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CHARTERED ACCOUNTANTS

NEWSFLASH

Legatum Ventures Ltd. vs. ACIT
[TS 210 ITAT 2023 (Mum)]

Capital gain on sale of shares of Indian private company by non-resident or foreign company has to be computed as per section 112(1)(iii)(c) and not as per first proviso to section 48 of the Income Tax Act ('the Act')

Brief Background

The assessee, a company incorporated in UAE was involved in investment activities in India. During the AY 2018-19, the assessee sold shares of Indian private company which were acquired by them in foreign currency. The assessee computed capital gains applying first proviso to section 48 of the Act which permits converting the cost of acquisition, expenditure incurred in connection with the transfer and full value of consideration into the same foreign currency as was utilised in the purchase of shares. This resulted in the assessee incurring long term capital loss of Rs. 3.64 crores.. The assessee, filed its Indian tax return declaring the total income as Nil.

The AO observed that the assessee, being a foreign company having sold shares of the unlisted Indian company, the capital gain ought to be computed as per section 112(1)(c)(iii) of the Act. Section 112(1)(c)(iii) requires long term capital gain to be computed without allowing benefit of currency fluctuation and would be taxed at 10%. As per section 112(1)(c)(iii), long term capital gains worked out to Rs. 17.14 crores as against capital loss of Rs. 3.64 crores computed by the assessee.

In reaching this conclusion the AO relied on the Supreme Court decisions in CIT vs. Gold Coin Health Food Private Ltd. (304 ITR 308) and CIT vs. Harprasad & Co Ltd. (99 ITR 118) wherein it was held that the term "income" also includes loss. The AO held that provisions of section 112(1)(c)(iii) of the Act supplement the provision of section 48 of the Act, which is a special provision applicable in certain specific circumstances, and therefore the assessee does not have any option to choose between section 48 and section112(1)(c)(iii) of the Act.

Argument of the assessee

Section 112 of the Act applies only if the total income of the assessee includes any income arising from the transfer of a long-term capital asset which is chargeable under the head "capital gains" and where such income from transfer of a long-term capital asset forms part of the total income, section 112 provides for the manner in which the tax payable by the assessee shall be computed. Thus, for the applicability of section 112, there should be long term capital gains.

Section 112 of the Act is not applicable to the present case, as the same deals with a situation 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 "capital gains". Since, the assessee incurred loss as per section 48 read with first proviso, the same will not fall under section 112 of the Act.

Argument of the Income tax department

The term "income" has a wider connotation and even includes negative income. Section 112(1)(c)(iii) is applicable, since the assessee is a non-resident and has sold unlisted shares of an Indian company/private company.

Observation of the Tribunal

- Section 112 of the Act deals with the determination of tax payable by the assessee on the total income which includes any income arising from the transfer of a long term capital asset chargeable under the head "capital gains". However, section 112(1)(c) also provides the mode of computation of capital gains.

- As section 112(1)(c) provides for code of computation of capital gains and does not merely prescribe the rate of tax on such long term capital gains, the assessee does not have an option to choose between the two sections. Where non-resident or foreign company earns income from long term capital gains from the transfer of unlisted shares or securities of an Indian private company, the capital gains is required to be computed as per section 112(1)(c)(iii) and not as per section 48.

- Section 48 is a general provision which deals with computation of capital gains on transfer of all capital assets, whereas first proviso to Section 48 deals with transfer of shares or debenture of an Indian company acquired by non-resident in foreign currency. Section 112(1)(c)(iii) is a special provision for computation of capital gains, in case of a non-resident, arising from transfer of unlisted shares and securities.

- If a special provision is made respecting a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim "*Generallia specialibus non derogant*". When, in an enactment, two provisions exist, which cannot be reconciled with each other, they should be so interpreted that, if possible, the effect should be given to both

- In the present case, the income chargeable under the head "capital gains" is computed only as per section 48, then computation mechanism as per section 112(1)(c)(iii) would be completely otiose and redundant.

CNK Comments

- Nonresident/ foreign companies invest in shares of an Indian companies in foreign currency. They are concerned with, whether they have made a gain or loss in the currency in which they have invested. Considering the fact that rupee has depreciated over years, these investors would face a double whammy, whereby they could pay income tax at 10% on capital gains computed in rupee terms, but could make a loss when computed in the currency in which investment was made. The above is illustrated by the way of an example herein below:

Date of Acquisition	1 April 2020
Investment in shares of Indian private company in USD	USD 10,00,000
Exchange rate as on 1 April 2020	INR 75 = 1 USD
Cost of acquisition in INR	7,50,00,000
Date of sale of shares	31 March 2023
Sale consideration in INR	8,00,00,000
Exchange date on 31 March 2023	INR 82 = 1 USD
Sale consideration in USD	975,610
Long term capital gains/ loss as per first proviso to section 48 in USD	(USD 24,390)
Long term capital gains/ loss as per first proviso to section 48 in INR	(INR 19,99,980)
Long term capital gains/ loss as per section 112(1)(c)(iii) in INR	INR 50,00,000
Income tax at 10% as per section 112(1)(c)(iii)	INR 5,00,000

- From the above example it can be seen that though the non-resident assessee has incurred long term capital loss of USD 24,390 applying the rationale of the given decision the taxpayer will still be required to pay income tax of INR 5,00,000. In other words, in the context of transfer of unlisted securities the provisions of section 112(1)(c)(iii) will prevail making proviso to section 48 redundant.

- Unless this issue is addressed urgently, it could have a direct bearing on future Foreign Direct Investment ('FDI') in India. The said decision will be challenged before the High Court to decide whether section 112(1)(c)(iii) is a separate computation mechanism or merely provides for applicable tax rate.

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