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# *CAPITAL GAINS – CERTAIN TRANSACTIONS NOT REGARDED AS TRANSFER*

## *SECTION 47: CERTAIN TRANSACTIONS NOT REGARDED AS TRANSFER*

The following transactions will not be regarded as transfers for the purposes of section 45 and therefore, no capital gains will arise:

(i) any distribution of capital assets on the partial or total **partition of a HUF**.

(ii) any transfer of a capital asset under a **gift**, **will** or an **irrevocable trust**.

(iii) any transfer, in a scheme of **amalgamation**, of a capital asset by the amalgamating company to the amalgamated company provided that the amalgamated company is an Indian company.

(iv) any transfer of a capital asset by a **holding company to its subsidiary company** provided that the following conditions are satisfied:

  (a) the holding company or its nominees hold the entire share capital of the subsidiary company and
  (b) the subsidiary company is an Indian company.

***Note:*** This exemption shall not be available if the capital asset is transferred as stock in trade.

(v) any transfer of a capital asset by a **subsidiary company to its holding company** provided that the following conditions are satisfied:

  (a) the holding company or its nominees hold the entire share capital of the subsidiary company and
  (b) the holding company is an Indian company.

***Note:*** This exemption shall not be available if the capital asset is transferred as stock in trade.

**Section 49(1) – Cost of Acquisition & Improvement**
In the above 5 cases, the cost of acquisition of the asset to the transferee shall be deemed to be the cost to the previous owner acquired it as increased by the cost of improvements incurred by the previous owner and the assessee.

**Section 2(42A) – Period of Holding**
In the above 5 cases, for determining the nature of capital gains period of holding of the previous owner shall also be considered.

**Section 55 – FMV as on 1.4.1981**
In the above 5 cases, if the previous owner, has acquired the asset before 1.4.1981, the cost to the transferee shall be the cost to the previous owner or FMV as on 1.4.1981, whichever is higher.

**Section 47A – Withdrawal of Exemption**

Where at any time **before the expiry of a period of 8 years** from the date of transfer of a capital asset referred to in Clause (iv) or (v) of section 47 (i.e. Holding company to subsidiary company or subsidiary company to holding company) –

(a) such capital asset is **converted into stock in trade** by the transferee company, OR

(b) the holding company or its nominees **cease to hold the whole of the share capital** of the subsidiary company,

then, exemption under section 47 shall be withdrawn. The capital gains arising on transfer shall be charged to tax in the previous year in which the transfer took place.

**Section 155 – Rectification**
- Where section 47A is attracted,
- the assessment of the transferor company will be rectified under section 154.
- For the purposes of section 154,
- four years shall be counted from the end of the previous year
- in which the capital asset was converted into Stock-in-trade or
- in which the holding company or its nominees ceased to hold the whole of the share capital of subsidiary company.

**Section 49(3) – Cost of Acquisition in the hands of Transferor Company**
- If exemption is withdrawn under section 47A
- then, for calculating capital gains
- in the hands of transferor
- cost of acquisition shall be the price at which
- the asset is transferred by the transferee company.

## SUMMARY

***Holding Company*** → ***Subsidiary Company***

***Subsidiary Company*** → ***Holding Company***

***Case I    CAPITAL ASSET IS TRANSFERRED AS CAPITAL ASSET***

Section 47 + Section 49(1) + Section 2(42A) + Section 55 + Section 47A+
Section 45(2) + Section 155 + Section 49(3)

***Case II    CAPITAL ASSET IS TRANSFERRED AS STOCK-IN-TRADE***

Section 47 exemption is not available. Therefore, the entire chain of sections is not applicable. It is a normal transfer under section 45(1).

***Summary***

| | | |
|---|---|---|
| Amalgamating Company | ⟶ | Amalgamated Company |
| Partition of HUF | ⟶ | Members of HUF |
| Gift, Will, Irrevocable Trust | ⟶ | |

***Case I CAPITAL ASSET IS TRANSFERRED AS CAPITAL ASSET***

Section 47 + Section 49(1) + Section 2(42A) + Section 55

***Case II CAPITAL ASSET IS TRANSFERRED AS STOCK-IN-TRADE***

Section 47 + Section 43C

***SECTION 43C: SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION IN CERTAIN CASES***

Section 43C provides that if under an amalgamation, partition of HUF, gift, will or irrevocable trust, a capital asset is transferred as stock in trade, then, the cost of acquisition of such stock-in-trade shall be the actual cost of the capital asset in the hands of transferor as increased by cost of improvements incurred by transferor and transferee, as increased by expenditure on transfer incurred by the transferor.

***LATEST IN JUDICIARY***

***1. RM. Arunachalam v. CIT (Supreme Court) 1997***

The cost of acquisition to the legal heir is the aggregate of the cost to the previous owner and the amount paid to clear the mortgage.

***2. V.S.M.R. Jagadishchandran v. CIT (Supreme Court) 1997***

Where the mortgage was created by the assessee himself, there will be no tax treatment of discharge of mortgage debt and the same cannot be said to be cost of acquisition or cost of improvement of the property.

## *SECTION 47: CERTAIN TRANSACTIONS NOT REGARDED AS TRANSFER*

The following transactions will not be regarded as transfers for the purposes of section 45 and therefore, no capital gains will arise:

(vi) any transfer in a scheme of **amalgamation**, of **shares held in an Indian company, by the amalgamating foreign company** to the amalgamated foreign company if the following conditions are satisfied:

  (a) at least 25% of the Shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company and
  (b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated[*].

(vii) any transfer, in a scheme of **amalgamation of banking company with a banking institution** sanctioned and brought into force by the Central Government under section 45(7) of the Banking Regulation Act,1949 of a capital asset by the banking company to the banking institution.

***Note: 1. Section 49(1) - In cases (i) to (vii) above, the cost of acquisition of the assets in the hands of transferee shall be the cost of acquisition to the previous owner i.e., the transferor.***

***Note: 2. Section 2(42A) - In determining the nature of capital gains in the hands of the transferee in cases (i) to (vii) above, the period of holding of the asset of the transferor shall also be considered.***

(viii) Any transfer of bonds or ***Global Depository Receipts*** referred to in section 115AC, **made outside India** by a NON-RESIDENT to another NON-RESIDENT

(ix) Any transfer of a capital asset, being any **work of art, archaeological, scientific, or art collection, book, manuscript, drawing, painting, photograph or print,** to the Government, University, National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government.

(x) Any transfer by way of **conversion of bonds, or debentures or debenture stock or deposit certificates** of a company into the shares or debentures of that company.

***Note 1:*** ***Section 49(2A):*** The cost of acquisition of the share or debenture so received on conversion shall be cost of that part of the debenture, bond, debenture stock or deposit certificate, which is so converted.

***Note 2:*** Section 2(42A) does not define the period of holding in this case. Therefore, the period of holding of bond\ debenture\ debenture-stock\ deposit certificate so converted, shall not be taken into account for the purposes of determining the nature of capital gains on the sale of the share\debenture so received on conversion.

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[*] If such transfer attracts tax on capital gains in the country in which the amalgamating company is incorporated then, the transfer is NOT EXEMPT under section 47 of Income-tax Act, 1961. The capital gains shall be taxable as per the relevant DTAA.

***<u>Note 3:</u>*** **If preference shares are converted into equity shares, then there is an exchange amounting to transfer, which will attract capital gains. Exemption under section 47 is not available on such conversion.**

(xi) Any **transfer by a Shareholder**, in a scheme of amalgamation, **of the shares held by him in the amalgamating company**, provided that the following conditions are satisfied:

(a) The transfer is made in consideration of allotment to him of the shares in the amalgamated company and

(b) The amalgamated company is an Indian company.

***<u>Note: 1.</u>*** ***<u>Section 49(2)</u>***

The cost of acquisition of the shares in the amalgamated company shall be the cost of acquisition of the shares of the amalgamating company.

***<u>Note: 2.</u>*** ***<u>Section 2(42A)</u>***

For computing the nature of capital gains arising from the sale of the shares of the amalgamated company, the period of holding of the Shares in the amalgamating company shall also be considered.

***<u>Note: 3.</u>*** ***<u>Gautam Sarabhai Trust</u>***

If the consideration for transfer of Shares in amalgamating company consists of something more than the shares in the amalgamated company, then exemption under section 47 will not be available. This is because composite consideration is not contemplated by the section.

(xii) any transfer of a capital asset, **being land** of a sick industrial company provided the following conditions are satisfied:

- ***the company transfers land*** (if any other asset is transferred, then normal provisions of capital gains shall apply to that asset. Exemption is only for land)
- ***the land is transferred during the period beginning from*** the previous year in which the said company has become a sick industrial company ***and ending with*** the previous year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses.
- ***the sick industrial company is managed by its workers' co-operative***
- ***the land is transferred under a scheme prepared and sanctioned by BIFR.***

(xiii) where a **firm is succeeded by a company** in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company:

***Provided*** that -

(a) all the assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company;

(b) all the partners of the firm immediately before the succession become the ***shareholders*** of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of succession;

(c) the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and

(d) the aggregate of the shareholding in the company of the partners of the firm is not less than **50% *of the total voting power in the company*** and their shareholding continues to be as such for a period of 5 years from the date of the succession.

(xiv) where a **sole proprietary concern is succeeded by a company** in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company:

***Provided*** that -

(a) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession becomes the assets and liabilities of the company;

(b) the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to so remain as such for a period of five years from the date of the succession; and

(c) the sole proprietor does not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company;

(xv) any transfer in a scheme for **lending of any securities** under an agreement or arrangement, which the assessee has entered into with the borrower of such securities and which is subject to the guidelines issued by the SEBI or the RBI, in this regard.".

(xvi) any transfer of a capital asset to a company in the course of **demutualisation or corporatisation** of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company:

***Provided*** that -

(a) all the assets and liabilities of the AOPs or BOIs relating to the business immediately before the succession become the assets and liabilities of the company;

(b) the corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme of ***demutualisation*** or corporatisation which is approved by SEBI.

(xvii) any transfer of a capital asset being a **membership right held by a member of a recognized stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member** in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the SEBI.

***Note 1:*** Under a scheme for ***demutualisation or*** corporatisation approved by the SEBI in relation to a capital asset, being:

| | **Cost of Acquisition Section 55** | **Period of Holding Section 2(42A)** |
|---|---|---|
| Equity share or shares allotted to a shareholder of a recognised stock exchange in India | Cost of acquisition of his original membership of the exchange | ***The period from which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation shall also be considered.*** |
| ***Trading or clearing rights of the recognized stock exchange acquired by a shareholder*** | NIL | |

## *SECTION 51: ADVANCE MONEY FORFEITED*

Where any capital asset was on any previous occasion the subject matter of negotiations for its transfer, and any advance money **or other money received** is Forfeited by the assessee, then the amount so Forfeited shall be deducted from

(a) the cost for which the asset was acquired or

(b) the FMV or

(c) the WDV

as the case may be, in computing the cost of acquisition.

***Notes:***

- ***Amount forfeited before 1/4/1981 is also to be deducted as per section 51.***

- ***Amount forfeited by the previous owner is not to be deducted under section 51.***

- ***Travancore Rubber & Tea Co. Ltd. v. CIT [2000] 109 Taxman 250/243 ITR 158 (SC)***

  ***If advance money forfeited exceeds the cost, the excess shall be a Capital Receipt not taxable. The advance money forfeited or other money forfeited shall be reduced from the cost of the assets and any excess shall be capital receipt not taxable.***

## *SECTION 55A: REFERENCE TO VALUATION OFFICER*

- For ascertaining the FMV of a capital asset
- for the purposes of the chapter of capital gains,
- the Assessing Officer may refer the valuation of capital asset to a Valuation Officer –

(a) in a case where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer, if the Assessing Officer is of opinion that the value so claimed is less than its fair market value;

(b) in any other case, if the Assessing Officer is of opinion –

(i) that the FMV of the asset exceeds the value of the asset as claimed by the assessee by more than 15% of the value of the asset or by more than Rs. 25,000, whichever is less; or

(ii) that having regard to the nature of the asset and other relevant circumstances, it is necessary so to do.