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**Deemed Income under Section
56(2) of the Income Tax Act,
1961**

**J B Nagar CPE Study Circle of WIRC of ICAI
10th July 2016**

Section 56(2)

Section 56(2)(vii) –

- Applicable to Individual/HUF
- Amounts/immovable property/specified movable property
- Received without consideration/for consideration less than FMV

Section 56(2)(viiia) –

- Applicable to firm (including LLP)/co in which public not substantially interested
- Shares of co in which public not substantially interested
- Without consideration/for consideration less than FMV

Section 56(2)(viiib) –

- Applicable to co in which public not substantially interested
- Receipt of consideration for issue of shares
- Consideration exceeding face value of shares, and FMV of shares

Fair Market Value – in accordance with rules 11U and 11UA

Recent Amendments to s.56(2)

Amendments by Finance Act 2016:

- ❑ **Provisions of section 56(2)(vii) not applicable to following transactions, not regarded as transfer u/s 47:**
 - Section 47(vicb) – business re-organisation of co-operative bank
 - Section 47(vid) – Scheme of Demerger
 - Section 47(vii) – Scheme of Amalgamation
- ❑ **Exclusion only if exempt transfer under relevant provision**
 - Not necessarily taxable otherwise?

Recent Recommendations for Changes

❖ Recommendation of Income Tax Simplification Committee – Easwar Committee – 1st Batch of Recommendation.

Deletion of section 56(2)(viib) – *“provision works on the assumption that the buyer of the property would have paid consideration more than the stated consideration. This presumption is not in accordance with judicial interpretation and therefore deserves to be deleted”* – No amendment in recent budget

❖ Startup India Action Plan – Funding Support and Incentives: Tax Exemption on investment above Fair Market Value.

“In the context of Startups, where the idea is at a conceptualization or development stage, it is often difficult to determine the FMV of such shares. In majority of the cases, FMV is also significantly lower than the value at which the capital investment is made. This results into the tax being levied under section 56(2) (viib).

Currently, investment by venture capital funds in Startups is exempted from operations of this provision. The same shall be extended to investment made by incubators in the Startups” – No amendment in recent budget

**ISSUES UNDER SECTION 56(2)(vii),
(viia) & (viib)**

Consideration – section 56(2)(vii)

- ❑ **Can the term “consideration” in section 56(2)(vii) be understood not only in monetary terms, but also in terms of the definition found under the Indian Contract Act?**
 - Section 2(d) of the Indian Contract Act, 1872 defines “consideration” as:
 - *“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 abstain from doing something, such act or abstinence or promise is called a consideration for the promise”*
 - Pritam Das Narang (2015) 61 taxmann.com 322 (Del) – cancellation of proposed employment
 - Purvez A Poonawalla v ITO (2011) 138 TTJ 673 (Rajkot) – giving up of right to challenge will
 - ACIT v Meenakshi Khanna 143 ITD 744 (Del) – amounts received in lieu of monthly alimony from ex-husband
 - Chandrakant H Shah v ITO (2009) 28 SOT 315 (Mum) – consideration as per Indian Contract Act

Partition of HUF

- ❑ Does section 56(2)(vii) apply to receipt of specified assets by an individual on partition of an HUF?
- ❑ Would the position be different if the partition is unequal?
 - Whether without consideration?
 - Whether receipt of existing interest?
 - Sudha V Iyer v ITO [2011] 15 taxmann.com 234 (Mumbai) –
 - *The money received by the assessee in her capacity as coparcener as and towards her share of the properties of the HUF, on partition of HUF, cannot be said to be sum of money or property received without consideration. The right, title and interest of the coparcener in the assets of the HUF will itself be a consideration.*
 - Unequal Partition – also a means of settling interest of a coparcener
 - Also, though received from HUF (which is not relative), higher share would be to detriment of other relatives

Family Arrangement

- ❑ **Does section 56(2)(vii) apply to receipt of assets under a family arrangement?**
 - Dy CIT v Paras D Gundecha (2015) 155 ITD 880 (Mum)
 - Where assessee received certain sum out of family settlement, same was not taxable as under section 56(2)(v) – receipt from wife of brother of assessee – falling within exemption
 - SKM Shree Shivkumar vs. ACIT (2014) 65 SOT 232 (Chen)
 - Section 56(2)(vi) will not apply in case of receipt of assets under a family arrangement – receipt from company under family arrangement

Receipt by AOP

❑ Does section 56(2)(vii) apply to receipt of assets by an AOP?

- Mridu Hari Dalmia Parivar Trust v. AO (2016) 68 taxmann.com 376 (Del Trib)

Section 56(2) is a charging section. It is palpable from the definition of 'person' as given in section 2(31) that AOP is a person different from an individual or a HUF. Even if an AOP consists of some individuals, the status of such a group of individuals remains as that of 'AOP', in the same way in which when some individuals enter into partnership, the body which comes into existence is called a 'Firm'

Settlement on Trust

- ❑ **Does section 56(2)(vii) apply to assets settled in trust and received by the trustees of (a) a specific trust, (b) a discretionary trust?**
- ❑ **If so, in whose hands is the income taxable - the trustees or the beneficiaries?**
 - Status of Trustees – in like manner and to same extent as beneficiaries – where all beneficiaries individual, status is individual
 - Who is recipient – trustees or beneficiaries?
 - Specific trusts
 - Discretionary trusts
 - Whether receipt without consideration by trustees?
 - What if all beneficiaries are “relatives”?
 - Whether obligation undertaken by trustees is adequate consideration?

Settlement on Trust

- Amy F Cama v CIT 237 ITR 82 (Bom)

- *In law, the beneficiaries are real owners and the trustee holds the properties for and on behalf of the beneficiaries*

- Govardhandhari Devasthan v Collector of Ahmednagar & Ors AIR 1982 Bom 332

- *When the property is vested in a trust and there under the ownership and vesting is conferred upon the trustees, in law a peculiar relation arises between the holder of such property and his capacity to deal with the same. The trust creates a sort of duplicate ownership. The trust property, in law, is owned not only by the trustees but also by the beneficiaries and the relation between them is governed by the obligation annexed to the ownership which enjoins upon the trustee to apply and use the same in the fulfillment and discharge of that obligation for the benefit of the other. That is why the trust ownership is qualified by the annexed obligations and is not an absolute ownership known to law. (See Halsbury's Laws of England, Volume 33, page 87, and Salmond on Jurisprudence, 9th Edition, page 349). When there arises such a dual or duplicate ownership in the matter of the property, the resultant is the trust, the trustee's ownership being a matter of form rather than of substance, it being nominal rather than real. In legal theory no doubt, the position of the trustee*

Settlement on Trust

is that of an owner subjected to the obligation by the instrument of trust to apply and use the property vested in him for the purposes and for the benefit of then real owner. Between the trustee and the beneficiary in substance, the property belongs to the beneficiary though for its application and use it vests in the trustee. However qua third person, fiction of ownership continues to prevail in favour of the trustee. The trustee, thus, gets the right and entitlement to represent the beneficiary in dealings with the would at large.

Settlement on Trust

- Shardaben Jayantilal Mulji v. Commissioner of Wealth Tax 106 ITR 667 (Bom)
 - *Halsbury's Laws of England* - where a trust has been completely constituted, consideration is not necessary at all, but where a trust is not completely constituted, that is to say, where something remains to be done to perfect it, a court of equity compels its completion and execution if it has been created for valuable consideration, but not if it is purely voluntary and without consideration
 - If the contention that the undertaking of the obligation to carry out the trust is the consideration for the transfer of the trust property by the settlor to the trustees was to be accepted, the result would be that there would be consideration in the case of every trust, a position wholly inconsistent with the statements of the law in *Halsbury* as well as in *Keeton* referred to above. What is more, it is difficult to understand how such an obligation can be said to be valuable consideration or consideration in money or money's worth within the terms of section 4(1)(a)(iii) of the Wealth-tax Act.

Settlement on Trust

- CGT v G G Morarji 58 ITR 505 (Bom)

- *The argument is that what a beneficiary gets under the settlement is only a right against the trustee and not any interest in the trust fund. Now, reading section 3 as a whole, it is clear that the right which the beneficiary gets against the trustee is not a right in air. It is a right in respect of the property which is called the trust property. The right of the beneficiary against the trustee in respect of the trust property is called beneficial interest. It is in law termed as equitable title to the property. It is not possible to hold that the right which a beneficiary gets under the trust is not an interest in the trust property. The fundamental attribute of ownership of property is power or right of transfer and right to possess and enjoy property and/or its income. The trustee has no power to transfer trust property for his benefit, nor can he enjoy the trust property for his benefit. He undoubtedly possesses the trust property, but the possession is for the benefit of others, the beneficiaries. The trust thus is merely a means or a vehicle by which a donor passes on his interest in the trust property to the beneficiaries. In effect, a trust is a gift of trust property or an interest therein to the beneficiaries.*

Distribution of Assets Held in Trust

- ❑ **Does section 56(2)(vii) apply when the Trustees of (a) a specific trust (b) a discretionary trust, distribute the assets held in trust amongst the beneficiaries?**
 - Specific exemption for receipt from charitable trust – not for private trust
 - Whether merely receipt of existing interest?
 - Explanatory Memorandum to Finance Bill, 2010
 - *The provisions of section 56(2)(vii) were introduced as a counter evasion mechanism to prevent laundering of unaccounted income under the garb of gifts, particularly after abolition of the Gift Tax Act.*
 - Ashok C Pratap v Addl CIT (2012) 139 ITD 533 (Mum)
 - Amount received by a person as beneficiaries on dissolution of discretionary trust cannot be termed to be an amount received 'without consideration' and, hence section 56(2) cannot apply

Distribution of Income by Trust

- ❑ **Does section 56(2)(vii) apply to receipt on distribution of income by a discretionary trust?**
 - **Mrs Sharon Nayak v DyCIT [TS-291-ITAT-2016(Bang)]**
 - *In a trust, whether discretionary or otherwise, the trustees hold the property and income for the benefit of the beneficiaries.... Thus what was received by the assessee as a beneficiary from the thirteen trusts were nothing but his own income in his status as a beneficiary of the said trust. What has flown from the trustee to the beneficiary is the income the trustee collected on behalf of the beneficiaries. That the character of income in the hands of the beneficiary remains the very same*

S.56(2)(vii) – Receipt of Immovable Property

Only land, building or both

- Not applicable to rights in land or building, such as tenancy rights, leasehold rights, property under construction (provided sold before completion)
- Applicable to development agreements – agreement for transfer of land/building
- Whether applicable to immovable property located outside India? No stamp duty valuation
- Whether applicable to receipt of agricultural land (not capital asset)?

Limit of Rs.50,000

- Vis-à-vis each individual property

Land acquired as stock in trade

- Notional difference from stamp duty valuation taxable as income from other sources
- Cost of stock-in-trade remains unchanged
- Whether double taxation?
- Whether can be taxed under IFOS?

S.56(2)(vii) – Receipt of Immovable Property

- Unstamped/Unregistered Letter of Allotment
 - Whether agreement fixing price?
- Payment made but for Unidentified Flat
 - Whether would qualify as payment made under agreement fixing consideration
Where the date of agreement fixing the value of consideration for transfer of the asset and the date of registration of such transfer.....
- Payment made few days after agreement
 - Whether on or before date of agreement to be strictly construed?
Only in a case where the amount of consideration or a part thereof has been received by any mode other than cash on or before the date of agreement for transfer of the asset
- Whether difference in valuation on date of agreement mandatory?
 - may be taken
- Relevant date of receipt – Date of Possession, Date of Conveyance/Sale Deed or Date of Registration of Conveyance/Sale Deed?
 - CIT v Mormasji Mancharji Vaid 250 ITR 542 (Guj)(FB)

Amounts Received on Retirement/Dissolution of Firm

- ❑ **Do the provisions of section 56(2)(vii) apply to assets received by a partner on dissolution of the partnership firm, given the specific provisions of section 45(4)?**
 - Post s.45(4), only firm taxable – not partner
 - Specific v General provision
 - In Satisfaction of his interest in the firm
- ❑ **Does the provision apply to amounts received by a partner on his retirement from the firm, which is in excess of his capital, loan and current accounts**
 - Various decisions holding not taxable u/s 28(iv) – whether can be considered under IFOS?
 - Specific provisions of s.45(4)

Allotment of Rights Shares

- ❑ Does section 56(2)(vii) apply to receipt of shares by a shareholder allotted under a rights issue, where the rights issue has been made at a price lower than the book value, where all the shareholders do not exercise their rights?
- ❑ If it applies, to which shares does it apply - only the additional shares allotted over and above the rights entitlement of the shareholder, or to all allotted shares?

- Allotment of shares - whether receipt of shares
- Explanatory Memorandum to Finance Act 2010

These are anti-abuse provisions which are currently applicable only if an individual or an HUF is the recipient. Therefore, transfer of shares of a company to a firm or a company, instead of an individual or an HUF, without consideration or at a price lower than the fair market value does not attract the anti-abuse provision.

Allotment of Rights Shares

In order to prevent the practice of transferring unlisted shares at prices much below their fair market value, it is proposed to amend section 56 to also include within its ambit transactions undertaken in shares of a company (not being a company in which public are substantially interested) either for inadequate consideration or without consideration where the recipient is a firm or a company (not being a company in which public are substantially interested)

Allotment of Rights Shares

○ Sudhir Menon HUF v ACIT (2014) 148 ITD 260 (Mum)

True, the shareholders get the right to acquire the additional shares on the passing of the board resolution, but the receipt of the property is only on their allotment, on which date the shares, a specified property, is in existence.

Till such allotment the shares do not exist as such, and in a sense come into existence on their allotment. In this view of the matter, the plea of the rights under reference being not a property specified under the provision or the provision being sought to be applied by the Revenue to a non-existing property, is without basis.

As long as, therefore, there is no disproportionate allotment, i.e., shares are allotted pro rata to the shareholders, based on their existing holdings, there is no scope for any property being received by them on the said allotment of shares; there being only an apportionment of the value of their existing holding over a larger number of shares. There is, accordingly, no question of s. 56(2)(vii)(c), though per se applicable to the transaction, i.e., of this genre, getting attracted in such a case. A higher than proportionate or a non-uniform allotment though would, and on the same premise, attract the rigour of the provision.

In case of issue of bonus shares, no property is being conveyed to the shareholder in as much as the property therein is comprised in the existing shareholding of the

Allotment of Rights Shares

allottee. There is as such no case of a gift; the shareholder only receiving his own property, albeit in a different form. A 'right' share, on the other hand, is placed differently.

To the extent it is allotted to a person not against his existing shareholding or, even so, albeit disproportionately, there is, depending on the terms of the allotment, which is the mode of acquisition and, thus, its receipt, scope for value or property being passed on to him, which cannot be said to be in lieu of or as recompense of his existing property. The section would, therefore, apply, though the extent of income, if any, chargeable thereunder would depend on the actual allotment and its terms.

'Receipt' is a word or term of wide import, and would include acquisition of the subject matter of receipt - defined capital assets in the present context, by modes other than by way of transfer as well. We find no reason to limit or restrict the scope of the word 'receipt' in the provision to cases of 'transfer' only. Doing so would not only amount to reading down the provision, which the tribunal is even otherwise not competent to, being not a court of law, but reading it in a manner totally inconsistent with the unambiguous language and the clear intent (of the Legislature) conveyed thereby, but also its context as well as the drift of section, in complete violence thereto.

Allotment of Rights Shares

- **Khoday Distilleries Ltd v CIT (2008) 307 ITR 312 (SC)**

There is a vital difference between 'creation' and 'transfer' of shares. The words 'allotment of shares' have been used to indicate creation of shares by appropriation out of the unappropriated share capital to a particular person. There is a difference between issue of a share to a subscriber and the purchase of a share from an existing shareholder. The first case is that of creation, whereas the second case is that of transfer of chose in action. In this case, when twenty shareholders did not subscribe to the rights issue, the appellant allotted them to 7 investment companies; such allotment was not transfer. Thus, s. 4(1)(a) was not applicable as held by the Tribunal.

ESOPs, Sweat Equity, Bonus

- ❑ **Does section 56(2)(vii) apply to ESOPs granted by a company to an employee, shares received on exercise of ESOPs, bonus shares and shares received by way of sweat equity?**
 - ESOPs, Sweat Equity – whether without consideration
 - Bonus
 - Khoday Distilleries Ltd v CIT (2008) 307 ITR 312 (SC)

The idea behind the issue of bonus shares is to bring the nominal share capital into line with the excess of assets over liabilities. A company would like to have more working capital but it need not go into the market for obtaining fresh capital by issuing fresh shares. The necessary money is available with it and that money is converted into shares which really means that the undistributed profits have been ploughed back into the business and converted into share capital. Therefore, fully paid-up bonus shares are merely a distribution of capitalized undivided profit. It would be a misnomer to call the recipients of bonus shares as donees of shares from the company.

ESOPs, Sweat Equity, Bonus

○ Sudhir Menon HUF v ACIT (2014) 148 ITD 260 (Mum)

- *In the case of issue of bonus shares (as also on demerger), no property is being conveyed to the shareholder in as much as the property therein is comprised in the existing shareholding of the allottee. There is as such no case of a gift; the shareholder only receiving his own property, albeit in a different form.*

○ DyCIT v Dr Rajan Pai ITA 1209/Bang/2015 dated 29.4.2016

- *during the period Gift-tax Act was applicable, issue of bonus shares was never considered as gift by a company to its share holder and never subjected to gift-tax in the hands of the company considering it to be a donor*
- *any profit derived by the assessee on account of receipt of bonus shares is theoretically offset by the depression in the value of the equity shares already held by him. Bonus shares does not result in recipient getting a property without consideration or for inadequate consideration*
- *When bonus shares are received, it is not something which has been received free or for a lesser fair market value. A consideration has flown 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.*

Allotment of Shares on Conversion

- ❑ **Does the provision apply to allotment of shares on conversion of convertible debentures or convertible preference shares, when the terms of conversion had been decided upfront at the time of issue of the debentures or preference shares?**
 - Whether applicable to allotment of shares – allotment whether receipt
 - Whether without consideration
 - Fair market value to be seen as of what date – date of allotment of debentures/preference shares, or date of conversion into equity shares
 - Capital Gains Specific Exemption for Transfer on conversion of debentures to shares
 - S.55(2)(b)(v) – cost of shares on conversion of one type of shares for another

Receipt on Reduction of Capital/Liquidation

- ❑ **Does the section apply to receipt of assets or money by a shareholder on reduction of capital of a company, or on liquidation of a company?**
 - Specific provisions – section 2(22)(d) for reduction, section 2(22)(c) and s.46(2) for liquidation
 - In lieu of existing rights

Bonus Preference Shares

- ❑ **Since the section uses the term “shares and securities”, does it apply to unlisted preference shares of a private limited company received by way of bonus by an equity shareholder?**
- ❑ **How does one reconcile this with section 55(2)(aa)?**
 - Not taxable as dividends – 2(22)(b) – distribution of debentures, debenture stock or deposit certificate to its shareholders – distribution of shares to preference shareholders
 - Briggs of Burton India Pvt Ltd, in re (2005) 274 ITR 595 (AAR) – not taxable as dividends at time of issue – may be taxable as dividend at time of redemption, as release of assets of co to shareholders
 - S.55(2)(aa) – allotment of any additional financial asset without any payment by virtue of holding a capital asset, being a share or any other security – cost to be taken at nil
 - Specific v General Provision
 - Capital Gains v Income from Other Sources

Balance Sheet on Valuation Date

- ❑ **Can a valuation report based on the balance sheets of the preceding and subsequent 31st March therefore suffice, without preparation of a balance sheet as on the date of receipt of the shares?**
 - Schedule II to Gift Tax Act – Explan to Rule 5 – as drawn up on date on which gift was made, and where there is no such balance sheet, the balance sheet drawn up on a date immediately preceding that date
 - S.Viji v. CGT 229 ITR 421 (SC)
 - Nearest balance sheet (even later) with suitable adjustments
 - CWT v. S. Ram 147 ITR 278 (Mad)

Where a day or two separated the date of the gift from the date of the balance-sheet, it would be an unnecessary exercise of one's labour not to take note of the nearest balance-sheet, but to go upon some other laboured valuation of the company's assets involving effort and time. In all these cases of valuation of unquoted shares, however, the true principle is that if it were possible to draw up a precise balance-sheet as on the date of the gift, that would afford quite an accurate basis and an ideal solution.

Balance Sheet on Valuation Date

- *But since the valuation question arises only in a shareholder's assessment, neither the shareholder nor the Department can expect the staff and accountants of the company to oblige them by meticulously drawing up a balance-sheet as on the date of the gift even assuming that the drawing up of a balance-sheet on that date would be feasible or is capable of being done in a correct manner, after a passage of time. In the absence of the facility of drawing up a balance-sheet precisely on the date of the gift, the next best thing, both for the assessee who is the holder of the unquoted shares and the Department, which is charged with the duty of evaluating the market value of the shares, not to speak of the company itself, is to take the balance-sheets falling both before and after the date of the gift and arrive, as near as may be, at the break-up value of the assets and liabilities of the company as on the date of the gift on a time basis, or on some other basis.We cannot be dogmatic about taking, as the basis, either the balance-sheet which falls before or the balance-sheet which falls after the date of the gift. We have to take into account both.*

Receipt & Issue in Different Years

- ❑ **Whether the provision of section 56(2)(viiia) applies and in which year, in a situation where the issue price is not decided at the time of receipt of the consideration, but in a later year, at the point of issue of the shares.**
 - Section 56(2)(viiia) applies if amounts to receipt of shares
 - Receives any property, being shares of a company – year of allotment of shares

Valuation of Preference Shares

- ❑ **Does section 56(2)(viib) apply to allotment of preference shares?**
- ❑ **How does one value preference shares under rule 11UA?**
 - Receivesany consideration.....for issue of shares that exceeds the face value of such shares
 - Both equity and preference shares covered
 - Valuation of preference shares – rule 11UA(1)(c)
 - *the fair market value of unquoted shares and securities other than equity shares in a company which are not listed in any recognized stock exchange shall be estimated to be price it would fetch if sold in the open market on the valuation date and the assessee may obtain a report from a merchant banker or an accountant in respect of such valuation.*
 - Comparable listed preference shares yield
 - Discounting cash flows to shareholder? What discount rates?
 - Earlier WT Rules – 9A – paid-up value or adjusted paid-up value to 8%

Valuation of Preference Shares

❑ Australian Tax Office – Guidance for Valuing a Preference Share

- Factors to be considered
 - issue date
 - issue rating
 - issue price
 - term/maturity
 - reset dates (if applicable)
 - dividend rate
 - dividend payment period
 - whether it is cumulative or non-cumulative
 - whether it is redeemable or non-redeemable
 - conversion details (if applicable)
 - conversion discount (if applicable)
 - voting rights
 - ranking
 - liquidation preferences.

Binding Nature of Accountants Report

- ❑ **What is the binding nature of the accountant's report on the assessing officer – can he challenge any of the DCF assumptions, and compute a different value?**
 - Does AO necessarily have to make reference to Valuation Officer or can he make computation himself?
 - Specific reference in section 56(2) in regard to immovable property
 - Earlier only s.55A for purposes of Capital Gains computation
 - s.142A provides for reference to VO for purposes of assessment/ reassessment to estimate value of any asset, property, or investment – earlier specific reference to s.56(2) wef 30.9.2004

FMV as per Rules and not market value.

❑ **Medplus Health Services P. Ltd v. ITO (2016) 68 taxmann.com 29 (Hyd)**

- Value as per rules = (64.48), transaction value = Re.1, Market Value = Rs.75.49
- AO invoked provisions of section 56(2)(vii-a) considering Market value as FMV
- Taxation u/s 56(2)(vii-a) based on Market Value not provided either under the Act or under the Rules.
- On prescription of specific method, AO precluded from adopting other method
- Had the section provided that the FMV shall be the value computed in accordance with the rule or the actual market value, if any, whichever is higher, action of AO correct.
- The legislature in its wisdom has also given a formula for computation of the fair market value which cannot be ignored by the authorities below.

Can s.56(2)(viib) and s.68 be invoked simultaneously

- ❖ **Can an assessing officer invoke both the provisions simultaneously, taxing the entire share contribution as an unexplained cash credit, while also adding the issue price over and above the fair market value to the income of the issuing company?**
- ❖ Shubhalakshmi Vanijya (P) Ltd v CIT (2015) 172 TTJ 721 (Kol)

We fail to find out any parallel between the amendments made to section 68 and section 56(2)(viib) except for the fact that these provisions have been added by the Finance Act, 2012. A conjoint reading of proviso to section 68 and section 56(2)(viib) divulges that where a closely held company receives, inter alia, some amount as share premium whose genuineness is not proved by the assessee company or its source etc. is not proved by the shareholder to the satisfaction of the AO, then the entire amount including the fair market value of the shares, is chargeable to tax u/s 68 of the Act. If however, the genuineness of the amount is proved and the shareholder also proves his source, then the hurdle of section 68 stands crossed and the share premium, to the extent stipulated, is chargeable to tax u/s 56(2)(viib) of the Act.

Can s.56(2)(viib) and s.68 be invoked simultaneously

It shows that only when source of such share premium in the hands of a shareholder is properly explained to the satisfaction of the AO, that the provisions of section 56(2)(viib) gets triggered. Approaching this section presupposes that the assessee genuinely received share premium from the share-holder having satisfactorily explained the transaction. Thus it is evident that sections 68 and 56(2)(viib) can never simultaneously operate. The later excludes the former and vice versa.

Section 56(2)(viib)

- ❖ Whether the substance and overall impact of all the transactions can be considered, as opposed to the individual transactions?
- ❖ Whether commercial substance and justification can take a case outside the rigours of section 56(2)(viib), given the intention behind s.56(2)(viib)?
- ❖ Explanatory Memorandum to Finance Bill 2012

The new clause will apply where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares. In such a case if the consideration received for issue of shares exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income tax under the head "Income from other sources. However, this provision shall not apply where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a venture capital fund.

Section 56(2)(viib)

Further, it is also proposed to provide the company an opportunity to substantiate its claim regarding the fair market value. Accordingly, it is proposed that the fair market value of the shares shall be the higher of the value—

(i) as may be determined in accordance with the method as may be prescribed; or

(ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

THANK YOU