



DECODING SECTION
56 OF THE INCOME
TAX ACT, 1961

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HEADS OF INCOME



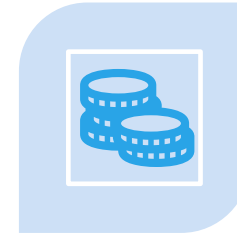
SALARIES



INCOME FROM
HOUSE PROPERTY



PROFITS AND GAINS
OF BUSINESS OR
PROFESSION



CAPITAL GAINS



INCOME FROM
OTHER SOURCES
("IFOS")



Residuary head of income

Charging S. 56. "(1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E."

SECTION 56(2) – SPECIFIC INCOMES LISTED UNDER IFOS

(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head "Income from other sources", namely :—

- Dividend
- Winning from lotteries, crossword puzzles, horse race, card games, etc.
- Employee's contribution to PF, Superannuation Fund, etc.
- Interest on securities
- Machinery, Plant or Furniture let on Hire, with or without building
- Receipt under Keyman Insurance Policy
- Gifts and deemed gifts
- Issue of shares by company
- Interest on compensation for compulsory acquisition
- Money received without transfer of capital asset
- Compensation in connection with termination or modification of employment terms



TAXATION OF GIFTS

LEGISLATIVE HISTORY

1958
Gift Tax Act, 1958 which entered into force on 01.04.1958.

1998

- Finance (No. 2) Act, 1998 abolished the Gift Tax Act, 1958.
- Proposed to tax value of any movable or immovable property received on or after 01.10.1998 by any person without consideration in money or money's worth as income. This provision, was however not enacted.

2004

S. 56(2)(v) introduced by Finance (No. 2) Act, 2004 applicable to any sum of money (above threshold) received by individual or HUF without consideration ("gifts"), on or after 01.09.2004.

2006

S. 56(2)(vi) introduced by Taxation Laws (Amendment) Act, 2006, replaced S. 56(2)(v) - applicable to gifts made on or after 01.04.2006-threshold defined.

2017

S. 56(2)(x) introduced by Finance Act, 2017 – S. 56(2)(vii) & (viiia) merged into S. 56(2)(x) and scope expanded to any person receiving sum of money or any property, on or after April 1, 2017, without consideration or for inadequate consideration.

2010

Valuation Rules IIU and IIUA notified on 07.04.2010 w.r.e.f. 01.10.2009 for determination of fair market value of the property other than immovable property.

2010

S. 56(2) (viiia) introduced by Finance Act, 2010 - applicable to firms or closely held companies receiving shares of closely held companies, on or after 01.06.2010, without consideration or for inadequate consideration-threshold defined.

2009

S. 56(2)(vii) introduced by Finance (No. 2) Act, 2009, replaced S. 56(2)(vi) - applicable to gifts made on or after 01.10.2009. Property also covered for the first time-threshold defined.

MISCHIEF RULE

- These are Anti-abuse provisions - counter evasion mechanism to prevent laundering of unaccounted income under the garb of gifts.
- Mischief Rule (**Heydon's Rule**) – A provision enacted to counter a “mischief” must be construed keeping in mind the “mischief”: Four things are to be discerned and considered:
 1. what was the common law before making the Act;
 2. what was the mischief and defect for which the common law did not provide;
 3. what remedy Parliament has resolved and appointed to cure the disease of the commonwealth; and
 4. the true reason of the remedy.
- **Supreme Court in K. P. Verghese vs. ITO (131 ITR 597)**, based on the Mischief rule of construction, held that even violence to the plain meaning of the language of statute was found permissible with reference to the deeming provision u/s. 52(2) (now deleted by the Finance Act, 1987 w.e.f 1.4.88).
- Applying the Mischief Rule, the prevailing S. 56(2)(x) must be read in a manner that it is applied only to plug the mischief which is sought to be solved and not applied to genuine cases.
 - Unfortunately, the literal reading of the provision has wider ramifications.

GIST OF SECTION 56(2)(X)

- S. 56(2)(x) covers sum of money or property received by 'any person'



Clause (a): Taxation of **'sum of money'** exceeding Rs. 50,000 received without consideration



Clause (b): Taxation of **'immovable property'**

- If received without consideration: Stamp Duty Value (SDV) exceeds Rs. 50,000, then SDV = IFOS
- If received for inadequate consideration: SDV (-) consideration = IFOS, where such excess is greater than Rs. 50,000 or 10% of consideration (tolerance limit), whichever is higher
 - If date of transfer agreement and date of registration are not the same, SDV on date of agreement can be taken. Benefit not available where consideration is paid by non-cash means on or before date of agreement
 - If SDV is disputed u/s 50C(2), the AO can refer the matter of Valuation Officer
 - In the following case covered u/s 43CA(1) (2nd proviso), the tolerance limit would be 20% instead of 10%
 - The transfer of residential unit takes place during the period from 12th November, 2020 to 30th June, 2021;
 - The transfer is by way of first-time allotment of the residential unit to any person; and
 - The consideration received or accruing as a result of such transfer does not exceed Rs. 2 cr.



Clause (c): Taxation of **'property (other than immovable property)'**

- If received without consideration: Fair Market Value (FMV) exceeds Rs. 50,000, then FMV = IFOS
- If received for inadequate consideration: FMV (-) consideration = IFOS, where such excess is greater than Rs. 50,000
- FMV has to be computed as per Rule 11U and Rule 11UA

INCOME

- **CIT vs. Khatau Makanji Spinning and Weaving Co. Ltd. (40 ITR 189):** income-tax is a tax on the income of the previous year and it would not cover something which is not the income of the previous year, or made fictionally so.
- **Navinchandra Mafatlal vs. CIT (26 ITR 758):** "income" must be given its ordinary, natural and grammatical meaning and that was, income is a thing that comes in.
- **Navnit Lal C. Javeri v. K. K. Sen (56 ITR 198):** The Parliament cannot choose to tax as income an item which in no rational sense can be regarded as a citizen's income. The item taxed should rationally be capable of being considered as the income of a citizen.
- **CBDT Circular No. 158 [F. No. 173/2/73-IT(A-I)], dated 27-12-1974:** "2. Receipts which are of a casual and non-recurring nature will be liable to income tax only if they can properly be characterised as "income" either in its general connotation or within the extended meaning given to the term by the Income-tax Act. Hence, gifts of a purely personal nature will not be chargeable to income-tax except when they can be regarded as an addition to the salary or when they arise from the exercise of a profession or vocation."
- It is a settled principle that revenue receipt are taxable, unless specifically exempt. Conversely, capital receipts are exempt, unless specifically made taxable.
- S. 2(24) defines income in an inclusive manner and contains various artificial categories on income.
- S. 56(2)(x) is a notional income and is expressly included vide sub-clause (xviiia) in the scope of 'income' u/s 2(24).

'ANY PERSON'

where 'any person' receives in any previous year, from any person or persons.....

- Section 2(31) defined "person" to include
 - i. an individual,
 - ii. a Hindu undivided family,
 - iii. a company,
 - iv. a firm,
 - v. an association of persons or a body of individuals, whether incorporated or not,
 - vi. a local authority, and
 - vii. every artificial juridical person, not falling within any of the preceding sub-clauses.

'RECEIVES'

where any person 'receives' in any previous year, from any person or persons...

- **McCullough's Estate, 193 Wash. 145, 74 P.2d 877 (1928):** To receive means **to get by a transfer**, as, to receive a gift, to receive a letter, or to receive money and involves an actual receipt.
 - **CIT v. Dharamdas Hargovandas [1961] 42 ITR 427 (SC):** The words 'are received' are not terms of art and their meaning **must receive colour from the context** in which they are used.
 - **Keshav Mills Ltd. vs. CIT [1953] 23 ITR 230 (SC):** The word receipt of income refers to the **first occasion when the recipient gets the money under his own control**.
 - **Chief CIT vs. Smt. Shantavva [2004] 267 ITR 67 (Kar HC):** The word "received" in the context of S. 45(5)(b) refers only to such receipts which an assessee **receives in pursuance of a vested right or enforceable decree/award**. A **conditional receipt** of money subject to the final decision **cannot be said to have been received** by an assessee in his own right.
 - **CIT vs. N. M. A. Mohammed Haniffa [2001] 247 ITR 66 (Mad HC):** The word 'receive' does not necessarily connote the actual receipt of the cash into the hands of the assessee-transferor. **The discharge of the transferor's liability** can, in this context, also be regarded as a receipt by the transferor to the extent to which part of the consideration is retained by the transferee for such discharge.
- Will following transactions fall under 'receives'? - Subscription to shares/securities | Share Application Money against which no shares are issued | Interest-free loan received | Rights in receivables assigned

'SUM OF MONEY'

(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

- **H.H. Rama Varma vs. CIT (187 ITR 308)(SC):** The usage of expression 'any sum' paid contemplates payment of an amount of money.
- **CIT vs. Kasturi Sons Ltd (237 ITR 24)(SC):** While interpreting the expression 'moneys payable' in section 41(2), SC held that "money" has to be interpreted only as actual money or cash and not as any other thing or benefit which could be evaluated in terms of money.
- **ACIT vs. Anuj Agarwal [2010] 3 taxmann.com 46 (Mum Trib):** The receipt of gift of IMD certificates with gift deed does not amount to receiving sum of money without consideration u/s 56(2)(v).
- **ITO vs. Komal Kumar Bader [2009] 33 SOT 58 (Jaipur Trib):** 'Money' in simple sense' is a medium of exchange in a particular form or denominated in currency'. It cannot be of the nature where value has to be derived. The amount has to be definite and exact and it should not be subject to individual valuation.
 - In the context of section 56(2)(v), it observed that the 'sum of money' shall include cash, cheques, drafts, etc.
 - Referring to various other sections of the Act, ITAT noted that though the term 'money' has not been specifically defined in the Income-tax Act, but the term 'money' has been appropriately distinguished within the Income-tax Act from the term 'other assets' wherever the intention of the Legislature was so.

? Whether 'money's worth' is covered?

‘SUM OF MONEY’

(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;


- Threshold of Rs. 50,000 is qua the ‘recipient’
- Illustration: Mr.A receives following amounts in FY 2020-21 without consideration:
 - Rs. 20,000 from Mr.ABC
 - Rs. 10,000 from Mr. PQR
 - Rs. 40,000 from Mr. MNO
 - Aggregate amount received in FY 2020-21 = Rs. 70,000.

? Will section 56(2)(x) apply?

CONSIDERATION

- **Section 2(d) of the Indian Contract Act:** When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise.
- **DCIT vs. Dr. Rajan Pai [2016] 48 ITR 170 (Bang Trib):** When bonus shares are received, it is not something which is received without consideration. A consideration flows out from the holder of the shares, may be unknown to him, which is reflected in the depression in the intrinsic value of the original shares held by him.
- **Ashok C. Pratap vs. ACIT [2012] 139 ITD 533 (Mum Trib):** The amount received in pursuance of dissolution of trust cannot be termed to be an amount received by the beneficiaries "without consideration"- S. 56(2)(vi)
- **Chandrakant H. Shah vs. ITO [2010] 124 ITD 177 (Mum Trib):** There can be a consideration without any apparent monetary consideration and the only requirement is that the consideration should create a legal relationship between the contracting parties.
- consideration for a promise may consist of either some benefit conferred on the promisor or detriment suffered by the promisee or both.
 - In this case, the assessee had gained by way of interest free loan and the lenders had suffered by way of giving interest free loans and such suffering had got some value. Thus, transaction could not be said to be without consideration. – S 56(2)(v)

CONSIDERATION (CONT'D...)

- Adequacy of consideration is not tested for receipt of 'sum of money'. In case of receipt of property, both absence of consideration and adequacy of consideration have to be examined
-  Whether the following can be said to be without consideration or for inadequate consideration -
 - Subvention money,
 - Family arrangements,
 - Conversion of CCDs/CCPS into Equity Shares,
 - Bonus shares,
 - Right to receive alimony

‘PROPERTY’

- Clause (d) of Explanation to S. 56(2)(vii): "property" means the following capital asset of the assessee, namely:—
 - (i) immovable property being land or building or both;
 - (ii) shares and securities;
 - (iii) jewellery;
 - (iv) archaeological collections;
 - (v) drawings;
 - (vi) paintings;
 - (vii) sculptures;
 - (viii) any work of art;
 - (ix) bullion;

'PROPERTY' (CONT'D...)

 Are the following covered under 'property'?

- Transfer of 'business undertaking' on slump sale or demerger
- Interest in partnership firm/AOP/BOI
- Land, being stock in trade
- Transfer of Agricultural land
- Intangible like trademarks, patents, goodwill, etc.
- Bitcoins or any other crypto currency
- Plant & Machinery
- Receivables

IMMOVABLE PROPERTY – WHETHER ‘RIGHTS’ COVERED?

- Clause (d) of Explanation to S. 56(2)(vii): "property" means the following capital asset of the assessee, namely:—
 - (i) immovable property being land or building or both;.....
- Other provisions under Income Tax Act
 - S. 50C & S. 43CA - land or building or both
 - S. 54D, 54G, 54GA - land or building or any right in land or building
 - S. 197LA & S. 194-IA – land or building or part of building
 - S. 269A & S. 269UA – immovable property inter alia means land or building or any right therein
- In the context of section 50C, which covers ‘land or building’ it is held that ‘rights’ therein are not covered:
 - Leasehold rights - CIT vs. Greenfield Hotels & Estates (P.) Ltd. [2017] 245 Taxman 125 (Bom HC); Atul G. Puranik v. ITO [2011] 132 ITD 499 (Mum Trib)
 - Tenancy rights - DCIT vs. Tejinder Singh [2012] 50 SOT 391 (Kol Trib)
 - Development rights - Volats Ltd. vs. ITO [2016] 61 ITD 199 (Mum Trib)
 - Right to purchase - Smt. Devindraben I. Barot vs. ITO [2016] 159 ITD 162 (Ahd Trib)

WHAT IS THE DATE OF RECEIPT OF IMMOVABLE PROPERTY

- Sale complete if consideration paid and possession handed over [Balbir Singh Maini (SC)]
- Development agreement entered into and irrevocable power of attorney given [Chaturbhuj Dwarkadas (Bom HC)]

TOLERANCE LIMIT OF 10% - PROSPECTIVE OR RETROSPECTIVE

- FA, 2020 provided tolerance limit of 10% on difference between stamp duty value and actual consideration w.e.f. April 1, 2021.
- **Chandra Prakash Jhunjunwala vs. DCIT [2020] 181 ITD 185 (Kol Trib.):** Tolerance limit provided u/s 50C is applicable from 1.4.2003 (i.e. the date on which the section was introduced) since the proviso is curative in nature.
- **Contrary view: Welfare Properties (P.) Ltd. vs. DCIT [2020] 180 ITD 591 (Mum Trib):** held that the tolerance limit inserted in section 43CA(1) by FA, 2018 is effective only from 1-4-2019.

INTERPLAY BETWEEN S. 50C, 43CA & 56(2)(X)

Property	Scenario	In the hands of the transferor	In the hands of the transferee
Land or Building or both held as capital asset by the transferor	Transfer of property below SDV	Section 50C: Capital Gains = Consideration SDV (-) Cost of Acquisition	Section 56(2)(x) IFOS = SDV (-) Consideration
Land or Building or both held as stock in trade by the transferor (held as capital asset by transferee)		Section 43CA: Business Income Consideration SDV (-) Cost of Acquisition	

INTERPLAY BETWEEN S. 50CA & 56(2)(X)

Property	Scenario	In the hands of the transferor	In the hands of the transferee
Unquoted share	Transferred below FMV as per Rule 11UA	Section 50CA Capital Gains = Consideration SDV (-) Cost of Acquisition	Section 56(2)(x) Deemed IFOS = SDV (-) Consideration

- Incidence of double taxation on SDV (-) Consideration - Both in the hands of transferor as well as transferee
- The value taxed u/s 56(2)(x) will be allowed as cost of acquisition u/s 49(4) in the hands of transferor on subsequent transfer

BONUS ISSUE

- Issue of bonus shares by capitalization of reserves is merely a reallocation of the company's funds.
 - It does not result into any change in the capital structure of the company
 - There is no increase or decrease in the wealth of shareholder and his % holding remains constant
- The market value as well as intrinsic value of two shares put together = Value of original share (before bonus issue). What in effect transpires is that a share gets split.
- A consideration has flown out from the shareholder, may be unknown to him, which is reflected in the depression in the intrinsic value of the original shares.
- There is no receipt of property. What stands received by the shareholder is split shares out of his own holdings. Thus, S. 56(2)(x) will not apply.
- **PCIT vs. Dr. Ranjan Pai [2021] 431 ITR 250 (Kar HC); DCIT vs. Smt. Mamta Bhandari [2019] 178 ITD 89 (Delhi Trib); Sudhir Menon HUF vs. ACIT [2014] 162 TTJ 425 (Mum Trib)**

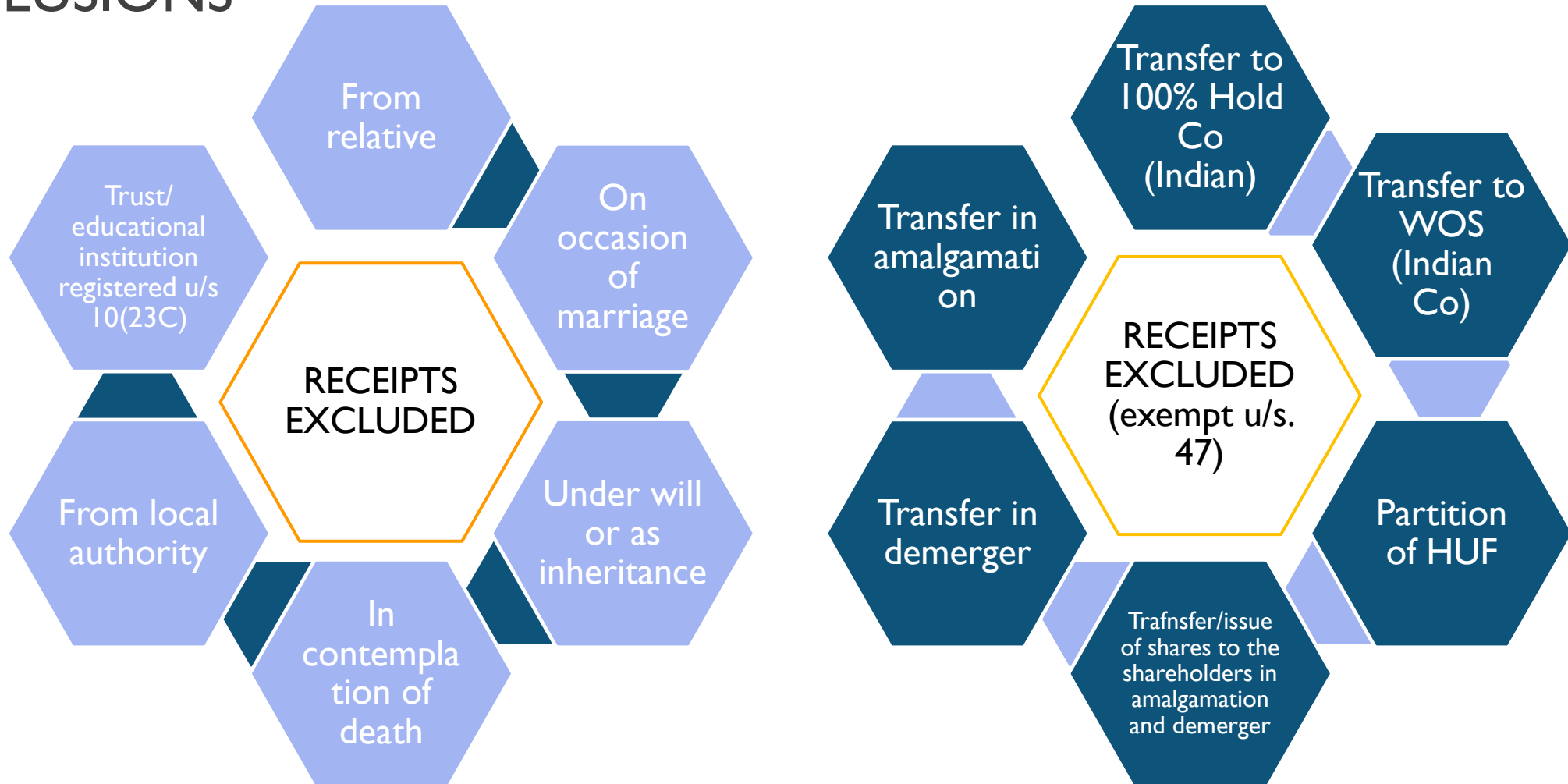
RIGHTS ISSUE

- A rights issue is an invitation to existing shareholders to purchase additional new shares in the company generally at a discounted price.
- Issue of fresh shares – can S. 56(2)(x) apply
 - **Khoday Distilleries Ltd. [2008] 307 ITR 312 (SC):** There is a vital difference between 'creation' and 'transfer' of shares. Allotment of shares indicate creation of shares. Such allotment is not transfer.
 - **Circular No. 10/2018 dated December 31, 2018:** CBDT stated that keeping in view the legislative intent to apply anti-abuse provisions contained in erstwhile section 56(2)(viii) to transfer of shares for no or inadequate consideration, the provisions would not be applicable in cases of receipt of shares as a result of fresh issuance. However, the circular was withdrawn by CBDT vide Circular No. 02/2019 dated January 04, 2019.
- **Proportionate allotment:**
 - Shares are allotted pro-rata to the shareholders, based on their existing holdings
 - No additional property is received by the shareholder Only an apportionment of the value of existing holding over a larger number of shares
 - S. 56(2)(x) not applicable. Akin to tax implications in case of bonus issue
- **Disproportionate allotment:** May attract the rigors of S. 56(2)(x)
- **Sudhir Menon HUF vs. ACIT [2014] 162 TTJ 425 (Mum Trib)**

BUY BACK OF SHARES

- To attract S. 56(2)(x) one of the requirement is receipt of a 'property'.
- To become property of the recipient company, the shares should be of any other company. Because own shares cannot be become property of the recipient company.
- Section 68 of Companies Act, 1961 mandates cancellation of shares with 7 days of the last date of completion of buy-back.
- The term 'property' conceives holding and enjoying or exercising the rights in the property. Since the shares have to be extinguished, they cannot become property of the recipient company.
- The shares cannot be said to have an innate value.
- **Vora Financial Services (P.) Ltd. vs. ACIT [2018] 171 ITD 646 (Mum Trib)**

EXCLUSIONS



RELATIVES

- Clause (e) of S. 56(2)(vii) defines “relative” to mean,—
 - (i) in case of an individual—
 - (A) spouse of the individual;
 - (B) brother or sister of the individual;
 - (C) brother or sister of the spouse of the individual;
 - (D) brother or sister of either of the parents of the individual;
 - (E) any lineal ascendant or descendant of the individual;
 - (F) any lineal ascendant or descendant of the spouse of the individual;
 - (G) spouse of the person referred to in items (B) to (F); and
 - (ii) in case of a Hindu undivided family, any member thereof;

RELATIVES (CONT'D)

- Definition of relative is unchanged – Controversies under the old provisions still persist



Receipt by HUF from member

Covered in definition of “relative” – Hence, exempt



Receipt by HUF from relative of Karta

Harshadbhai Dahyalal Vaidhya (HUF) vs. ITO [2013] 155 TTJ 71 (Ahmed Trib) – Not taxable

Subodh Gupta (HUF) vs. PCIT (169 ITD 60) (Delhi Trib.) – Taxable



Receipt by member from HUF

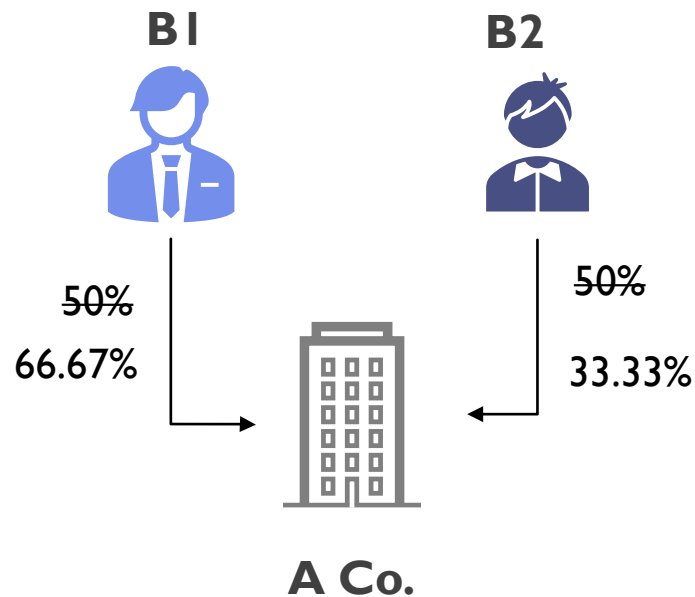
Not explicitly covered by definition;

However, relative includes group of relatives - HUF = Group of relatives

Vineetkumar Raghavjibhai Bhalodia vs. ITO [2011] 46 SOT 97 (Rajkot) – Not Taxable

Gyanchand M. Bardia vs. ITO [2018] 93 taxmann.com 144 (Ahmd Trib) – Taxable

RELATIVES – RECEIPT FROM FAMILY OWNED COMPANY



Pre-Rights Issue: 50% : 50%

Post-Rights Issue: 66.67% : 33.33%

- A Co. is a closely held family company.
 - Shares of A Co. are equally held by two brothers (B1 & B2)
 - A Co. does a rights issues at Rs. 75 per share
 - FMV as per Rule 11UA is Rs. 100
 - B2 renounces his right to subscribe to the rights
 - A Co. offers to B1 rights share originally issued to B2
 - B1 subscribes to entire rights issue.
- ?** Whether Rs. 25 per share (multiplied by 50% rights subscription) would be taxable as IFOS in hands of B1 u/s 56(2)(x)?
- Kumar Pappu Singh vs. DCIT [2019] 174 ITD 465 (Vizag Trib)
 - ACIT vs. Y. Venkanna Choudary [2020] 180 ITD 166 (Vizag Trib).

S. 68 V/S S. 56(2)(X)

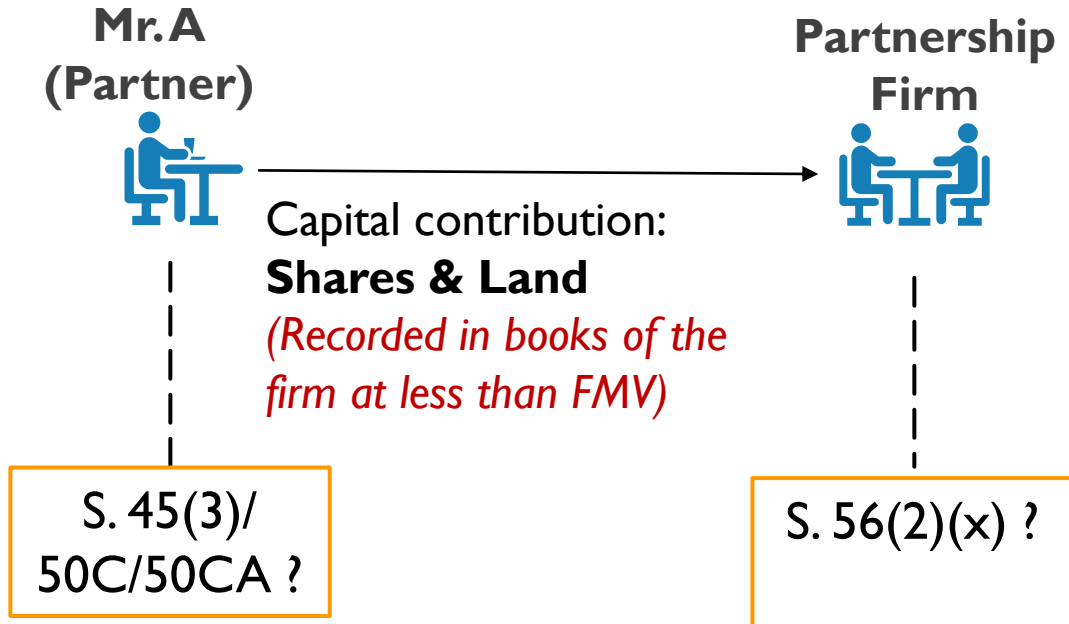
Illustrations

- Mr A. receives Rs. 15 lakh from his brother. S. 56(2)(x) will not apply as receipt from relative is excluded. Can S. 68 apply?
 - E. Ummer Bava vs. CIT [2016] 72 taxmann.com 123 (Ker HC), Assessee's SLP dismissed in [2017] 244 Taxman 193.
- Mr A receives Rs. 15 lakh from a friend. He demonstrates the identity and creditworthiness of the friend and genuineness of the transaction. S. 68 will not apply. Can S. 56(2)(x) apply?

- S. 68 & S. 56(2)(x), both target bogus gifts – These are anti-abuse provisions to prevent money laundering in the garb of gifts.

S. 68	S. 56(2)(x)
Applicable to all assessees	Applicable to all assessees
No monetary threshold/exemption	Gifts above monetary threshold taxable
No exclusion for gifts received from relatives or gifts received on occasion of marriage	Gifts from specified relatives or on occasion of marriage are excluded
Pre-condition for attracting section 68 is that assessee maintains books of account and credits the gift in his books	No such condition
Addition, made if assessee is unable to discharge initial onus of proving identity & creditworthiness of the creditor and genuineness of the transaction.	No question of discharging any onus on literal reading of the provision
Income treated as undisclosed income, taxable at a base rate of 60% prescribed u/s 115BBE(1). No deduction allowed in respect of expenditure, allowance or set-off of losses	Income will be taxed at applicable slab rates. Set-off of losses, etc. allowed.

INTERPLAY BETWEEN S. 50C, 50CA, 45(3) & S. 56(2)(x)



- Carlton Hotel (P.) Ltd. vs. ACIT [2017] 399 ITR 611 (All HC)
- DCIT vs Amartara (P.) Ltd. (ITA No.6050/Mum/2016)
- CIT v. Moon Mills Ltd. [1966] (59 ITR 574) (SC)
- Sunil Siddharthbhai v. CIT [1985] (156 ITR 509) (SC)

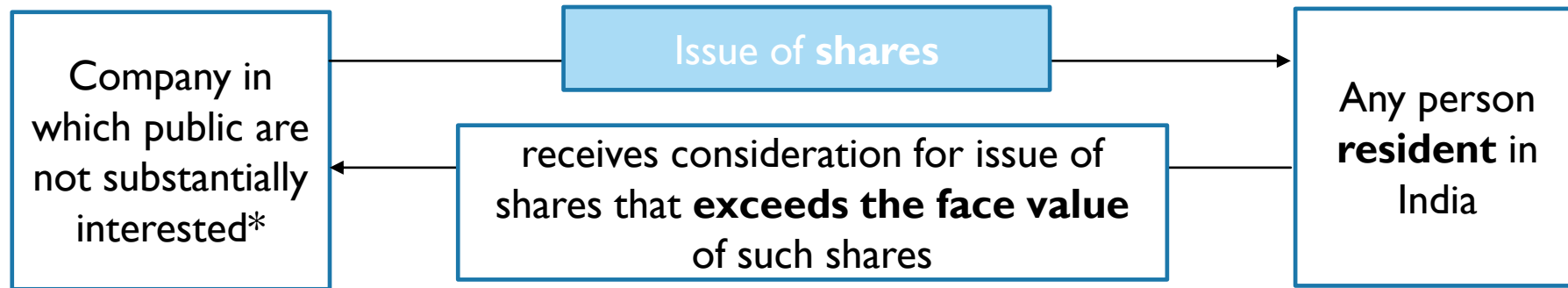
Capital Contribution – Land/Shares by partner into the firm		Tax implications in the hands of			
Nature of asset in the hands of		Partner		Firm Property	
Partner	Firm	50C/ 50CA	45(3)	Below SDV	Above SDV
				56(2)(x)	56(2)(x)
CA	SIT	No	Yes	No	No
CA	CA	No	Yes	Yes	No
SIT	SIT	No	No	No	No
SIT	CA	No	No	Yes	No

- CA – Capital Asset
- SIT – Stock in Trade



ISSUE OF EQUITY SHARES

S. 56(2)(viib): APPLICABILITY



Income u/s. 56(2)(viib) = **Aggregate Consideration (-) Fair Market Value**

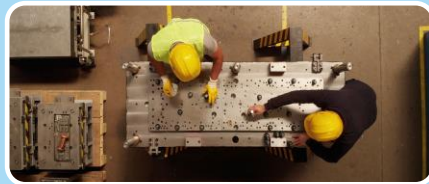
- Equity & Preference Shares - Both covered
- Issue of shares to non-resident – S. 56(2)(viib) not applicable

* *Company in which public are substantially interested is defined u/s 2(18) of the Act*

S. 56(2)(viib): CARVE OUT



Venture Capital Undertaking



A Startup recognized by DPIIT

(share capital + share premium after proposed issue does not exceed Rs. 25 Cr)



Consideration received by a company from a class or classes of persons as may be notified by the Central Government in this behalf

Section 56(2)(viib): FMV

Explanation to s. 56(2)(viib) determines FMV to be the **higher of the following** in case of equity shares:



DCF Method by a Merchant Banker

Net Asset Value (Book Value) of the Company based on Rule 11UA(2)

As may be substantiated by the Company to the satisfaction of the Assessing Officer

- In case of Preference Shares, the fair value shall be value determined in open market as determined by a Merchant Banker or an accountant.

DCF V/S NAV – ‘AT THE OPTION OF THE ASSESSEE’

- Rule 11UA allows assessee to determine FMV based DCF or NAV – ‘at the option of the assessee’

Vodafone M-Pesa Ltd.
[2020] 181 ITD 242
(Mum Trib)

CIT(A) and AO attempted to compare the ‘projections’ with actual figures.

However, ITAT held that it is not proper and also the actuals are based on so many factors subsequent to adoption of projection and valuation.

AO has to see basis and assumptions for projection and if they are not scientific, then only report can be rejected but on ground of deviation, it cannot be rejected.

Vodafone M-Pesa Ltd.
(2018) 256 Taxman
240 (Bom HC)

The AO is undoubtedly entitled to scrutinise the valuation report and determine a fresh valuation either by himself or by calling for a final determination from an independent valuer to confront the petitioner.

However, the basis has to be the one which has been opted by the Assessee and it is not open for the AO to change the method of valuation.

DCF V/S NAV – ‘AT THE OPTION OF THE ASSESSEE’ (CONT’D)

VVA Hotels (P.) Ltd.
[T.C.A No 670 of
2019] (Mad HC)

HC ruled that assessee had an option to adopt the NAV method or DCF Method to arrive at the valuation of unquoted shares.

If the AO was unable to bring out any evidence of abuse of the provisions with an intention to defraud the revenue, the option accorded to the assessee to choose the method of valuation shall be held to be absolute.

Innoviti Payment
Solutions (P.) Ltd.
(175 ITD 10) (Bang
Trib)

The primary onus to prove the correctness of the Valuation Report is on the assessee as he has special knowledge and he is privy to the facts of the company and only he has opted for this method.

Hence, he has to satisfy about the correctness of the projections, discounting factor and terminal value etc. with the help of empirical data or industry norm if any and/or scientific data, scientific method, scientific study and applicable guidelines regarding DCF Method of Valuation.

Other favourable decisions

- Signure Technologies (P.) Ltd. vs. ACIT [2021] 187 ITD 368 (Bang Trib);
- I-Exceed Technology Solutions (P.) Ltd vs. ITO [2020] 185 ITD 8 (Bang Trib);
- Valencia Nutrition Ltd. vs. DCIT [2020] 120 taxmann.com 238 (Bang Trib)

OTHER JUDICIAL PRECEDENTS

Ozone India Ltd.
[2021] 189 ITD
476 (Ahmd Trib)

ISSUE OF SHARES BY AMALGAMATED COMPANY:

S. 56(2)(viib) when read in conjunction with Memorandum Explaining of Finance Bill, 2012 and CBDT Circular No. 3/2012 dated 12-6-2012 is a measure to tax hefty or excessive share premium received by private companies on issue of shares without carrying underlying value to support such premium and thereby enriching itself without paying taxes legitimately due to them. Thus, issue of shares by amalgamated company to shareholders of amalgamating company in pursuance to scheme of amalgamation does not fall under S. 56(2)(viib).

Apollo Sugar
Clinics Ltd. [2019]
105 taxmann.com
254 (Hyd Trib)

S. 56(2) v/s S. 56(1):

Second level subsidiary of a company in which public was substantially interested would also be a company in which public is substantially interested u/s. 2(18)(b)(B) of the Act and thus S. 56(2)(viib) would not apply.

AO accepted this fact but made addition u/s 56(1).

ITAT held that the same would not fall within the definition of income and when there is a specific sub-section, it would not get covered under general sub-section and deleted the addition.

OTHER JUDICIAL PRECEDENTS

Unnati Inorganics
(P.) Ltd. [2019]
109 taxmann.com
165 (Ahmd Trib)

BOOK ENTRY IS NOT NECESSARY FOR DETERMINING FMV:

The FMV of all the assets whether recorded in the books or not, appearing in the books at their intrinsic value or not, is a sufficient warrant to value the premium on issue of unquoted equity shares by closely held company. Explanation (a)(ii) itself implies that book entry for recognition of intrinsic value is not necessary at all.

Cinestaan
Entertainment (P.)
Ltd. (2019) 177
ITD 809 (Del Trib)

MISCHIEF RULE APPLIED:

The arguments of the assessee that the provision cannot be invoked on a normal business transaction of issuance of shares unless it has been demonstrated by the Revenue authorities that the entire motive for such issuance of shares on higher premium was for the tax abuse with the objective of tax evasion by laundering its own unaccounted money was accepted by ITAT.

Further, where nothing was brought on record that it is unaccounted money of assessee company routed through circuitous channel or any other dubious manner through these accredited investors, the addition was deleted.



FAIR MARKET VALUE

KEY TERMS – RULE 11U



Valuation date

The date on which the property or consideration, as the case may be, is received by the assessee.



Balance sheet

- R 11UA(2): BS drawn up on the valuation date as audited by the auditor of the company or last audited BS.
- R 11UA(1):
 - In case of Indian Co. – BS on valuation date as audited by auditor appointed under company law
 - Other Co. – BS on valuation date as audited by auditor appointed under laws in force in their country
- Amended w.e.f. FY 2018-19



Quoted equity shares

- Shares quoted with regularity on a recognised stock exchange
- Quotation based on current transaction in ordinary course

VALUATION OF SHARES & SECURITIES – RULE 11UA(I)

Quoted Shares & Securities

- Transaction on the floor of the market – value recorded on the market
- Transaction off market – lowest price quoted on
 - any exchange on the transaction date
 - or last date before the transaction date, if not traded on the transaction date

Unquoted Equity Shares

- Book value of assets other than –
 - Jewellery artistic work at open market value
 - Shares and securities as per this rule
 - Stamp duty value for immovable properties
- Less: Book Value of liabilities
 - not including – paid up capital, amount set apart from payment of dividend, reserves and surplus, provision for tax in excess of tax paid, provision for unascertained liabilities, liabilities that are contingent
- Applicable for determining FMV u/s 50CA as well

Other Shares & Securities

- Price it would fetch in the open market on valuation date.
- Report to be obtained from merchant banker or accountant

Particulars	Rs.
A = Book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property)	xx
Less: Amount of income tax paid, less the amount of income-tax refund claimed	xx
Less: Amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset	xx
Total A	xx
	xx
B = Price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer	xx
C = FMV of shares and securities as determined in the manner provided in this rule	xx
D = Value adopted or assessed or assessable by any authority of the government for the purpose of payment of stamp duty in respect of the immovable property	xx
L = Book value of liabilities	xx
Less: Paid-up capital in respect of equity shares	xx
Less: Amount set apart for payment of dividends on preference shares and equity shares	xx
Less: Reserves and surplus other than for depreciation (net off negative balance of P & L)	xx
Less: Provision for taxation (excluding (advance tax- refund due, if any))	xx
Less: Provisions for liabilities other than those for ascertained liabilities (General Contingency Provision)	xx
Less: Contingent Liabilities other than cumulative preference shares	xx
Total L	xx
A + B + C + D - L	xx
PE = Paid-up equity share capital as shown in Balance Sheet	xx
PV = Paid-up value of equity share capital as shown in Balance Sheet	xx
Value per share (in Rs.) = $(A + B + C + D - L) * (PV) / (PE)$	xx



- Does 56(2)(x) apply to receipt of foreign shares?
- Are foreign shares required to be valued as per this modified break-up value?
- Can immovable property located outside India be taken at cost?

VALUE OF UNQUOTED EQUITY SHARES - RULE 11UA(2)

At the option of the Assessee, FMV =

- Book Value or DCF Value determined by merchant banker

Book Value

	Particulars	Rs.
A =	Book value of all the assets	xx
Less:	Amount of income tax paid, less the amount of income-tax refund claimed	xx
Less:	Amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset	xx
	Total A	xx
L =	Book value of liabilities	xx
Less:	Paid-up capital in respect of equity shares	xx
Less:	Amount set apart for payment of dividends on preference shares and equity shares	xx
Less:	Reserves and surplus other than for depreciation (net off negative balance of P & L)	xx
Less:	Provision for taxation (excluding (advance tax- refund due, if any))	xx
Less:	Provisions for liabilities other than those for ascertained liabilities (General Contingency Provision)	xx
Less:	Contingent Liabilities other than cumulative preference shares	xx
	Total L	xx
	A – L	xx
	PE = Paid-up equity share capital as shown in Balance Sheet	xx
	PV = Paid-up value of equity share capital as shown in Balance Sheet	xx
	Value per share (in Rs.) = $(A - L) * (PV) / (PE)$	xx

DCF	Book Value	Modified NAV	Issue Price
100	150	80	80
100	150	120	120
100	150	120	150
100	150	180	150
100	150	180	150
100	80	(negative)	10 (Face Value)
100	80	(negative)	80

BOOK VALUE V/S MODIFIED NAV

- A Co. is closely held company.
- All the shareholders are resident of India.
- A Co. issues further shares of face value Rs. 10 per shares, at a premium. Value per Shares is tabulated above.

? Will S. 56(2)(x) or S. 56(2)(viib) apply?

VALUE OF OTHER ASSETS – RULE 11UA(I)

Jewellery

- Price it would fetch on valuation date
- If purchased from registered dealer, then invoice value

Archaeological collections, drawings, paintings, sculptures, work of art

- Price it would fetch on valuation date
- If purchased from registered dealer, then invoice value



TAXATION OF DIVIDEND

The image is a conceptual representation of finance and taxation. It features a blue-tinted background with several key elements: a calculator on the left with buttons for numbers and mathematical symbols; a silver pen resting diagonally across the center; a stack of silver coins on the right; and a financial line chart in the background. The chart has a y-axis with values 6,000, 6,250, 6,500, and 6,750, and an x-axis with months labeled AUG, SEP, and OCT. The text 'TAXATION OF DIVIDEND' is prominently displayed in the center in a white, bold, sans-serif font, underlined.

SECTION 56(2)(I) - DIVIDENDS

- The term 'Dividend' is defined u/s 2(22) of the Act.
- Dividend, in ordinary sense, means sum paid to a share holder in proportion of his shareholding in a company out of the total profit distributed.
- The definition u/s 2(22) is an inclusive one.
 - Contains clauses (a) to (e) which bring within the ambit of the term 'dividend' certain outflows which otherwise would not be considered as dividend.
 - In common parlance, these items are referred to as 'deemed dividend' as they artificially expand the scope of dividend.

TAXABILITY OF DIVIDEND - PRE - FINANCE ACT, 2020



DOMESTIC COMPANY
LIABLE TO PAY DIVIDEND
DISTRIBUTION TAX U/S
115-O EXCEPT DIVIDEND
U/S 2(22)(E)



DIVIDEND [EXCEPT
DIVIDEND U/S 2(22)(E)] IN
EXCESS OF TEN LAKH
RUPEES TAXABLE IN HANDS
OF SHAREHOLDERS AT THE
RATE OF 10% U/S 115BBDA



DIVIDEND SUBJECT TO
DDT U/S 115-O EXEMPT IN
THE HANDS OF
SHAREHOLDERS U/S 10(34)



DIVIDEND U/S 2(22)(E)
TAXABLE IN THE HANDS
OF SHAREHOLDER

TAXABILITY OF DIVIDEND - POST FINANCE ACT, 2020

Dividend Distribution Tax u/s 115-O abolished

S. 80M inserted to provide deduction in respect of inter-corporate dividends. to remove cascading effect of dividend Akin to S. 115-O(IA)

S. 115BBDA to tax dividends in certain cases made inoperative for dividends from FY 2020-21 onwards

From FY 2020-21, dividend is taxable in hands of shareholders

TDS u/s 194 at 10% by domestic company on dividend paid to resident shareholders

TDS u/s 195, 196D, etc. in case of non-resident shareholders

S. 57 amended to allow deduction on only interest against dividend, to the extent of 20% of dividend income

S. 14A of the Act becomes redundant in respect of dividend income. **Can indirect expenses disallowed u/s 14A earlier now be disallowed u/s S. 57?**

POINT OF TAXABILITY OF DIVIDENDS

- Provision for inclusion of dividend income in total income governed by S. 8 of the Act.
- Dividend declared, distributed or paid by a company within the meaning of sub-clauses (a) to (e) of clause (22) of section 2 taxed in the year in which it is declared, distributed or paid as the case maybe.
- Interim dividend to be taxed when unconditionally made available to the shareholder.
- **Purshotamdas Thakurdas vs. CIT [1958] 34 ITR 204 (Bom HC):** In view of the specific provision, the dividend is to be taxed as provided therein and the method of accounting adopted by the assessee has no significance for determining the year of taxability of dividend.
- Taxation of dividend is the date of declaration, the liability to deduct tax at source u/s 194 is at the time of payment of dividend. Thus, there may be a gap and issue may arise in respect of claim of credit of tax. However, one may contend that as per provisions of Rule 37BA(3), credit for tax is to be allowed in the assessment year in which income is assessable.
- Relief in Proviso to Section 234C – advance tax to be computed only from quarter in which dividend arises.

S. 14A V/S S. 57(III)

- S. 14A provides that “no deduction shall be allowed **in respect of expenditure** incurred by the assessee in relation to income which does not form part of the total income under this Act.”
- S. 57(iii) provides for deduction of “any other expenditure (not being in the nature of capital expenditure) laid out or expended **wholly and exclusively for the purpose of making or earning such income;**”
- Is S. 14A wider in scope as compared to S. 57(iii)?
- **CIT vs. General Insurance Corpn. of India (No. 1) [2002] 254 ITR 203 (Bom HC):** In the context of deduction u/s 80M (pre-DDT), HC held that salary paid to staff, stamp duty, transfer fee and safe custody charges are not relatable to earning of dividend. They may be relatable to acquisition of share but not to dividend being earned.
- Scope of S. 57(iii):
 - **Vijaya Laxmi Sugar Mills Ltd. vs. CIT [1991] 59 Taxman 22 (SC):** The requirement u/s 57(iii) that the expenditure should have been incurred 'for the purpose of making or earning such income' shows that the object of spending or the end or aim or the intention of such spending was for earning the interest income.
 - **Anant Mills Co. Ltd. (In liquidation) vs. CIT [1995] 212 ITR 72 (Guj HC):** Expenditure incurred by assessee on advertisements, advocate's fee, court fee stamps and provisional fees could not be allowed as deduction under section 57(iii) from interest income on bank deposits as there was **no material on record to show that said expenses were incurred wholly and exclusively for earning interest income.**

Two white dice with black pips are shown in a dynamic, slightly blurred position, suggesting they have just been rolled. They are set against a light beige, neutral background. The text 'WINNINGS FROM LOTTERIES, ETC.' is overlaid in the center, with a thin white horizontal line underneath it.

WINNINGS FROM LOTTERIES, ETC.

SCHEME OF TAXATION

S. 2(24)(ix)

- Includes in the scope of 'income' any winnings from:
 - lotteries,
 - crossword puzzles,
 - races including horse races,
 - card games and
 - other games of any sort or from gambling or betting of any form or nature whatsoever.
- "lottery" includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
- "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;

S. 56(2)(ib)

Income referred u/s 2(24)(ix) shall be chargeable to tax as IFOS

S. 115BB

Winnings shall be taxable at 30% + Applicable Surcharge & Cess

S. 194B & S. 194BB

Withholding tax at 30% on winnings exceeding Rs. 10,000/-

TDS ON WINNINGS IN KIND

- **Prior 1.6.1997 – Vide Circular No. 390 dated 8-8-1984:** Instructions for deduction of tax at source from winnings from lottery etc. - Where the prize is given partly in cash and partly in kind, income-tax will be deductible from each prize with reference to the aggregate amount of the cash prize and the value of the prize in kind. **Where, however, the prize is given only in kind no income-tax will be required to be deducted.**
- **After 1.6.1997 – Vide Finance Act 1997 – Proviso to S. 194B:** where the **winnings are wholly in kind or partly in cash and partly in kind** but the part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of the winnings, the person responsible for paying shall, before releasing the winnings, **“ensure”** that tax has been paid in respect of the winnings.
- Section uses ‘Ensure’ against ‘Deduct’, hence, one cannot invoke S. 201 where winning are wholly in kind - **CIT vs. Hindustan Lever Ltd. [2014] 361 ITR 1 (Kar HC)**
- Moral obligation and No Legal Obligation – Disallowance under S.40(a)(ia) may be warranted.
- Penal & Prosecution - S. 271 & 276B.

GAME OF SKILLS v/s GAME OF CHANCE

- **Game of Skills:**
 - Acquired through practice, application of mind, evaluation of statistical data
 - Competitions where success depends on substantial degree of skill are not 'gambling'
 - Despite there being an element of chance if a game is preponderantly a game of skill it would nevertheless be a game of "mere skill".
- **Game of Chances:** Future outcome is based on luck/chance
- **State of Andhra Pradesh vs. K Satyanarayana & Ors. (AIR 1968 SC 825):** Rummy was not entirely based on chance. Rummy was a game involving preponderance of skill rather than chance based on the fact that Rummy required a certain amount of skill as the fall of the cards needs to be memorized and the building up of Rummy requires considerable skill in holding and discarding cards.
- **Manoranjithan Manamyil Mandram vs. State of Tamil Nadu (AIR 2005 Mad 261):** Whether the game is a game of skill or chance is a question of fact and has to be decided by the facts and circumstances of each case.
- **Varun Gumber v. Union Territory of Chandigarh [CWP No. 7559/ 2017] (P&H HC):** Online fantasy sports platform Dream 11 is predominantly based on skill and thus, does not qualify as gambling. Apex Court dismissed the Special Leave Petition filed against the ruling. Similar ruling have been passed by Bom HC & Raj HC and SLPs have also been dismissed (most recent being in this month itself).

THANK YOU!



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