Bom.HC-Even bonus shares eligible for lower tax rate

Benefit of lower tax rate under Proviso to s. 112 available to bonus shares despite no indexation

CIT vs. Anuj A. Sheth HUF

The proviso to s. 112(1) provides that "where the tax payable in respect of any income arising from the transfer of a long-term capital asset, being listed securities … exceeds ten per cent of the amount of capital gains **before giving effect to the provisions of the second proviso to section 48** (i.e. indexation), then, such excess shall be ignored for the purpose of computing the tax payable by the assessee". The assessee sold bonus shares of Infosys for Rs. 6.13 crores. As there was no cost of acquisition of bonus shares and no indexation, the long-term capital gains were computed at Rs. 6.13 crores. The assessee sold other shares and computed a long-term capital loss of Rs. 2.68 crores after indexation, which was claimed as a set off against the LTCG of Rs. 6.13 crores. On the balance of Rs. 3.45 crores (comprising of gains on the bonus shares), the assessee paid tax at 10% as per the Proviso to s. 112. The AO took the view that as the assessee was not eligible to claim indexation benefits in respect of the bonus shares, it was not entitled to the option given by the Proviso to s. 112 and tax was payable on the entire gains at the rate of 20%. The AO's stand was upheld by the CIT (A) though reversed by the Tribunal. On appeal by the revenue, HELD dismissing the appeal:

(i) U/s 45 (1), **the capital gains on the transfer of each capital asset have to be computed separately**. Under the second proviso to s. 48, the gains have to be computed by deducting the "indexed cost of acquisition" from the consideration. U/s 70, the assessee is entitled to set off the loss sustained on the sale of shares from the capital gains realized from the sale of the bonus shares of Infosys resulting in the net capital gain of Rs.3.45 crores. U/s 112, the said long term capital gains are chargeable to tax at the rate of 20% subject to the Proviso;

(ii) **In the case of bonus shares, the question of indexation does not arise because the cost of acquisition is taken to be nil**. What the proviso to s. 112 essentially requires is that where the tax payable in respect of a listed security (being LTCG) exceeds 10% of the capital gains before indexation, such excess beyond 10% is liable to be ignored. The proviso to s. 112 requires a comparison to be made between the tax payable at 20% after indexation with the tax payable at 10% before indexation. **If the shares were acquired at a cost, it becomes necessary for purposes of the proviso to s. 112(1) to compute capital gains before giving effect to indexation. However, that does not arise in respect of bonus shares**. There is nothing in the s. 112 to suggest that the assessee would be entitled to a set off of the loss u/s 70 but without the benefit of indexation;

(iii) Circular Nos. 721 and 779 dated 13.9.1995 and 14.9.1999 respectively are significant because they reflect the Revenue's understanding that (i) the benefit of a set off would be available while computing the income arising from the transfer of a long term capital asset, which is part of the total income of an assessee and (ii) The benefit of the cost inflation index or indexation would continue to be available subject to the condition that

where the tax on long term capital gains without adjustment for indexation exceeds 10%, such excess shall be ignored.

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

O. O. C. J.
INCOME TAX APPEAL NO.2285 OF 2009
The Commissioner of Income Tax 21
Mumbai ..Appellant.
Vs.
Anuj A. Sheth HUF, Mumbai ..Respondent.
....
Mr. N.A. Kazi for the Appellant.
Mr. P.J. Pardiwala, Senior Advocate with Dr. K. Shivram with Mr.
A.R. Singh and Mr. P.S. Savla for the Respondent.
CORAM : DR. D.Y.CHANDRACHUD &
J.P. DEVADHAR, JJ.
7th April, 2010

ORAL JUDGMENT (Per DR.D.Y.CHANDRACHUD, J.):

1. Admit. The following question of law will arise in the appeal filed by the Revenue under Section 260A of the Income Tax Act, 1961 :

> "Whether the assessee's claim of computation of long term capital gains on the sale of shares, other than the bonus shares of Infosys Technologies, after giving the benefit of indexation is in consonance with the proviso to Section 112(1) and the other provisions of the Act?"

2. The question of law has been reframed during the course of the hearing of the appeal since the question as formulated by the Revenue was lacking in clarity.

3. The appeal arises out of an order passed by the Income Tax Appellate Tribunal on 5th September, 2008. The Assessment Year is 20 01 02. In the present case the assessee entered into eight sale transactions involving the shares of four companies. Of the sale transactions, the shares of Infosys Technologies comprised entirely of bonus shares where the cost of acquisition was nil. The bonus shares of Infosys Technologies were sold for a consideration of Rs.6.13 Crores. There being no cost of acquisition, the long term capital gains were computed at Rs.6.13 Crores. Out of the remaining seven transactions one sale resulted in a long term capital gain of Rs.9.47 lacs with indexation whereas in the remaining transactions the assessee reported a loss of Rs.2.78 Crores with indexation. The assessee set off the long term capital loss of Rs.2.68 Crores from the long term capital gains of Rs.6.13 Crores and paid a tax of 10% on the net long term capital gain of Rs.3.45 Crores.

4. The Assessing Officer adopted the sale price realized from the shares sold by the assessee of Rs.7.51 Crores and after deducting the cost of acquisition of shares of Rs.3.16 Crores, assessed the long term capital gains without indexation at Rs.4.34 Crores. In other words, what the Assessing Officer did in effect was to deny the benefit of indexation to the assessee while giving effect to the proviso to Section 112(1). The appeal against the Assessment Order on this issue failed before the CIT(A). The Tribunal came to the conclusion that shares transferred on every occasion constitute a separate capital asset as provided in Section 48. Moreover, the Tribunal held that merely because the assessee had not claimed indexation on the sale of its bonus shares of Infosys Technologies, the Revenue was not justified in denying the benefit of indexation on the sale of shares of other companies to the assessee. The conclusion of the Tribunal was that the assessee's claim of computation of long term capital gains on the sale of shares, other than the bonus shares of Infosys Technologies, after giving the benefit of indexation was in consonance with the proviso to Section 112(1) and the other provisions of the Act and that accordingly the assessee was assessable to net long term capital gains computed at Rs.3.45 Crores as returned. The appeal filed by the assessee on the aforesaid ground was allowed.

5. Counsel appearing on behalf of the Revenue has assailed the finding of the Tribunal by submitting that the Assessing Officer was justified in denying to the assessee the benefit of indexation and in computing the long term capital gain by deducting from the total sale price of the listed securities (Rs.7.51 Crores) the absolute cost of acquisition (Rs.3.16 Crores) thereby resulting in a net gain of Rs.4.34 Crores.

6. Section 45(1) of the Income Tax Act, 1961 stipulates that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as provided in certain specific sections referred to therein, 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. For the purpose of sub section (1) of Section 45 the capital gains on the transfer of each capital asset have to be computed separately. Section 48 provides for the computation of income chargeable under the head 'capital gains'. The marginal note to Section 48 is entitled 'mode of computation'. Section 48 stipulates that income chargeable under the head 'capital gains' shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, viz.

(i) Expenditure incurred wholly and exclusively in connection with such transfer; and

(ii) (ii) The cost of acquisition of the asset and the cost of any improvement thereto. The second proviso is to the effect that where long term capital gains arise from the transfer of a long term capital asset (other than capital gain arising to a non resident from the transfer of shares or debentures of an Indian company) the provisions of Clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" have respectively been substituted. The indexed cost of acquisition is computed so as to bring the actual cost of acquisition in line with the cost of inflation

index. Section 70 provides for the set off of loss from one source against income from another source under the same head of income. Prior to its substitution with effect from 1st April, 2003 by the Finance Act of 2002, Section 70 provided that save as otherwise provided in the Act, where the net result for any Assessment Year in respect of any source falling under any head of income is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.

7. In consonance with the provisions of Section 70, the assessee in the present case was entitled to set off the loss sustained on the sale of shares which constitute a long term capital asset against the capital gains which were realized from the sale inter alia of the bonus shares of Infosys Technologies. The net capital gain reported by the assessee after carrying out that exercise was Rs.3.45 Crores.

8. Section 112 of the Act provides that where the total income of an assessee includes any income, arising from the transfer of a long term capital asset, which is chargeable under the head of 'capital gains', the tax payable by the assessee on the total income shall in the case of an individual or a Hindu Undivided Family, being a resident, be the aggregate of (i) the amount of income tax payable on the total income as reduced by the amount of such long term capital gains, had the total income as so reduced been his total income; and (ii) the amount of income tax calculated on such long term capital gains at the rate of 20%. The proviso to Section 112 states that "where the tax payable in respect of any income arising from the transfer of a long term capital asset, being listed securities or unit or zero coupon bond exceeds 10% of the amount of capital gains before giving effect to the provisions of the second proviso to Section 48, then such excess shall be ignored for the purpose of computing the tax payable by the assessee. Section 112 forms a part of Chapter 12 of the Act which deals with the determination of tax in certain special cases. Section 112 provides for a tax on long term capital gains. Ordinarily, under clause (a) of sub section (1) of Section 112 the income tax calculated on long term capital gains is 20%.

9. The opening words of sub section (1) of Section 112 contemplate a situation where "the total income of an assessee includes any income arising from the transfer of a long term capital asset". This would be indicative of the fact that in computing income for the purposes of capital gains, the assessee would be entitled to the benefit of the normal provisions of the Act inter alia in regard to a set off under Section 70. The effect of the proviso to Section 112 is that in the event that the tax which is payable in respect of income arising from the transfer of a listed security, which is a long term capital asset, exceeds 10% of the amount of capital gains before giving effect to indexation as provided in the second proviso to Section 48, the tax would be liable to be capped at 10% , by ignoring the excess beyond 10%.

10. The view point of the assessee was that every transfer constituted a separate transfer of a capital asset on which capital gains would be required to be computed separately. The shares of Infosys Technologies were sold for Rs.6.13 Crores by the assessee.

These were bonus shares on which there was no cost of acquisition.

11. The assessee was entitled to indexation by virtue of the second proviso to Section 48. Moreover, in view of the provisions of Section 70 the assessee was entitled to set off the loss sustained in respect of one source falling under the same head of income from its income against any other source under the same head. In the present case, as a matter of fact, the question of indexation in relation to the shares of Infosys Technologies would not arise since the cost of acquisition of the shares, being bonus shares was nil. Where the cost of acquisition is nil, the indexed cost would necessarily be nil. While computing the loss sustained in respect of the six transactions and the profit sustained in one of the other transactions the assessee sought indexation. For the purposes of working out the application of the proviso to Section 112, there is nothing in the section which would deprive the assessee of the indexation claimed on the sale of shares where there was a resultant loss. What the proviso to Section 112 essentially requires is that where the tax payable in respect of income arising from a listed security, being a long term capital asset, exceeds 10% of the capital gains before indexation, then such excess beyond 10% is liable to be ignored. The assessee reported a net capital gain of Rs.3.45 Crores which was computed after setting off the loss sustained in the sale of shares in certain transactions relating to the sale of listed securities against capital gains arising inter alia out of the sale of the bonus shares of Infosys Technologies. The proviso to Section 112 requires a comparison to be made on the one hand between the tax payable in respect of income arising from the transfer of listed securities, computed at 20% with the tax payable at the rate of 10% on the capital gains before giving effect to indexation. We are not dealing in the present case with a situation where the assessee had acquired at a cost, shares on the sale of which a capital gain had arisen. Were the assessee to acquire those shares on which a capital gain was to arise, at a cost, then it would have been necessary for the purposes of the proviso to Section 112(1) to compute the capital gains before giving effect to indexation under the second proviso to Section 48. That, however, would not arise in the facts of this case inasmuch as the bonus shares of Infosys Technologies on which the assessee realized a capital gain of Rs.6.13 Crores were acquired at no cost. There is nothing in the provisions of Section 112 which would lead to the acceptance of the contention of the Revenue that the assessee would be entitled to a set off of the loss under Section 70, but without the benefit of indexation. No such requirement is legislated upon by Parliament either under Section 70 or in Section 112.

12. The fact that an assessee is entitled to a set off of the loss sustained on the sale of certain shares is clarified in a circular issued by the Central Board of Direct Taxes on 13th September, 1995 (Circular 721). The circular notes that Section 112 includes two significant expressions viz. “total income” and “includes any income”. The circular states that the total income is to be computed in the manner prescribed by the Act and the set off of a loss, in accordance with the provisions of Sections 70 to 80, is a stage which is part of this procedure. The circular then states that when this procedure is adopted for computing the gross total income or total income, only the amount of income after set off remains under the head as part of the gross total income or total income. Consequently, only that amount of long term capital gains which is included in the total income would be subject to tax at a prescribed flat rate. A subsequent circular of the CBDT dated 14th

September, 1999 (Circular 779) clarifies that "the benefit of cost inflation index shall continue as before but where the tax on long term capital gains without adjustment of cost inflation exceeds 10%, such excess shall be ignored".

13. Both these circulars are of significance because they clearly reflect the Revenue's understanding that (i) The benefit of a set off would be available while computing the income arising from the transfer of a long term capital asset, which is part of the total income of an assessee; and (ii) The benefit of the cost inflation index or indexation would continue to be available subject to the condition that where the tax on long term capital gains without adjustment for indexation exceeds 10%, such excess shall be ignored.

14. In the circumstances, we are of the view, on the balance, that the Tribunal was justified in coming to the conclusion that the assessee's claim of computation of long term capital gains on the sale of shares other than the bonus shares of Infosys Technologies, after giving the benefit of indexation was in consonance with the proviso to Section 112(1) and that the assessee was assessable to net long term capital gain of Rs.3.45 Crores. In this view of the matter, the question of law as framed is answered against the Revenue and in favour of the assessee. The appeal shall accordingly stand dismissed. In the circumstances, there shall be no order as to costs.

(Dr. D.Y.Chandrachud, J.)
(J.P. Devadhar, J.)