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KARTIKEYA V. SARABHAI
v.
COMMISSIONER OF INCOME TAX

SEPTEMBER 4, 1997

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[B.N. KIRPAL AND K.T. THOMAS, JJ.]

Income Tax Act, 1961—Sections 2 (47) and 45.

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Capital gains—Transfer of capital asset—Reduction in face value of shares—Amounts received by holder of such shares on reduction—Held, is transfer within the meaning of S. 2(47) and taxable as capital gains.

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Companies Act 1956—Sections 87(2)(c) and 100—Reduction in face value of shares—Amounts received by the holder of such shares on reduction is subject to capital gains.

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The Appellant had purchased 90 non-cumulative preference shares of a Company, each of the face value of Rs. 1,000 at a price of Rs. 420 per share. Earlier in 1965, a sum of Rs. 500 per share was paid off to the assessee upon a reduction of the share capital of the company under Section 100(1)(c) of the Companies Act.

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In the year 1966, there was a further reduction of the face value of the shares and in the Extra-ordinary general meeting of the company, by a special resolution passed, liability of the company was reduced from Rs. 500 per share to Rs. 50 per share by paying off in cash a sum of Rs. 450 per share. The receipt of a sum of Rs. 450 per share received by the assessee was held to be subject to capital gains by the Income Tax Officer but however this finding was set aside by the Appellate Assistant Commissioner. On appeal, the Income Tax Appellate Tribunal restored the order of the Income Tax Officer, which stood affirmed by the order of the High Court.

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In the present appeal preferred by the assessee, the contention of the appellant was that there could be no capital gains tax as the reduction in the face value of the share from Rs. 500 to Rs. 50 per share did not amount to extinguishment of any right and therefore, could not be regarded as transfer within the meaning of Section 2(47) of the Act. It was also *inter*

alia submitted that the appellant continued to be a shareholder of the company and that Section 45 of the Act was not applicable as the appellant had not made any sale and that the money was only received by him against the surrender of the shares. A

Dismissing the appeal, this Court

HELD : 1.1. The High Court was right in coming to the conclusion that capital gains tax was payable by the appellant in the instant case, as a result of reduction in the face value of the preference shares. [754-D] B

1.2. Reduction of right on the capital asset would amount to transfer within the meaning of the expression in Section 2(47) of the Income Tax Act, 1961. [753-H] C

1.3. Section 2(47) of the Act defining 'transfer' in relation to a capital asset is an inclusive definition which *inter-alia* provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. It is not necessary that for a capital gain to arise, there must be a sale of a capital asset. Relinquishment of the asset or extinguishment of any right in it, which may not amount to a sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under Section 45 of the Act. [751-D-E] D E

2.1. By virtue of Section 100(1)(c) of the Companies Act 1956, a company has a right to reduce the share capital and one of the modes that could be adopted is to reduce the face value of the preference shares. [753-B] F

2.2. On the reduction in face value of the shares, the voting right of the holder of such shares on a poll stands reduced in view of section 87(2)(c) of the Companies Act, even though he continues to remain a shareholder. Also the right of the preference shareholder to dividends on his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital. [753-G, 751-F] G

Anarkali Sarabhai Ltd. v. CIT, (1997) 224 ITR 422 (SC), relied on.

Anarkali Sarabhai v. CIT, Gujarat, (138) ITR 437, referred to. H

A *CIT v. R.M. Amin, (106) ITR 368, distinguished.*

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1098 of 1982.

B From the Judgment and Order dated 6.8.81 of the Gujarat High Court in I.T.R. No. 68 of 1976.

S. Ganesh, Mrs. A.K. Verma for M/s. J.B.D. & Co. for the Appellant.

S. Rajappa and B.K. Prasad for the Respondent.

C The Judgment of the Court was delivered by

KIRPAL, J. The only question which arises for consideration in this appeal, under certificate having been granted by the High Court, is whether on a reduction of share capital with the company paying a part of the capital by reducing face value of its share, results in extinguishment of right in the shares held by the share-holder so that the amount paid on reduction of share capital would be exigible to capital gain tax.

E The appellant had purchased 90 non-cumulative preference shares, each of the face value of Rs. 1,000 at a price of Rs. 420 per share, of a company called Sarabhai Limited. In 1965, a sum of Rs. 500 per preference share was paid off to the assessee upon a reduction of a share capital of the company under Section 100(1)(c) of the Companies Act. This was done by reducing the face value of each share from Rs. 1,000 to Rs. 500 and by paying off Rs. 500 in cash. As a result thereof the appellant became a holder in respect of 90 non-cumulative preference shares of the value of Rs. 500 per share, in place of being the holder of shares of the face value of Rs. 1000 per share.

G In the present case, we are concerned with the further reduction of the face value of the shares which took place in the year 1966. In the Extra-Ordinary General Meeting of Sarabhai Limited held on 10.1.1966, a special resolution was passed by the Company by virtue of which it reduced its liability on the preference shares from Rs. 500 per share to Rs. 50 per share by paying off in cash a sum of Rs. 450 per share. Thus, the share held by appellant which was originally of the face value of Rs.1,000 became a share of the face value of Rs. 50 only. This reduction had taken place in two stages, firstly when the face value was reduced from Rs. 1,000 to Rs.

500 per share and secondly when the face value was reduced from Rs. 500 A
per share to Rs. 50 per share.

The appellant had originally purchased the preference shares of the B
face value of Rs. 1000 per share at a price of Rs. 420 per share. At the
time of first reduction, he got back Rs. 500 per share in cash. At the time
of second reduction, with which we are concerned in this case, the appel-
lant got a further sum of Rs. 450 per share in cash.

The Income Tax Officer was of the opinion that a sum of Rs. 450 C
per share, which was now received by the assessee, was liable to be
subjected to levy of capital gain tax. The appellant, however, contended
that such reduction of the face value did not result in extinguishment of
the assessee's right and there was no transfer within the meaning of that
expression as contained in Section 2(47) of the Income Tax Act, 1961
(hereinafter referred to as 'the Act') and, secondly no tax could be imposed
thereon. The Income-Tax Officer did not accept the appellant's contention D
and taxed the said amount.

The appeal of the appellant before the Appellate Assistant Commis- E
sioner succeeded and a sum of Rs. 23,490, which had been included as
capital gains, was held not to be liable to tax. The Revenue, however, filed
a second appeal and the Income Tax Appellate Tribunal set aside the order
of the Appellate Assistant Commissioner and restored the orders of the
Income Tax Officer. At the instance of the appellant, the Income Tax
Tribunal referred the following question of law to the High Court of
Gujarat.

"Whether, on the facts of the case, the Tribunal rightly held that F
the assessee had made capital gains on the reduction of preference
share capital which was exigible to capital gains tax?"

The High Court considered the matter in its entirety and came to G
the conclusion that the Tribunal had rightly held that the appellant had
made capital gains on the reduction of preference share capital and the
same was exigible to capital gains tax. Thereafter, at the request of the
appellant, the High Court granted leave to appeal. Hence, this appeal.

On behalf of the appellant, it was vehemently contended by Mr. H
Ganesh, learned counsel that no capital gains tax could be levied in the

- A present case. It was submitted that reduction of the face value of the share from Rs. 500 to Rs. 50 per share did not amount to extinguishment of any right and, therefore, could not be regarded as transfer within the meaning of Section 2(47) of the Act and the appellant continued to be a share holder of the Company. It was also submitted that there can be no transfer where share-holders get back money from the company and in this connection, he relied upon the decision in the case reported as *Commissioner of Income Tax, Gujarat v. R.M. Amin*, 106 ITR 368. Lastly, it was submitted that Section 45 of the Act was not applicable as the appellant had not made any sale. It was submitted that as a result of the Company's Special Resolution, the appellant got the money against surrender of shares and this would not amount to a sale.

It is not possible to accept the contention of Shri Ganesh, learned counsel that reduction does not amount to a transfer of the capital asset. Section 2(47) of the Act reads as follows :

- D "2(47) 'transfer' in relation to a capital asset, includes,-
- (i) the sale, exchange or relinquishment of the asset; or
- (ii) the extinguishment of any rights therein; or
- E (iii) the compulsory acquisition thereof under any law; or
- (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade or a business carried on by him, such conversion or treatment; or
- F (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 (4 of 1882); or
- G (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable
- H property :

Explanation - For the purposes of sub-clauses (v) and (vi), immovable property' shall have the same meaning as in clause (d) of Section 269UA." A

Section 45 of the Act reads as follows :

"Capital gains - (1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 53, 54, 54B, 54D, 54E, 54F and 54G, 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." B C

Section 2(47) which is an inclusive definition, *inter alia*, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. While, it is no doubt true that the appellant continues to remain a share-holder of the company even with the reduction of a share capital but it is not possible to accept the contention that there has been no extinguishment of any part of his right as a share holder qua the company. It is not necessary that for a capital gain to arise that there must be a sale of a capital asset. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. Relinquishment of the asset or the extinguishment of any right in it, which may not amount to sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under Section 45 of the Act. D E

When as a result of the reducing of the face value of the share, the share capital is reduced, the right of the preference share holder to the dividend or his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital. Whereas the appellant had a right to dividend on a capital of Rs. 500 per share that stood reduced to his receiving dividend on Rs. 50 per share. Similarly, if the liquidation was to take place whereas he originally had a right to Rs. 500 per share, now his right stood reduced to receiving Rs. 50 per share only. Even though the appellant continues to remain a share holder his right as a holder of those shares clearly stands reduced with the reduction in the share capital. F G

The Gujarat High Court had in another case reported as *Anarkali Sarabhai v. Commissioner of Income-Tax, Gujarat*, (138) I.T.R. 437, fol- H

A lowed the judgment under appeal. That was a case where there had been redemption of preference share capital by the company and money was paid to the share- holders. It was held therein that difference between the face value received by the share-holder and the price paid for preference share was exigible to capital gains tax. In coming to this conclusion, the Gujarat High Court had followed the judgment under appeal in the present case.

The aforesaid decision of the Gujarat High Court in *Anarkali's* case (supra) was challenged and this Court in the *Anarkali Sarabhai v. Commissioner of Income- Tax*, (224) I.T.R. 422, upheld the High Court's decision. It had been contended in *Anarkali's* case (supra) on behalf of the assessee that reduction of preference share was not a sale or relinquishment of asset and, therefore, no capital gains tax was payable. Repelling this contention, this Court considered the definition of word "transfer" occurring in Section 2(47) of the Act and reading the same along with Section 45, it came to the conclusion that when a preference share is redeemed by a company, what the share holder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. It was observed that in effect the company buys back the preference shares from the share-holders. Further, referring to the provisions of the Companies Act, it held that the reduction of preference shares by a company was a sale and would squarely come within the phrase "sale, exchange or relinquishment" of an asset under Section 2(47) of the Act. It was also held that the definition of word "transfer" under Section 2(47) of the Act was not an exhaustive definition and that sub-section (I) of clause (47) of Section 2 implies that parting with any capital asset for gain would be taxable under Section 45 of the Act. In this connection, it was noted that when preference shares are redeemed by the company, the share-holder has to abandon or surrender the shares, in order to get the amount of money in lieu thereof.

G In our opinion, the aforesaid decision of this Court in *Anarkali's* case (supra) is applicable in the instant case. The only difference in the present case and *Anarkali's* case (supra) is that whereas in *Anarkali's* case (supra) preference shares were redeemed in entirety, in the present case, there has been a reduction in the share capital inasmuch as the company had redeemed its preference share of Rs. 500 to the extent of Rs. 450 per share.

The liability of the company in respect of the preference share which was previously to the extent of Rs. 500 now stood reduced of Rs. 50 per share.

The company under Section 100(1)(c) of the Companies Act has a right to reduce the share capital and one of the modes, which can be adopted, is to reduce the face value of the preference shares. This is precisely what has been done in the instant case. Instead of there being a 100% extinction of the right which was there in the *Anarkali's* case (supra), here the right as a preference share holder of the appellant stands reduced from Rs. 500 to Rs. 50 per share. A sum of Rs. 450 per share has been paid by the company to the appellant on account of the extinguishment of his right to the aforesaid extent.

Yet another right which is apparently effected as a consequence of this reduction is with regard to the voting right. According to Section 87(2)(a) of the Companies Act, a holder of a preference share has a right to vote only on resolution placed before the company which directly affect the rights attached to his preference shares. In the case of cumulative preference share, if dividend remains unpaid for not less than two years preceding the date of commencement of the meeting, then even a preference share holder, by virtue of Section 87(2)(b) of the Companies Act, gets a right to vote on every resolution placed before the company at any meeting like a member holding equity shares. What is important for our purposes is the provisions of Section 87(2)(c) which, inter alia, provides :

"Where the holder of any preference share has a right to vote on any resolution in accordance with the provisions of this sub-section, his voting right on a poll, as the holder of such share, shall, subject to the provisions of Section 89 and sub-section (2) of Section 92, be in the same proportion as the capital paid up in respect of the preference share bears to the total paid-up equity capital of the company."

Therefore, with the reduction in the face value of the share from Rs. 500 per share to Rs. 50 per share, the value of the vote of the appellant in the event of there being a poll would stand considerably reduced. Such reduction of the right in the capital asset would clearly amount to a transfer within the meaning of that expression in Section 2(47) of the Act.

- A The decision in *R.M. Amin's* case (supra) can be of no help to the appellant. In that case, the company had gone into voluntary liquidation and the assessee had received a sum in cash of the amount which he had paid for the share. It was held that when a share holder receives money representing his share on the distribution of the net assets of a company
- B in liquidation, he receives that money in satisfaction of the right which belongs to him by virtue of his holding the share and not by any operation of any transaction which amounted to sale, exchange, relinquishment, transfer of a capital asset or extinguishment of any right in capital assets. The payments received by the contributories on the liquidation of the
- C company would not amount to a transfer and it is for this reason that *R.M. Amin's* case (supra) was distinguished by this Court in *Anarkali's* case.

- In our opinion, the High Court was right in coming to the conclusion that the appellant was liable to pay capital gains tax on the capital gain of Rs. 28710 as a result of reduction in the preference share in Sarabhai
- D Limited. this appeal is, accordingly dismissed with costs.

R.D.

Appeal dismissed.