr. Dee, till the date of sale. i.e. from January 2009 (P.Y. 2008-09) to February, 2021 (P.Y. 2020-21). Since house property was acquired before 1st April, 2001, higher of fair market value on 1.4.2001 or actual cost of acquisition can be considered as cost of acquisition. However, fair market value cannot exceed stamp duty value on 1.4.2001.

Indexed cost of acquisition = (₹ 2,20,000 × 301/137) = ₹ 4,83,358

Indexed cost of improvement = (₹ 2,35,000 × 301/137) = ₹ 5,16,314

Amount forfeited by previous owner, Mr. Kay, shall not be deducted from cost of acquisition.

Alternative view - As per the view expressed by Bombay High Court in *CIT v. Manjula J. Shah 16 Taxman 42*, 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 indexed cost of acquisition would have to be calculated by taking the CII of F.Y.2001-02, since the Fair Market Value as on 1.4.2001 has been taken as the cost of acquisition.

ILLUSTRATION 15

Mr. X purchases a house property in December 1993 for ₹ 5,25,000 and an amount of ₹ 1,75,000 was spent on the improvement and repairs of the property in March, 1997. The property was proposed to be sold to Mr. Z in the month of May, 2007 and an advance of ₹ 40,000 was taken from him. As the entire money was not paid in time, Mr. X forfeited the advance and subsequently sold the property to Mr. Y in the month of March, 2021 for ₹ 52,00,000. The fair value of the property on April 1, 2001 was ₹ 11,90,000 and Stamp duty value on the said date was ₹ 10,20,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2021-22?

| Financial year | Cost Inflation Index |
|----------------|----------------------|
| 2001-02 | 100 |
| 2007-08 | 129 |
| 2020-21 | 301 |

SOLUTION

Capital gains in the hands of Mr. X for the A.Y.2021-22 is computed as under

| Particulars | ₹ |
|--|------------------|
| Sale proceeds | 52,00,000 |
| Less : Indexed cost of acquisition [Note 1] | 29,49,800 |
| Indexed cost of improvement [Note 2] | - |
| Long term capital gains | 22,50,200 |

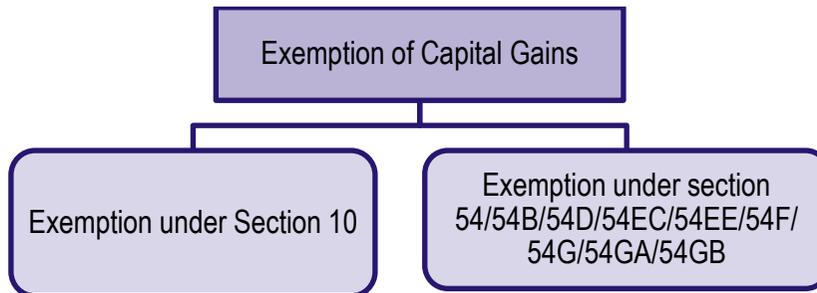
Note 1: Computation of indexed cost of acquisition

| | |
|---|-----------|
| Cost of acquisition (higher of fair market value as on April 1, 2001 and the actual cost of acquisition. Fair market value, however, should not exceed ₹ 10,20,000, being the stamp duty value on 1.4.2001) | 10,20,000 |
| Less: Advance taken and forfeited | 40,000 |
| Cost for the purposes of indexation | 9,80,000 |
| Indexed cost of acquisition (₹ 9,80,000 x 301/100) | 29,49,800 |

Note 2: Any improvement cost incurred prior to 1.4.2001 is to be ignored.



7.19 EXEMPTION OF CAPITAL GAINS



(1) Exemption under section 10

The following are the exemption in respect of capital gains under section 10:

- (i) Exemption of capital gain on transfer of a unit of Unit Scheme, 1964 (US 64) [Section 10(33)]

This clause provides that any income arising from the transfer of specified units, shall be exempt from tax. Such transfer should take place on or after 1.4.2002.

(ii) **Exemption of capital gains on compulsory acquisition of agricultural land situated within specified urban limits [Section 10(37)]**

With a view to mitigate the hardship faced by the farmers whose agricultural land situated in specified urban limits has been compulsorily acquired, clause (37) provide to exempt the capital gains arising to an individual or a HUF from transfer of urban agricultural land by way of compulsory acquisition.

Such exemption is available where the compensation or the enhanced compensation or consideration, as the case may be, is received on or after 1.4.2004.

The exemption is available only when such land has been used for agricultural purposes during the immediately preceding two years from the date of transfer by such individual or a parent of his or by such HUF.

Clarification on taxability of the compensation received by the land owners for the land acquired under the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (RFCTLARR Act) [Circular No. 36/2016, dated 25-10-2016]

The RFCTLARR Act which came into effect from 1st January, 2014, in section 96, inter alia provides that income-tax shall not be levied on any award or agreement made (except those made under section 46) under the RFCTLARR Act. Therefore, compensation received for compulsory acquisition of land under the RFCTLARR Act (except those made under section 46 of RFCTLARR Act), is exempted from the levy of income-tax.

As no distinction has been made between compensation received for compulsory acquisition of agricultural land and non-agricultural land in the matter of providing exemption from income-tax under the RFCTLARR Act, the exemption provided under section 96 of the RFCTLARR Act is wider in scope than the tax-exemption provided under the existing provisions of Income-tax Act, 1961.

The CBDT has clarified that compensation received in respect of award or agreement which has been exempted from levy of income-tax vide section 96 of the RFCTLARR Act shall also not be taxable under the provisions of Income-tax Act, 1961 even if there is no specific provision for exemption of such compensation in the Income-tax Act, 1961.

ILLUSTRATION 16

Mr. Kumar has an agricultural land costing ₹ 6 lakh in Lucknow on 1.4.2003 and has been using it for agricultural purposes till 1.8.2012 when the Government took over compulsory acquisition of this land. A compensation of ₹ 12 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2020. Compute the amount of capital gains taxable in the hands of Mr. Kumar.

Cost Inflation Index: 2003-04: 109, 2012-13: 200, 2020-21: 301

SOLUTION

In the given problem, compulsory acquisition of an urban agricultural land has taken place and the compensation is received after 1.4.2004. This land had also been used for at least 2 years by the assessee himself for agricultural purposes. Thus, as per section 10(37), entire capital gains arising on such compulsory acquisition will be fully exempt and nothing is taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e. A.Y.2021-22.

ILLUSTRATION 17

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Examine.

SOLUTION

As per section 10(37), exemption is available if compulsory acquisition of urban agricultural land takes place. Since the sale is out of own will and desire, the provisions of this section are not attracted and the capital gains arising on such sale will be taxable in the hands of Mr. Kumar.

ILLUSTRATION 18

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Examine and compute the amount of capital gains taxable in the hands of Mr. Kumar, if any.

SOLUTION

As per section 10(37), exemption is available only when such land has been used for agricultural purposes during the preceding two years by such individual or his parent or by such HUF. Since the assessee has not used it for agricultural activities, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of Mr. Kumar in the year of receipt of compensation i.e., A.Y. 2021-22.

Computation of capital gains

| Particulars | Amount (₹) |
|--|------------|
| Sales consideration | 12,00,000 |
| Less: Cost of acquisition (₹ 6,00,000 x 200/109) | 11,00,917 |
| Long term capital Gains | 99,083 |

ILLUSTRATION 19

Will your answer be different if the land belonged to ABC Ltd. and not Mr. Kumar and compensation on compulsory acquisition was received by the company? Examine.

SOLUTION

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If the land belongs to ABC Ltd., a company, the provisions of this section are not attracted and the capital gains arising on such compulsory acquisition will be taxable in the hands of ABC Ltd.

(2) Exemption of Capital Gains under section 54/ 54B/ 54D/ 54EC/54F/ 54G/ 54GA/ 54GB**(i) Capital Gains on sale of residential house [Section 54]**

Eligible assesseees – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of residential house (buildings or lands appurtenant thereto)
- It must be a long-term capital asset
- Income from such house should be chargeable under the head “Income from house property”
- **Where the amount of capital gains exceeds ₹ 2 crore**

Where the amount of capital gain exceeds ₹ 2 crore, **one residential house in India** 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.

Where the amount of capital gains does not exceed ₹ 2 crore

Where the amount of capital gains does not exceed ₹ 2 crore, the assessee i.e., individual or HUF, may at his option,

- purchase **two residential houses in India** within 1 year before or 2 years after the date of transfer (or)
- construct **two residential houses in India** within a period of 3 years after the date of transfer.

Where during any assessment year, the assessee has exercised the option to purchase or construct two residential houses in India, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

This implies that if an assessee has availed the option of claiming benefit of section 54 in respect of purchase of two residential houses in Jaipur and Jodhpur, say, in respect of capital gains of ₹ 1.50 crores arising from transfer of residential house at Mumbai in the P.Y.2020-21 then, he will not be entitled to avail the benefit of section 54 again in respect of purchase of two residential houses in, say, Pune and Baroda,

in respect of capital gains of ₹ 1.20 crores arising from transfer of residential house in Jaipur in the P.Y.2023-24, even though the capital gains arising on transfer of the residential house at Jaipur does not exceed ₹ 2 crore.

- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the Capital Gains Account Scheme (CGAS) [Refer points (ix) and (x) of this sub-heading (2)]. Amount utilised by the assessee for purchase or construction of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of Exemption

- If cost of new residential house or houses, as the case may be \geq Long-term capital gains, entire long-term capital gains is exempt.
- If cost of new residential house or houses, as the case may be $<$ Long-term capital gains, long-term capital gains to the extent of cost of new residential house is exempt

Example 6 - If the long-term capital gains is ₹ 5 lakhs and the cost of the new house is ₹ 7 lakhs, then, the entire long-term capital gains of ₹ 5 lakhs is exempt.

Example 7 - If long-term capital gains is ₹ 5 lakhs and cost of new house is ₹ 3 lakhs, then, long-term capital gains is exempt only upto ₹ 3 lakhs. Balance ₹ 2 lakhs is taxable @ 20%.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its acquisition or construction, then, cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.
- Continuing Example 6, if the new house was sold after 21 months for ₹ 8 lakhs, then short term capital gain chargeable to tax would be –

| Particulars | ₹ |
|---|-----------------|
| Net Consideration | 8,00,000 |
| Less: Cost of acquisition minus capital gains exempt earlier (₹ 7,00,000 – ₹ 5,00,000) | 2,00,000 |
| Short term capital gains chargeable to tax | 6,00,000 |

ILLUSTRATION 20

Mr. Cee purchased a residential house on July 20, 2018 for ₹ 10,00,000 and made some additions to the house incurring ₹ 2,00,000 in August 2018. He sold the house property in April, 2020 for ₹ 20,00,000. Out of the sale proceeds, he spent ₹ 5,00,000 to purchase another house property in September, 2020.

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y. 2021-22?

SOLUTION

The house is sold before 24 months from the date of purchase. Hence, the house is a short-term capital asset and no benefit of indexation would be available.

| Particulars | ₹ |
|---------------------------------|-----------------|
| Sale consideration | 20,00,000 |
| Less: Cost of acquisition | 10,00,000 |
| Cost of improvement | 2,00,000 |
| Short-term capital gains | 8,00,000 |

Note: The exemption of capital gains under section 54 is available only in case of long-term capital asset. As the house is short-term capital asset, Mr. Cee cannot claim exemption under section 54. Thus, the amount of taxable short-term capital gains is ₹ 8,00,000.

(ii) Capital Gains on transfer of agricultural land [Section 54B]

Eligible assessee – Individual & HUF

Conditions to be fulfilled

- There should be a transfer of urban agricultural land.
- Such land must have been used for agricultural purposes by the assessee, being an individual or his parent, or a HUF in the 2 years immediately preceding the date of transfer.
- He should purchase another agricultural land (urban or rural) within 2 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS [Refer points (ix) and (x) of this sub-heading (2)]. Amount utilised by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new agricultural land \geq capital gains, entire capital gains is exempt.
- If cost of new agricultural land $<$ capital gains, capital gains to the extent of cost of new agricultural land is exempt.

Example 8 - If the capital gains is ₹ 3 lakhs and the cost of the new agricultural land is ₹ 4 lakhs, then the entire capital gains of ₹ 3 lakhs is exempt.

Example 9 - If capital gains is ₹ 3 lakhs and cost of new agricultural land is ₹ 2 lakhs, then capital gains is exempt only upto ₹ 2 lakhs.

Consequences of transfer of new agricultural land before 3 years

- If the new agricultural land is transferred before 3 years from the date of its acquisition, then cost of the land will be reduced by capital gains exempted earlier for computing capital gains of new agricultural land.
- However, if the new agricultural land is a rural agricultural land, there would be no capital gains on transfer of such land.
- Continuing Example 8, if the new agricultural land (urban land) is sold after, say, 1 year for ₹ 6 lakhs, then short-term capital gain chargeable to tax would be –

| Particulars | ₹ | ₹ |
|--|---|-----------------|
| Net consideration | | 6,00,000 |
| Less: Cost of acquisition minus capital gains exempt earlier (₹ 4,00,000 – ₹ 3,00,000) | | 1,00,000 |
| Short-term capital gains chargeable to tax | | 5,00,000 |

(iii) Capital Gains on transfer by way of compulsory acquisition of land and building of an industrial undertaking [Section 54D]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be compulsory acquisition of land and building or any right in land or building forming part of an industrial undertaking.
- The land and building should have been used by the assessee for purposes of the business of the industrial undertaking in the 2 years immediately preceding the date of transfer.
- The assessee must purchase any other land or building or any right in land or building or construct any building (for shifting or re-establishing the existing undertaking or setting up a new industrial undertaking) within 3 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS [Refer points (ix) and (x) of this sub-heading (2)]. Amount utilised by the assessee for purchase of new asset and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new asset \geq Capital gains, entire capital gains is exempt.
- If cost of new asset $<$ Capital gains, capital gains to the extent of cost of new asset is exempt.

Note: The exemption in respect of capital gains from transfer of capital asset would be available even in respect of short-term capital asset, being land or building or any right in any land or building, provided such capital asset is used by assessee for the industrial undertaking belonging to him, even if he was not the owner for the said period of 2 years.

Consequences of transfer of new asset before 3 years

- If the new asset is transferred before 3 years from the date of its purchase or construction, then cost of the asset will be reduced by capital gains exempted earlier for computing capital gains.

ILLUSTRATION 21

PQR Ltd., purchased a land for industrial undertaking in May 2004, at a cost of ₹ 3,50,000. The above property was compulsorily acquired by the State Government at a compensation of ₹ 12,00,000 in the month of January, 2021. The compensation was received in February, 2021. The company purchased another land for its industrial undertaking at a cost of ₹ 2,00,000 in the month of March, 2021. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2021-22?

| Financial year | Cost Inflation Index |
|----------------|----------------------|
| 2004-05 | 113 |
| 2020-21 | 301 |

SOLUTION

Computation of capital gains in the hands of PQR Ltd. for the A.Y.2021-22

| Particulars | ₹ |
|---|---------------|
| Sale proceeds (Compensation received) | 12,00,000 |
| Less : Indexed cost of acquisition [₹ 3,50,000 × 301/113] | 9,32,301 |
| | 2,67,699 |
| Less: Exemption under section 54D (Cost of acquisition of land for its undertaking) | 2,00,000 |
| Taxable long-term capital gain | 67,699 |

(iv) Capital Gains not chargeable on investment in certain bonds [Section 54EC]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There should be transfer of a long-term capital asset being land or building or both.
- Such asset can also be a depreciable asset being a building held for more than 24 months. [CIT v. Dempo Company Ltd (2016) 387 ITR 354 (SC)]

- The capital gains arising from such transfer should be invested in a long-term specified asset within 6 months from the date of transfer.
- Long-term specified asset means specified bonds, redeemable after 5 years, issued on or after 1.4.2018 by the National Highways Authority of India (NHAI) or the Rural Electrification Corporation Limited (RECL) or any other bond notified by the Central Government in this behalf.
- The assessee should not transfer or convert or avail loan or advance on the security of such bonds for a period of **5 years** from the date of acquisition of such bonds.

Note - In case of conversion of capital asset into stock in trade and subsequent sale of stock in trade - Period of 6 months to be reckoned from the date of sale of stock in trade for the purpose of section 54EC exemption [CBDT Circular No.791 dated 2-6-2000].

Quantum of exemption

Capital gains or amount invested in specified bonds, whichever is lower.

Ceiling limit for investment in long-term specified asset

The maximum investment which can be made in notified bonds or bonds of NHAI and RECL, out of capital gains arising from transfer of one or more assets, during the previous year in which the original asset is transferred and in the subsequent financial year cannot exceed ₹ 50 lakhs.

Violation of condition

In case of transfer or conversion of such bonds or availing loan or advance on security of such bonds before the expiry of 5 years, the capital gain exempted earlier shall be taxed as long-term capital gain in the year of violation of condition.

ILLUSTRATION 22

Long-term capital gain of ₹ 75 lakh arising from transfer of building on 1.5.2020 will be fully exempt from tax if such capital gain is invested in the bonds redeemable after five years, issued by NHAI under section 54EC. Examine with reasons whether the given statement is true or false having regard to the provisions of the Income-tax Act, 1961.

SOLUTION

False: The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e. bonds of NHAI or RECL or any other bond notified by Central Government in this behalf, redeemable after 5 years) to ₹ 50 lakh, whether such investment is made during the relevant previous year or the subsequent previous year, or both. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of ₹ 50 lakh, provided the investment is made before 1.11.2020 (i.e., within six months from the date of transfer).

(v) Capital gains in cases of investment in residential house [Section 54F]**Eligible assessee:** Individuals/ HUF**Conditions to be fulfilled**

- There must be transfer of a **long-term capital asset, not being a residential house**.
- Transfer of plot of land is also eligible for exemption
- The assessee should -
 - ◆ Purchase **one residential house situated in India** within a period of 1 year before or 2 years after the date of transfer; or
 - ◆ Construct one residential house in India within 3 years from the date of transfer.
- If such investment is not made before the date of filing of return of income, then the net sale consideration has to be deposited under the CGAS [*Refer points (ix) and (x) of this sub-heading (2)*] Amount utilised by the assessee for purchase or construction of new asset and the amount so deposited shall deemed to be the cost of new asset.
- The assessee should not own more than one residential house on the date of transfer.
- The assessee should not –
 - ◆ purchase any other residential house within a period of 2 years or
 - ◆ construct any other residential house within a period of 3 years
 from the date of transfer of the original asset.

Quantum of exemption

- If cost of new residential house \geq Net sale consideration of original asset, entire capital gains is exempt.
- If cost of new residential house $<$ Net sale consideration of original asset, only proportionate capital gains is exempt i.e.

$$\text{LTCG} \times \frac{\text{Amount invested in new residential house}}{\text{Net sale consideration}}$$

ILLUSTRATION 23

From the following particulars, compute the taxable capital gains of Mr. D for A.Y.2021-22 -

| Particulars | Amount (₹) |
|--|-------------------|
| Cost of jewellery [Purchased in F.Y.2005-06] | 4,52,000 |
| Sale price of jewellery sold in January 2021 | 12,50,000 |

| | |
|---|----------|
| Expenses on transfer | 7,000 |
| Residential house purchased in March 2021 | 5,00,000 |

The Cost Inflation Index are as follows:

| Financial Year | Cost Inflation Index |
|----------------|----------------------|
| 2005-06 | 117 |
| 2020-21 | 301 |

SOLUTION

Computation of taxable capital gains for A.Y.2021-22

| Particulars | ₹ |
|--|---------------|
| Gross consideration | 12,50,000 |
| Less: Expenses on transfer | 7,000 |
| Net consideration | 12,43,000 |
| Less: Indexed cost of acquisition ($\text{₹ } 4,52,000 \times 301/117$) | 11,62,838 |
| | 80,162 |
| Less: Exemption under section 54F ($\text{₹ } 80,162 \times \text{₹ } 5,00,000 / \text{₹ } 12,43,000$) | 32,245 |
| Taxable long-term capital gains | 47,917 |

Consequences if the new house is transferred within 3 years from the date of its purchase

- If the new asset is transferred before the expiry of 3 years from the date of its purchase or construction, as the case may be, then the capital gains arises on transfer of the new house and capital gains exempted earlier under section 54F would be taxable as long-term capital gains.
- In the given illustration, if the new residential house is sold for ` 6,00,000 after say, 1 year, then
 - ◆ ₹ 1,00,000 [i.e. ₹ 6,00,000 (-) ₹ 5,00,000] would be chargeable as short-term capital gain of that year in which the new house is sold.

Note – In case the new residential house is sold after 2 years, the capital gains would be long-term capital gains and indexation benefit would be available.

- ◆ ₹ 32,245, being the capital gains exempt earlier, would be taxable as long-term capital gains of the year in which the new house is sold.

Consequences where assessee purchases any other residential house within 2 years or constructs within 3 years from the date of transfer of original asset

The capital gain exempted earlier under section 54F would be deemed to be long-term capital gains and chargeable to tax in the previous year in which such residential house is purchased or constructed.

(vi) Exemption of capital gains for shifting of industrial undertaking from urban areas [Section 54G]

Eligible assessee: Any assessee

Conditions to be fulfilled

- There should be a shifting of the industrial undertaking from an urban area to any other area other than an urban area.
- There should be a transfer of machinery, plant, building or land or any right in building or land used for the business of an industrial undertaking situated in an urban area.
- Such transfer should be in the course of, or in consequence of, shifting the industrial undertaking from an urban area to any other area other than an urban area.
- The capital gain (short-term or long-term) should be utilised for any of the following purposes within 1 year before or 3 years after the date of transfer –
 - ◆ purchase of new plant and machinery for the purposes of business of the industrial undertaking in the area to which the said undertaking is shifted;
 - ◆ acquisition of building or land or construction of building for the purposes of his business in the said area;
 - ◆ shifted the original asset and transferred the establishment of such industrial undertaking from the urban area to the other area;
 - ◆ incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS. [Refer points (ix) at the end of this sub-heading (2)]. Amount utilised by the assessee for purchase of new asset and expenses of shifting and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new assets plus expenses incurred for the specified purpose \geq Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for the specified purpose $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

Consequences if the new asset is transferred within a period of 3 years

If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54G would be deducted from the cost of acquisition of the new asset for the purpose of computation of capital gains in respect of the transfer of the new asset.

(vii) Exemption of capital gains on transfer of certain capital assets in case of shifting of an industrial undertaking from an urban area to any SEZ [Section 54GA]

Eligible assessee – Any assessee

Conditions to be fulfilled

- There must be transfer of capital assets
- Such transfer must be effected in the course of, or in consequence of the shifting of an industrial undertaking from an urban area to any SEZ, whether developed in an urban area or not.
- The capital asset should be either machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situated in an urban area.
- The assessee should, within a period of 1 year before or 3 years after the date of transfer,
 - ◆ purchase machinery or plant for the purposes of business of the industrial undertaking in the SEZ;
 - ◆ acquire building or land or construct building for the purposes of his business in the SEZ;
 - ◆ shifted the original asset and transferred the establishment of such industrial undertaking from the urban area to the SEZ; and
 - ◆ incurred expenses for such other purposes as may be specified in a scheme framed by the Central Government.
- If such investment is not made before the date of filing of return of income, then the capital gain has to be deposited under the CGAS [Refer points (ix) at the end of this sub-heading (2)]. Amount utilised by the assessee for purchase of new asset and expenses of shifting and the amount so deposited shall be deemed to be the cost of new asset.

Quantum of exemption

- If cost of new assets plus expenses incurred for shifting \geq Capital gains, entire capital gains (short-term or long-term) is exempt.
- If cost of new assets plus expenses incurred for shifting $<$ Capital gains, capital gains (short-term or long-term) to the extent of such cost and expenses is exempt.

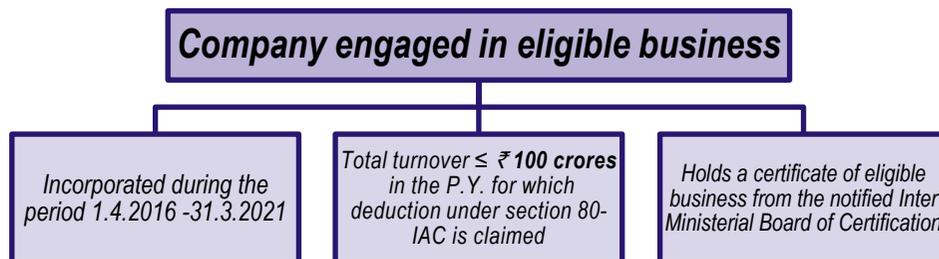
Consequences if the new asset is transferred within a period of 3 years

- If the new asset is transferred within a period of 3 years of its purchase or construction, then the capital gain, which was exempt earlier under section 54GA would be deducted from the cost of acquisition of the new asset for the purpose of computation of capital gains in respect of the transfer of the new asset.

(viii) Exemption of long-term capital gains on transfer of residential property if the net sale consideration is used for subscription in equity shares of an eligible start-up company to be used for purchase of new plant and machinery [Section 54GB]

- Section 54GB exempts 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 net sale consideration in the equity shares of an eligible company being an eligible start-up, which is utilized by the company for the purchase of new plant and machinery.
- In order to qualify as an “eligible company” under section 54GB the company should be –
 - (i) incorporated in the financial year in which the capital gain arises or in the following year on or before the due date of filing return of income by the individual or HUF;
 - (ii) engaged in an eligible business;
 - (iii) a company in which the individual or HUF holds more than **25%** of the share capital or **25%** of the voting rights, after the subscription in shares by the individual or HUF; and
 - (iv) a company which is an eligible start-up.

Meaning of eligible start-up:



Meaning of eligible business:

A business carried out by an eligible start up engaged in

- innovation, development or improvement of products or processes or services or
- a scalable business model with a high potential of employment generation or wealth creation.

Conditions to be fulfilled

- (i) The amount of net consideration should be used by the individual or HUF before the due date of furnishing of return of income under section 139(1), for subscription in equity shares of the eligible company.
- (ii) The amount of subscription as share capital is to be utilized by the eligible company for the purchase of new plant and machinery within a period of one year from the date of subscription in the equity shares.
- (iii) If the amount of net consideration subscribed as equity shares in the eligible company is not utilized by the company for the purchase of plant and machinery before the due date of filing of return by the individual or HUF, the unutilized amount shall be deposited under the CGAS [Refer point (ix) at the end of this sub-heading (2)] on or before due date of filing return of income under section 139. The return of income furnished by the assessee, should be accompanied by the proof of such deposit.
- (iv) The said amount is to be utilized in accordance with any scheme which may be notified by the Central Government in the Official Gazette.

The amount of net consideration utilized by the company for purchase of new plant and machinery and the amount deposited as mentioned in (iv) above, will be deemed to be the cost of new plant and machinery for the purpose of computation of capital gains in the hands of individual or HUF.

New plant and machinery does not include -

- (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
- (ii) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
- (iii) any office appliances including computer and computer software;
- (iv) any vehicle; or
- (v) any machinery or plant, the whole of the actual cost of which is allowed as a deduction, whether by way of depreciation or otherwise, in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

In case of an eligible start-up, being a technology driven start-up so certified by the notified Inter-Ministerial Board of Certification (IMBC), the company can also utilize the amount received as share capital to purchase computers or computer software. This is because computers or computer software form the core asset base of such technology driven start-ups.

- Quantum of exemption under section 54GB

- ◆ If cost of new plant and machinery \geq 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.

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

- The exemption under this section would not be available in respect of transfer of residential property made after **31st March, 2021**.
- If the amount deposited by the company in specified banks/ institutions, is not utilized wholly or partly for the purchase of new plant and machinery within the period specified, then, the amount of capital gains not charged to tax under section 45 on account of such deposit by the company shall be charged to tax under section 45 as income of the assessee for the previous year in which the period of 1 year from the date of subscription in the equity shares by the assessee expires.
- If the equity shares of the company acquired by the individual or HUF or the new plant and machinery acquired by the company **are sold or transferred within a period of five years** from the date of acquisition (within a period of three years from the date of acquisition, in case the new asset is computer or computer software acquired by a technology driven start-up), the amount of capital gains earlier exempt under section 54GB shall be deemed to be the income of the individual or HUF chargeable under the head "Capital Gains" of the previous year in which such equity shares or such new plant and machinery are sold or otherwise transferred. This would be in addition to the capital gains arising on transfer of shares by the individual or HUF or capital gains arising on transfer of new plant and machinery by the company, as the case may be.
- These are safeguards **to restrict the transfer of the shares** of the company and of the plant and machinery **for a period of 5 years (3 years in case of computer or computer software)** to prevent diversion of these funds.

ILLUSTRATION 24

Mr. Akash sold his residential property on 2nd February, 2021 for ₹ 90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2002 for ₹ 24,36,000. In June, 2021, he invested ₹ 75 lakh in equity of A(P) Ltd., an eligible start-up company, which constituted 27% of share capital of the said company. A(P) Ltd. utilized the said sum for the following purposes –

- (a) Purchase of new plant and machinery during July 2021 – ₹ 65 lakh
- (b) Included in (a) above is ₹ 8 lakh for purchase of cars.

(c) Air-conditioners purchased for ₹1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.

(d) Amount deposited in specified bank on 28.9.2021 – ₹10 lakh

Compute the chargeable capital gain for the A.Y.2021-22. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2021 and he files his return on 29.09.2021.

Cost Inflation Index: 2002-03: 105, 2020-21: 301

SOLUTION

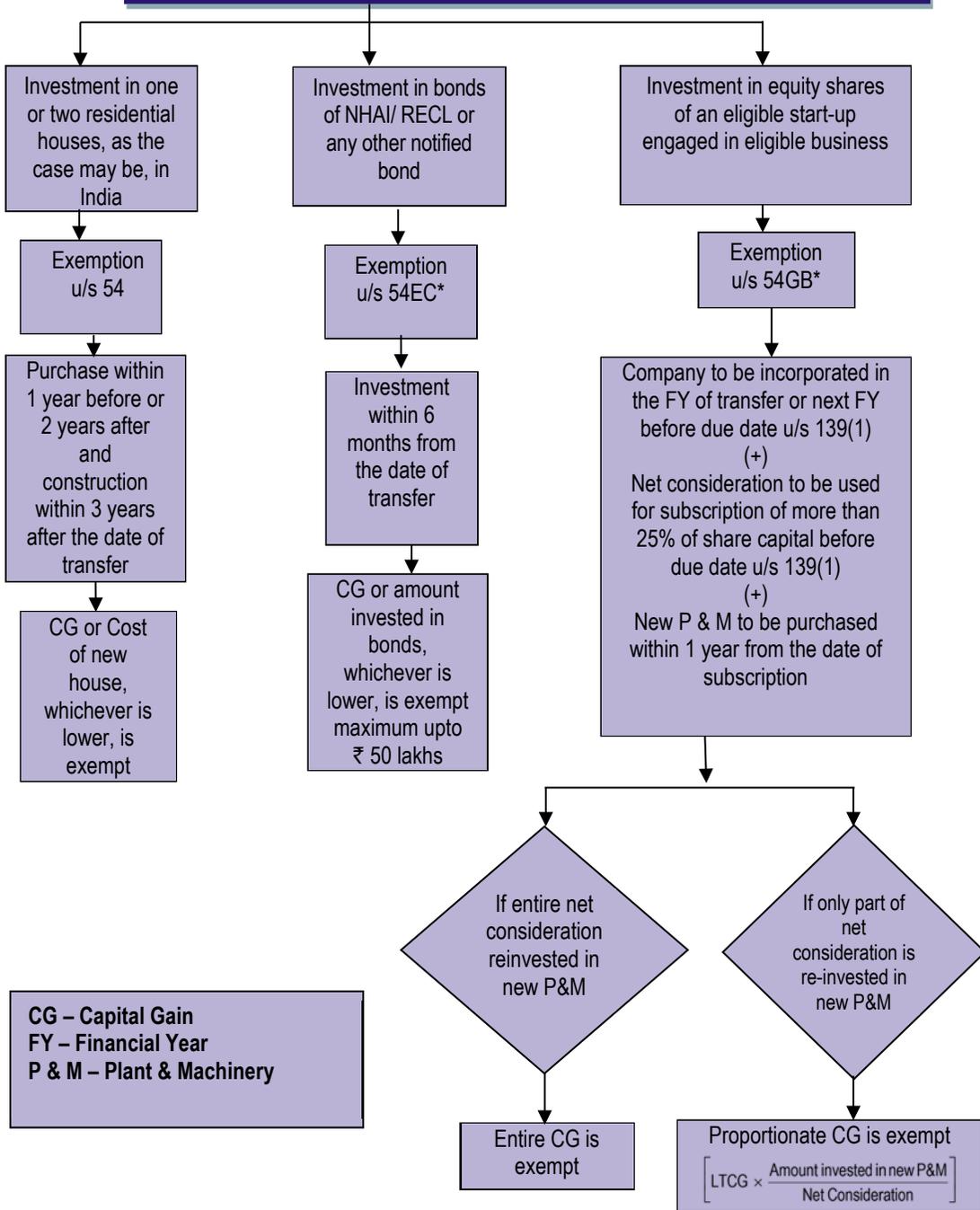
Computation of taxable capital gains for A.Y.2021-22

| Particulars | ₹ |
|--|-----------------|
| Gross consideration | 90,00,000 |
| Less: Expenses on transfer (1% of the gross consideration) | 90,000 |
| Net consideration | 89,10,000 |
| Less: Indexed cost of acquisition (₹ 24,36,000 × 301/105) | 69,83,200 |
| | 19,26,800 |
| Less: Exemption under section 54GB (₹ 19,26,800 × ₹ 66,00,000 / ₹ 89,10,000) | 14,27,259 |
| Taxable long-term capital gains | 4,99,541 |

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

| Particulars | ₹ | ₹ |
|--|----------|------------------|
| (1) Purchase cost of new plant and machinery acquired in July, 2021 | | 65,00,000 |
| Less: Cost of vehicles, i.e., cars | 8,00,000 | |
| Cost of air-conditioners installed at the residence of Mr. Akash | 1,00,000 | 9,00,000 |
| | | 56,00,000 |
| (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 under section 54GB | | 66,00,000 |

Exemption of Long-term Capital Gains on sale of residential house



*The exemption under section 54EC is available in respect of capital gains on transfer of long term capital asset, being land or building or both. The exemption under section 54GB is available in respect of capital gains on transfer of capital asset, being a residential property (a house or a plot of land).

(ix) **Capital Gains Account Scheme (CGAS)**

Under sections 54, 54B, 54D, 54F, 54G, 54GA and 54GB, capital gains is exempt to the extent of investment of such gains/ net consideration (in the case of section 54F) in specified assets within the specified time. If such investment is not made before the date of filing of return of income, then the capital gain or net consideration (in case of exemption under section 54F & 54GB) has to be deposited under the CGAS.

Time limit

Such deposit in CGAS should be made before filing the return of income or on or before the due date of filing the return of income, whichever is earlier. Proof of such deposit should be attached with the return. The deposit can be withdrawn for utilization for the specified purposes in accordance with the scheme.

Consequences if the amount deposited in CGAS is not utilized within the stipulated time of 2 years / 3 years

If the amount deposited is not utilized for the specified purpose within the stipulated period, then the **unutilized amount shall be charged as capital gain** of the previous year in which the specified period expires. In the case of section 54F and 54GB, proportionate amount will be taxable.

CBDT Circular No.743 dated 6.5.96 clarifies that in the event of death of an individual before the stipulated period, the unutilized amount is not chargeable to tax in the hands of the legal heirs of the deceased individual. Such unutilized amount is not income but is a part of the estate devolving upon them.

(x) **Extension of time for acquiring new asset or depositing or investing amount of Capital Gain [Section 54H]**

In case of compulsory acquisition of the original asset, where the compensation is not received on the date of transfer, the period available for acquiring a new asset or making investment in CGAS under sections 54, 54B, 54D, 54EC and 54F would be considered from the date of receipt of such compensation and not from the date of the transfer.



7.20 REFERENCE TO VALUATION OFFICER [SECTION 55A]

Section 55A provides that the Assessing Officer may refer the valuation of a capital asset to a Valuation Officer in the following circumstances with a view to ascertaining the fair market value of the capital asset for the purposes of capital gains -

- (i) In a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of the opinion that the value so claimed is at variance with its fair market value.

Under this provision, the Assessing Officer can make a reference to the Valuation Officer in cases where the fair market value is taken to be the sale consideration of the asset. An Assessing Officer can also make a reference to the Valuation Officer in a case where the fair market value of the asset as on 01.04.2001 is taken as the cost of the asset, if he is of the view that there is any variation between the value as on 01.04.2001 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.

- (ii) If the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of asset as so claimed or by more than ₹ 25,000.
- (iii) The Assessing Officer is of the opinion that, having regard to the nature of asset and other relevant circumstances, it is necessary to make the reference.



7.21 TAX ON SHORT TERM CAPITAL GAINS IN RESPECT OF EQUITY SHARES/ UNITS OF AN EQUITY ORIENTED FUND/ UNITS OF A BUSINESS TRUST [SECTION 111A]

- (1) **Concessional rate of tax in respect of STCG on transfer of certain assets:** This section provides for a concessional rate of tax i.e. 15% on the short-term capital gains on transfer of-
 - (i) an equity share in a company or
 - (ii) a unit of an equity oriented fund or
 - (iii) a unit of a business trust.
- (2) **Conditions:** The conditions for availing the benefit of this concessional rate are –
 - (i) the transaction of sale of such equity share or unit should be entered into on or after 1.10.2004, being the date on which Chapter VII of the Finance (No. 2) Act, 2004 came into force; and
 - (ii) such transaction should be chargeable to securities transaction tax under the said Chapter.

However, short-term capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an International Financial Services Centre (IFSC) would be taxable at a concessional rate of 15% even though STT is not leviable in respect of such transaction.

- (3) **Adjustment of Unexhausted Basic Exemption Limit:** In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then the short-term capital gain will be reduced by the unexhausted basic exemption limit and only the balance

would be taxed at 15%. However, the benefit of availing the basic exemption limit is not available in the case of non-residents.

- (4) **No deduction under Chapter VI-A against STCG taxable under section 111A:** Deductions under Chapter VI-A cannot be availed in respect of such short-term capital gains on equity shares of a company or units of an equity oriented fund or unit of a business trust included in the total income of the assessee.



7.22 TAX ON LONG TERM CAPITAL GAINS [SECTION 112]

- (1) **Concessional rate of tax:** Where the total income of an assessee includes long-term capital gains, tax is payable by the assessee @20% on such long-term capital gains. The treatment of long-term capital gains in the hands of different types of assesseees are as follows -

- (i) **Resident individual or Hindu undivided family:** Income-tax payable at normal rates on total income as reduced by long-term capital gains plus 20% on such long-term capital gains.

Adjustment of Unexhausted Basic Exemption Limit: However, where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax then such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax and the tax on the balance of such long-term capital gains will be calculated @20%.

- (ii) **Domestic Company:** Long-term capital gains will be charged @ 20%.

- (iii) **Non-corporate non-resident or foreign company:**

(i) Long-term capital gains arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which public are substantially interested, would be calculated at the rate of 10% on the capital gains in respect of such asset without giving effect to the indexation provision under second proviso to section 48 and currency fluctuation under first proviso to section 48.

(ii) In respect of other long-term capital gains, the applicable rate of tax would be 20%.

- (iv) **Residents (other than those included in (i) above):** Long-term capital gains will be charged @20%.

- (2) **Lower rate of tax for transfer of listed securities and zero coupon bonds:** Where the tax payable in respect of any income arising from the transfer of a listed security (other than a unit) or a zero coupon bond, being a long-term capital asset, exceeds 10% of the amount of capital gains before indexation, then such excess shall be ignored while computing the tax payable by the assessee i.e. lower of the tax @10% without indexation or tax @20% with indexation benefit.

Consequently, long-term capital gains on transfer of units and unlisted securities are not eligible for concessional rate of tax@10% (without indexation benefit). Therefore, the long-term capital gains, in such cases, are taxable @20% (with indexation benefit).

However, in case of non-corporate non-residents and foreign companies, long-term capital gains arising from transfer of a capital asset, being unlisted securities or shares in a company in which public are not substantially interested are eligible for a concessional rate of tax @10% (without indexation benefit).

- (3) **No deduction under Chapter VI-A against LTCG:** The provisions of section 112 make it clear that the deductions under Chapter VIA cannot be availed in respect of the long-term capital gains included in the total income of the assessee.

Tax on long-term capital gains [Section 112]

| | Person | Rate of tax | Particulars |
|----|--|-------------|---|
| 1. | Resident persons, other than companies | | |
| | Resident Individuals and HUF | 20% | Unexhausted basic exemption limit can be exhausted against LTCG taxable u/s 112 |
| | Resident AOPs and BOIs | 20% | Unexhausted basic exemption limit cannot be adjusted against LTCG taxable u/s 112 |
| | Resident Firms and LLPs | 20% | |
| 2. | Domestic companies | 20% | |
| 3. | Non-corporate non-residents and foreign companies | 20% | Capital assets, other than unlisted securities or shares of closely held companies |
| | | 10% | Unlisted securities or shares of closely held companies (without benefit of indexation or foreign currency fluctuation) |

In case of transfer of listed securities (other than units) and Zero Coupon Bonds, LTCG would be taxable at the lower of the following rates –

- (1) 10% without indexation benefit; and
- (2) 20% with indexation benefit.



7.23 TAX ON LONG TERM CAPITAL GAINS ON CERTAIN ASSETS [SECTION 112A]

- (1) **Concessional rate of tax in respect of LTCG on transfer of certain assets:** In order to minimize economic distortions and curb erosion of tax base, section 112A provides that notwithstanding anything contained in section 112, a concessional rate of tax @10% will be leviable on the long-term capital gains exceeding ₹ 1,00,000 on transfer of –
- an equity share in a company or
 - a unit of an equity oriented fund or
 - a unit of a business trust.
- (2) **Conditions:** The conditions for availing the benefit of this concessional rate are–
- In case of equity share in a company, STT has been paid on acquisition and transfer of such capital asset
 - In case of unit of an equity oriented fund or unit of business trust, STT has been paid on transfer of such capital asset.

However, the Central Government may, by notification in the Official Gazette, specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

Accordingly, the Central Government has, vide notification No. 60/2018, dated 1st October, 2018, notified that the condition of chargeability of STT shall not apply to the acquisition of equity shares entered into

- before 1st October, 2004 or
- on or after 1st October, 2004 which are not chargeable to STT, other than the following transactions.

In effect, only in respect of the following transactions mentioned in column (2), the requirement of paying STT at the time of acquisition for availing the benefit of concessional rate of tax under section 112A would apply. It may be noted that the exceptions are listed in column (3) against the transaction. The requirement of payment of STT at the time of acquisition for availing benefit of concessional tax rate under section 112A will not apply to acquisition transactions mentioned in column (3).

| (1) | (2) | (3) |
|-----|--------------------------------------|---|
| | Transaction | Non-applicability of condition of chargeability of STT |
| (a) | Where acquisition of existing listed | Where acquisition of listed equity share in a company – |
| | (i) | has been approved by the Supreme Court, High Court, |

| | | | |
|------------|--|--------|--|
| | equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue | | National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf; |
| | | (ii) | is by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India; |
| | | (iii) | is by an investment fund referred to in clause (a) of Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer; |
| | | (iv) | is through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply. |
| (b) | Where transaction for acquisition of existing listed equity share in a company is not entered through a recognised stock exchange in India | | Following acquisitions of listed equity share in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956: |
| | | (i) | acquisition through an issue of share by a company other than through preferential issue referred to in (a); |
| | | (ii) | acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business; |
| | | (iii) | acquisition approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf; |
| | | (iv) | acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999; |
| | | (v) | acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India; |
| | | (vi) | acquisition in accordance with Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011; |
| | | (vii) | acquisition from the Government; |
| | | (viii) | acquisition by an investment fund referred to in clause (a) to Explanation 1 to section 115UB or a venture capital fund referred to in section 10(23FB) or a Qualified Institutional Buyer; |

| | | | |
|-----|---|------|---|
| | | (ix) | acquisition by mode of transfer referred to in section 47 (e.g., transfer of capital asset under a gift, an irrevocable trust, transfer of capital asset between holding company and its subsidiary, transfer pursuant to amalgamation, demerger, etc.) or section 50B (slump sale) or section 45(3) (Introduction of capital asset as capital contribution in firm/ AOPs/ BOIs) or section 45(4) (Distribution of capital assets on dissolution of firm/ AOPs/ BOIs) of the Income-tax Act, if the previous owner or the transferor, as the case may be, of such shares has not acquired them by any mode referred to in (a), (b) or (c) listed in column (2) [other than the exceptions listed in column (3)] |
| (c) | acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with SEBI Act, 1992 and the rules made thereunder. | | |

Further, long-term capital gains arising from transaction undertaken on a recognized stock exchange located in an International Financial Service Centre (IFSC) would be taxable at a concessional rate of 10%, where the consideration for transfer is received or receivable in foreign currency, even though STT is not leviable in respect of such transaction.

- (3) **Adjustment of Unexhausted Basic Exemption Limit:** In the case of resident individuals or HUF, if the basic exemption is not fully exhausted by any other income, then such long-term capital gain exceeding ₹ 1 lakh will be reduced by the unexhausted basic exemption limit and only the balance would be taxed at 10%.

However, the benefit of adjustment of unexhausted basic exemption limit is not available in the case of non-residents. It is also not available in case of resident AOPs and BOIs.

- (4) **No deduction under Chapter VI-A against LTCG taxable under section 112A:** Deductions under Chapter VI-A cannot be availed in respect of such long-term capital gains on equity shares of a company or units of an equity oriented fund or unit of a business trust included in the total income of the assessee.
- (5) **No benefit of rebate under section 87A against LTCG taxable under section 112A:** Rebate under section 87A is not available in respect of tax payable @10% on LTCG under section 112A.

Subsequent to insertion of section 112A, the CBDT has issued clarification F. No. 370149/20/2018-TPL dated 04.02.2018 in the form of a Question and Answer format to clarify certain issues raised in different fora relating to the new tax regime for taxation of long-term capital gains. The relevant questions raised and answers to such questions as per the said Circular are given hereunder:

Q 1. What is the meaning of long term capital gains under the new tax regime for long term capital gains?

Ans 1. Long term capital gains mean gains arising from the transfer of long-term capital asset.

It provides for a new long-term capital gains tax regime for the following assets–

- (i). Equity Shares in a company listed on a recognised stock exchange;
- (ii). Unit of an equity oriented fund; and
- (iii). Unit of a business trust.

The new tax regime applies to the above assets, if–

- a. the assets mentioned in (i) & (ii) are held for a minimum period of twelve months from the date of acquisition; and the asset mentioned in (iii) is held for a minimum period of thirty six months; and
- b. the Securities Transaction Tax (STT) is paid at the time of transfer. However, in the case of equity shares acquired after 1.10.2004, STT is required to be paid even at the time of acquisition (subject to notified exemptions).

Q 2. What is the point of chargeability of the tax?

Ans 2. The tax will be levied only upon transfer of the long-term capital asset on or after 1st April, 2018, as defined in clause (47) of section 2 of the Act.

Q 3. What is the method for calculation of long-term capital gains?

Ans 3. The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset.

Q 4. How do we determine the cost of acquisition for assets acquired on or before 31st January, 2018?

Ans 4. The cost of acquisition for the long-term capital asset acquired on or before 31st of January, 2018 will be the actual cost.

However, if the actual cost is less than the fair market value of such asset as on 31st of January, 2018, the fair market value will be deemed to be the cost of acquisition.

Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

Q 5. Please provide illustrations for computing long-term capital gains in different scenarios, in the light of answer to question 4.

Ans 5. The computation of long-term capital gains in different scenarios is illustrated as under

Scenario 1 – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2020 at ₹250. As the actual cost of acquisition is less than the fair market value as on 31st of January, 2018, the fair market value of ₹200 will be taken as the cost of acquisition and the long-term capital gain will be ₹50 (₹250 – ₹200).

Scenario 2 – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2020 at ₹150. In this case, the actual cost of acquisition is less than the fair market value as on 31st of January, 2018. However, the sale value is also less than the fair market value as on 31st of January, 2018. Accordingly, the sale value of ₹150 will be taken as the cost of acquisition and the long-term capital gain will be NIL (₹150 – ₹150).

Scenario 3 – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹50 on 31st of January, 2018 and it is sold on 1st of April, 2020 at ₹150. In this case, the fair market value as on 31st of January, 2018 is less than the actual cost of acquisition, and therefore, the actual cost of ₹100 will be taken as actual cost of acquisition and the long-term capital gain will be ₹50 (₹150 – ₹100).

Scenario 4 – An equity share is acquired on 1st of January, 2017 at ₹100, its fair market value is ₹200 on 31st of January, 2018 and it is sold on 1st of April, 2020 at ₹50. In this case, the actual cost of acquisition is less than the fair market value as on 31st January, 2018. The sale value is less than the fair market value as on 31st of January, 2018 and also the actual cost of acquisition. Therefore, the actual cost of ₹100 will be taken as the cost of acquisition in this case. Hence, the long-term capital loss will be ₹50 (₹50 – ₹100) in this case.

Q 6. Whether the cost of acquisition will be inflation indexed?

Ans 6. Third proviso to section 48, provides that the long-term capital gain will be computed without giving effect to the provisions of the second proviso of section 48. Accordingly, it is clarified that the benefit of inflation indexation of the cost of acquisition would not be available for computing long-term capital gains under the new tax regime.

Q 7. What will be the tax treatment of transfer made on or after 1st April 2018?

Ans 7. The long-term capital gains exceeding ₹1 lakh arising from transfer of these assets made on after 1st April, 2018 will be taxed at 10 per cent. However, there will be no tax on gains accrued upto 31st January, 2018.

Q 8. What is the date from which the holding period will be counted?

Ans 8. The holding period will be counted from the date of acquisition.

Q 9. Whether tax will be deducted at source in case of gains by resident tax payer?

Ans 9.No. There will be no deduction of tax at source from the payment of long-term capital gains to a resident tax payer.

Q 10. What will be the cost of acquisition in the case of bonus shares acquired before 1st February 2018?

Ans 10. The cost of acquisition of bonus shares acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of the bonus shares as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt⁶.

Q 11. What will be the cost of acquisition in the case of right share acquired before 1st February 2018?

Ans 11. The cost of acquisition of right share acquired before 31st January, 2018 will be determined as per section 55(2)(ac). Therefore, the fair market value of right share as on 31st January, 2018 will be taken as cost of acquisition (except in some typical situations explained in Ans 5), and hence, the gains accrued upto 31st January, 2018 will continue to be exempt.

Q 12. What will be the treatment of long-term capital loss arising from transfer made on or after 1st April, 2018?

Ans 12. Long-term capital loss arising from transfer made on or after 1st April, 2018 will be allowed to be set-off and carried forward in accordance with existing provisions of the Act. Therefore, it can be set-off against any other long-term capital gains and unabsorbed loss can be carried forward to subsequent eight years for set-off against long-term capital gains.

The Finance (No. 2) Act, 2019 has levied an enhanced surcharge of 25% and 37%, where the total income of individuals/HUF/AOPs/BOIs exceeds ₹ 2 crores and ₹ 5 crores, respectively. However, the enhanced surcharge is not applicable on tax payable on dividends or tax payable at special rates under section 111A and 112A on short-term and long-term capital gains arising from the transfer of equity share in a company or unit of an equity-oriented fund/ business trust, which has been subject to securities transaction tax. Refer to Chapter 1 containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income.

⁶ Subject to the notification issued by the Central Government to specify the nature of acquisition of equity share in a company on which the condition of payment of STT on acquisition would not be applicable.

ILLUSTRATION 25

Calculate the income-tax liability for the assessment year 2021-22 in the following cases:

| | Mr. Arun (age 52) | Mrs. Binu (age 67) | Mr. Charan (age 83) | Mr. Dharam (age 82) |
|--|------------------------------------|---|--|--------------------------------|
| Status | Resident | Non-resident | Resident | Non-resident |
| Total income other than long-term capital gain | 2,40,000 | 2,80,000 | 5,90,000 | 4,80,000 |
| Long-term capital gain | 15,000 from sale of vacant site | 10,000 from sale of listed equity shares (STT paid on sale and purchase of shares) | 60,000 from sale of agricultural land in rural area | Nil |

Note - Assume that Mr. Arun, Mrs. Binu, Mr. Charan and Mr. Dharam do not opt for section 115BAC.

SOLUTION**Computation of income-tax liability for the A.Y. 2021-22**

| Particulars | Mr. Arun (age 52) | Mrs. Binu (age 67) | Mr. Charan (age 83) | Mr. Dharam (age 82) |
|---|-----------------------------------|---|--|--------------------------------|
| Residential Status | Resident | Non-resident | Resident | Non-resident |
| Applicable basic exemption limit | ₹ 2,50,000 | ₹ 2,50,000 | ₹ 5,00,000 | ₹ 2,50,000 |
| Asset sold | Vacant site | Listed equity shares (STT paid on both sale and purchase of shares) | Rural agricultural land | - |
| Long-term capital gain (on sale of above asset) | ₹ 15,000 [Taxable@20% u/s 112] | ₹ 10,000 [Exempt u/s 112A since it is less than ₹ 1,00,000] | ₹ 60,000 (Exempt since it is not a capital asset) | - |
| Other income | ₹ 2,40,000 | ₹ 2,80,000 | ₹ 5,90,000 | ₹ 4,80,000 |

| | | | | |
|---|------------|----------------|-----------------|-----------------|
| Tax liability | | | | |
| On LTCG (after adjusting unexhausted basic exemption limit of ₹ 10,000) i.e., 20% x ₹ 5,000 | ₹ 1,000 | - | - | - |
| On Other income | Nil | ₹ 1,500 | ₹ 18,000 | ₹ 11,500 |
| | ₹ 1,000 | ₹ 1,500 | ₹ 18,000 | ₹ 11,500 |
| Less: Rebate u/s 87A | ₹ 1,000 | - | - | - |
| | Nil | ₹ 1,500 | ₹ 18,000 | ₹ 11,500 |
| Add: Health and education cess @4% | Nil | ₹ 60 | ₹ 720 | ₹ 460 |
| Total tax liability | Nil | ₹ 1,560 | ₹ 18,720 | ₹ 11,960 |

Notes:

1. Since Mrs. Binu and Mr. Dharam are non-residents, they cannot avail the higher basic exemption limit of ₹ 3,00,000 and ₹ 5,00,000 for persons over the age of 60 years and 80 years, respectively.
2. Since Mr. Arun is a resident whose total income does not exceed ₹ 5 lakhs, he is eligible for rebate of ₹ 12,500 or the actual tax payable, whichever is lower, under section 87A



7.24 SURPLUS ON SALE OF SHARES AND SECURITIES - WHETHER TAXABLE AS CAPITAL GAINS OR BUSINESS INCOME? [CIRCULAR NO. 06/2016, DATED 29-2-2016]

Section 2(14) defines the term "capital asset" to include property of any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets subject to certain exceptions. As regards shares and other securities, the same can be held either as capital assets or stock-in-trade/trading assets or both.

Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

Parameters laid down by CBDT and Courts to distinguish shares held as investments and shares held as stock in trade

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The CBDT has also, through Instruction

No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007, summarized the said principles for guidance of the field formations.

Principles to determine whether gains on sale of listed shares and other securities would constitute capital gains or business income

Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principle in absolute terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), CBDT realizing that major part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs the Assessing Officers to take into account the following while deciding whether the surplus generated from sale of listed shares or other securities would be treated as Capital Gain or Business Income—

- a) **Where assessee opts to treat such shares and securities as stock-in-trade:** Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,
- b) **Listed shares and securities held for a period of more than 12 months:** In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;
- c) **Other cases:** In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

Principles listed above not to apply in case of sham transactions

It is, however, clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long Term Capital Gain/Short Term Capital Loss or any other sham transactions.

Objective of formulation of principles: Reducing litigation and ensuring consistency

It is reiterated that the above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities. All the relevant provisions of the Act shall continue to apply on the transactions involving transfer of shares and securities.

SIGNIFICANT SELECT CASES

1. **Can any transaction which enables the enjoyment of immovable property be considered as enjoyment as a purported owner thereof for being treated as a “transfer” of a capital asset u/s 2(47)(vi) and levy of tax on capital gains arising therefrom?**

Seshasayee Steels P. Ltd. v. ACIT [2020] 421 ITR 46 (SC)

Facts of the case: The assessee did not file a return for A.Y.2004-05. It was detected that the assessee had sold a landed property at Perungudi, Chennai, to a builder for a total consideration of Rs.6,10,00,000, *vide* memo of compromise dated July 19, 2003. Even then, neither any return of income was filed by the assessee-company nor any tax was paid on the capital gains arising out of the sale of the land. Notice under section 148 was issued, and finally order u/s 144 passed taxing the entire sales consideration as capital gains.

The assessee entered into an “agreement to sell” with a builder (V Ltd.) which provided that both parties were entitled to specific performance of the agreement. Under the agreement, the assessee gave permission to the builder to start construction on the land. Pursuant to the agreement, a power of attorney was given by the assessee to a director of the builder-company to execute, and join in execution of, the sale agreements or sale deeds in respect of the subject property after developing it into flats. Subsequently, a memorandum of compromise was entered into between the parties, under which the “agreement to sell” and the “power of attorney” were confirmed, and a sum of Rs. 50 lakhs was reduced from the total consideration of Rs.6.10 crores. Clause 3 of the compromise deed confirmed that the assessee had received a sum of Rs. 4.68 crores out of the agreed sale consideration. Clause 4 recorded that the balance Rs.1.05 crores towards full and final settlement in respect of the agreement entered into would be paid by seven post-dated cheques. Clause 5 stated that the last two cheques would be presented only upon due receipt of the discharge certificate. The Tribunal concurred with the Commissioner (Appeals) view that on or about the date of the agreement to sell (May 15, 1998), the conditions mentioned in section 2(47)(v) could not be stated to have been complied with and thus, section 53A of the Transfer of Property Act, 1882 could not be attracted. The Tribunal held that the transfer took place during A.Y. 2004-05 as the last cheque was dated January 25, 2004. The assessee objected to the levy of capital gains tax in the A.Y.2004-05 and the ex-parte assessment in terms of section 144 read with section 147. The High Court ruled in favour of the Department.

Relevant provision of the Income-tax Act, 1961: Section 2(47) defines “transfer” in relation to a capital asset. Sub-clause (v) deals with any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882; and sub-clause (vi) covers any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any

agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Issue: The issue under consideration is what constitutes “transfer” for purposes of the Act in relation to an immovable property which is contracted to be sold?

Supreme Court’s Observations: In relation to the meaning and scope of “transfer” u/s 2(47)(vi) of the Act, the Supreme Court took note of the following decision in **CIT v. Balbir Singh Maini [2018] 12 SCC 354:**

"... Under section 2(47)(vi), any transaction which has the effect of transferring or enabling the enjoyment of any immovable property would come within its purview.....The object of section 2(47)(vi) appears to be to bring within the tax net a *de facto* transfer of any immovable property. The expression 'enabling the enjoyment of' takes colour from the earlier expression 'transferring', so that it is clear that any transaction which enables the enjoyment of immovable property must be enjoyment as a purported owner thereof. The idea is to bring within the tax net, transactions, where, though title may not be transferred in law, there is, in substance, a transfer of title in fact."

Supreme Court’s Decision: The Supreme Court held that, in this case, the assessee's rights in the said immovable property were extinguished on the receipt of the last cheque, as also that the compromise deed could be stated to be a transaction which had the effect of transferring the immovable property in question. Accordingly, the transaction fell under section 2(47)(ii) and (vi) of the Income-tax Act, 1961. Hence, it is a transfer in relation to the capital asset and capital gains tax liability would be attracted.

2. **Can the amount incurred by the assessee towards perfecting title of property acquired through will, for making further sale, be included in the cost of acquisition for computing capital gains?**

CIT v. Aditya Kumar Jajodia [2018] 407 ITR 107 (Cal)

Facts of the Case: The assessee obtained a leasehold property under a will which gave some interest to a trust and, thus, the assessee's acquisition of the perpetual lease was subject to rights of the trust as flowing from the will. The testator of the trust had also entered into an agreement to sell with a third party. The assessee had to, thus, perfect the ownership title before he transferred the property. For this purpose, he made payment to the Delhi Development Authority (DDA) for conversion of leasehold rights to freehold rights. He also made payments to the trust and to the third party to give up his right under the agreement.

Issue: The issue under consideration is whether the amount incurred by the assessee towards perfecting title of property acquired through will, for making further sale, can be included in the cost of acquisition for computing capital gains.

Assessee’s contention vis-à-vis Assessing Officer’s contention: The assessee contended that his interest in the property was clouded by the rights conferred to the trust by

the will as well as the rights of the third party with whom agreement for sale was entered into by the trust. He could not have transferred the property without taking care of these claims and hence, the payments made to the trust, the third party and the DDA should count towards cost of acquisition. The Assessing Officer, on the other hand, contended that such payments cannot be included in cost of acquisition. The Commissioner (Appeals) and the Tribunal, however, held in favour of the assessee.

High Court's Observations: The High Court observed that the assessee had inherited the immovable property under a will and the costs incurred by him for perfection of the title from perpetual leasehold rights to the complete ownership had to be regarded as a cost of acquisition within the meaning of sections 48 and 55, as the assessee was transferring the complete ownership rights to the transferee, and not the leasehold rights. Further, the High Court took note of the Supreme Court's ruling in *RM. Arunachalam v. CIT [1997] 227 ITR 222* holding that the amount incurred in discharging the mortgage created by the predecessor-in-interest of the assessee has to be regarded as cost of acquisition of the assessee.

The High Court, accordingly, observed that, in this case, the encumbrances were got rid of by the assessee by making certain payment, consequent to which a better title to the property was acquired by the assessee and transferred to the assessee's transferee. The cost of getting rid of such encumbrances in any immovable property had to be accepted as a part of the cost of acquisition of the property, subject, however, to the assessment as to the genuineness and validity of such encumbrances.

High Court's Decision: The High Court, accordingly, held that, the assessee is entitled to deduction of amount incurred towards perfecting title of property acquired under will and the amount incurred towards making payments to the trust and the third party in whose favour rights were created, as cost of acquisition under section 55.

3. **Whether receipt of higher compensation after notification of compulsory acquisition would change the character of transaction into a voluntary sale?**

Balakrishnan v. Union of India & Others (2017) 391 ITR 178 (SC)

Facts of the case: The assessee owned vast area of agricultural land. The State Government acquired the property for development of a techno park. The assessee was awarded compensation of ₹14.37 lakhs. Aggrieved by the amount, the assessee initiated negotiations with the Collector, further to which compensation was increased to ₹38.42 lakhs. The assessee claimed exemption from capital gains under section 10(37)(iii) stating that the transfer of agricultural land was on account of compulsory acquisition. The Revenue authorities contended that the exemption should be denied as it was not a compulsory acquisition but a voluntary sale.

Issue: Whether receipt of higher compensation on account of negotiations transforms the character of compulsory acquisition into a voluntary sale, so as to deny exemption under section 10(37)(iii)?

Supreme Court's Observations: The Supreme Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiations only for securing the market value of the land without having to go to the Court. Merely because the compensation amount is agreed upon during negotiations, the character of acquisition will not change from compulsory acquisition to a voluntary sale. The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

Supreme Court's Decision: The Supreme Court held that when proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition. The claim of exemption from capital gains under section 10(37)(iii) is, therefore, tenable in law.

4. **Whether the Assessing Officer is bound to consider the report of Departmental Valuation Officer (DVO) when it is available on record?**

Principal CIT v. Ravjibhai Nagjibhai Thesisia (2016) 388 ITR 358 (Guj)

Facts of the case: The assessee sold his property for ₹16 lakhs. The State stamp valuation authority valued the property at ₹233.71 lakhs. During the course of assessment proceedings, at the request of the assessee, the Assessing Officer referred the matter of valuation to the DVO who valued the property at ₹24.15 lakhs. The Assessing Officer passed the order before the receipt of the report of the DVO by treating ₹217.71 lakhs (difference between ₹233.71 lakhs and ₹16 lakhs) as undisclosed income. The report of the DVO was received by the Assessing Officer after the date of assessment order but before the order was received by the assessee.

Appellate Authorities' Views: The Commissioner (Appeals) directed the Assessing Officer to compute the capital gain by taking the value given by the DVO. The Revenue carried the matter before Tribunal. The Tribunal agreed with the view of the CIT (Appeals) and dismissed the appeal. The Tribunal relied on *CIT v. Dr. Indra Swaroop Bhatnagar (2012) 349 ITR 210 (All)* which held that the DVO's valuation under section 50C(2) is binding on the Assessing Officer.

Issue: Whether the Assessing Officer having made reference to the DVO must consider the report of the DVO for the purpose of assessment?

High Court's Observations: The High Court observed that when the Assessing Officer has referred the matter to DVO, the assessment has to be completed in conformity with the estimate given by the DVO. As the DVO has estimated the value of the capital asset at an

amount lower than the value assessed by the stamp valuation authority, as per 50C(2), it is such valuation which is required to be taken into consideration for the purposes of assessment.

High Court's Decision: The High Court held that capital gains has to be computed in conformity with the value so determined by the DVO.

5. **Whether indexation benefit in respect of the gifted asset shall apply from the year in which the asset was first held by the assessee or from the year in which the same was first acquired by the previous owner?**

CIT v. Manjula J. Shah (2013) 355 ITR 474 (Bom.)

As per *Explanation 1* to section 2(42A), in case the capital asset becomes the property of the assessee in the circumstances mentioned in section 49(1), *inter alia*, by way of gift by the previous owner, then for determining the nature of the capital asset, the aggregate period for which the capital asset is held by the assessee and the previous owner shall be considered.

As per the provisions of section 48, the profit and gains arising on transfer of a long-term capital asset shall be computed by reducing the indexed cost of acquisition from the net sale consideration. The indexed cost of acquisition meant the amount which bears to the cost of acquisition the same proportion as Cost Inflation Index (CII) for the year in which the asset is transferred bears to the CII for the year in which the asset was first held by the assessee transferring it i.e., the year in which the asset was gifted to the assessee in case of transfer by the previous owner by way of gift.

Facts of the case: In the present case, the assessee had acquired a capital asset by way of gift from the previous owner. The said asset when transferred was a long-term capital asset considering the period of holding by the assessee as well as the previous owner. The assessee computed the long-term capital gain considering the CII of the year in which the asset was first held by the previous owner. The Assessing Officer raised an objection mentioning that as per meaning assigned to the indexed cost of acquisition, the CII of the year in which the asset is first held by the assessee need to be considered and not the CII of the year in which the asset was first held by the previous owner.

High Court's Observations: In the present case, the Bombay High Court observed that by way of 'deemed holding period fiction' created by the statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under Section 48, the assessee must be treated to have held the asset from the year the asset was first held by the previous owner and accordingly the CII for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

High Court's Decision: Hence, the indexed cost of acquisition in case of gifted asset has to be computed with reference to the year in which the previous owner first held the asset and not the year in which the assessee became the owner of the asset.

Note - The Delhi High Court, in the case of **Arun Shungloo Trust v. CIT (2012) 205 Taxman 456 (Delhi)** has also given the similar view on the said issue. The Court observed that as per Explanation (iii) to section 48, the expression 'asset held by the assessee' is not defined and therefore, in the absence of any intention to the contrary, it has to be construed in consonance with the meaning given in section 2(42A). However, the Assessing Officer contended that in cases covered under section 49, the benefit of indexed cost of acquisition will be available only from the date the capital asset was first held by the assessee and not from the date on which the asset was held by the previous owner.

The High Court observed that this will result in inconsistency because as per the provisions of Explanation to section 48, the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, the cost of improvement and indexed cost of improvement, but not for the purpose of indexed cost of acquisition.

In the present case, the Bombay High Court held that by way of 'deemed holding period fiction' created by the Statute, the assessee is deemed to have held the capital asset from the year the asset was held by the previous owner and accordingly, the asset is a long term capital asset in the hands of the assessee. Therefore, for determining the indexed cost of acquisition under section 48, the assessee must be treated to have held the asset from the year in which the asset was first held by the previous owner and accordingly the cost inflation index for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

6. **Would the cost of purchase of land and cost of construction of residential house thereon incurred by the assessee prior to transfer of previously owned residential house property, qualify for exemption under section 54?**

C Aryama Sundaram v. CIT [2018] 407 ITR 1 (Mad)

Facts of the Case: The assessee sold a residential house property for a consideration of ₹12.5 crores on January 15th, 2010. Long-term capital gains arising to the assessee on sale of such property was ₹10.48 crore. In May, 2007, the assessee had purchased a property with a superstructure thereon for a total consideration of ₹15.96 crores and after demolishing the existing superstructure, the assessee constructed a residential house at a cost of ₹18.74 crores. For the A.Y.2010-11, the assessee had claimed exemption of the entire long-term capital gains of ₹10.48 crore under section 54, since it was lower than the cost of construction of ₹34.70 crores.

Assessing Officer's view: The Assessing Officer opined that only that part of the construction expenditure incurred after the sale of the original asset was eligible for exemption under section 54. Based on records, the Assessing Officer calculated the cost

of construction incurred after the sale of the original asset, amounting to ₹1.15 crores and accordingly, allowed exemption only to that extent. The Commissioner (Appeals) upheld the view of the Assessing Officer.

Appellate Tribunal's view: The Tribunal held that section 54 was a beneficial provision and had to be construed liberally on compliance with the conditions stipulated thereunder. The Tribunal observed that the assessee had complied with the following conditions stipulated under section 54 for claim of exemption:

- (a) The assessee should have purchased one residential house in India either one year before or two years after the date of transfer of a residential house which resulted in capital gains or alternatively, constructed a new residential house in India within a period of three years from the date of the transfer of the residential property which resulted in the capital gains.
- (b) If the amount of capital gains is greater than the cost of the residential house so purchased or constructed, the difference between the amount of the capital gains and the cost of the new asset is to be charged under section 45 as the income of the previous year.
- (c) If the amount of the capital gains is equal to or less than the cost of the new residential house, the capital gains shall not be charged under section 45.

Issue: The issue under consideration is whether the cost of purchase of land and cost of construction of residential house thereon incurred by the assessee prior to transfer of previously owned residential house property would qualify for exemption under section 54.

High Court's Observations: The High Court opined that statutory provisions should, to the extent feasible, be construed in accordance with the plain meaning of the language used in those provisions.

According to section 54, capital gains exemption is available in respect of the cost of new residential house purchased or constructed. Section 54(1) is specific and clear in that it mentions cost of new residential house and not just the cost of construction of the new residential house. The cost of the new residential house would necessarily include the cost of the land, materials used in the construction, labour and any other cost relating to the acquisition or construction of the residential house. Also, in this case, the assessee's construction of new house is within the timeline stipulated in section 54(1).

Section 54 does not lay down that construction could not have commenced prior to the date of transfer of the asset that resulted in capital gains. Also, section 54(1) does not contemplate that the same money received from the sale of a residential house should be used in the acquisition of new residential house. This is apparent as section 54 also provides exemption in respect of property purchased one year prior to the transfer of residential house property, which gave rise to the capital gains.

High Court's Decision: The High Court, accordingly, held that, in this case, the cost of land and cost of construction incurred thereon prior to transfer of residential house property also have to be considered for the purpose of capital gains exemption under section 54. As capital gains arising on transfer of previously owned house property of the assessee is less than the cost of the new residential house in this case, the entire capital gains would be exempt under section 54.

7. Where a building, comprising of several floors, has been developed and re-constructed, would exemption under section 54/ 54F be available in respect of the cost of construction of -
- (i) the new residential house (i.e., all independent floors handed over to the assessee); or
 - (ii) a single residential unit (i.e., only one independent floor)?

CIT v. Gita Duggal (2013) 357 ITR 153 (Delhi)

Facts of the case: In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a collaboration agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own costs and expenses. The assessee handed over to the builder, the physical possession of the entire property, along with 22.5% undivided interest over the land. The handing over of the entire property was, however, only for the limited purpose of development. The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment. In addition to the cost of construction incurred by the builder on development of the property, a further amount of ₹ 4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.

Assessee's contention vis-à-vis Assessing Officer's contention: The assessee, in her return of income, showed only ₹ 4 crores as sales consideration. The Assessing Officer, however, took the view that the sale consideration for the transfer should include not only the amount of ₹ 4 crores received by the assessee in cash, but also the cost of construction amounting to ₹ 3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as re-investment in the residential house for exemption under section 54.

However, the Assessing Officer rejected the claim for exemption under section 54 on the ground that the floors obtained by the assessee contained separate residential units having separate entrances and cannot qualify as a single residential unit. He contended that

deduction under section 54F was allowable, and that too only in respect of cost of construction incurred in respect of one unit i.e., one floor.

Appellate Authorities' views: The Commissioner (Appeals), on the basis of the judgment in *CIT v. D. Ananda Basappa [2009] 309 ITR 0329 (Kar.)*, took a contrary view. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: The High Court observed that sections 54 and 54F use the expression "residential house" and not "residential unit" and it is the Assessing Officer who has introduced a new concept of "residential unit" into these sections. Sections 54 and 54F require the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

High Court's Decision: The High Court held that the fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the deduction under section 54 or section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, the assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.

Notes :

- (i) *The Department's Special Leave Petition against the Delhi High Court's judgment was dismissed on 29th August, 2014.*
- (ii) *Section 54 has been amended by the Finance Act, 2019 to permit claim of deduction in respect of two residential houses purchased/constructed, where long-term capital gains on sale of the old residential house does not exceed ₹ 2 crores. However, this case law will still hold good since the exemption for investment in two residential houses cannot be availed -*
 - *where long term capital gains > ₹ 2 crores; and*
 - *more than once where long term capital gains ≤ ₹ 2 crores*

Even in these cases, the benefit of treating individual residential units purchased in a residential complex as one residential house for claiming exemption under section 54 can be availed as per this High Court ruling.

8. **Would an assessee be entitled to exemption under section 54 in respect of purchase of two flats, adjacent to each other and having a common meeting point?**

CIT v. Syed Ali Adil (2013) 352 ITR 0418 (A.P.)

Facts of the case: The assessee-individual had inherited an ancestral house property, which he sold during the relevant previous year. Out of the sale consideration, he purchased two adjacent residential flats. The assessee claimed exemption under section 54 in respect of investment in both the residential flats, in view of the decision of the Karnataka High Court in *CIT v. Ananda Basappa (2009) 309 ITR 329*, wherein investment in two adjacent flats were considered eligible for exemption under section 54.

Assessing Officer's contention: The Assessing Officer, however, restricted the exemption under section 54 only in respect of investment in one residential flat (including stamp duty paid for registration of the flat), contending that –

- (i) the two residential units were separated by a strong wall;
- (ii) the two flats were purchased from two different vendors under two separate sale deeds.

Appellate Authorities' views: The Commissioner (Appeals), however, observed that the assessee was entitled to exemption under section 54 in respect of investment in both the flats, since the two flats had adjacent kitchens and toilets and also had a common meeting point. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: On appeal by the Revenue, the High Court referred to the Karnataka High Court decision in *CIT v. Ananda Basappa (2009) 309 ITR 329*, wherein it was observed that where the flats are situated side by side and the builder had effected the necessary modification to make it as one unit, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds.

The above ruling was also followed by the Karnataka High Court in *CIT v. K.G. Rukminiamma (2011) 331 ITR 211*, wherein it was held that where a residential house was transferred and four flats in a single residential complex were purchased by the assessee, all the four residential flats constituted "a residential house" for the purpose of section 54.

High Court's Decision: The Andhra Pradesh High Court, on the basis of the above rulings of the Karnataka High Court, held that in this case, the assessee was entitled to investment in both the flats purchased by him, since they were adjacent to each other and had a common meeting point, thus, making it a single residential unit.

Note – Section 54 has been amended by the Finance Act, 2019 to permit claim of deduction in respect of two residential houses purchased/constructed, where long-term capital gains on sale of residential house does not exceed ₹ 2 crores.

However, this case law will still hold good since the exemption for investment in two residential houses cannot be availed -

- where long term capital gains > ₹ 2 crores; and
- more than once where long term capital gains ≤ ₹ 2 crores

Even in these cases, the benefit of treating adjacent flats as one residential house for the purpose of exemption under section 54 would be available as per this High Court ruling.

9. **Can exemption under section 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?**

CIT v. Gurnam Singh (2010) 327 ITR 278 (P&H)

Facts of the case: The assessee claimed deduction under section 54B in respect of the land purchased by him along with his son out of the sale proceeds of the agricultural land. However, the same was denied by the Assessing Officer on the ground that the land was registered in the name of the assessee's son.

Tribunal's Observation: The Tribunal observed that the agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the Revenue was that the land was registered in the name of his son. Therefore, it cannot be said that the capital gains were in any way misused for any other purpose contrary to the provisions of law.

High Court's Decision: In this case, the High Court concurred with the Tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the Revenue that the land in question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.

10. **Can exemption under section 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?**

CIT v. Kamal Wahal (2013) 351 ITR 4 (Delhi)

Facts of the case: The assessee sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed deduction under section 54F in respect of the new residential house purchased by him in the name of his wife. However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name.

The Tribunal, however, accepted the assessee's contention observing that since section 54F is a beneficial provision enacted for encouraging investment in residential houses, the said provision has to be interpreted liberally.

High Court's Observations: The Delhi High Court concurred with the Tribunal's view and observed that, for the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name. A similar view was upheld by this Court in *CIT v. Ravinder Kumar Arora (2012) 342 ITR 38*, where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.

Further, in this case, the Delhi High Court observed that the assessee had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife. The entire investment for purchase of new residential house had come out of the sale proceeds of the capital asset (of the assessee) and there was no contribution from his wife.

High Court's Decision: Hence, the Delhi High Court, having regard to the rule of purposive construction and the object of enactment of section 54F, held that the assessee is entitled to claim exemption under section 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.

11. **In case of a house property registered in joint names, whether the exemption under section 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?**

CIT v. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)

Facts of the case: In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

High Court's Decision: Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.

Note - A similar view was taken by the Karnataka High Court in the case of **DIT (IT) v. Mrs. Jennifer Bhide (2011) 203 Taxman 208**, in the context of deductions under section 54 and 54EC, wherein the assessee had sold a residential house property. The assessee, in order to claim exemption of the long-term capital gain, made the investment in the residential house property and bonds jointly in her name and in the name of her husband. The Karnataka High Court, in this case, observed that it was clear from the facts of this case that the entire investment was done by the assessee and no contribution was made by her husband. Therefore, in the present case, it was, held that section 54 and 54EC only stipulate that the capital gain arising on a sale of property is to be invested in a residential house property or in the long-term specified asset i.e., bonds. It is not mandatory in those sections that the investment is to be made in the name of the assessee only. The name of the assessee's husband is shown in the sale deed as well as in the bonds, as a joint owner. However, since the consideration for acquisition flows entirely from the assessee's funds, the assessee is entitled to claim deduction under section 54 and 54EC in respect of the full amount invested. Therefore, in the present case, the exemption under section 54 and 54EC shall not be restricted to 50%, being the share of the assessee in the ownership of the house property and the bonds. The assessee is entitled to 100% exemption of the long-term capital gain so invested in the residential house property and in the bonds.

12. **Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter etc.?**

CIT v. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)

Facts of the case: In this case, the assessee has claimed benefit of exemption under section 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property. However, the Assessing Officer contended that no exemption under section 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of three years from the date of transfer of the shares.

High Court's Observations: The Karnataka High Court observed that the condition precedent for claiming the benefit under section 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house within the stipulated period. If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F. In fact, in this case, the assessee has taken the possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters.

High Court's Decision: The Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

13. **In a case where a depreciable asset held for more than 36 months is transferred, can benefit of exemption under section 54EC be claimed, if the capital gains on sale of such asset are reinvested in long-term specified assets within the specified time?**

CIT v. V.S. Dempo Company Ltd (2016) 387 ITR 354 (SC)

Facts of the case: The assessee sold its loading platform (a depreciable asset, held for 17 years) for ₹137.25 lakhs and re-invested the resultant capital gain in long-term specified assets under section 54EC and claimed exemption thereunder. The Assessing Officer, however, rejected the claim for exemption under section 54EC on the ground that assessee had claimed depreciation on such asset and therefore, the provisions of section 50 were applicable. The Commissioner (Appeals) upheld the order of Assessing Officer.

The Appellate Tribunal, however, allowed the appeal of the assessee, holding that the asset, though a depreciable asset, was held for more than 36 months before its sale and, hence, the reinvestment of capital gains in long-term specified assets is eligible for exemption under section 54EC.

High Court's Observations: The High Court observed that section 50 is a special provision for computation of capital gains in the case of depreciable asset, and has limited application in the context of computation of capital gains to the extent that the provisions of sections 48 and 49 would apply with the modifications stated thereunder. It does not deal with exemption which is provided in a totally different provision i.e. section 54EC.

The High Court referred the decision of the Bombay High Court in the case of *CIT v. ACE Builders (P) Ltd (2006) 281 ITR 210 (Bom)*, wherein it was analysed that the assessee cannot be denied exemption under section 54EC, because firstly, there is nothing in section 50 to suggest that the fiction created therein is not restricted to only sections 48 and 49. Secondly, fiction created by the legislature has to be confined for the purpose for which it is created. Thirdly, section 54EC does not make any distinction between depreciable and non-depreciable asset for the purpose of re-investment of capital gains in long term specified assets for availing the exemption thereunder. Further, section 54EC specifically provides that when the capital gain arising on the transfer a long-term capital asset is invested or deposited in long-term specified assets, the assessee shall not be subject to capital gains to that extent. Therefore, the exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50.

Supreme Court's Decision: The Apex Court, concurred with the view of the High Court holding that since the depreciable asset is held for more than 36 months and the capital gains are re-invested in long-term specified assets within the specified period, exemption under section 54EC cannot be denied.

Note: *The case in respect of which decision is rendered pertained to the assessment year 1989-90, and the above decision was in relation to exemption contained in section 54E. The rationale of the above decision can also be applied in the current context in relation to the exemption allowable under section 54EC on re-investment of capital gains arising on transfer of depreciable asset, **being building**, in long-term specified assets being bonds issued by NHA/RECL or other notified bonds within six months from the date of transfer.*

14. Where the stamp duty value under section 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption under section 54F, irrespective of the source of funds for such reinvestment?

Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)

Facts of the case: In the present case, the assessee sold a plot of land for ₹ 20 lakhs and reinvested the sale consideration of ₹ 20 lakhs together with agricultural income of ₹ 4 lakhs, in construction of a residential house. The assessee claimed capital gains exemption under section 54F, taking into consideration the entire investment of ₹ 24 lakhs. The Assessing Officer, applying the provisions of section 50C, deemed the stamp duty value of ₹ 36 lakhs as the full value of consideration since the consideration received or accruing as a result of transfer of capital asset (i.e. ₹ 20 lakhs) was less than the value adopted by the stamp valuation authority (i.e., ₹ 36 lakhs). The same was not disputed by the assessee before the Assessing Officer.

Assessing Officer's contention vis-a-vis Assessee's contention: The Assessing Officer allowed exemption under section 54F, taking into consideration investment in construction of residential house, to the extent of actual net consideration of ₹ 20 lakhs. He did not consider the balance amount of ₹ 4 lakhs, invested in the construction of residential house, out of agricultural income, for computation of exemption under section 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of ₹ 36 lakhs, was more than the amount of ₹ 24 lakhs invested in the new house.

The assessee contended that the entire investment of ₹ 24 lakhs made in construction of the residential house should be considered for computation of exemption under section 54F, irrespective of the source of funds for such reinvestment. Further, the assessee also contended before the High Court that the registration value adopted under section 50C was excessive and disproportionate to the market value of the property.

High Court's Observations: On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the Assessing Officer, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a Valuation Officer for assessing the fair market value of the property. The High Court held that when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value. Hence, the value of ₹ 36 lakhs adopted under section 50C has to be deemed as the full value of consideration.

High Court's Decision: On the issue of exemption under section 54F, the High Court held that when capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ₹ 36 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ₹ 24 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment.

15. **Can exemption under section 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six months period?**

Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)

High Court's Observations: In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period.

High Court's Decision: For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

16. **Can advance given for purchase of land, building, plant and machinery tantamount to utilization of capital gain for purchase and acquisition of new machinery or plant and building or land, for claim of exemption under section 54G?**

Fibre Boards (P) Ltd v. CIT (2015) 376 ITR 596 (SC)

Facts of the case: The assessee-company had an industrial unit in Thane, which had been declared a notified urban area by notification dated September 22, 1967, issued under section 280Y(d) of the Income-tax Act, 1961. The assessee, in order to shift its industrial undertaking from an urban area to a non-urban area, sold its land, building and plant and machinery situated at Thane and out of the capital gains so earned, paid advances of various amounts to different persons for purchase of land, plant and machinery, construction of factory and building in the year 1991-92. The assessee claimed exemption under section 54G of the Income-tax Act, 1961, on the capital gains earned from the sale proceeds of its erstwhile industrial undertaking situated in Thane in view of the advances so made, which was more than the capital gains earned by it. The Assessing Officer refused to grant exemption to the assessee under section 54G on the ground that the non-urban area had not been declared to be so by any general or special order of the Central Government and that giving advances did not amount to utilisation of capital gains for acquiring the assets.

Appellate Authorities' views: The CIT (Appeals) dismissed the case of the assessee while the Appellate Tribunal allowed the appeal by stating that even an agreement to purchase is good enough and that Explanation to section 54G is declaratory in nature and would be retrospectively applicable.

High Court's Decision: The High Court reversed the order of the Appellate Tribunal and denied the exemption on the reasoning that the notification declaring Thane to be an urban area stood repealed with the repeal of the section under which it was made. Further the expression "purchase" in the section 54G cannot be equated with the expression "towards purchase" and accordingly the advance for purchase of land, plant and machinery would not entitle the assessee to claim exemption under section 54G.

Supreme Court's Observations: The Apex Court observed that, on a conjoint reading of the Speech of the Finance Minister introducing the Finance Bill, 1987, and the Notes on Clauses and Memorandum explaining the provisions of the Finance Bill of 1987, it becomes clear that the idea of omitting section 280ZA of the Income-tax Act, 1961 and introducing section 54G on the same date was to do away with the tax credit certificates scheme together with the prior approval required by the Board and to substitute the repealed provision with the new scheme contained in section 54G. Once section 280ZA was omitted from the statute book, section 280Y(d) having no independent existence would for all practical purposes also cease to exist. Section 280Y(d) which was a definition section defining "urban area" for the purpose of section 280ZA alone was also omitted subsequently by the Finance Act, 1990. Apart from this, section 54G(1) by its *Explanation* introduces the very definition contained in section 280Y(d) in the same terms. It is obvious that both provisions are not expected to be applied simultaneously and it is clear that the *Explanation* to section 54G(1) repeals, by implication, section 280Y(d).

Unlike section 6 of the General Clauses Act, 1897 which saves certain rights, section 24 merely continues notifications, orders, schemes, rules, etc., that are made under a Central Act which is repealed and re-enacted with or without modification. The idea of section 24 of the 1897 Act is, as its marginal note shows, to continue uninterrupted subordinate legislation that may be made under a Central Act that is repealed and re-enacted with or without modification.

Section 54G gives a time limit of 3 years after the date of transfer of capital asset in the case of shifting of industrial undertaking from urban area to any area other than urban area. The expression used in section 54G(2) is that the amount "which is not utilized by him for all or any of the purposes aforesaid has to be deposited in the capital gain account scheme".

For the purpose of availing exemption, all that was required for the assessee is to "utilise" the amount of capital gain for purchase and acquisition of new machinery or plant and building or land. Since the entire amount of capital gain, in this case, was utilized by the assessee by way of advance for acquisition of land, building, plant and machinery, the assessee was entitled to avail exemption/deduction under section 54G.

Supreme Court's Decision: To avail exemption under section 54G in respect of capital gain arising from transfer of capital assets in the case of shifting of industrial undertaking from urban area to non-urban area, the requirement is satisfied if the capital gain is given as advance for acquisition of capital assets such as land, building and / or plant and machinery.

Note – In this case, two issues have been touched upon, namely, whether notification of an area as an urban area under a repealed provision would hold good under the re-enacted provision and whether advance given for purchase of an eligible asset would tantamount to utilisation of capital gains for purchase of the said asset for availing exemption under section 54G. The former issue was decided taking support from section 24 of the General Clauses Act, 1897, which provides for uninterrupted subordinate legislation in case of repeal and re-enactment, with or without modification. The latter issue was also decided in favour of the assessee by holding that payment of advance for purchase of eligible asset would tantamount to utilisation of capital gains for purchase of the said asset.

17. **Would sale of fertilizer bonds (issued in lieu of government subsidy) at loss be treated as a business loss or a loss under the head “Capital gains”?**

Principal CIT v. Gujarat State Fertilizers and Chemicals Limited [2018] 409 ITR 378 (Guj)

Facts of the Case: The assessee is engaged in manufacturing of fertilizers. The sale price of fertilizers is fixed by the Government of India and many a times, such price is even lower than the cost of production. Therefore, to compensate the manufacturer for the difference between the retention price of individual unit and sale price, fertilizer subsidy is given by the Government. Due to cash crunch, sometimes the Government of India discharges its dues of paying the subsidy by issue of fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying.

In this case, when such bonds were sold in the open market, the assessee incurred a loss of ₹ 91,45,000 which it treated as a business loss. The Assessing Officer disallowed the same treating it as a loss under the head “Capital Gains”. The Tribunal, however, allowed the same.

Issue: The issue under consideration is whether sale of fertilizer bonds (issued in lieu of government subsidy) at a loss should be treated as a business loss or a loss under the head “Capital gains”.

High Court’s Observations: The High Court observed that there is no dispute that fertilizer subsidy given to an assessee to compensate the loss on sale of fertilisers should be treated as business income of the assessee. Due to cash crunch, the Government of India had discharged its dues of paying the subsidy by issue of fertilizer bonds. These bonds are saleable in the open market and the prices of such bonds are varying. In this case also, the assessee received fertilizer bonds (in lieu of subsidy) which were sold at a loss in the open market.

High Court’s Decision: The High Court, accordingly, held that since the subsidy would have been treated as business income, loss on sale of fertilizer bonds issued is to be allowed as business loss.

TEST YOUR KNOWLEDGE

Question 1

Hari has acquired a residential house property in Delhi on 15th April, 2002 for ₹9,00,000 and decided to sell the same on 3rd May, 2005 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, 2020, he has sold this house to Mr. Suri for ₹ 40,00,000. On 4th April, 2020, 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, 2021, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2020 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 2021-22.

[Cost inflation Index - 2002-03: 105; 2005-06: 117; 2020-21: 301]

Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2021-22

| Particulars | ₹ |
|--|-----------------|
| Sale proceeds | 40,00,000 |
| Less: Indexed cost of acquisition (See Note 1) | 25,08,333 |
| Long Term Capital Gain | 14,91,667 |
| Less: Exemption under section 54 in respect of investment in house at Delhi (See Note 2) | 8,00,000 |
| Exemption under section 54 in respect of investment in house at Chennai (See Note 3) | 5,00,000 |
| Taxable long-term capital gain | 1,91,667 |

Notes:

1. Computation of indexed cost of acquisition

| Particulars | ₹ |
|--|-----------|
| Cost of acquisition | 9,00,000 |
| Less: Advance taken and forfeited | 25,000 |
| Cost for the purpose of Indexation | 8,75,000 |
| Indexed cost of acquisition (₹ 8,75,000 x 301/105) | 25,08,333 |

Note: Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute indexed cost of acquisition while determining capital gains on sale of such property.

However, in this case, since the advance was received and forfeited in the year 2005, such advance has to be reduced for calculating indexed cost of acquisition for the purpose of arriving at capital gains.

2. In order to avail exemption of capital gains under section 54, 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 31.3.2021 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 As per section 54, since the amount of capital gain does not exceed ₹ 2 crore, Mr. Hari can claim exemption thereunder in respect of investment made in two residential houses situated in India.

However, if Mr. Hari exercises the option to claim exemption in respect of two residential houses in Delhi and Chennai in P.Y. 2020-21, he shall not be subsequently entitled to exercise the option for the same or any other assessment year.

Question 2

The proprietary firm of "Mr. Amolak" a practicing Chartered Accountant, was converted into partnership on 01.09.2020 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

"Mr. Amolak" was credited and paid an amount of ₹ 5 lacs in his account from the firm. Explain as to chargeability of this amount of ₹ 5 lacs in the hands of "Mr. Amolak" when it stands paid for:

- (i) transfer of business into partnership;
- (ii) goodwill by the incoming partner.

Answer

(i) If the amount was paid for transfer of business/ profession to partnership

As per section 45(3), the profits and gains arising from the transfer of a capital asset by a person to the firm in which he becomes a partner shall be chargeable to tax as the income of the previous year in which such transfer takes place. The amount recorded in the books of

account of the firm would be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Since in this case, consideration of ₹ 5 lacs **is received for such transfer**, profit or gain accrues to the transferor for the purposes of section 45. The amount of ₹ 5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) If the amount is paid by the incoming partner for Goodwill

The Supreme Court, in *CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294*, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration “the cost of acquisition of the capital asset”. If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax.

Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in *B.C. Srinivasa Setty's* case would not apply. However, in respect of other self-generated assets, including goodwill of profession, the decision of the Supreme Court in *B.C. Srinivasa Setty's case*, would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability.

Therefore, in this case, since the consideration of ₹ 5 lakhs is paid towards goodwill of a profession, whose cost is **NOT** to be taken as ‘Nil’ since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

Question 3

Mr. Ganesh sold his residential house in Mumbai and earned long term capital gain of ₹ 2.5 crores. He 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 since the long-term capital gain exceeds ₹ 2 crore, sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase 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.*

Examine 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 house.

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 residential house**. Therefore, the contention of the Assessing Officer is not correct.

Question 4

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 2021-22. 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 2021-22 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 one residential house situated in India 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 "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

Question 5

Aries Tubes Private Ltd. went into liquidation on 1.6.2020. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

| | ₹ |
|---|------------------|
| Share Capital (issued on 1.4.2013) | 5,00,000 |
| Reserves prior to 1.6.2020 | 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 gain in long term specified assets as defined in section 54EC. You are required to examine the various issues and advise 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) [chargeable to tax in the hands of shareholders under the head "Income from other sources"] 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 the deemed dividend under section 2(22)(c). The same is taxable in the hands of the shareholder under the head "Income from other sources".

Therefore, ₹ 2,00,000 [i.e. ₹ 2,60,000 minus ₹ 60,000, being the 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 24 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) would be taxable under section 112. The benefit of concessional rate of tax @10% without indexation would also not be available. Hence, such long-term capital gain would be taxable @20% with indexation benefit.

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. Furthermore, with effect from A.Y. 2019-20, exemption under section 54EC is available only on transfer of long-term capital asset, being land or building or both.

Question 6

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.5.2002 for ₹ 5 lacs. The said property was inherited by his son Abraham in financial year 2009-10 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.2.2010 of ₹ 15 lacs. The said house property was sold by Abraham on 16.3.2021 for ₹ 50 lacs. Examine with reasons the amount chargeable to capital gains for A.Y. 2021-22

(Cost Inflation Index 2002-03: 105, 2009-10: 148 and 2020-21: 301).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iii) and therefore, ₹ 5 lacs, being the cost to his father (amount paid by his father on 26.5.2002 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. 2021-22

| 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 × 301/148) | 10,16,892 | |
| (ii) Loan amount paid by Mr. Abraham | | |

| | | |
|--|-----------|-----------------|
| (Benefit of CII is available since the loan amount was paid in the financial year 2009-10) (₹ 15,00,000 × 301/148) | 30,50,676 | 40,67,568 |
| Capital gains | | 9,32,432 |

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. 2009-10.

However, as per the view expressed by Bombay High Court, in the case of *CIT v. Manjula J. Shah (2013) 355 ITR 474*, 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 indexed cost of acquisition would be ₹ 44,84,009 (₹ 14,33,333 + ₹ 30,50,676) and long term capital gain would be ₹ 5,15,991.

Question 7

Gama Ltd, located within the corporation limits decided in December, 2020 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, 2021) | 8 | 18 | 16 | 3 |
| (ii) | Indexed cost of acquisition | 4 | 10 | 12 | 2 |
| (iii) | WDV in terms of section 50 | -- | 4 | 5 | 2 |
| (iv) | Cost of new assets purchased in July, 2021 for the purpose of business in the new place | 4 | 7 | 17 | 2 |

Compute the capital gains of *Gama Ltd* for the assessment year 2021-22.

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 capital 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 asset) | 8,00,000 |
| | Less: Indexed cost of acquisition | 4,00,000 |
| | Long term capital gain | 4,00,000 |
| | Less: Cost of new assets purchased within three year after the date of transfer (under section 54G) (See Note below) | 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: Section 54G [New assets purchased] (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 term 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.

The taxable capital gains would be:

| | |
|--------------------------------------|---|
| Long-term capital gains | ₹ 1,00,000 (taxable @20% under section 112) |
| Short-term capital gains (furniture) | <u>₹ 1,00,000</u> (taxable at applicable tax rates) |
| | <u>₹ 2,00,000</u> |

Question 8

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth ₹ 4 lacs on 1.5.2017 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2020 was ₹ 1,87,850. 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, 2020 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of ₹ 4 lacs from the insurance company on 15th March, 2021. Examine the issues arising on account on the transactions and their tax treatment.

(Cost inflation index for financial year 2008-09 and 2020-21 are 137 and 301 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 as a result of, *inter alia*, accidental fire then, any profits and gains arising from 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 compute 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 | ₹ 4,00,000 |
| Less: Written down value as on April 1 st , 2020 | ₹ <u>1,87,850</u> |
| Short term capital gains | ₹ <u>2,12,150</u> |

Question 9

Tani purchased a land at a cost of ₹ 35 lakhs in the financial year 2004-05 and held the same as her capital asset till 31st May, 2018. Tani started her real estate business on 1st June, 2018 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 ₹ 210 lakhs.

She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is ₹ 10 lakhs. Construction was completed in January, 2021. She sold 10 flats at ₹ 30 lakhs per flat between January, 2021 and March, 2021. The remaining 5 flats were held in stock as on 31st March, 2021.

She invested ₹ 50 lakhs in bonds issued by National Highway Authority of India on 31st March, 2021 and another ₹ 50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2021.

Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2021-22 indicating clearly the reasons for treatment for each item.

Cost Inflation Index: FY 2004-05: 113; FY 2018-19: 280; FY 2020-21: 301.

Answer

Computation of capital gains and business income of Tani for A.Y. 2021-22

| 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) | 2,10,00,000 |
| Less: Indexed cost of acquisition [₹ 35,00,000 × 280/113] | 86,72,566 |
| | 1,23,27,434 |
| Proportionate capital gains arising during A.Y.2021-22 [₹1,23,27,434 × 2/3] | 82,18,289 |
| Less: Exemption under section 54EC | 50,00,000 |
| Capital gains chargeable to tax for A.Y.2021-22 | 32,18,289 |

| | |
|--|------------------|
| Business Income | |
| Sale price of flats [10 × ₹ 30 lakhs] | 3,00,00,000 |
| Less: Cost of flats | |
| Fair market value of land on the date of conversion [₹ 210 lacs × 2/3] | 1,40,00,000 |
| Cost of construction of flats [10 × ₹ 10 lakhs] | 1,00,00,000 |
| Business income chargeable to tax for A.Y.2021-22 | 60,00,000 |

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 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2020-21, only proportionate capital gains (i.e., 2/3rd) would be chargeable in the A.Y.2021-22.
- (5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be computed after deducting the fair market value on the date of conversion of the capital asset into stock-in-trade and cost of construction of flats from the price at which the stock-in-trade is sold.
- (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 NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising in any financial year, the maximum deduction under section 54EC would be ₹ 50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of ₹ 50 lakhs has been made in bonds of NHAI during the P.Y.2020-21 and investment of ₹ 50 lakhs has been made in bonds of RECL during the P.Y.2021-22, both within the stipulated six month period, the maximum deduction allowable

for A.Y.2021-22, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y.2020-21, is only ₹ 50 lakhs.

Question 10

X Limited has transferred its Unit N to Y Limited by way of slump sale on November 30, 2020. 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.

- Lump sum consideration on transfer of Unit N is ₹ 880 lakhs.
- Fixed assets of Unit N include land which was purchased at ₹ 60 lakhs in August 2007 and revalued at ₹ 90 lakhs as on March 31, 2020.
- 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.
- Unit N was set up by X Limited in July, 2007.
- Cost inflation index for financial year 2007-08 and financial year 2020-21 are 129 and 301, respectively.

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@7% | 1.54 |
| | 23.54 |
| Add: Health and Education cess @4% | 0.94 |
| Total tax liability on capital gain arising on slump sale of Unit N | 24.48 |

Notes:

- 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 |

- 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.

Question 11

Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2021:

- Rental income from property at Bangalore - ₹ 3 lakhs, Standard Rent - ₹ 2,50,000, Fair Rent - ₹ 2,80,000.
- Municipal and water tax paid during 2020-21: Current year ₹ 35,000, Arrears - ₹ 1,50,000.
- Interest on loan borrowed towards major repairs to the property: ₹ 1,50,000.

- (iv) Arrears of rent of ₹ 30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai:

- (i) Mr. Singh's father acquired a residential house in April 2006 for ₹ 1,25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 2007.
- (ii) The property, so gifted, was sold by Mr. Singh on 10th June 2020. The consideration received was ₹ 25,00,000.
- (iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was ₹ 3,90,000.
- (iv) Out of the sale consideration received:
- (a) On 02/01/2021, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being ₹ 8,00,000 and ₹ 7,00,000, respectively.
- (b) On 10/10/2020, ₹ 10 lakhs were invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2021.

Compute Mr. Singh's taxable income for assessment year 2021-22.

Cost inflation index: F.Y. 2006-07: 122; F.Y. 2020-21: 301

Answer

Computation of taxable income of Mr. Singh for A.Y.2021-22

| Particulars | ₹ | ₹ |
|---|----------|----------|
| Income from house property | | |
| Gross Annual Value [Higher of Expected Rent & Actual Rent] | | 3,00,000 |
| Expected Rent [lower of Fair Rent and Standard Rent] | 2,50,000 | |
| Actual Rent | 3,00,000 | |
| Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [₹ 35,000 + ₹ 1,50,000] | | 1,85,000 |
| Net Annual Value (NAV) | | 1,15,000 |
| Less: Deductions under section 24 | | |
| (a) 30% of NAV | 34,500 | |
| (b) Interest on loan borrowed for major repairs | 1,50,000 | 1,84,500 |
| | | (69,500) |

| | | |
|--|-----------|-----------------|
| Arrears of rent taxable under section 25A | 30,000 | |
| Less: Deduction@30% | 9,000 | 21,000 |
| | | (48,500) |
| Capital Gains | | |
| Full value of consideration | | 30,00,000 |
| As per section 50C, the full value of consideration would be the higher of - | | |
| Actual Consideration | 25,00,000 | |
| Stamp Duty Value [₹ 3,90,000/13%] | 30,00,000 | |
| Since stamp duty value > 110% of actual consideration | | |
| Less: Indexed cost of acquisition [₹ 1,25,000 × 301/122] | | |
| As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset | | 3,08,402 |
| | | 26,91,598 |
| Less: Exemption under section 54 (₹ 8,00,000 + ₹ 7,00,000) | | |
| Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds] | | |
| [<i>CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)</i>] | 15,00,000 | |
| Note: Since two adjacent flats are treated as one residential house, Mr. Singh can defer availing exemption under section 54 in respect of two residential houses (where capital gains do not exceed ₹2 crores) to a later assessment year. | | |
| Exemption under section 54EC | | |
| Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six months period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months [<i>Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)</i>] | 10,00,000 | 25,00,000 |
| Long-term capital gains | | 1,91,598 |
| Total Income | | 1,43,098 |

Question 12

SS(P) Ltd., an Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., an Indian company, by way of demerger. The net worth of SS(P) Ltd. immediately before demerger was ₹ 40 crores. The net book value of assets transferred to RV(P) Ltd. was ₹ 10 crores. The demerger was made in January 2021. In the scheme of demerger, it was fixed that for each equity share of ₹ 10 each (fully paid up) of SS(P) Ltd., two equity shares of ₹ 10 each (fully paid up) were to be issued.

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2004-05 for ₹ 6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2021. He sold all the shares of RV(P) Ltd. for ₹ 8,00,000 in March, 2021. In this background you are requested to answer the following:

- (i) Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?
- (ii) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.
- (iii) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.
- (iv) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?
- (v) Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd.? If so, mention in brief.

| Note: | Financial Year | Cost inflation index |
|--------------|-----------------------|-----------------------------|
| | 2004-05 | 113 |
| | 2020-21 | 301 |

Answer

- (i) No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) Ltd. or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as "transfer" for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company

- (ii) There would be no capital gains tax liability in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as "transfer" for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.

(iii) Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.

Sale consideration 8,00,000

Less: Indexed cost of acquisition of shares of RV (P) Ltd.

Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C):

Cost of acquisition of shares of SS(P) Ltd. $\times \frac{\text{Net book value of assets transferred in a demerger}}{\text{Net worth of the demerged company immediately before demerger}}$

$$₹6,00,000 \times \frac{10 \text{ crore}}{40 \text{ crore}} = ₹1,50,000$$

Indexed cost of acquisition of shares of RV (P) Ltd. [₹ 1,50,000 \times 301/113] ₹ 3,99,558

Long-term capital gain (since period of holding of shares in demerged company is also to be considered)

₹ 4,00,442

(iv) No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV (P) Ltd.

One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case.

There is no stipulation that they continue to remain shareholders for any period of time thereafter.

(v) Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.

Question 13

The Balance sheet of JB Opticals Limited as on 31-03-2021 reads as under:

Paid up capital ₹ 2,52,00,000

| | Unit A (₹) | Unit B (₹) |
|----------------|-------------|-------------|
| Fixed assets | 1,00,00,000 | 1,50,00,000 |
| Debtors | 1,00,00,000 | 75,00,000 |
| Liabilities | 28,00,000 | 50,00,000 |
| Stock in trade | 50,00,000 | 25,00,000 |
| Reserves | | 1,48,00,000 |
| Share premium | | 22,00,000 |

The company acquired Unit B on 1.04.2018. They made certain capital additions in the form of Generator set and additional building etc., for ₹ 25 lacs during the year 2018-19. The members of the company have authorized the Board in their meeting held on 28.01.2021 to dispose of Unit 'B'. The company decides to sell Unit 'B' by way of slump sale for ₹ 225 lacs as consideration. The buyer is keen on buying the unit at the earliest, preferably before 31.3.2021. JB Opticals Ltd. has offered 4% discount if the buyer closes the sale and makes payment between 1.4.2021 and 30.4.2021, since the company would be able to avail benefit of concessional rate of tax on long-term capital gains. Accordingly, this discount would not be available if the sale is completed (and payment is made) before 31.03.2021. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is ₹ 120 lacs.

Would your answer change if the buyer is ready to accept discount of 3%, other facts remaining the same? Assume company does not opt for section 115BAA.

Note: Total turnover for the P.Y. 2018-19 was ₹ 450 crore.

Solution

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

| | ₹ (in lacs) |
|------------------------------------|-------------|
| Written down value of fixed assets | 120 |
| Debtors | 75 |
| Stock-in-trade | 25 |
| | 220 |
| Less : Liabilities | 50 |
| Net worth | 170 |

Comparative calculation of chargeable capital gains

| | Sale before 31.3.2021 | Sale after 31.03.2021 |
|---|-----------------------|-----------------------|
| Sale consideration | 2,25,00,000 | 2,25,00,000 |
| Less: Discount | Nil | 9,00,000 |
| Net sale consideration | 2,25,00,000 | 2,16,00,000 |
| Less: Net worth | 1,70,00,000 | 1,70,00,000 |
| Short term capital gain | 55,00,000 | N.A. |
| Long term capital gain | N.A. | 46,00,000 |
| Tax rate (since turnover in the P.Y. 2018-19 exceeds Rs. 400 crore) | 31.2% | 20.8% |
| Tax thereon | 17,16,000 | 9,56,800 |

Computation of Net Cash flow

| | Sale before 31.3.2020 | Sale after 31.03.2020 |
|------------------------|-----------------------|-----------------------|
| Net sale consideration | 2,25,00,000 | 2,16,00,000 |
| Less: Income-tax | 17,16,000 | 9,56,800 |
| Net Cash flow | 2,07,84,000 | 2,06,43,200 |

Note: The assessee is advised to effect slump sale before 31.03.2021 as the net cash flow arising from sale effected before 31.03.2021 is higher than the net cash flow arising from sale effected after 31.03.2021, inspite of the higher rate of tax on short-term capital gains.

Alternate Situation: If the buyer is ready to accept discount of 3% offered by J.B. Opticals Ltd.

In this case, the capital gain tax and net cash flow would be as under:

Comparative calculation of chargeable capital gains

| | Sale before 31.3.2021 | Sale after 31.03.2021 |
|-------------------------|-----------------------|-----------------------|
| Sale consideration | 2,25,00,000 | 2,25,00,000 |
| Less: Discount | Nil | 6,75,000 |
| Net sale consideration | 2,25,00,000 | 2,18,25,000 |
| Less: Net worth | 1,70,00,000 | 1,70,00,000 |
| Short term capital gain | 55,00,000 | N.A. |
| Long term capital gain | N.A. | 48,25,000 |
| Tax rate | 31.2% | 20.8% |
| Tax thereon | 17,16,000 | 10,03,600 |

Computation of Net Cash flow

| | Sale before 31.3.2021 | Sale after 31.03.2021 |
|------------------------|-----------------------|-----------------------|
| Net sale consideration | 2,25,00,000 | 2,18,25,000 |
| Less: Income-tax | 17,16,000 | 10,03,600 |
| Net Cash flow | 2,07,84,000 | 2,08,21,400 |

Note: In case the buyer is ready to accept discount of 3%, the assessee can effect slump sale after 31.03.2021 as the net cash flow arising from sale effected after 31.03.2021 is higher than the net cash flow arising from sale effected before 31.03.2021.

Question 14

PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its

software unit as a going concern by way of slump sale for ₹ 385 lacs to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2021, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2021

| Liabilities | ₹ (in lacs) | Assets | ₹ (in lacs) |
|----------------------------|--------------------|---------------------|--------------------|
| Paid up Share Capital | 300 | <u>Fixed Assets</u> | |
| General Reserve | 150 | Hardware unit | 170 |
| Share Premium | 50 | Software unit | 200 |
| Revaluation Reserve | 120 | <u>Debtors</u> | |
| <u>Current Liabilities</u> | | Hardware unit | 140 |
| Hardware unit | 40 | Software unit | 110 |
| Software unit | 90 | <u>Inventories</u> | |
| | | Hardware unit | 95 |
| | | Software unit | 35 |
| | 750 | | 750 |

Following additional information are furnished by the management:

- (i) The Software unit is in existence since May, 2015.
- (ii) Fixed assets of Software unit includes land which was purchased at ₹ 40 lacs in the year 2008 and revalued at ₹ 60 lacs as on March 31, 2021.
- (iii) Fixed assets of Software unit mirrored at ₹ 140 lacs (₹ 200 lacs minus land value ₹ 60 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is ₹ 90 lacs.
 - (a) Ascertain the tax liability, which would arise from slump sale to PQR Limited, assuming it does not opt for section 115BAA..
 - (b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

Answer

- (a) As per section 50B, any profits and gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of Software unit

| Particulars | ₹ (in lacs) |
|---|---------------|
| Sale consideration for slump sale of Software Unit | 385 |
| Less: Cost of acquisition, being the net worth of Software Unit | 185 |
| Long term capital gains arising on slump sale | 200 |
| (The capital gains is long-term as the Software Unit is held for more than 36 months) | |
| <u>Tax liability on LTCG</u> | |
| Under section 112 @ 20% on ₹ 200 lacs | 40.00 |
| Add: Surcharge@ 7% | 2.80 |
| | 42.80 |
| Add: Health and Education cess@4% | 1.712 |
| | 44.512 |

Working Note:

Computation of net worth of Software Unit

| | ₹ (in lacs) |
|---|-------------|
| (1) Book value of non-depreciable assets | |
| (i) Land (Revaluation not to be considered) | 40 |
| (ii) Debtors | 110 |
| (iii) Inventories | 35 |
| (2) Written down value of depreciable assets under section 43(6) (See Note below) | 90 |
| Aggregate value of total assets | 275 |
| Less: Current liabilities of Software unit | 90 |
| Net worth of software unit | 185 |

Note : For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

(b) Tax advice

- (i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should

try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

- (ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

Question 15

Determine the capital gains/loss on transfer of listed equity shares (STT paid both at the time of acquisition and transfer of shares) and units of equity oriented mutual fund (STT paid at the time of transfer of units) for the A.Y.2021-22 and tax, if any, payable thereon, in the following cases, assuming that these are the only transactions covered under section 112A during the P.Y.2020-21 in respect of these assessees:

- (i) Mr. Prasun purchased 300 shares in A Ltd. on 20.5.2017 at a cost of ₹ 400 per share. He sold all the shares of A Ltd. on 31.5.2020 for ₹ 1200. The price at which these shares were traded in National Stock Exchange on 31.1.2018 is as follows –

| Particulars | Amount in ₹ |
|-----------------------|-------------|
| Highest Trading Price | 700 |
| Average Trading Price | 680 |
| Lowest Trading Price | 660 |

- (ii) Mr. Raj purchased 200 units each of equity oriented funds, Fund A and Fund B on 1.2.2017 at a cost of ₹ 550 per unit. The units were not listed at the time of purchase. Subsequently, units of Fund A were listed on 1.1.2018 and units of Fund B were listed on 1.2.2018 on the National Stock Exchange. Mr. Raj sold all the units on 3.4.2020 for ₹ 900 each. The details relating to quoted price on National Stock Exchange and net asset value of the units are given hereunder:

| Particulars | Fund A | Fund B |
|------------------------------|--------------------|-------------------|
| | Amount in ₹ | Amount in ₹ |
| Highest Trading Price | 750 (on 31.1.2018) | 800 (on 1.2.2018) |
| Average Trading Price | 700 (on 31.1.2018) | 750 (on 1.2.2018) |
| Lowest Trading Price | 650 (on 31.1.2018) | 700 (on 1.2.2018) |
| Net Asset Value on 31.1.2018 | 800 | 950 |

Answer

- (i) For the purpose of computation of long-term capital gains chargeable to tax under section 112A, the cost of acquisition in relation to the long-term capital asset, being an equity share

in a company or a unit of an equity oriented fund or a unit of a business trust acquired before 1st February, 2018 shall be the higher of

- (a) cost of acquisition of such asset, i.e., actual cost; and
- (b) lower of
 - (i) the fair market value of such asset as on 31.1.2018; and
 - (ii) the full value of consideration received or accruing as a result of the transfer of the capital asset.

The fair market value of listed equity shares as on 31.1.2018 is the highest price quoted on the recognized stock exchange as on that date.

Accordingly, long-term capital gain on transfer of STT paid listed equity shares by Mr. Prasun would be determined as follows:

The FMV of shares of A Ltd. would be ₹ 700, being the highest price quoted on National Stock Exchange on 31.1.2018. The cost of acquisition of each equity share in A Ltd. would be ₹ 700, being higher of actual cost i.e., ₹ 400 and ₹ 700 [being the lower of FMV of ₹ 700 as on 31.1.2018 (i.e., the highest trading price) and actual sale consideration of ₹ 1,200]. Thus, the long-term capital gain would be ₹ 1,50,000 i.e., (₹ 1,200 – ₹ 700) x 300 shares. The long-term capital gain of ₹ 50,000 (i.e., the amount in excess of ₹ 1,00,000) would be subject to tax@10% under section 112A, without benefit of indexation.

- (ii) In the case of units listed on recognised stock exchange on the date of transfer, the FMV as on 31.1.2018 would be the highest trading price on recognised stock exchange as on 31.1.2018 (if units are listed on that date), else, it would be the net asset value as on 31.1.2018 (where units are unlisted on that date).

Accordingly, the FMV of units of Fund A as on 31.1.2018 would be ₹ 750 (being the highest trading price on 31.1.2018, since the units of Fund A are listed on that date) and the FMV of units of Fund B as on 31.1.2018 would be ₹ 950 (being the net asset value as on 31.1.2018, since the units of Fund B are unlisted on that date).

The cost of acquisition of a unit of Fund A would be ₹ 750, being higher of actual cost i.e., ₹ 550 and ₹ 750 (being the lower of FMV of ₹ 750 as on 31.1.2018 and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund A would be ₹ 30,000 (₹ 900 – ₹ 750) x 200 units.

The cost of acquisition of a unit of Fund B would be ₹ 900, being higher of actual cost i.e., ₹ 550 and ₹ 900 (being the lower of FMV of ₹ 950 as on 31.1.2018 (net asset value) and actual sale consideration of ₹ 900). Thus, the long-term capital gains on sale of units of Fund B would be Nil (₹ 900 – ₹ 900) x 200 units.

Since the long-term capital gains on sale of units is ₹ 30,000, which is less than ₹ 1,00,000, the said sum is not chargeable to tax under section 112A.