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Income-tax Alert

Mumbai Tribunal in the case of Legatum Ventures Limited has held that long term capital gain arising from sale of unlisted shares of Indian company taxable in the hands of a foreign company shall be computed under section 112(1)(c)(iii) of Income Tax Act, 1961 without considering effect of foreign exchange fluctuation u/s. 48 1st proviso

Legatum Ventures Limited v/s. ACIT, International Taxation ITA No. 1627/Mum/2022 A.Y.: 2018 - 19

Facts of the Case:

- The assessee, a foreign company, declared a total income of Rs. NIL in its return of income. The Department selected the assessee's return of income for audit (i.e. scrutiny assessment).

- During the audit, Assessing Officer observed that the assessee had sold the shares of an unlisted Indian company. The assessee had computed long-term capital loss on the sale of shares as per the first proviso to Sec. 48[1]. The long-term capital loss was intended to carry forward u/s. 74.

- The Assessing Officer was of the view that since the assessee is a foreign company and had sold shares of an unlisted Indian company, the capital gain is to be computed as per Sec. 112(1)(c)(iii)[2]. Accordingly, Assessing Officer has computed long-term capital gain and rejected the long-term capital loss computed by the assessee. The same was confirmed by the Dispute Resolution Panel (DRP). Being aggrieved the assessee further appealed before the second appellate authority i.e. Income-tax Appellate Authority (ITAT).

[1] First proviso to section 48 allows non-resident to compute long term capital gains from transfer of shares or debentures held in an Indian company after factoring in cost of acquisition and neutralising the impact of foreign exchange fluctuation

[2] Section 112(1)(c)(iii) provides for concessional rate of tax i.e. 10% on long term capital gains arises on transfer of the capital assets being unlisted securities or shares of a company not being a company in which the public are not substantially interested. Gains are required to be computed factoring cost of acquisition but without giving effect to the first and second proviso to section 48 i.e. without neutralising the effect of foreign exchange fluctuation and inflation.

Issue before the Tribunal:

Whether a foreign company has the option to compute long-term capital gains on the sale of shares of an unlisted Indian Company by applying provisions of the 1st Proviso to Section 48 or under section 112(1)(c)(iii), whichever is beneficial to the assessee or it is mandatorily to be computed as per section 112(1)(c)(iii)?

Arguments of the Assessee:

Before the Tribunal, the assessee justified its manner of computation of capital gains based on the following:

- Sec 112 of the Act only provides the rate of tax, which is a step subsequent to the determination of income.
- For the computation of income chargeable under the head "Capital gains", Sec. 48 provides the mode of computation of capital gains. Since the assessee is a non-resident and has earned capital gains from the transfer of shares of an Indian company, therefore the benefit of 1st proviso to sec 48 is also available to the assessee.
- Section 112 applies only if the total income of the assessee includes any income arising from the transfer of long-term capital assets which is chargeable under the head "capital gains". Thus, for the applicability of section 112, there should be long-term capital gains. Since in the present case, there is a capital loss, section 112 is not applicable.

Arguments of the Department:

The Department made the following arguments:

- The term "income" has a wider connotation and even includes negative income.
- Since the assessee is a non-resident and has sold shares of an unlisted Indian company giving rise to long-term capital gain, section 112(1)(c)(iii) is applicable.

ITAT held

- Though section 112 deals with the determination of tax payable, in the case of a non-resident (not being a company) or a foreign company, where long-term capital gains arising from the sale of shares of an unlisted Indian company, section 112(1)(c)(iii) also provides the mode of computation.
- Section 112(1)(c)(iii) is a special provision for the computation of long-term capital gains arising from the transfer of unlisted

shares and securities in the case of a non-resident (other than a company) and a foreign company whereas section 48 is a general provision which deals with computation of capital gains in all cases of transfer of capital assets. The Tribunal held that where a special provision exists, the special provision will prevail over the general provision. Thus, the benefit of the first proviso to section 48, which neutralizes the impact of foreign exchange fluctuations, cannot be availed by the assessee.

- In the given case, capital gains have to be computed only with reference to section 112(1)(c)(iii) and the assessee has no right to choose to be taxed under the provision which leaves him with a lesser tax burden.

KPB Comments

The ruling would lead to higher tax payments in respect of capital gains arising on the transfer of shares on unlisted companies, even if the non-resident taxpayer has incurred losses in dollar terms. Further, withholding tax needs to be computed and considering gains in rupee terms on the transfer of such shares.

The non-resident investors would be required to consider this ruling and potential tax obligations before entering into the transaction. Further non-residents may also be required to re-evaluate positions taken in past which may be contrary to the current ruling (unless ruling is reversed by higher appellate authority), where re-opening of the assessment is still possible.

In past, when it was judicially held that a concessional rate of tax of 10% under the provisions of section 112(1)(ii) is not applicable with respect to the transfer of shares held in an unlisted company, the law was amended to extend concession.

Indian Income-tax Act provides an option to the Non-resident to approach the Authority for Advance Ruling to determine the tax liability of the non-resident under the transaction.

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Key Contacts – International Tax

Priti Savla
Partner
priti@kpbca.com

Paras Savla
Partner
paras@kpbca.com

Prity Dharod
Partner
prity@kpbca.com

Archana Kshatriya
Associate Consultant
Archana.Kshatriya@kpbca.com

Visit us www.kpbca.com

Our Offices

904, Centrum, Opp. Rayladevi Lake,
Next to IMCOST, S G Barve Road, Thane 400 604
MH India T: +91.22.2582 7822/38

1004, Level 10, Sunshine Tower,
Senapati Bapat Marg, Prabhadevi, Mumbai 400 013
MH India T: +91.22.2432 2258/68