

BOMBAY HIGH COURT

Sath Gwaldas Mathuradas Mohata

Vs.

Commissioner Of Income-Tax

Income-tax Reference No. 346 of 1979

(S.P Bharucha and V.A. Mohta, JJ.)

30.01.1987

JUDGMENT

V.A. Mohta, J.

1. The following question has been referred at the instant of the assessee under section 256(1) of the Income-tax Act :

"On a true interpretation of section 45 read with section 2(47) of the Income-tax Act, 1961, was the Tribunal right in holding that the amount received by the assessee on redemption of preference shares was liable to be taxed under the head 'capital gains' ?".

2. The reference relates to the assessment year 1975-76. The assessee had purchased 1,000 cumulative fully paid redeemable preference shares of Mr. R.S. Rekchand Spinning and Weaving Mills (P) Ltd., Hinganghat, from Shri Girdhardas Mohota before 1970. The purchase price was ₹ 50 per shares an against the fully paid-up value of the ₹ 100 per share. During the accounting year relevant to the assessment year 1975-76, the company redeemed the preference shares held by the assessee by payment of ₹ 1,00,000 for 1,000 shares. A sum of ₹ 36,360 was paid by the company in addition towards dividend. The dividend was offered for assessment and was duly assessed. However, the assessee's gain of ₹ 50,000 in the transaction representing the difference between the purchase price paid by the assessee for the shares and the value that the assessee received on the redemption of the shares, was neither offered for assessment nor assessed by the Income-tax Officer. A notice under section 263 was issued by the Commissioner to the assessee, asking him to show cause as to why the sum of ₹ 50,000 should not be assessed as capital gain. The assessee made a written statement objecting to the assessment. The Commissioner took the view that shares were capital assets and there was a 'transfer' of a capital asset within the meaning

of section 2(47) of the Income-tax Act. According to the Commissioner not only 'sale' but also 'relinquishment' and 'extinguishment' within the extended meaning assigned to the word 'transfer' were involved in the transaction. Section 2(47), as it stood at the material time, read thus :

"transfer' in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the compulsory acquisition thereof under any law."

3. Aggrieved by the order of the Commissioner, an appeal was carried to the Tribunal which confirmed the order passed by the Commissioner.

4. Sri Thakkar, learned counsel for the assessee, contended that in the transaction, no transfer was involved as the redemption did not involve any purchase of rights by the company, and the property ceased to be in existence. Strong reliance was placed in support on the case of *Commissioner of Income Tax v. G. Narasimhan*¹, We will deal with that judgement first. The point involved in that case was whether there was any extinguishment of any capital asset held by the assessee as a result of reduction of capital by the company. The basis facts in the said decision were that the assessee held 70 shares out of 2,400 shares of ₹ 1,000 each in private limited company. During the accounting period ending on 31 March, 1963, relevant to the assessment year 1963-64, the capital of the company was reduced, the result of which was to reduce the value of each share from ₹ 1,000 to ₹ 210. Consequent on this reduction, there was distribution of assets and money to the shareholders and a point arose whether any 'transfer' was involved and whether the amount received by the shareholders was taxable as capital gain, and the Madras High Court, in the said judgment, took the view that there was no extinguishment of any right of the assessee and, consequently, there was no transfer principally because –

"All the rights of shareholder as a shareholder in the company still remains. He continues to hold the same number of shares."

5. In the case of *Kartikey V. Sarabhai v. Commissioner of Income Tax*², the Gujarat High Court had occasion this very point. The assessee had placed reliance on the above Madras High Court decision. Disagreeing with the view expressed by the Madras High Court, it was observed (at page 435) :

"The number of shares remained the same but the face value of the shares was reduced and there was a proportionate curtailment of his right in respect of the right to received dividend and to share in the net assets of the company upon liquidation..... To the extent that his right in this behalf is curtailed, there is an extinguishment of his right notwithstanding the fact that he continues to be a shareholder..."

6. With respect, we prefer the line of reasoning adopted in the Gujarat decision as, in our view, it

represents the correct legal position. It is apparent that even though the number of shares remains the same, its value gets reduced.

7. The case on hand stands on a somewhat different footing. Here, a regular 'sale' itself has taken place. That is the ordinary concept of transfer. The company paid the price for the redemption of the shares out of its fund to the assessee and the transaction was clearly a purchase. As rightly observed by the Tribunal, if the company had purchased a valuable

¹(1979) 118 ITR 60 (Mad)

²(1982) 138 ITR 425 (Guj)

right, the assessee had sold a valuable right. 'Relinquishment' and 'extinguishment' which are not in the normal concept of transfer but are included in the definition by the extended meaning attached to the word are also attracted in the transaction. The shares were assets and they were relinquished by the assessee and thus relinquishment of assets did take place. The assessee by virtue of his being a holder of redeemable cumulative preference shares had a right in the profits of the company, if and when made, at a fixed rate of percentage. Quite obviously, this was a valuable right and this right had come to an end by company's redemption of shares. Thus, the transaction also amounted to 'extinguishment' of right. Under the circumstances, viewed from any angle, there is no escape from the conclusion that section 2(47) was attracted and that the amount of ₹ 50,000 received by the assessee was liable to be taxed under the head 'capital gains'.

8. In the result, the question is answered in the affirmative and against the assessee. The applicant to bear the cost of this reference.

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