

(2012) 08 GUJ CK 0069
In the Gujarat High Court
Case No : Tax Appeal No. 260 of 2000

ASSTT CIT

APPELLANT

Vs

Biraj Investment Pvt. Ltd.

RESPONDENT

Date of Decision : 07-08-2012

Acts Referred:

Companies Act, 1956 — Section 108
Income Tax Act, 1961 — Section 2(47), 269UA
Transfer of Property Act, 1882 — Section 53A

Citation : (2012) 210 TAXMAN 418

Hon'ble Judges : Harsha Devani, J; Akil Abdul Hamid Kureshi, J

Bench : Division Bench

Advocate : Mauna M. Bhatt, for the Appellant; S.N. Soparkar With Mr. Bandish Soparkar, for the Respondent

Final Decision : Dismissed

Judgement

Honourable Mr. Justice Akil Kureshi

1. Revenue is in appeal against the judgment of the Income Tax Appellate Tribunal ("Tribunal" for short) dated 15.9.99. While admitting the appeal, Division Bench framed following substantial questions of law for consideration :

1. Whether, the Appellate Tribunal is right in law and on facts in holding that the assessee could make valid transfer of the shares which were pledged with the Industrial Development Bank of India and whether on the basis of the transfer of shares, there was a resultant capital loss?

2. Whether, the Appellate Tribunal is right in law and on facts in holding that the transaction in question cannot be said to be a device for reducing tax effect and thereby holding that the decision in the case of McDowell & Company had no application.

Brief facts may be noted at this stage.

Respondent assessee is a company registered under the Companies Act. During the previous year to the relevant assessment year 1993-94, the assessee had sold certain shares of Rustom Spinners Ltd and had shown a long term capital gain of Rs. 1,46,792/- and short term capital gain of Rs. 7,41,563/- on sale of such shares. The assessee had also sold 80200 equity shares of Rustom Mills and Industries Ltd. for total consideration of Rs. 4,01,000/-. On such sale of shares, the assessee had claimed long term capital loss of Rs. 8,38,798/-.

2. The Assessing Officer noted that the shares of Rustom Mills and Industries Ltd., which the assessee sold were pledged with the IDBI Bank. The original share certificates were also lying with the said Bank. The assessee had also handed over duly executed transfer forms to IDBI. The Assessing Officer, therefore, called upon the assessee to clarify how under such circumstances the assessee could sell the shares. The Assessing Officer further noted that the purchaser company, viz. Bijal Investment Ltd and the assessee company, viz. Biraj Investment Pvt. Ltd. were part of the same group of companies. The Assessing Officer also noted that directors of both these companies were common. He noticed that the husband of the common Director of these companies was the Managing Director of Rustom Mills and Industries Ltd. These companies, i.e. the assessee company and the purchaser company were therefore aware of the bad financial condition of Rustom Mills and Industries Ltd. The purchaser company was also aware that shares were pledged with IDBI and therefore delivery of shares was not possible. On the basis of these factors, the Assessing Officer asked the assessee to justify the claim of long term capital loss on sale of such shares.

3. In response to such queries, the assessee contended before the Assessing Officer that law does not require that the transfer of share can happen only upon delivery of shares. The shares form a capital asset and for the purpose of computing the capital gain and loss, what is to be seen is the transfer as defined in section 2(47) of the Income Tax Act, 1961 ("the Act" for short) which includes extinction of any rights in the capital asset. The Assessing Officer, however, was not convinced by such explanation. He was of the opinion that transfer of shares would be complete only when the share certificates along with duly executed transfer forms are delivered. In the present case, this was not done. Share certificates were lying with IDBI who had lien over such shares. The shares therefore could not have been validly transferred. He was of the opinion that full transaction was intended for creating loss to the assessee so that its capital gains resulting from sale of shares of Rustom Spinners can be set off.

4. The assessee carried the matter in appeal. The Commissioner (Appeals), by his order dated 23.3.98, dismissed the appeal. He was of the opinion that sale of shares can be completed only when the share certificates are handed over to the buyer with duly completed transfer forms. Since the assessee did not have the possession of share certificates, it could not have completed these formalities. In his opinion, therefore, no sale of shares had been effected. He also concurred

with the view of the Assessing Officer that the entire transaction was a colourable device. He noted that the assessee company and the purchaser company had common Directors. Even Rustom Mills and Industries Ltd. whose shares were under contention had common Directors. He was of the opinion that looking to the impediments attached to such shares, the same would hardly have any market value. He was, therefore, of the opinion that the ratio of the decision of the Supreme Court in the case of McDowell and Co. Ltd. Vs. Commercial Tax Officer, would apply.

5. The assessee carried the matter further in appeal before the Tribunal. The Tribunal by the impugned order reversed the orders passed by the Revenue Authorities. Tribunal placed reliance on a decision of the Madras High Court in the case of A.M.P. Arunachalam v. A.R. Krishnamurthy, 49 Company Cases 662 (Mad) wherein the facts were that R had borrowed a sum of Rs. 35,000/- with security of 5000 shares held by him in a private limited company. The share certificates together with blank transfer forms duly signed by R were handed over to the creditors. R sold the shares to the plaintiff requesting him to discharge the debts due to defendant Nos. 1 and 2 amounting to Rs. 37,602/- out of the sale consideration. He authorized defendant Nos. 1 and 2 to deliver the share certificates and the blank transfer forms on the debt being discharged. When defendant Nos.1 and 2 failed to hand over the share certificates together with blank transfer deeds signed by R and other related documents, the 1st plaintiff instituted suit seeking declaration that he had title over the shares and they belonged to him and for consequential directions. In this background, the High Court upheld the case of the plaintiff observing that transfer of interest in the shares from the transferor to the transferee is independent of the requirements of its registration for the purpose of Companies Act.

6. The Tribunal on the basis of such decision concluded that merely because the physical possession of the shares was with IDBI, it would not automatically follow that the person who is entitled to legal possession, that is, the assessee would be deprived of his right to deal with such goods until he secures the cooperation of the third party. The Tribunal was of the opinion that the assessee had the right to transfer the shares because legal title vested in the assessee.

7. Before us, learned counsel Shri M.R. Bhatt for the Revenue vehemently contended that this was a clear case of colourable device created for tax avoidance. He submitted that the assessee and the purchaser company were part of the same group. In fact, the assessee, the purchaser Company and Rustom Mills and Industries Ltd. whose shares were under consideration had directors from the same family. He submitted that the shares in question were subjected to severe restrictions. They were pledged with IDBI Bank. Original share certificates with transfer forms duly signed by the assessee were in possession of the Bank. The assessee had agreed not to transfer the forms and given undertaking to this effect to the Bank. Such shares, therefore, had no real market value. The very fact that the purchaser Company agreed to purchase

such shares at the market value would show that the entire transaction was not a genuine transaction.

8. Counsel drew our attention to section 108 of the Companies Act, 1956 to contend that such transfer could not have been registered without following the mandatory requirements contained in sub-section (1) of section 108 of the Companies Act. In this respect, counsel relied on the decision of the Apex Court in the case of Mannalal Khetan and Others Vs. Kedar Nath Khetan and Others, wherein the Apex Court held that the requirements of section 108 of the Companies Act were mandatory and not directory. In the said case, finding that despite the shares being under attachment and despite a separate prohibitory order having been issued to the Company, the Company registered transfer of shares, the Apex Court held that such action on the part of the Company was contrary to law.

9. Counsel placed heavy reliance on the decision in the case of McDowell & Co. Ltd. (supra) to contend that transaction itself should be ignored as being a colourable device to avoid tax. Counsel drew our attention to some of the observations made in a recent decision in the case of Vodafone International Holdings B.V. Vs. Union of India (UOI) and Another, , wherein the ratio of the decision in the case of McDowell & Co. Ltd. (supra) came up for consideration in view of the later decision of the Apex Court in the case of Union of India and Another Vs. Azadi Bachao Andolan and Another, .

10. On the other hand, learned counsel Shri Bandish Soparkar for the respondent assessee contended that this is not a case of colourable device. The assessee in its own wisdom desired to dispose of certain loss making shares. No provision of the Act or any other provision of law prohibits the assessee from disposing of such assets. Simply because during the same year, the assessee also sold certain other shares for a profit, it cannot be stated that there was an attempt to avoid tax.

11. Counsel submitted that what section 108 of the Companies Act prohibits is registration of transfer of shares by the company without following certain mandatory requirements and not transfer of shares themselves by the owner of the shares. In this respect, counsel relied upon the decision of the Madras High Court in the case of A.M.P. Arunachalam (supra). Counsel pointed out that the assessee had entered into an agreement dated 24.3.93 with the purchaser company under which the shares of Rustom Mills and Industries Ltd. were transferred. He further pointed out that the assessee had also given irrevocable power of attorney to the purchaser company on 30th March 1993 to deal in such shares as the Company desired. He further pointed out that the entire sale consideration was also received by the assessee company. He, therefore, submitted that in view of such facts, the provisions of section 2(47) of the Act would apply and in relation to capital asset in question, transfer at least for the purpose of the Income Tax Act would be complete.

12. Counsel submitted that the ratio of the decision of the Apex court in the case of McDowell & Co. Ltd. stands substantially diluted by virtue of subsequent decision in the case of Azadi Bachao Andolan (supra).

12.1 Counsel also relied on a decision in the case of Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat, wherein the Apex Court observed as under :

11. In its general sense, the expression "transfer of property" connotes the passing of rights in the, property from one person to another. In one case there may be a passing of the entire bundle of rights from the transferor to the transferee. In another case, the transfer may consist of one of the estates only out of all the estates comprising the totality of rights in the property. In a third case, there may be a reduction of the exclusive interest in the totality of rights of the original owner into a joint or shared interest with other persons. An exclusive interest in property is a larger interest than a share in that property. To the extent to which the exclusive interest is reduced to a shared interest it would seem that there is a transfer of interest. Therefore when a partner brings in his personal asset into the capital of the partnership firm as his contribution to its capital he reduces his exclusive rights in the asset to shared rights in it with the other partners of the firm. While he does not lose his rights in the asset altogether what he enjoys now is an abridged right which cannot be identified with the fullness of the right which he enjoyed in the asset before it entered the partnership capital.

13. Having thus heard the learned counsel for the parties, we find that the relevant facts are not in dispute. The respondent assessee sold shares of Rustom Mills and Industries Ltd for a sum of Rs. 4,01,000/- on which transaction, the assessee claimed long term capital loss of Rs. 8,38,790/-. During the same period, the assessee also sold certain shares of Rustom Spinners Ltd. and showed long term capital gain of Rs. 1,46,792 and short term capital gain of Rs. 7,41,563/-. It is also not in dispute that the shares of Rustom Mills and Industries Ltd. were pledged by the assessee with IDBI Bank. The original share certificates along with the transfer form duly signed by the assessee were in possession of the IDBI Bank. The assessee had also undertaken not to transfer such shares.

14. Despite such facts, we are of the opinion that the assessee having entered into the agreement dated 24th March 1993 with the purchaser Company and further having given power of attorney dated 30th March 1993 and received the full sale consideration from the purchaser company, by virtue of section 2(47) of the Act for the purpose of income tax, transfer of share was complete. Section 2(47) as is well known defines transfer in relation to a capital asset as under:

(47) "transfer: in relation to a capital asset, includes -

(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) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or
- (v) 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, 1982 (4 of 1882); or
- (vi) 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.

Explanation - for the purpose of sub-clauses (v) and (vi) "immovable property" shall have the same meaning as in clause (d) of section 269UA.

It may be that by virtue of pledging of shares with IDBI, having handed over the original share certificates to such financial institution along with the duly signed transfer forms, in so far as the assessee's relation with IDBI is concerned, there would be a serious question of validity of such transaction. We are, however, in the present proceedings, not concerned with such internal possible dispute between the assessee and the said financial institution. It may also be that if the purchaser Company desired to have such shares transferred in its name, such attempt would run into serious road block. Primarily, without the original share certificates in possession of the purchaser company, which was in possession of the IDBI Bank, the Company would not, in view of section 108 of the Companies Act, be able to register such transfer. Sub-section (1) of section 108 provides that a company shall not register a transfer of shares in or debentures of, unless a proper instrument of transfer duly stamped and executed by or on behalf of the transferor and by or on behalf of the transferee and further fulfilling the procedural requirements specified therein has been delivered to the company along with the certificate relating to the shares or debentures along with the letter of allotment of shares or debentures. Therefore, it would not be difficult to envisage that if the purchaser company had tried to register the same in its name by virtue of the present transfer, such attempt would be met with stiff resistance from IDBI Bank.

15. In the present proceedings, however, we are not concerned with such internal disputes. We are primarily concerned with the question whether by virtue of the agreement dated 24th March 1993, and the irrevocable power of attorney given by the assessee to the purchaser company on 30th March 1993, and also having received the full sale price of the shares, section 2(47) of the Act apply. In our opinion, the assessee did transfer whatever rights it had in the

shares to the purchaser company. If such transfer is not recognized by the IDBI and there are other legal implications of breach of undertaking given to IDBI, such issue would have to be thrashed out between the concerned parties. Insofar as income tax proceedings are concerned, we are of the opinion that by virtue of section 2(47) of the Act, the assessee was entitled to claim that upon transfer of shares or interest thereon, it had suffered long term capital loss which it was entitled to set off against the capital gain on sale of shares during the same previous year.

16. We are not inclined to accept the Revenue's contention that this was a colourable device and that the entire arrangement was a paper arrangement. Firstly, there is no provision in the Act which would prevent the assessee from selling loss making shares. Simply because such shares were sold during the previous year when the assessee had also sold some shares at profit by itself would not mean that this is a case of colourable device or that there is a case of tax avoidance. Further, there is no restriction that such sale or transaction cannot be effected with a group company. As long as the Revenue could not doubt the sale price of the shares, it would not be open for the Revenue to contend that the assessee had shown loss which it did not really suffer. In the present case, it is not even the case of the Revenue that shares were sold at a price lower than the market rate. If that be so, the question of inflating the loss by transferring the shares to group company would not arise. Under ordinary circumstances, it is always open to the assessee in his own wisdom to either hold on to certain bunch of shares or to sell the same to avoid further loss, if he finds that market value of the shares is fast diminishing. It is equally open for the assessee to effect such sale during the same year when he also chooses to dispose of certain profit making shares. In the present case, of course, there is a further angle of the shares in question being pledged to IDBI and therefore it would not be possible for the assessee to deliver the original share certificates to its purchaser along with the duly signed transfer forms. As already noted, such special angle may have repercussion insofar as the legal relation between the assessee and the IDBI is concerned and insofar as the purchaser's right to have shares transferred in its name is concerned. This, however, by itself would not establish that the sale of shares was only a paper transaction and a device contrived by the assessee to claim loss which it did not suffer and thereby seek set off against the capital gain received by it during the year under consideration.

17. In the case of Commissioner of Income Tax Vs. Sakarlal Balabhai, , a Division Bench of this Court observed that avoidance of tax cannot include every case of reduction of tax liability of an assessee. The assessee may enter into a transaction which has the effect of diminishing his income and consequently reducing his tax liability. In such a case, there would be no avoidance of tax, For example, a case where the assessee makes a gift of shares to his son. By reason of gift income from the shares would not accrue to the assessee but would accrue to the son and to that extent the income of the assessee would be diminished and his tax liability reduced. This cannot be regarded as a case of tax

avoidance even if the motive of the assessee in making the gift was to save tax on the income from shares at a higher rate applicable to him.

18. Under the circumstances, even without referring to the decision of the Apex Court in the case of *Azadi Bachao Andolan* (supra) and the observations made in the later decision in the case of *Vodafone* (supra), we do not find that this a case which would fall within the parameters of the decision in the case of *McDowell & Company Ltd* (supra). In the result, we answer the questions in the affirmative, i.e. in favour of the assessee and against the Revenue. Tax Appeal is accordingly dismissed.