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TAX BULLETIN

M/s. Carestream Health Inc.
(Mum ITAT)

Mumbai ITAT Ruling: Whether reduction in share capital amounts to a transfer and thereby gives rise to capital gains, if consideration is paid for such reduction?

M/s. Carestream Health Inc. vs. DCIT

[(ITA No. 826/Mum/2016) / TS-75-ITAT-2020(Mum)]

Facts of the case:

- Carestream Health Inc. (taxpayer or the assessee) is a tax resident and company incorporated in the United States (USA). Carestream Health Pvt. Ltd. (CHIPL) is a wholly owned subsidiary of the taxpayer, resident in India.
- In assessment year (AY) 2011-12, a capital reduction scheme, duly approved by the High Court (HC), was undertaken by CHIPL, wherein its share capital was reduced. This was done by the virtue of cancellation of some equity shares.
- On account of reduction/cancellation of shares, the taxpayer was paid a compensation by CHIPL.
- The consideration up to the extent of accumulated profits of CHIPL, was treated as dividend and dividend distribution tax was also paid by CHIPL.
- In respect of the consideration exceeding the accumulated profits, the taxpayer considered the same as full value of consideration and calculated capital gains, which resulted in a capital loss.
- The capital loss arising to the taxpayer was ignored by the Assessing Officer (AO). Further, the Dispute Resolution Panel (DRP) placed reliance on the Special Bench decision in the case of Bennett Coleman & Co v. ACIT (133 ITD 1) (Mum – SB) (Bennett Coleman), ignored the capital loss and upheld the order of the AO.
- Thus, the taxpayer approached the Income-tax Appellate Tribunal (ITAT or Tribunal) on the ground that since there is a transfer of capital asset for which consideration is received, there is a capital loss under the head of income - Capital Gains, which should be allowed.

Contentions of the AO:

- The main ground of contention by the AO was that, there is no extinguishment of rights of the taxpayer, as earlier the taxpayer was entitled to 100% control over CHIPL and even after the capital reduction scheme, the taxpayer enjoyed 100% control over CHIPL.
- An alternative plea by the taxpayer of treating the impugned transaction as buyback was rejected by the AO on the ground that, the scheme of capital reduction was duly approved by the HC and accordingly the scheme cannot be considered as buyback of shares.

Contentions of the taxpayer:

- It was contended by the taxpayer that it is the shares in CHIPL, which is an asset and percentage of shareholding is not to be considered in determination of capital gains.
- The reduction of share capital also leads to a reduction on proportionate basis, in the right to receive dividend and the right to share in distribution of net assets on liquidation.
- The HC, before approving the capital reduction scheme, has to be satisfied that the consent of the creditor to the reduction of capital is obtained. This itself signifies and implies that there is a variation/ extinguishment in rights, and thus, the transaction of capital reduction tantamounts to a transfer of a capital asset.

Key observations and the decision of the Hon'ble Mum ITAT:

- The ITAT distinguished the Special Bench decision of Bennett Coleman relied by the DRP. The taxpayer in the present case has received separate consideration, whereas no such consideration was received in the case of Bennett Coleman.
- The ITAT relied on the Hon'ble Supreme Court (SC) in the case of CIT v. Grace Collis (248 ITR 323), which is in context to amalgamation. The ITAT held that the case of the taxpayer amounts to extinguishment of rights in shares, which falls under the limb '*extinguishment of any rights*' under section 2(47) of the Income-tax Act, 1961 (the Act) which defines 'Transfer'.
- The ITAT also relied on the below decisions of the Hon'ble SC, wherein it was held that reduction of share capital amounts to 'Transfer':

- Kartikeya V Sarabhai v. CIT [(288 ITR 163) (SC)] and
 - CIT v. G Narashiman [(236 ITR 327)(SC)]
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- The ITAT further relied on the case of the Hon'ble Bangalore ITAT in the case of Jupiter Capital Pvt. Ltd v. ACIT (ITA No. 445/Bang/2018), wherein on similar facts it was held that reduction in capital amounts to 'Transfer'.
 - The ITAT held that, *even though the shareholder remains a shareholder after the capital reduction, first right as a holder of those shares stands reduced with the reduction in the share capital.*

Our Comments:

- The Special Bench in case of Bennett Coleman gave reference to the percentage of shareholding to determine whether there arises any capital gains or not, however in the present case, the ITAT clearly held that it is the 'share in the company' which is a capital asset and the same has to be taken into consideration for determining capital gains and not the 'percentage of shareholding in a company'.
- It would therefore be interesting to see how jurisprudence will evolve, when in reduction of share capital, the equity shareholders suffer by way of cancellation of shares or paid up value of shares being reduced, to wipe out accumulated losses, etc. In such cases would such negative consideration not be considered as loss to the shareholder, which is eligible to capital gains?

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