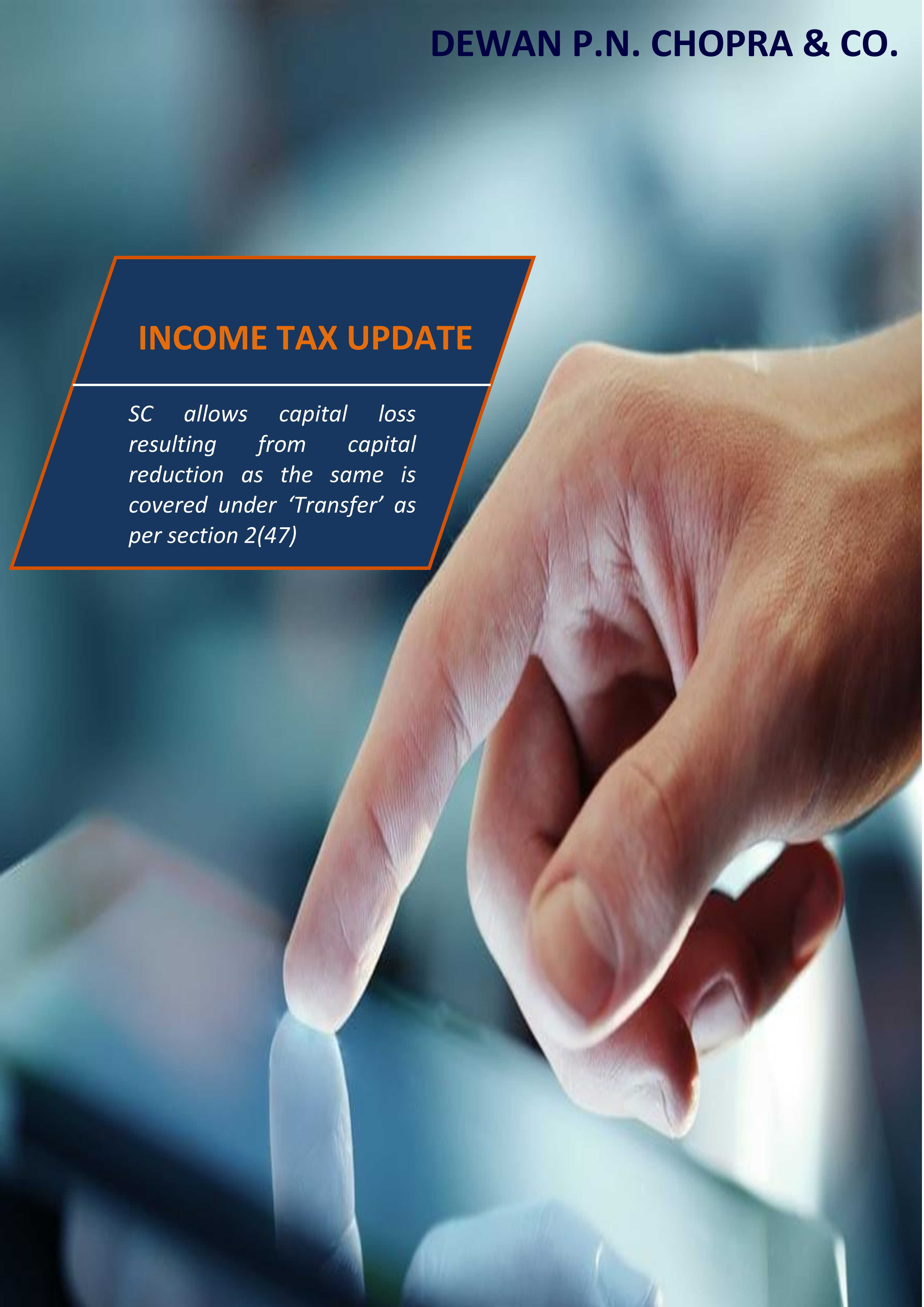
INCOME TAX UPDATE

SC allows capital loss resulting from capital reduction as the same is covered under 'Transfer' as per section 2(47)



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Facts of the case: -

- Assessee, engaged in the activities of investing in shares, leasing, financing, and money lending, invested in Asianet News Network Pvt. Ltd. (ANNPL), an Indian company by acquiring 14,95,44,130 shares with a face value of ₹10/- each. Subsequently, the assessee purchased additional 38,06,758 shares from other parties, increasing its total shareholding to 15,33,40,900 shares, representing 99.88% of the total share capital of the company, which stood at 15,35,05,750 shares.

- ANNPL incurred losses and later filed a petition before Bombay High Court seeking a reduction in its share capital. High Court approved the reduction, decreasing the company's share capital from 15,35,05,750 shares to 10,000 shares. Consequently, the assessee's shareholding was proportionately reduced from 15,33,40,900 shares to 9,988 shares, though the face value of the shares remained unchanged at ₹10/- per share. The High Court also directed the company to pay ₹3,17,83,474/- to assessee as consideration.

- During the relevant financial year, assessee claimed a long-term capital loss arising from reduction in share capital resulting from adjustment in number of shares held in company.

Contention of AO: -

- The Assessing Officer took the view that although the number of shares got reduced by virtue of reduction in share capital of the company, yet the face value of each share as well as shareholding pattern remained the same.
- Thus, it was held that reduction in shares of subsidiary company did not result in the transfer of a capital asset as envisaged in Section 2(47) of the Income Tax Act.

Before CIT(A) :-

- CIT(A) distinguished the facts of the present case from those involved in **Kartikeya V. Sarabhai v. Commissioner of Income Tax (1997) 7 SCC 524** and took the same stand as AO and held that there was no effective transfer, which could result in any real Long Term Capital Loss as claimed by the appellant in the present case as the shareholding ratio of the assessee company also remained constant even after implementation of the share-reduction scheme.

Before ITAT and High Court: -

- The ITAT reversed the order passed by the CIT(A) and allowed the appeal filed by the assessee observing that the decision of this Court in Kartikeya V. Sarabhai (1997) 7 SCC 524 is squarely applicable to facts of the present case and held that assessee's claim for capital loss on account of reduction in share capital in ANNPL is allowable.
- High Court dismissed the appeal and affirmed the order passed by the ITAT.

Judgement by Supreme Court

- The court relied on the following judgements and concluded that the reduction in share capital of the subsidiary company and subsequent proportionate reduction in shareholding of assessee would be squarely covered within the ambit of expression "sale, exchange or relinquishment of the asset" used in Section 2(47) the Income Tax Act.

- **Kartikeya V. Sarabhai (1997) 7 SCC 524 –** Section 2(47) of Income Tax Act which is an inclusive definition, inter alia, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. While the taxpayer continues to remain a shareholder of the company even with reduction of share capital, it could not be accepted that there was no extinguishment of any part of his right as a shareholder qua the company. When as a result of the reducing of the face value of the share, the share capital is reduced, the right of the preference shareholder to the dividend or his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital. Such a reduction of the right of the capital asset clearly amounts to a transfer within the meaning of section 2(47) of Income Tax Act.

- **Commissioner of Income-Tax v. Jaykrishna Harivallabhdas (1998) 231 ITR 108 -**

  Receipt of some consideration in lieu of the extinguishment of rights is not a condition precedent for the computation of capital gains as envisaged under Section 48 of the Income Tax Act.

- **Commissioner of Income Tax v. Vania Silk Mills (P.) Ltd (1977) 107 ITR 300 (Guj)-**
  The expression "extinguishment of any right therein" is of wide import. It covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the bundle of rights - qualitative or quantitative - which the assessee has in a capital asset, whether such asset is corporeal or incorporeal.

- **Anarkali Sarabhai v. CIT (1997) 3 SCC 238-**
  Reduction of share capital or redemption of shares is an exception to the rule contained in

Section 77(1) of Companies Act, 1956. Both reduction of share capital and redemption of shares involve the purchase of its own shares by the company and hence will be included within the meaning of transfer under Section 2(47) of Income Tax Act.

For complete details, please refer to the Supreme Court Judgement dated 02/01/2025 passed in the case of *JUPITER CAPITAL PVT. LTD. SPECIAL LEAVE PETITION NO. 63 OF 2025* https://api.sci.gov.in/supremecourt/2024/39934/39934_2024_15_15_58197_Judgement_02-Jan-2025.pdf

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