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### TAX TRIBUNAL VIEWS TRANSACTIONS INTER SE GROUP ENTITIES AS SHAM, DISALLOWS SET-OFF OF RESULTING CAPITAL LOSS

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#### Introduction

The Income Tax Appellate Tribunal, Delhi (ITAT) in the case of *Deputy Commissioner of Income Tax v M/s BS Infosolution Private Limited* (ITAT Order dated 23 August 2018) rejected the taxpayer's claim for setting-off long term capital loss (Loss) arising on sale of unlisted shares against long term capital gains (Gain) arising on sale of immovable property. The ITAT held that the share sale was a sham transaction and a colourable device to avoid capital gains tax liability on the Gain. Even though the Income-tax Act, 1961 allows setting-off long term capital loss against long term capital gains, the ITAT looked at the surrounding circumstances to disallow the set-off of Loss against Gain in the present case.

#### Background

In the relevant year, the taxpayer entered into 3 transactions which are as follows:

- **First Transaction:** The taxpayer had sold an immovable property (Property) to a company "A" (for which the taxpayer had received part consideration in the preceding year). The taxpayer declared certain Gain on this transaction.
- **Second Transaction:** Despite having received part consideration for the sale of Property, the taxpayer entered into a collaboration agreement with a group company "B" for the development of the Property. Pursuant to the collaboration agreement, the taxpayer received an amount as refundable security deposit from B.
- **Third Transaction:** The taxpayer utilised most of the abovementioned security deposit to subscribe to shares of another group company "C" at a premium of INR 190 per share (face value INR 10 per share). It is pertinent to note that this share transaction took place merely 2 months after the incorporation of C. However, the issue price was justified by a valuation report.

Thereafter, within 5 months of the Second Transaction (i.e. the collaboration agreement), the taxpayer entered into a deed of cancellation for the collaboration agreement with B. Consequently, the security deposit was returned to B. While a portion of the security deposit was paid back in cash, the balance was returned by way of transfer of shares of C at book value (INR 82.50 per share). The transfer of shares was executed after holding them for about 12 months. As a result, the taxpayer incurred loss on this transfer of shares (as the acquisition price was INR 200 per share, and the shares were transferred at a price

of INR 82.50 per share) which was then claimed by the taxpayer as a set-off against the Gain on sale of Property.

Upon examining the sequence of events, the tax officer concluded that the purchase and sale of shares was a colourable device to generate Loss to be set-off against the Gain and therefore, disallowed the set-off claimed by the taxpayer. However, the first appellate authority accepted the transactions as genuine and allowed the taxpayer's claim of set-off.

## ITAT Ruling

The ITAT set aside the findings of the first appellate authority and restored the order of the tax officer who held that the purchase and sale of shares was a sham transaction amongst group companies, to avoid capital gains tax liability and therefore disallowed the claim for set-off. According to ITAT, in the present case, the Property was the subject matter of two distinct transactions – sale of property to A as well as collaboration agreement for development of property with B. However, ultimately the property was sold to A. With regard to the purchase of shares, the ITAT observed that though the hefty premium was justified by a valuation report, it did not appear genuine that shares of a company could fetch a premium of INR 190 in a span of about 2 - 3 months from incorporation. The ITAT further noted that purchase of shares at a hefty premium and subsequent sale at book value did not seem commercially prudent.

The ITAT observed that the cumulative effect of all these instances points out the real intention behind the purchase and sale of shares. The taxpayer, being aware that the sale of Property would result into gain and to avoid capital gains liability, used group companies B and C as conduits to generate Loss to be set-off against the Gain.

## Comment

This ruling establishes the detail in which factual aspects such as valuations, timing, sequence of events / transactions as well as relationship between the transacting entities, are evaluated by the tax and appellate authorities to ascertain intention and genuineness of arrangements. While this ruling pertains to a year when the General Anti Avoidance Rules (GAAR) were not in force, the transaction steps have been seen as abusive and the taxpayer has been denied the tax advantage sought to be achieved.

On a standalone basis, the proximity of the date between purchase and sale of shares; or the purchase of shares at a hefty premium; or the loss incurred by the sale of shares may not lead to a conclusion that a transaction is sham. In the present case, the tax authorities and the ITAT have considered the cumulative effect of all these instances and scrutinised the surrounding circumstances to determine the real intention behind the transactions.

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