VOLUME 61,SEPTEMBER 2019

Chir Amrit Legal LLP
Jaipur | Mumbai | Delhi
www.chiramritlaw.com

THE NEWSLETTER

Update Yourself

Inside this issue:

Cash Withdrawals From 01.04.2019 to be Considered for Computing the Threshold of Rs. 1 Crore U/S 194N

In order to discourage cash transactions and to promote the digital economy, new Section 194N has been inserted in the Income-tax Act, 1961 ('**Act**') is inserted by the Finance Act, 2019. Section 194N, provides for deduction of tax at source ('**TDS**') @2% on payment made by any banking company, co-operative society or a post office to any person from the account maintained by such person, where the amount exceeds Rs. 1 Crores ***during the previous year.*** The said section is applicable w.e.f. 01.09.2019. Since, the said section aims to prohibit cash withdrawals during the previous year commencing from 01.04.2019 and deduction of TDS u/s 194N shall be made from 01.09.2019, concerns have been raised with respect to the applicability of the said section on withdrawals of cash made by persons from 01.04.2019 to 31.08.2019 i.e. prior to 01.09.2019. With respect to this issue, the Hon'ble CBDT *vide* its press release dated 30.08.2019 has clarified that withdrawals of cash prior to 01.09.2019 shall not be subject to deduction of tax u/s 194N of the Act. However, since the Section provides that threshold of Rs. 1 crore pertains to the previous year, calculation of amount of cash withdrawal for triggering deduction under section 194N of the Act shall be counted from 01.04.2019. For example, if Rs. 2.10 Crore in cash has been withdrawn up to 31.08.2019 from one or more accounts maintained with a banking company, etc., TDS @2% shall be deducted on all the subsequent withdrawals made from the said accounts on or after 01.09.2019.

Clarification on 'Acquisition Date' and 'Appointed Date' for Merger and Acquisition under the Companies Act, 2013

The Ministry of Corporate Affairs *vide* circular no. 09/2019 dated 21.08.2019 ('**Circular**') clarified on issue whether it is mandatory to indicate a specific calendar date as 'appointed date' in the scheme of merger or amalgamation ('**Scheme**') under Section 232(6) of the Companies Act, 2013 ('**Act**'). Section 232(6) of the Act states that the Scheme shall be effective from the 'appointed date' and not any date which is subsequent to the appointed date. The Circular has clarified following: (a) under Section 232(6) of the Act, the companies are allowed to choose a specific calendar date or a date based on occurrence of any event which is relevant to the Scheme such as grant of license by competent authority etc.; (b) the 'appointed date' which is identified by the parties under the Scheme shall also be deemed to be the 'acquisition date' and date of transfer of control for the purpose of conforming to accounting standards (including Ind-AS 103 Business Combinations); (c) In case the 'appointed date' is chosen as a specific calendar date, the date may precede the date of filing of the application for Scheme before the National Company Law Tribunal. However, in case the date is significantly ante-dated beyond a year from the date of filing, the company shall provide a justification for the same in the Scheme and it should not be against public interest; (d) when parties to the Scheme identify 'appointed date' on the basis of occurrence of a trigger event which is relevant for the proposed Scheme, they are required to indicate the same in the Scheme itself. However, in case the appointed date is based on an event which is subsequent to date of filing the order with the Registrar under Section 232(5) of the Act, the company is required to file an intimation of the same with the Registrar within 30 days of such Scheme coming into force. Thus, the Circular would bring into line the practice of ascertaining 'appointed date' of merger/ amalgamation. The parties to the Scheme can now easily align the 'appointed date' in accordance with their business and legal requirements, adding to the ease of doing business.

सत्यमेव जयते
Ministry of Corporate Affairs
Government Of India

No Adverse Inference of Non-Appearance to be Drawn Despite Service of Postal Notice

The Hon'ble High Court of Delhi in the case of ***Reena Pathak vs. Union of India and Ors*** *[W.P.(C) 8329/2019 dated 27.08.2019]* while adjudicating upon an issue relating to Industrial Disputes Act laid down that 'merely because the solitary postal notice sent to the Petitioner did not return unserved, the Tribunal could not have drawn any adverse inference against her on account of her non-appearance.' The Industrial Dispute Tribunal had previously presumed the matter to be a case of 'No Claim' due to non-appearance of the Petitioner despite the issuance of Notice. The Court while observing that though the Tribunal has followed the procedure imbibed under the Code of Civil Procedure, 1908 but at the same time the Tribunal must not lose sight of the fact that it is dealing with a dispute raised by an aggrieved workman under a special act. With this the matter was remanded back to the Tribunal. The Hon'ble Court further observed that '*Once the Petitioner did not appear despite issuance of notice to her, the Tribunal ought to have made at least one more endeavour to ensure service of notice upon her, especially when an adverse inference was being drawn against her only because of non-return of the unserved notice.*'

Clarifications on Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019

The Central Board of Indirect and Customs ('**CBIC**') *vide* **Notification No. 4/2019-CE (NT) dated 21.08.2019** has prescribed that the Sabka Vishwas (Legacy Dispute Resolution) Scheme, 2019 ('**Scheme**') will come into force from 01.09.2019. The CBIC has also notified the Rules for the Scheme *vide* **Notification No. 5/2019-CE (NT) dated 21.08.2019**. According to Rule 3 of the said Rules, a declaration under the Scheme can be filed electronically in Form SVLDRS-1 available at https://cbic-gst.gov.in on or before 31.12.2019. The Rules also specify the constitution of the designated committee and the process of verification and payment pursuant to the declaration. The CBIC has provided further clarification on the Scheme through **Circular No. 1071/4/2019-CX.8 dated 27.08.2019** ('**Circular**'), wherein it has stated, *interalia*, that in cases where only penalty has been imposed upon a taxpayer, the same will be waived by making a declaration under the act, irrespective of the appellate stage the matter is at. However, in cases where duty has been imposed, and only penalty has been imposed on a co-noticee, the penalty cannot be waived until the main duty is disposed of. Further, it has been clarified that an amount admitted by a taxpayer in writing in the course of an audit, enquiry or investigation pending on 30.06.2019 shall also be considered as 'quantification' of the dues. The Circular also emphasizes on speedy disposal of cases and advises that in cases where the tax dues have been voluntarily disclosed or have been automatically calculated, the disposal should be done in 15 days, even though the Scheme has provided a longer period for disposal.

Consumer Protection Act, 2019

A three-decade old Consumer Protection Act, 1986 has been replaced by the new Consumer Protection Act, 2019 ('**Act**') to provide for better protection of the interests of the consumers. The Act received the assent of the President on 9th August 2019 however, the Act will be come into effect once it has been notified by the central government. The Act has enhanced the scope of protection afforded to the consumers by bringing within its purview advertising claims, endorsements and product liability, unfair contracts, all of which play a fundamental role in altering consumer behaviour and retail trends in the 21st century. The Act signifies an attempt to create more transparency in the marketplace, through legislative protection, with a view to ensure that consumer interests are above everything else. The Act has added 3 types of practices in the list of unfair trade practices which are (i) failure to issue a bill or receipt; (ii) refusal to accept a good returned within 30 days; and (iii) disclosure of personal information given in confidence, unless required by law or in public interest. Further, the Act defines the terms "Unfair Contracts" and "E-Commerce" which were not previously defined under the Consumer Protection Act, 1986. The Act defines Unfair Contract as a contract that cause significant change in consumer rights as specified under the Act. A provision for alternate dispute resolution mechanism through establishment of mediation cells which shall be attached to the District, State and National Commission is a new addition under the Act. The pecuniary jurisdiction of complaints under the Act that can be entertained by the District, State and National Commissions have been substantially increased. The District Commission and State Commission can now entertain complaints where the value of goods or services paid as consideration does not exceed Rs. 1 crore and exceeds Rs. 1 crore but does not exceed Rs. 10 crore, respectively. Whereas, the National Commission can entertain complaints where the value of goods or services exceeds Rs. 10 crore. Moreover, the Act provides for the establishment of a central regulator, Central Consumer Protection Authority to address issues related to consumer rights, unfair trade practices, misleading advertisements and impose penalties for selling faulty and fake products. Thus, the overall purpose of the Act is to strengthen the existing consumer rights.

It is to be noted that these amendments are of significance for the producers and sellers as well, since they will now be required to align their policies to the amended law.

Section 292BB of the IT Act applicable only when Notice Originates from Department

The Hon'ble Supreme Court of India ('***Court***') in the case of ***CIT v. Laxman Das Khandelwal*** *[C.A. No. 6162/2019] vide* order dated 13.08.2019 held that for applicability of Section 292BB of the Income Tax Act, 1961 ('***Act***'), notice must have originated from the department. Issue of notice u/s 143(2) of the Act for completion of regular assessment is a statutory requirement and non-issuance thereof is not a curable defect. A search and seizure operation were conducted u/s 132 at residential premises of the Assessee. The assessment of Assessee was completed u/s 143(3) r/w Section 153(D) of the Act with certain

additions. The Assessee filed an appeal before CIT(A) and the CIT(A) deleted the major addition. The Revenue being aggrieved by the order of CIT(A) filed an appeal to ITAT. The Assessee filed cross objection before ITAT on the ground of jurisdiction of AO regarding non-issue of notice u/s 143(2) of the Act. The Tribunal and High Court upheld the cross objection of the Assessee. The Revenue being aggrieved by the order of ITAT and High court filed an appeal before the Court relying on the provisions of Section 292BB of the Act that the Assessee having participated in the proceedings, the defect, if any, stood completely cured. The Court held that according to Section 292BB of the Act, if the Assessee had participated in the proceedings, by way of legal fiction, notice would be deemed to be valid even if there be infractions as detailed in said Section. The scope of the provision is to make service of notice having certain infirmities to be proper and valid if there was requisite participation on part of the assessee. It is, however, to be noted that the Section does not save complete absence of notice. For Section 292BB of the Act to apply, the notice must have originated from the department. It is only the infirmities in the manner of service of notice that the Section seeks to cure. The Section is not intended to cure complete absence of notice itself.

Copy of Seized Documents Cannot be Denied without Cogent Reasons

The High Court of Bombay ('**Court**') in the case of ***High Ground Enterprises Ltd. vs. Union of Indi*** *[W.P. No. 8075/2019] vide* order dated 14.08.2019 has held that any authority under the Central Goods and Service Tax Act, 2017 ('**CGST Act**') who seizes any documents, books or records of any person or company cannot keep such items in

their custody for a period longer than necessary. The Court also stated that the person from whom such documents are seized must also be provided a copy of these documents. In the present case, the Petitioner was facing a substantial penalty for non-disclosure of financial results to the Bombay Stock Exchange and was unable to submit the information since their relevant documents and records had been seized by GST authorities. The Respondents contended that the investigation was at a sensitive stage and providing the Petitioner with a copy of the documents would lead to tampering of evidence, and moreover the Petitioner would prejudicially affect the case by alerting their associates. The Court rejected the contention of the Respondents, holding that the Respondents were unable to provide any cogent reasons to withhold giving copies in the present case. The Court also observed that since the originals of all documents were with the Respondents, the Petitioner would be unable to tamper with any evidence. In light of Section 67(5) of the CGST Act creating a right in the concerned person, the Court held that the legislative intent therein clearly indicated that such person should not be needlessly prohibited from making copies of the documents that have been seized, except in cases where the authorised officer is of the opinion that it would prejudicially affect the investigation. Moreover, such opinion should be reflected on record and cannot be a mere unproven statement of the officer. The Court also directed the Respondent authorities to furnish a copy of the documents seized within two weeks.

Employees' Provident Funds and Miscellaneous Provisions Funds (Amendment) Bill, 2019

In wake of ***Regional Provident Fund Commissioner II West Bengal vs. Vivekananda Vidyamandir and Ors. [2019 (3) SCALE 831]*** ('**PF Case**') wherein the Hon'ble Supreme Court determined the components which are to be included in 'basic wage' of an employee under the Employees' Provident Funds and Miscellaneous Provisions Fund Act, 1952 ('**EPF Act**'), various officers under the Employees Provident Fund Organization ('**EPFO**') were carrying on inspection of the establishments in order to determine the amount due from the employer under the EPF Act. Further, on account of pendency of review petition filed by Surya Roshni Limited in the PF Case before the Hon'ble Supreme Court, the EPFO Department issued circular no. C-I-1(33)2019/Vivekandand Vidyamandir/717 dated 28.08.2019 directing the field officers not to take coercive actions or initiate inquiry against establishments without any *prima facie* evidence of wrong doing as well as not to initiate any coercive recovery actions till the disposal of said review petition. However, the review petition against the PF Case has been dismissed by the Hon'ble Supreme Court *vide* order dated 28.08.2019. Additionally, in order to resolve the issues and concerns surrounding PF Case and to bring the EPF Act in line with recently enacted Code on Wages, 2019, the Ministry of Labour and Employment *vide* notification no. S-35012/5/2017-SS-II dated 23.08.2019 has proposed several amendments in the EPF Act and requested general public to submit their comments/suggestions on the preliminary draft of the Employees' Provident Funds and Miscellaneous Provisions (Amendment) Bill, 2019 ('**EPF Bill**'). The EPF Bill proposes to bring following important amendments in the EPF Act:

(a) 'Basic wages' to be substituted by 'wages' in order to bring EPF Act in conformity with the Code on Wages, 2019;

(b) Flexibility with the government to prescribe different rates of contribution to the provident fund for different category of employees;

(c) Induction of 5 year limitation period under Section 7-A of the EPF Act which deals with the initiation of inquiry for the purpose of deciding applicability of the EPF Act and determining the amount due from employer under the EPF Act;

(d) The quantum of fines in pecuniary terms have been enhanced by approximate ten times;

(e) Pre-conditions for granting of exemption under the EPF Act will be introduced under the Employees' Provident Funds Scheme, 1952.

KEY TAKE AWAYS

- The Central Board of Indirect Taxes and Customs ('**CBIC**') vide **Notification No. 36/2019 dated 20.08.2019** has extended the implementation of Facility of Blocking and Unblocking of e-Way Bill to 21.11.2019.
- The High Court of Gujarat in the case of ***Vimal Yashwantgiri Goswami vs. State of Gujarat*** *[R/Special Civil Application No. 136/2019]* held *vide* Order dated 07.08.2019 that the power to arrest under Section 69 of the Central Goods and Service Tax Act, 2017 cannot be exercised on mere suspicion of tax evasion.
- The Karnataka Authority for Advance Ruling in the case of ***M/s Toolcomp Systems Pvt. Ltd.*** *[AAR No. KAR ADRG 13/2019]* has held *vide* its Order dated 16.07.2019 that Goods and Service Tax is not applicable on cost of tools supplied by Original Equipment Manufacturer on free of cost basis.
- The High Court of Gujarat in the case of ***Shabnam Petrofils Pvt. Ltd. vs. Union of India*** *[R/Special Civil Application No. 20626/2018]* has *vide* Order dated 16.07.2019 quashed Notification No. 20/2018 dated 26.07.2018 and Circular No. 56/30/2018-GST dated 24.08.2018 to the extent it provided that unutilized ITC after payment of tax for and up to July, 2018, on inward supplies received up to 31.07.2018 shall lapse.
- The CBIC *vide* **Notification No. 39/2019-CT dated 31.08.2019** has appointed 01.09.2019 as the date on which the amendment to Section 54 of the Central Goods and Service Tax Act, 2017 shall come into force, according to which sub-section (8A) will be being inserted so as to provide that the Central Government may disburse refund amount to the taxpayers in respect of refund of State taxes as well.
- The CBIC *vide* **Notification No. 13/2019-CT(R) dated 31.07.2019** has exempted the hiring of Electric buses by local authorities from GST.
- The Allahabad High Court in the case of ***Pancham Ram Yadav vs. The Uttar Pradesh Co-operative Federation Ltd.*** *[Special Appeal No. 435/2008 dated 02.09.2019]* has held that in absence of a specific remedy in Employees' Service Regulations, an employer may invoke civil liability to recover the loss incurred by him due to the actions of an employee.
- The Competition Commission of India in the case of ***National Consumers Co-Op. Federation of India Ltd****.* *[Case No. 18/2019 dated 05.08.2019]* held that inefficiency of services will not form a competition issue and dismissed the case against New Town Electric Supply Company Limited and West Bengal State Electricity Distribution Company Limited since no issue of abuse of dominant position could be made out.
- The Supreme Court in the case of ***National Highways Authority of India vs. Sayedabad Tea Company Ltd.*** *[C.A. No. 6958/2009 dated 27.08.2019]* held that an application under Section 11 of the Arbitration and Conciliation Act, 1996 in relation to disputes with the NHAI is not maintainable since that power has been exclusively vested with the Central Government as per Section 3G of the Act of 1956.

KNOWLEDGE CENTRE

MCQs on RERA

1. **Under RERA which of the following project is required to be registered?**

(a) Land 501 sq. mtrs. & No. of Apartments - 7
(b) Land 499 sq. mtrs. & No. of Apartments - 9
(c) Land 500 sq. mtrs. & No. of Apartments - 8
(d) Land 501 sq. mtrs. & No. of Apartments - 9

1. **In how many days the Regulatory Authority is required to decide on the application for registration of a real estate project failing which the same shall be deemed to be registered?**

(a) 30 days (b) 5 days
(c) 60 days (d) 90 days

1. **How much advance amount can be taken by promoters from allottees as a % of amount of consideration without entering into agreement for sale and register the same?**

(a) Upto 15% (b) Upto 20%
(c) Upto 10% (d) No advance

1. **As per Section 4(2) (I) (D) a separate account for each project is to be formed and maintained by developer to place ___% of amounts realised from the real estate project from the allottees in a scheduled bank?**

(a) 70% (b) 30%
(c) 75% (d) 50%

1. **As per provisos to section 4(2)(I)(D), which of these is not authorized to certify the proportion of percentage completion of the project?**

(a) Engineer (b) Architect
(c) Chartered Accountant (d) Contractor

1. **What is the rate of interest payable in case of default by the 'promoter' or the 'allottee'?**

(a) SBI Marginal Cost of Lending + 2% (b) SBI Marginal Cost of Lending +5%
(c) 2% p.a (d) 15% p.a.

1. **For which period the registration of real estate agent shall be valid ?**

(a) 1 Year (b) 2 Year
(c) 5 Year (d) 7 Year

1. **What is the penalty prescribed for non-registration of a project under Section 59 of the Act as a % of the estimated cost of the real estate project?**

(a) Upto 5% (b) Upto 20%
(c) Upto 10% (d) None of these but imprisonment

Answer key: 1-d, 2-a, 3-c, 4-a, 5-d, 6-a, 7-c, 8-c

Editorial

Taxability of Rights Issue: An Analysis

-By CA Shrayansh Jain, Senior Associate

INTRODUCTION

One of the common practices adopted by companies to gain two-fold advantages i.e. meeting fund requirements without diluting the voting power, is issuing equity shares to companies' existing shareholders. In legal terminology, this is called 'rights issue'. To make rights issue lucrative, companies tend to issue shares at a price less than fair market value. In such cases, wherein existing shareholders receive the shares at a price less than fair market value, there arises a possibility of applicability of income tax under the provisions of Income Tax Act, 1961 ("***Act***"). Thus, in the present note, an attempt has been made to analyze the probable income tax implications which may arise during a rights issue. Although, tax implication on issue of right shares may be multifold, in this article, we shall restrict our discussion to provisions of section 56(2)(x) of the Act.

UNDERSTANDING THE LEGAL PROVISIONS

As per section 56(2)(x) of the Act, any receipt of property (which also includes shares) without consideration or for a consideration which is less than its fair market value computed in accordance to the prescribed rules ("***Tax FMV***") by an amount exceeding Rs. 50,000/-, then difference between the fair market value and purchase consideration (if any), shall be treated as income in the hands of recipient. From the plain language of section 56(2)(x), it appears that issue of right shares where shareholder receives shares at a price less than Tax FMV, shall trigger the applicability of the said section. However, one should appreciate that right shares are 'ordinarily' issued at discount in comparison to the Tax FMV, therefore, one has to examine whether it is the intent of the legislature to tax the issue of right shares u/s 56(2)(x). To ascertain the same, provision of section 56(2)(x) of the Act is analyzed below in detail:

i. **Purposive Interpretation:** Clauses(v)/(vi)/(vii)/(viia)/(x) of section 56(2) of the Act were introduced (time to time) as a counter evasion mechanism to curb the practices of bogus capital building and money laundering. Accordingly, taxing issue of right shares u/s 56(2)(x) which are <u>ordinarily issued at discount</u> in comparison to the prevailing fair market value to infuse capital in the company <u>in the ordinary course of its business</u>, shall be against the <u>legislative mandate</u>.

ii. **Meaning of Consideration:** For triggering the applicability of section 56(2)(x), there should be receipt of shares for a 'consideration' less than Tax FMV. Term 'consideration' is not defined in the Act. Dictionary meaning of term 'consideration' suggests that it includes the cases where loss or detriment is suffered in lieu/exchange of something. In case of issue of right shares, gain arising to the shareholder pursuant to receipt of right shares at a price less than Tax FMV shall be offset by fall in the value of existing shares. Similar view has also been given by the Hon'ble ITAT. Accordingly, it can be said that in consideration of deprecation in value of existing shares, recipients are issued the right shares at a price less than Tax FMV. This is further illustrated with the example: Before issue of right shares, 10,000 shares held by **A&B** in the ratio of 60:40 were valued at Tax FMV of Rs. 400/- each. Company announced 1:2 right issue at a price of Rs. 100/-. Post right issue, Tax FMV of the Company reduced to Rs. 300/- per shares. Resultantly, right shares, Tax FMV of which is Rs. 300/- post right issue has been received at a price of Rs. 100/-, whereas, Tax FMV of existing shares has been reduced from Rs. 400/- to Rs. 300/-. Accordingly, in this case, gain arising of Rs. 6 Lakh pursuant to receipt of shares by Mr. A for lesser consideration (Rs. 200/- per share *3,000 shares) shall be offset by decline in value of existing shares amounting to Rs. 6 Lakh (Rs. 100/- per share *6,000 shares). Hence, in case of proportionate allotment to existing shareholders, no benefit appears to arise to the shareholders. One thing to point out in the above example is that we have considered Rs. 300/- as the Tax FMV which is post right issue price of shares. As per section 56(2)(x) of the IT Act read with Rule 11U and Rule 11UA of the Income Tax Rules, 1962, 'valuation date' for the purpose of determination of fair market value of any property to ascertain taxability u/s 56(2)(x) of the IT Act, shall be the date of receipt of property. In the issue under consideration, on the date of issue of right shares itself, the Tax FMV of shares has been reduced from Rs. 400 to Rs. 300. Accordingly, there are two fair market value of shares on the date of its receipt by shareholder, (i) pre rights issue share price (Rs. 400/-) (ii) post rights issue share price (Rs. 300). Taking pre right issue share price for the purpose tax implication u/s 56(2)(x) of the IT Act appears to be incorrect as on the date of receipt of right shares itself, Tax FMV of right shares has been reduced from Rs. 400 to Rs. 300 therefore, it would be incorrect to say that shareholder has received shares worth Rs. 400/- at a price of Rs. 100/-, but it would be correct to say that shareholder has received shares worth Rs. 300/- at a price of Rs. 100/-. However, it is pertinent to note that it shall be a grey area as to which value (post right issue share price or pre right issue share price) shall be adopted for the purpose of determination of tax implication u/s 56(2)(x) of the IT Act. In this article, we have considered the post rights issue share price as Tax FMV.

iii. **Cost of Acquisition of right shares:** As per section 55(2)(aa)(iii) of the Act, where by virtue of holding shares, assessee is entitled to additional financial asset being shares (i.e. right shares), then cost of acquisition of such additional shares being right shares shall be the amount actually paid for acquiring them (Rs. 100/- as per the above example). Whereas, as per the provision of section 49(4) of the Act, in case receipt of any capital asset has been subject to tax u/s 56(2)(x), then cost of acquisition of such capital asset shall be the value taken into account for the purpose of section 56(2)(x). Now, if receipt of right shares is subject to taxation u/s 56(2)(x), then shareholder would pay tax on the difference between the amount of Tax FMV (Rs. 300 as per the above example) and issue price (Rs.

100 as per the above example), then the issue would arise as to under which section, Section 49(4) or section 55(2)(aa)(iii), cost of acquisition of right shares shall be determined. From the perusal of section 55(2)(aa)(iii) and section 49(4) of the Act, section 55(2)(aa)(iii) of the IT Act appears to be a 'special provision' which is applicable only for determination of cost of acquisition of right shares whereas section 49(4) of the IT Act appears to be a 'general provision' which is applicable for determination of cost of acquisition in case of specified capital assets, whose value has been subject to taxation u/s 56(2)(x) of the IT Act. Applying the settled precedent 'special provision would prevail over general provision', section 55(2)(aa)(iii) should be applied for determination of cost of acquisition of right shares. However, in such case, whenever such right shares would be subsequently sold (say at a price of Rs. 500/-), then amount of taxable capital gain would be Rs. 400/- (Rs. 500 - Rs. 100) however, it is pertinent to note in this case, that there would be double taxation upon the shareholder to the extent of Rs. 200/- as shareholder has already paid tax u/s 56(2)(x) of the IT Act to the extent of Rs. 200/- (Rs. 300-Rs. 100) (Assuming that receipt of right shares is taxable u/s 56(2)(x) of the IT Act). Therefore, to avoid any double tax implication, cost of acquisition of such right shares should be determined u/s 49(4) (Rs. 300/- as per the above example). However, it would lead to a scenario where Section 55(2)(aa)(iii) of the Act would become totally redundant, which does not appear to be the intent of the legislature.

iv. **Concept of Real Income:** It is a settled principle under the Act that only real income can be taxed, not hypothetical income. In case of issue of right shares proportionate to existing shareholding, gain arising pursuant to receipt of right shares shall offset by decline in value of existing shares. Resultantly in such cases, assessee's wealth does not get increased by receipt of right shares and it remains intact. Meaning thereby, assessee has not earned anything from receipt of right shares. Hence, the deeming fiction arising from section 56(2)(x), which compares only the value of issue price of shares with the fair market value of share, may in effect not reflect the true position of any gain arising to the shareholder. Therefore, such deemed income in relation to receipt of right shares in case of proportionate allotment of right shares, may at best be considered as hypothetical income, which should not be taxed.

From the above it appears that taxing receipt of right shares u/s 56(2)(x) could not be a legislative intent. However, literal interpretation of section 56(2)(x) suggests its applicability upon shareholders on receipt of right shares at a price less than Tax FMV. Generally, in cases, whenever literal interpretation leads to unreasonable and absurd consequences, Hon'ble Supreme Court has categorically ruled that literal interpretation should be avoided. Therefore, it has to be seen by time as to how the judiciary at higher level interprets the provision of section 56(2)(x) of the Act in cases of receipt of right shares at a price less than Tax FMV.

POINT OF CAUTION

At this juncture, it is also relevant to note that certain companies resort to practice of right issue for transferring its ownership/control at a price less than prevailing market value by issuing shares disproportionate to the existing shareholding. In case of disproportionate allotment, right shares are not issued to shareholder in proportion to their shareholding. One example of disproportionate allotment could be where a company consisting of two shareholders, brings rights issue and one shareholder denies to subscribe his part of right shares and accordingly, other shareholder subscribe to his part of right shares as well as first mentioned shareholders' part of right shares. This case will lead to disproportionate allotment. The same can be understood with the help of certain modifications in the example as discussed above. Now, if Mr. B decides not to subscribe the right shares and Mr. A was given the offer to subscribe those right shares (2000 shares) along with his part of right shares (3000 shares), then shareholding proportion of Mr. A and Mr. B would be changed from 60:40 to 73.33:26.67.

Further, in such case, Mr. A has subscribed by subscribing to right shares for Rs. 5,00,000/- (5000 shares * Rs. 100) has increased his wealth from Rs. 24 lakhs (6000 shares * Rs. 400) to Rs. 33 Lakh (11000 shares * Rs. 300). Accordingly, Mr. A has increased his wealth by Rs. 9 Lakh after making payment of lesser consideration of Rs. 5 Lakh. Therefore, real income of Mr. A is Rs. 4 Lakh in the instant case and that should be the amount which should be taxed u/s 56(2)(x) of the Act. Accordingly, in case of disproportionate allotment of right shares, there are two parts of right shares which has been subscribed by Mr. A:
(i) Mr. A's entitlement i.e. 3,000 shares
(ii) Mr. B's entitlement offered to Mr. A (2,000 shares).

As far as receipt of right shares pertaining to Mr. A's entitlement is concerned, gain arising of Rs. 6 Lakh pursuant to receipt of shares by Mr. A for lesser consideration [Rs. 200/- per share *3,000 shares) shall be offset by decline in value of existing shares amounting to Rs. 6 Lakh (Rs. 100/- per share *6,000 shares). As far as receipt of right shares pertaining to Mr. B's entitlement is concerned, Mr. A has gained to the extent of Rs. 4,00,000/- (Rs. 200/- per share * 2,000 shares) without losing anything. Accordingly, to sum up, it can be said that in cases of disproportionate allotment, receipt of right shares by the shareholder would attract the rigor of provisions of section 56(2)(x) of the IT Act to certain extent.

CONCLUSION

In view of the above, it can be reasonably said that from the literal interpretation of section 56(2)(x) of the IT Act, it appears that receipt of right shares shall be taxable u/s 56(2)(x) of the IT Act, however, in cases where right shares are allotted to shareholders in proportion to their existing shareholdings, it can be very well argued before the judiciary on the basis of detailed discussion made above that no tax u/s 56(2)(x) should be applicable on receipt of shares. As far as cases of disproportionate allotment is concerned, such cases would hit by the provisions of section 56(2)(x) of the IT Act in view of the caution stated above.

Chir Amrit Legal LLP
Jaipur | Mumbai | Delhi
www.chiramritlaw.com

WE ARE ON THE WEB

www.chiramritlaw.com

For any queries regarding 'THE NEWSLETTER', please get in touch with us at:
newsletter@chiramritlaw.com

DISCLAIMER

The views expressed and the information provided in this newsletter are of general nature and are not intended to address the circumstances of any particular individual or entity. Further, the above content should neither be regarded as comprehensive nor sufficient for making decisions. No one should act on the information or views provided in this publication without appropriate professional advice. It should be noted that no assurance is given for any loss arising from any actions taken or to be taken or not taken by anyone based on this pub-

Jaipur- 6th Floor, 'Unique Destination', Opp. Times of India, Tonk Road, Jaipur - 302 015
Off: +91-141-4044500

Surat– 202, 2nd Floor, SNS Square, Opp. Reliance Market, Vesu Main Road, Vesu, Surat—395007