Income tax department lens on Rs 5 lakh crore share sales by India Inc

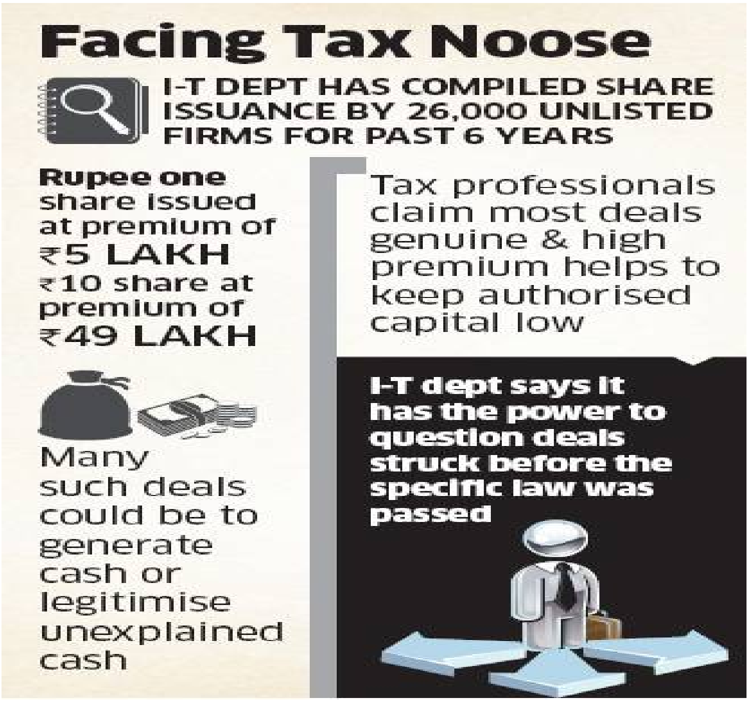
More than 5,000 closely held companies will come under the glare of the income tax department for transferring funds through suspicious share-sale deals. According to information compiled by the tax office, about Rs 5 lakh crore changed hands in past six years as 26,000-odd unlisted firms belonging to large and mid-sized corporate houses transferred funds by issuing equity and preference shares at high premiums.

Tax officers believe that as much as 25% of these transactions may not be genuine. They have come across deals where equity shares having a face value of Rs 1 were sold to another entity at a premium of Rs 5 lakh, and Rs 10 shares were issued at a premium of Rs 49 lakh, said a source aware of the ongoing I-T investigation.

Many share sale deals defy logic

In two cases, involving the same corporate group, three shares of Rs 10 each were offered at a premium of more than Rs 100 crore a share. "There are many such deals that defy logic and it will be difficult for companies with little activity and capital of few lakhs to justify the premium," said a government official.

On April 25, ET had reported that the tax department, in a directive issued a day before the fiscal closing, questioned hundreds of companies on the premium collected against the sale of shares. The companies have been told to justify the premiums, failing which the amount would be treated as income and therefore taxed. The 26,000 cases relate to companies based in Maharashtra. More firms will be covered with the department's offices in some of the northern states initiating similar procedures.



Corporate groups often use their unlisted arms to enter into such transactions either to generate cash or convert unexplained cash into income. Say, entity A needs Rs 5 crore cash for a property deal or to arrange a payoff. While it has the money, it fears withdrawing the amount from bank would alert tax authorities. Instead, it strikes a deal with B, which has cash and is looking for a way to legitimise it. B issues shares to A, receives Rs 5 crore through official banking channels and pays A the amount in cash. Such deals are also used to bring back funds that may have earlier been siphoned out from a company. But three senior tax professionals ET spoke to said that such cases are unlikely to exceed 5% of total transactions. The department, according to them, has rattled many companies by putting a question mark on bona fide transactions such as issuance of shares to joint venture partners, promoters and financial investors.

"Fewer shares with higher premium are also issued to keep the authorised capital low and reduce fees paid to the Registrar of Companies," said one of the tax practitioners. The particular section in the law that empowers the department to demand taxes on unjustified premiums came into effect on April 1, 2013. But based on the Bombay High Court ruling in the case Major Metals Ltd versus Union of India, the department maintains that it has the power to tax cases related to unjustified premiums came into effect on April 1, 2013. But based on the Bombay High Court ruling in the case Major Metals Ltd versus Union of India, the department maintains that it has the power to tax cases related to unjustified premiums even prior to this date.

According to the department, in a case where the share premium charged is in excess of their intrinsic valuation, there is ground for invoking the provisions of Section 68 of the Income-Tax Act, which requires the assessee to explain not only the 'source' of the credit entry but also its 'nature'. The assessments that have been reopened pertain to those in 2008-09, which would have become time-barred after March 31, 2014. But the department is collecting data for subsequent years as well.

(Economic Times)