

Kartikeya V. Sarabhai

Vs

Commissioner of Income Tax

Civil Appeal No. 1098 of 1982

(B.N. Kirpal, K.T. Thomas JJ)

04.09.1997

JUDGMENT

KIRPAL, J. -

1. The only question which arises for consideration in this appeal, under certificate having been granted by the High Court, is whether on a reduction of share capital with the company paying a part of the capital by reducing face value of its share, results in extinguishment of right in the shares held by the shareholder so that the amount paid on reduction of share capital would be exigible to capital gain tax.

2. The appellant had purchased 90 non-cumulative preference shares, each of the face value of Rs. 1000 at a price of Rs. 420 per share, of a company called Sarabhai Limited. In 1965, a sum of Rs. 500 per preference share was paid off to the assessee upon a reduction of a share capital of the Company under Section 100(1) (c) of the Companies Act. This was done by reducing the face value of each share from Rs. 1000 to Rs. 500 and by paying off Rs. 500 in cash. As a result thereof the appellant became a holder in respect of 90 non-cumulative preference shares of the value of Rs. 500 per share, in place of being the holder of shares of the face value of Rs. 1000 per share.

3. In the present case, we are concerned with the further reduction of the face value of the shares which took place in the year 1966. In the Extraordinary General Meeting of Sarabhai Limited held on 10-1-1966, a special resolution was passed by the Company by virtue of which it reduced its liability on the preference shares from Rs. 500 per share to Rs. 50 per share by paying off in cash a sum of Rs. 450 per share. Thus, the share held by the appellant which was originally of the face value of Rs. 1000 became a share of the face value of Rs. 50 only. This reduction had taken place in two stages, firstly when the face value was reduced from Rs. 1000 to Rs. 500 per share and secondly when the face value was reduced from Rs. 500 per share to Rs. 50 per share.

4. The appellant had originally purchased the preference shares of the face value of Rs. 1000 per share at a price of Rs. 420 per share. At the time of first reduction, he got back Rs. 500 per share in cash. At the time of second reduction, with which we are concerned in this case, the appellant got a further sum of Rs. 450 per share in cash.

5. The Income Tax Officer was of the opinion that a sum of Rs. 450 per share, which was now received by the assessee, was liable to be subjected to levy of capital gain tax. The appellant, however, contended that such reduction of the face value did not result in extinguishment of the assessee's right and there was no transfer within the meaning of that expression as contained in Section 2(47) of the Income Tax Act, 1961 (hereinafter referred to as "the Act") and, secondly no

tax could be imposed thereon. The Income Tax Officer did not accept the appellant's contention and taxed the said amount.

6. The appeal of the appellant before the Appellate Assistant Commissioner succeeded and a sum of Rs. 23,490, which had been included as capital gains, was held not to be liable to tax. The Revenue, however, filed a second appeal and the Income Tax Appellate Tribunal set aside the order of the Appellate Assistant Commissioner and restored the orders of the Income Tax Officer. At the instance of the appellant, the Income Tax Tribunal referred the following question of law to the High Court of Gujarat.

"Whether, on the facts of the case, the Tribunal rightly held that the assessee had made capital gains on the reduction of preference share capital which was exigible to capital gains tax ?"

7. The High Court considered the matter in its entirety and came to the conclusion that the Tribunal had rightly held that the appellant had made capital gains on the reduction of preference share capital and the same was exigible to capital gains tax. Thereafter, at the request of the appellant, the High Court granted leave to appeal. Hence, this appeal.

8. On behalf of the appellant, it was vehemently contended by Mr. Ganesh, learned counsel that no capital gains tax could be levied in the present case. It was submitted that reduction of the face value of the shares from Rs. 500 to Rs. 50 per share did not amount to extinguishment of any right and, therefore, could not be regarded as transfer within the meaning of Section 2(47) of the Act and the appellant continued to be a shareholder of the Company. It was also submitted that there can be no transfer where shareholders get back money from the company and in this connection, he relied upon the decision in the case reported as CIT v. R.M. Amin [(1977) 1 SCC 691 : 1997 SCC (Tax) 234 : (1977) 106 ITR 368]. Lastly, it was submitted that Section 45 of the Act was not applicable as the appellant had not made any sale. It was submitted that as a result of the Company's special resolution, the appellant got the money against surrender of shares and this would not amount to a sale.

9. It is not possible to accept the contention of Shri Ganesh, learned counsel that reduction does not amount to a transfer of the capital asset. Section 2(47) of the Act reads as follows :

"2. (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 or 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 53-A of the Transfer of Property Act, 1882 (4 of 1882); or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a cooperative 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 purposes of sub-clauses (v) and (vi), 'immovable property' shall have the same meaning as in clause (d) of Section 269-UA;"

10. Section 45 of the Act reads as follows :

"45. Capital gains. - (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 53, 54, 54-B, 54-D, 54-E, 54-F and 54-G, be chargeable to income tax under the head 'Capital gains' and shall be deemed to be the income of the previous year in which the transfer took place."

11. Section 2(47) 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, it is no doubt true that the appellant continues to remain a shareholder of the company even with the reduction of share capital but it is not possible to accept the contention that there has been no extinguishment of any part of his right as a shareholder qua the company. It is not necessary that for a capital gain to arise there must be sale of a capital asset. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. Relinquishment of the asset or the extinguishment of any right in it, which may not amount to sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under Section 45 of the Act.

12. When as a result of the reducing of the face value of the shares, 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. Whereas the appellant had a right to dividend on a capital of Rs. 500 per share that stood reduced to his receiving dividend on Rs. 50 per share. Similarly, if the liquidation was to take place whereas he originally had a right to Rs. 500 per share, now his right stood reduced to receiving Rs. 50 per share only. Even though the appellant continues to remain a shareholder his right as a holder of those shares clearly stands reduced with the reduction in the share capital.

13. The Gujarat High Court had in another case reported as Anarkali Sarabhai v. CIT [(1982) 138 ITR 437 (Guj)] followed the judgment under appeal. That was a case where there had been redemption of preference share capital by the company and money was paid to the shareholders. It was held therein that difference between the face value received by the shareholder and the price paid for preference shares was exigible to capital gains tax. In coming to this conclusion, the Gujarat High Court had followed the judgment under appeal in the present case.

14. The aforesaid decision of the Gujarat High Court in Anarkali case [(1982) 138 ITR 437 (Guj)] was challenged and this Court in Anarkali Sarabhai v. CIT [(1997) 3 SCC 238 : (1997) 224 ITR 422] upheld the High Court's decision. It had been contended in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] on behalf of the assessee that reduction of preference shares was not a sale or relinquishment of asset and, therefore, no capital gains tax was payable. Repelling this contention, this Court considered the definition of the word "transfer" occurring in Section 2(47) of the Act and reading the same along with Section 45, it came to the conclusion that when a preference share is

redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. It was observed that in effect the company buys back the preference shares from the shareholders. Further, referring to the provisions of the Companies Act, it held that the reduction of preference shares by a company was a sale and would squarely come within the phrase "sale, exchange or relinquishment" of an asset under Section 2(47) of the Act. It was also held that the definition of the word "transfer" under Section 2(47) of the Act was not an exhaustive definition and that sub-section (I) of clause (47) of Section 2 implies that parting with any capital asset for gain would be taxable under Section 45 of the Act. In this connection, it was noted that when preference shares are redeemed by the company, the shareholder has to abandon or surrender the shares, in order to get the amount of money in lieu thereof.

15. In our opinion, the aforesaid decision of this Court in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] is applicable in the instant case. The only difference in the present case and Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] is that whereas in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] preference shares were redeemed in entirety, in the present case, there has been a reduction in the share capital inasmuch as the company had redeemed its preference shares of Rs. 500 to the extent of Rs. 450 per share. The liability of the company in respect of the preference share which was previously to the extent of Rs. 500 now stood reduced to Rs. 50 per share.

16. The company under Section 100(1) (c) of the Companies Act has a right to reduce the share capital and one of the modes, which can be adopted, is to reduce the face value of the preference shares. This is precisely what has been done in the instant case. Instead of there being a 100% extinction of the right which was there in the Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422], here the right as a preference shareholder of the appellant stands reduced from Rs. 500 to Rs. 50 per share. A sum of Rs. 450 per share has been paid by the company to the appellant on account of the extinguishment of his right to the aforesaid extent.

17. Yet another right which is apparently effected as a consequence of this reduction is with regard to the voting right. According to Section 87(2) (a) of the Companies Act, a holder of a preference share has a right to vote only on resolution placed before the company which directly affects the rights attached to his preference shares. In the case of cumulative preference share, if dividend remains unpaid for not less than two years preceding the date of commencement of the meeting, then even a preference shareholder, by virtue of Section 87(2) (b) of the Companies Act, gets a right to vote on every resolution placed before the company at any meeting like a member holding equity shares. What is important for our purposes is the provisions of clause (c) of the Explanation to Section 87(2) (b) which, inter alia, provides :

"(c) Where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-section, his voting right on a poll, as the holder of such share, shall, subject to the provisions of Section 89 and sub-section (2) of Section 92, be in the same proportion as the capital paid up in respect of the preference share bears to the total paid-up equity capital of the company."

18. Therefore, with the reduction in the face value of the shares from Rs. 500 per share to Rs. 50 per share, the value of the vote of the appellant in the event of there being a poll would stand considerably reduced. Such reduction of the right in the capital asset would clearly amount to a transfer within the meaning of that expression in Section 2(47) of the Act.

19. The decision in R.M. Amin case [(1977) 1 SCC 691 : 1977 SCC (Tax) 234 : (1977) 106 ITR 368] can be of no help to the appellant. In that case, the company had gone into voluntary liquidation and the assessee had received a sum in cash of the amount which he had paid for the share. It was held that when a shareholder receives money representing his share on the distribution of the net assets of a company in liquidation, he receives that money in satisfaction of the right which belongs to him by virtue of his holding the share and not by any operation of any transaction which amounted to sale, exchange, relinquishment, transfer of a capital asset or extinguishment of any right in capital assets. The payments received by the contributories on the liquidation of the company would not amount to a transfer and it is for this reason that R.M. Amin [(1977) 1 SCC 691 : 1977 SCC (Tax) 234 : (1977) 106 ITR 368] was distinguished by this Court in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422].

20. In our opinion, the High Court was right in coming to the conclusion that the appellant was liable to pay capital gains tax on the capital gain of Rs. 28,710 as a result of reduction in the preference share in Sarabhai Limited. This appeal is, accordingly dismissed with costs.