

The Chamber of Tax Consultants

Re-introduction of Gift Tax- Section 56(2)(x) & Interplay of 50C and 50CA

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Section 56(2)(x)

ANALYSIS

- ❑ New clause (x) in sub-section 2 of section 56 inserted via Finance Act 2017;
- ❑ The clause provides that receipt of sum of money or ‘property’ by any person from any person without consideration or for inadequate consideration in excess of INR 50,000 shall be chargeable to tax in the hands of recipient under the head “IFOS ” ;
- ❑ Amendment applicable to receipt on or after April 1, 2017 (i.e. w.e.f. **AY 2018-19**)

Rationale

- Prior to amendment –
 - ✓ Section 56(2)(vii) was restricted to receipt of **certain property** including jewellery, shares of unlisted company for **individuals and HUFs only**;
 - ✓ Section 56(2)(viia) was restricted to receipt of **shares of a closely held company** by a **firm** or **another closely held company**
- These anti-abuse provisions covered only individuals, HUFs, firms and companies in certain cases and failed to cover all the assesseees;
- Gap bridged by insertion of new clause (x) and restricting operation of sections 56(2)(vii) and 56(2)(viia) to transactions **made before April 1, 2017**

ANALYSIS (CONTD...)

□ Effect of change

▪ Individuals and HUF's

- No change

▪ AOP and BOI

- The scope of section widened to cover these assesseees

▪ Firms and companies

- Scope extended to all “property”, which hitherto was applicable only in respect of shares of “closely-held companies”;
- Earlier, an exemption was provided to a company in which public are substantially interested, which is now withdrawn. Any “property” received by even listed companies for nil/inadequate consideration would be covered

ANALYSIS (CONTD...)

□ Effect of change (contd...)

▪ Trust

- Section 56(2)(x) not to apply to any sum of money or property received, inter alia:
 - From / by any trust or institution registered u/s 12A or 12AA;
 - From an individual by a trust created or established solely for the benefit of relative of the individual

AMENDMENT VIDE FINANCE ACT, 2018

- ❑ Inserted 5% tolerance limit in respect of immovable property ;
- ❑ Expanded the scope of exemption [Inserted in clause IX of fourth proviso to section 56(2)(x)] :
 - Transactions not regarded as transfer under clause (iv) and clause (v) of section 47
- ❑ **Effect of change**
 - Holding – subsidiary
 - Section 56(2)(x) not to apply to receipt of any sum of money or property received, inter alia:
 - By a wholly owned subsidiary from its holding company;
 - By a holding company from its wholly owned subsidiary ;
 - In both the cases, the recipient must be an Indian Company
 - No 8 years criteria like section 47A for capital gains here

AMENDMENT VIDE FINANCE ACT, 2018

❑ Inserted clause (xi) after clause (x) of sub-section (2) of Section 56 :-

“(xi) any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto.”

DEFINITION OF “PROPERTY”

Immovable property,
being land or
building or both

Shares and securities

Jewellery, bullion

Archaeological
collection, drawings,
paintings, sculptures,
art of work

ISSUES ON SECTION 56(2)(x)

Meaning of the term “property”- analysis

- ❑ The term “property” is defined in Explanation to section 56(2)(x) r.w. section 56(2)(vii) ;

- ❑ Interest in partnership firm:
 - The term “securities” is defined u/s 2(h) of Securities contracts (Regulation) Act, 1956- *to include “shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate”*.

 - Not covered

ISSUES ON SECTION 56(2)(x)

❑ Interest in LLP

- Meaning of “marketable security” – As per the decision of Supreme Court in case of **Bhagwati Developers Pvt Ltd Vs Peerless General Finance & Investment Company Ltd** (Civil Appeal No7445 Of 2004) - a marketable security is one which is freely transferable irrespective of the size of the market.
- Thus, interest in a LLP may not be covered (Section 42 of LLP Act, 2008 permits transfer. However, LLP Agreement may provide restrictions.)

❑ “Undertaking” is not covered under definition of property of section 56(2)(x)- Thus on transfer of undertaking there would be no implications u/s 56(2)(x) ;

❑ Right shares - Renunciation of rights – whether covered? – As per section 2(h) of SCRA, securities includes ‘rights or interest *in* securities’

ISSUES ON SECTION 56(2)(X)

□ Receipts from “any person”

- Government does not constitute a person –
 - CIT v. Dredging Corporation of India [1988] 39 Taxman 301 (AP)

- Government constitutes a person -
 - CIT v. Warner Hindustan Limited (1986) 158 ITR 51 (AP) – Companies (Profits) Surtax Act, 1964
 - State of Punjab v. Okara Grain Buyers Syndicate Ltd. [AIR 1964 SC 669] – Displaced Persons’ (Debts Adjustment) Act, 1954
 - Commentary by Kanga and Palkhiwala (10th Edition) – Based on judgments of House of Lord and Privy Council

- Possible views :-
 - Receipts anyway could qualify as “income” u/s section 2(24)(xviii)

ISSUES ON SECTION 56(2)(x) (CONTD...)

❑ Receipts from “any person” (contd...)

- Receipts from relative is excluded from scope of section 56(2)(x)

- Definition of relative is unchanged – Controversies under the old provisions still persist

- Example:

1. Receipt by HUF from member → Covered in definition of “relative” – Hence, exempt

Receipt by HUF from relative → **Harshadbhai Dahyalal Vaidhya (HUF) v ITO (144 ITD 605)**
of Karta (Ahmedabad - Trib.)

Subodh Gupta (HUF) v PCIT (169 ITD 60) (Delhi - Trib.)

Receipt by member from HUF → Not explicitly covered by definition;

However, relative includes group of relatives - HUF = Group of relatives – **Vineetkumar Raghavjibhai Bhalodia v. ITO [2011] 46 SOT 97 (Rajkot)**

→ *Does such receipt amount to partial partition ?*

ISSUES ON SECTION 56(2)(x) (CONTD...)

❑ Receipts from “any person” (contd...)

2. Receipt from nephew/ niece → Not covered under definition of relative – Sec. 56(2)(x) shall apply
Receipt by nephew/ niece → Covered under definition of relative – Sec. 56(2)(x) shall not apply

ISSUES ON SECTION 56(2)(x) (CONTD...)

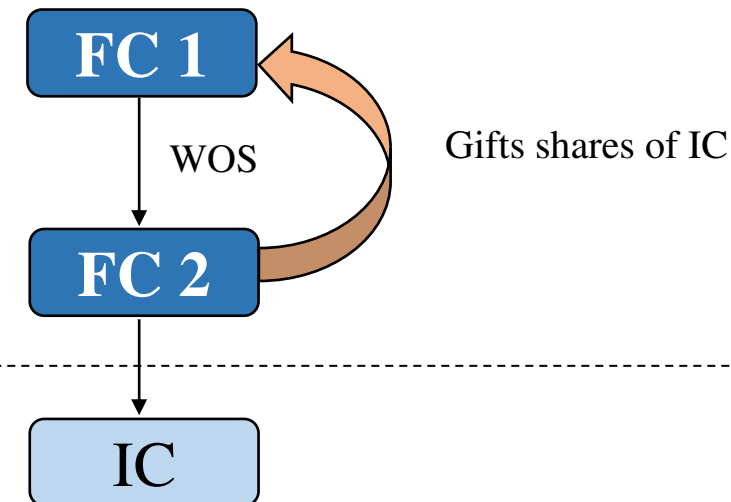
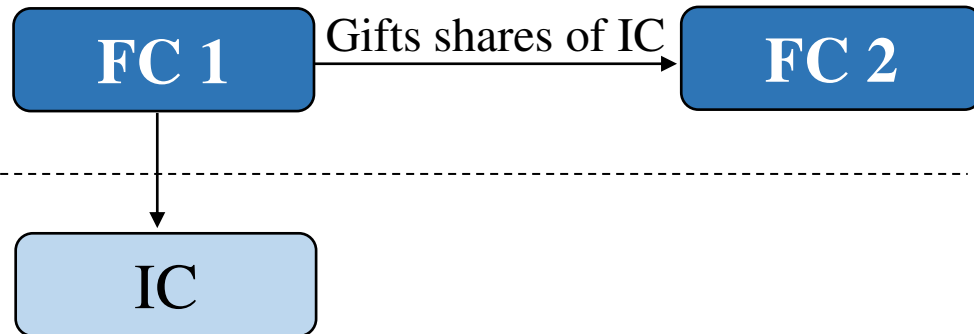
❑ Restructuring issues

- Section 56(2)(x) specifically exempts cases of qualifying amalgamation/demerger
 - *Whether the provisions of section 56(2)(x) be triggered in case of non-qualifying amalgamation/demerger ?*
 - Absence of consideration – Not possible
 - Inadequate consideration – Questionable
 - “Property”- does not include “undertaking”

- *Whether the provisions of section 56(2)(x) applicable to a company/firm on acquisition of business under a “slump sale” ?*
 - Slump sale – lumpsum consideration paid for acquisition of business
 - Consideration not determinable for each of the items separately
 - However, in cases of itemised sale of business – Section 56(2)(x) may apply
 - “Property”- does not include “undertaking”

- Conversion of firm into company/ LLP or conversion of company into LLP
 - Consideration is issue of shares or shares in future profits ;
 - Property does not include ‘undertaking’

APPLICABILITY TO TRANSFER OF INDIAN COMPANY SHARES BETWEEN FOREIGN COMPANIES EITHER BY WAY OF GIFT OR SALE



Section 56(2)(x)

- Where **any person** receives in any previous year, from any person
 - Receipt of shares by FC 2/ FC 1

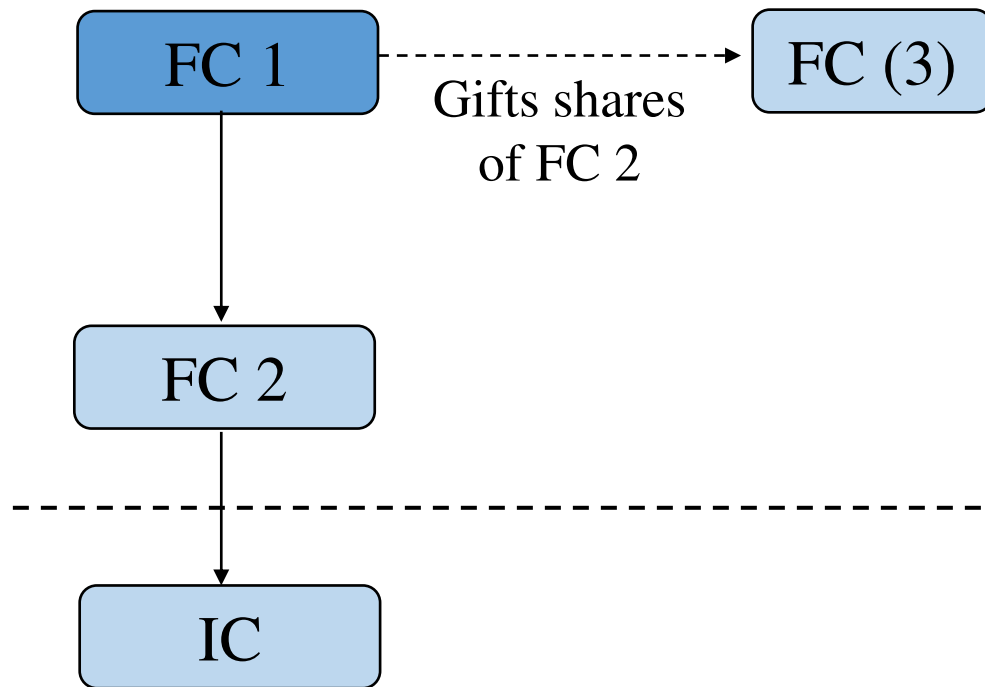
Section 5

- Since change of name in IC's Share Register - the receipt is in India
- Falls within the scope of total income

Therefore receipt taxable in India u/s 56(2)(x)

- Even in Case of WOS, FC1 is not an Indian Company hence 56(2)(x) applicable

APPLICABILITY TO TRANSFER OF INDIAN COMPANY SHARES BETWEEN FOREIGN COMPANIES EITHER BY WAY OF GIFT OR SALE (CONTD...)



Section 56(2)(x)

- Where any person receives in any previous year, from any person
 - Receipt of shares by FC (3)

Section 5

- Since, the receipt is not in India, it is outside the scope of total income

Section 9(1)

- Income accruing or arising directly or indirectly through the transfer of a capital asset situated in India

Taxability u/s 56(2)(x) is triggered on “receipt” and not on “transfer”

Applicability of section 56(2)(x) to Trusts

□ Applicability to trusts :-

- When Settlor settles his assets in a trust:
 - Trustee is receiving in a mere fiduciary capacity and not in his own rights;
 - Trustee is bound by obligation to carry out the directions of the Settlor - Hence, not without consideration or inadequate consideration
 - Impact of clause (X) of Proviso – from Individual by a Trust ;
 - Impact of clause (VII) of Proviso- from or by section 12A/12AA Trust

- On distribution of Corpus to beneficiaries, in case the trust is a Specific Trust or Discretionary Trust
 - It involves working out of rights of the beneficiaries
 - It does not qualify as a receipt without consideration
 - **Ashok Pratap v. ACIT (139 ITD 533) (Mum.)**

Applicability of section 56(2)(x) to Trusts

□ Applicability to trusts :-

▪ Settlement of a trust for “nephew” :-

- As per the definition of relative – “nephew” is not regarded as the ‘relative’ of the individual-

Question: On creation of trust for a nephew by an individual, whether rigors of section 56(2)(x) applicable ?

Eg : Mr.A individual – His nephew is not a ‘relative’ as per the definition of ‘relative’. Hence trust created for the nephew would not be covered by the proviso and hence 56(2)(x) would be applicable

- In case the beneficiary of a Private Trust is a charitable Trust- whether provisions of section 56(2)(x) would be applicable in the absence of any specific exemption;

ISSUES ON SECTION 56(2)(x) (CONTD...)

❑ Receipt of subvention money

- Subvention refers to a grant of money in aid or support
- Subvention money received by loss making subsidiary from holding company is capital receipt as it is paid for the purpose of protection of capital investment of the holding company – **Siemens Public Communication Network P. Ltd. V. CIT [2017] 77 taxmann.com 22 (SC)**
- *Subvention money is receipt without consideration ?*
 - To the extent of subvention by parent to its WOS, the intrinsic value of its shareholding in WOS increases. Hence, adequate consideration
 - If not a WOS- Questionable
 - If business consideration – Arguable

ISSUES ON SECTION 56(2)(x) (CONTD...)

❑ **Family Settlements- whether covered ?**

- No “transfer” - CIT v. R Ponnammal [(1986) 28 taxman 26 (Mad HC)];
- Not without adequate consideration - Smt. A. Omera Parvez v. GTO [(1983) 3 ITD 250 (Mad)]

❑ **Receipt of alimony whether covered ;**

- Lump sum alimony – Regarded as capital receipt-Not chargeable to tax
- Monthly alimony- Taxable

(Refer Princess Maheshwari Devi of Pratapgarh v CIT (147 ITR 258) (Bombay))

- Meenakshi Khanna (143 ITD 744) (Delhi - Trib.)[2013]- provisions of section 56(2)(vi) is not applicable to lump-sum alimony

ISSUES ON SECTION 56(2)(x) (CONTD...)

□ Whether conversion of bonds/preference shares into equity shares covered ?

- In case bonds/preference shares are issued prior to the date of the provisions of section 56(2)(x) becoming applicable and conversion takes place at any time after the AY 2017-18
 - Receipt of equity shares is in 'consideration' of extinguishment of rights in bonds/preference shares :-
 - ❖ Hence, not without consideration ;
 - ❖ Also not inadequate consideration – sacrifice = gain
 - ❖ Ratio of CIT Vs. Bai Shrinibai K. Kooka (46 ITR 86) (SC) and CIT vs. Groz-Beckert Saboo (116 ITR 125) (SC)
 - Taxing event arises when convertible instrument is issued. Upon conversion :-
 - ❖ Mere working out of pre-existing rights of the investor or mere discharging of pre-existing obligation by the issuer
 - ❖ Ratio of CIT v Mohanbhai Pamabhai [1973] (165 ITR 393) and CIT v. R.M. Amin (106 ITR 368) (SC)

Interplay between sections 50C/50CA and
56(2)(x)

INTERPLAY BETWEEN SECTIONS 50C AND 56(2)(X)

Section 50C

Provision to tax the difference between the FMV and the consideration received for transfer of capital asset being land or building or both as capital gains in the hands of transferor

Finance Act, 2017

Section 56(2)(x)

Provisions to tax the difference between the FMV and the consideration paid for transfer of capital asset (also covers immovable property) as income from other sources in the hands of transferee

Incidence of double taxation – Both in the hands of transferor as well as transferee- subject to section 49(4)

INTERPLAY BETWEEN SECTIONS 50CA AND 56(2)(X)

Finance Act, 2017

Section 50CA

Provision to tax the difference between the FMV and the consideration received for transfer of unquoted shares as capital gains in the hands of transferor

Section 56(2)(x)

Provisions to tax the difference between the FMV and the consideration paid for transfer of unquoted shares (also covers sum of money, immovable property, other property) as income from other sources in the hands of transferee

Incidence of double taxation – Both in the hands of transferor as well as transferee – subject to section 49(4)

INTERPLAY BETWEEN SECTIONS 50CA AND 56(2)(X)

Example

- Transferee/Buyer : A Ltd.
- Transferor/Seller : B Ltd.
- A Ltd. purchased 100 shares of a private company from B Ltd. for a price of INR 600 per share; total consideration = INR 60,000
- B Ltd. had acquired such shares at INR 500 per share; gross amount paid = INR 50,000
- Say, the FMV of said shares on transfer date is INR 700

What would be the implications of provisions of section 50CA and 56(2)(x) under the mentioned circumstances ?

INTERPLAY BETWEEN SECTIONS 50CA AND 56(2)(X)

❑ Prior to amendment

Impact on Transferor – B Ltd.		Impact on Transferee – A Ltd.	
Sale consideration	60,000	No impact	
Less: Cost of acquisition	<u>(50,000)</u>		
Capital gains	<u>10,000</u>		

❑ Post amendment

Impact of Sec. 50CA Transferor – B Ltd.		Impact of Sec. 56(2)(x) Transferee – A Ltd.	
FMV	70,000	FMV of shares	70,000
Less: Cost of acquisition	<u>(50,000)</u>	Less: Actual consideration	<u>(60,000)</u>
Capital gains	20,000	IFOS	10,000

INTERPLAY BETWEEN SECTIONS 50CA AND 56(2)(X)

□ Impact u/s 49(4) :-

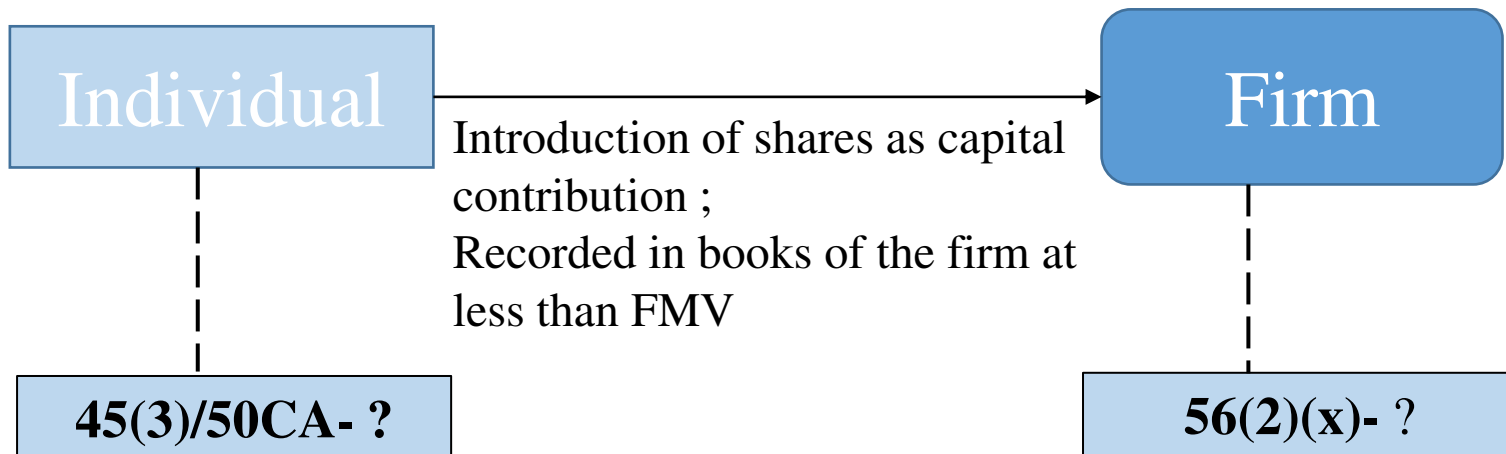
When A Ltd sells the shares at (say) Rs.800 (which is also its FMV) ;

FMV of shares (when sold)	80,000
Less: FMV (when purchased)	<u>(70,000)</u>
Capital gains	10,000

ISSUES ON SECTION 50CA

- ❑ **Applicability of the provisions in the absence of consideration:-**
 - In case no consideration is received or accruing, section is not applicable :-
 - Transfer by a partner to the firm as capital consideration ;
 - In case of a gift (no consideration at all) ;
 - No capital gains, therefore section is not applicable
 - Transfer should be in relation to transfer of a “capital asset” only

INTERPLAY BETWEEN SECTIONS 50CA AND 45(3)



- Carlton Hotel (P.) Ltd. v. ACIT (122 TTJ 515) Lucknow Bench
- DCIT v Amartara Mumbai (I.T.A No.6050/Mum/2016)
- CIT v. Moon Mills Ltd. [1966] (59 ITR 574) (SC)
- 45(3)v 45(4) – difference in language
- Sunil Siddharthbhai v. CIT [1985] (156 ITR 509) (SC)



AMENDMENT VIDE FINANCE ACT, 2018

ANALYSIS

- ❑ New proviso inserted in section 50C vide Finance Act 2018;
- ❑ The amended section reads as under

“Provided also that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed one hundred and five per cent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.”

- ❑ Amendment applicable to receipt on or after April 1, 2018 (i.e. w.e.f. **AY 2019-20**)
- ❑ **Similar amendment in section 56(2)(x)(b)(B) for determining value of immoveable property**

Rationale

- It has been pointed out that variation can occur in respect of similar properties in the same area because of a variety of factors, including shape of the plot or location. In order to minimize hardship in case of genuine transactions in the real estate sector, it is proposed to provide for the tolerance limit of 5%.

Valuation rules for purpose of section 50CA
and 56(2)(x) – Rule 11UA

PRESENT SUB-CLAUSE (B) OF CLAUSE (C) OF RULE 11UA(1)

$$\text{FMV of Unquoted Equity Share} = \frac{(A-L)}{(PE)} \times (PV)$$

where,

A	Book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset
L	Book value of liabilities, but not including certain amounts like, paid up capital of equity shares, amount representing provisions made for meeting liabilities, other than ascertained liabilities, etc
PE	Total amount of paid up equity share capital as shown in the balance-sheet
PV	Paid up value of such equity shares

SUB-CLAUSE (B) OF CLAUSE (C) OF RULE 11UA(1)

$$\text{FMV of Unquoted Equity Share} = \frac{(A+B+C+D-L)}{(PE)} \times (PV)$$

where,

A	Book value of the assets (other than jewellery, artistic work, shares, securities and immovable property) by- (i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any, and (ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset
B	Price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer
C	Price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer
D	Value adopted or assessed or assessable by any authority of the government for the purpose of payment of stamp duty in respect of the immovable property

SUB-CLAUSE (B) OF CLAUSE (C) OF RULE 11UA(1)

$$\text{FMV of Unquoted Equity Share} = \frac{(A+B+C+D-L) \times (PV)}{(PE)}$$

where,

L	Book value of liabilities, but not including certain amounts like, paid up capital of equity shares, amount representing provisions made for meeting liabilities, other than ascertained liabilities, etc
PE	Total amount of paid up equity share capital as shown in the balance-sheet;
PV	Paid up value of such equity shares

ISSUES

- ❑ Empirical studies show that market value of equity shares of an investment company does not capture the full market value of its investments in other companies. The value leakages are on account of distance of time and control of ownership, which, thereafter results in an inevitable discount especially because of the economic concept of liquidity preference which requires converting a future inflow to its present value by using a rate of discount. Also, erosion on account of tax leakages normally get factored in such valuation. The rule is unrealistic and would result in notional taxation in cases where the transaction has happened at fair value considering the above aspects.
- ❑ Valuation of equity shares of a company which carries on business as a going concern cannot be made based on present market value of its immovable property. Market value of an immovable property may be considered only in case the valuation is for the purpose of liquidation, or when the property is in surplus and is not actively used in business.
- ❑ For immovable property “the value adopted or assessed” will never exist in case of sale/transfer of shares of a company. It will always be “the value assessable”. Indeed, value assessable as per ready reckoner/circle rate does not always reflect the fair market value. There have to be enough safeguards like in s. 50C if Stamp Duty value is to be considered even for share valuation.

ISSUES (CONTD...)

- ❑ Valuation in cases of cross holdings is not addressed in the rules ;
- ❑ As per the rules, equity shares of a foreign company would be “unquoted equity share” even if it is listed on a foreign stock exchange.
- ❑ The rules shall come into force from 1.4.2018 – i.e. AY 18-19
 - Rule Notified on 12 July 2017. For Transaction between 1 April 2017 and 12 July 2017- will Rules apply;
- ❑ The rules shall apply irrespective of the valuation methodology agreed upon in Shareholder’s Agreement/ J.V. Agreement;

ISSUES (CONTD...)

- ❑ Acquisition of shares in tranches – what would be the date of valuation
 - As per Rule 11U of the Rules “valuation date” means the date on which the property or consideration, as the case may be, is received by the assessee

Question : In case of receipt of staggered consideration on different dates- what would be the date of valuation

- ❑ The rules may apply irrespective of lock-in-period under such Shareholder’s Agreement/ J.V. Agreement where internal transfer to Affiliates is permitted.

Abbreviations

Sr.	Abbreviation	Meaning
1.	AY	Assessment Year
2.	HC	High Court
3.	ICDR Regulations, 2009	SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009
4.	IFSC	International Financial Services Centre
5.	NCLT	National Company Law Tribunal
6.	LTCG	Long-term capital gains
7.	SC	Supreme Court
8.	SEBI	Securities and Exchange Board of India
9.	STT	Securities Transaction Tax
10.	RBI	Reserve Bank Of India
11.	RSE	Recognised Stock Exchange

Thank You!