IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI SPECIAL BENCH 'B' MUMBAI

BEFORE SHRI D. MANMOHAN, VICE PRESIDENT,
SHRI R.S.SYAL, ACCOUNTANT MEMBER &
SHRI T.R.SOOD, ACCOUNTANT MEMBER

I.T.A.NO.3013/Mum/2007 – A.Y 2002-03

Bennett Coleman & Co. Ltd., Times of India Bldg., Dr. D. N. Road, Mumbai 400 001. PAN: AAACB 4373 Q	**Vs.**	**The Addl. Commissioner of I.T., Range- 1(1), Mumbai.**
(Appellant)		**(Respondent)**
Appellant by	**:**	**S/Shri Arvind Sonde & Shri S. Venkatraman**
Respondent by	**:**	**Shri Pavan Ved.**

Date of Hearing: 16-08-2011	**Date of Pronouncement: 30-09-2011**

O R D E R

Per T.R.SOOD, AM:

This Special Bench has been constituted by the Hon'ble President to consider the following question:

> "Whether on the facts and in the circumstances of the case, the CIT(A) was justified in declaring long term capital loss of Rs.22,21,85,693/- on account of reduction in paid up equity share capital? "

2. At the commencement of the hearing, it was noticed by the Bench that the question is not very happily framed and, therefore, this was put to the parties. Both the parties agreed that the question referred by Hon,ble president implies that we have to answer the substantial issue as to whether reduction of capital would lead to claim for long term capital loss. Both the parties requested that we can proceed with the hearing without reframing the question. Therefore, we are proceeding with the same question on the

understanding that issue involved is whether on the facts and circumstances of the case, Ld. CIT(A) erred in disallowing the claim of long term capital loss.

3. Facts necessary for the disposal of the issue on hand are stated in brief. During the course of assessment proceedings, the Assessing Officer noticed that assessee had claimed long term capital loss amounting to Rs.22,21,85,693/-. It is not in dispute that assessee made an investment of Rs.2484.02 lacs in equity shares of a group company viz., Times Guarantee Limited [for short TGL]. Under sec.100 of the Companies Act, 1956 TGL applied for reduction of equity share capital and approached the Hon'ble Bombay High Court for approval of the same. The Hon'ble High Court approved the petition of TGL and allowed reduction in its share capital by 50% by reducing the face value of each equity share from Rs.10/- to Rs.5/- . Consequently, assessee's investment in TGL got reduced from Rs.2484.02 lacs to Rs.1242.01 lacs. After applying the indexation a sum of Rs.22,21,85,693/- was claimed as long term capital loss. On a query as to how this loss was allowable, it was mainly contended that in view of the decision of the Hon'ble Supreme Court in the case of Kartikeya V. Sarabhai [228 ITR 163]- wherein it was held that reduction in face value of shares would amount to transfer- such loss was allowable. Reliance was also placed on the decision of the Hon'ble Supreme Court in the case of CIT vs. G. Narsimhan (Decd) And Ors. [236 ITR 327], wherein similar view was taken.

4. The Assessing Officer, after considering these submissions, was of the opinion that in the case of Kartikeya V. Sarabhai [supra] the court was concerned with the reduction of non-cumulative preference shares. Therefore, according to the Assessing Officer, this was merely a case involving reduction

in face value of preference shares and accordingly same should not be applied particularly because the Hon'ble court had also observed that in terms of sec.87[2][i] the voting rights were also reduced proportionately on the resolution which effected the rights of preference shareholders whereas, in case of equity shares , there is no reduction in the rights of such equity shareholders. He further observed that in the present case assessee has not received any consideration for reduction in the value of shares, nor any part of the shares have been passed to anyone else. This means, that there was no change in the rights of the assessee vis-à-vis other shareholders and, therefore, no transfer had taken place and, thus, assessee was not entitled to the claim of long term capital loss.

5. On an appeal, similar submissions were made before the Ld. CIT(A) who upheld the action of the Assessing Officer on similar reasoning.

6. Before us, Ld. Counsel Shri Arvind Sonde, adverted our attention to pages 30 to 31 of the assessment order and also paras 17.2 to 17.5 of the appellate order to point out that the claim of long term capital loss has been rejected mainly on the ground that no transfer had taken place. Then he referred to page 60 of the paper book -which is a copy of a notice of Annual General meeting of TGL- which shows that a special resolution was proposed for reduction of share capital u/s.100 of the Companies Act, 1956 subject to the approval of the order of Hon'ble Bombay High Court; It was proposed that share capital of the company has to be reduced from Rs.179862990, divided into 17986299 equity shares of Rs.10/- each, to Rs.8993149, divided into 17986299 equity shares of Rs.5/- each , by cancelling the capital to the extent of Rs.5/- per equity share. Thus, TGL reduced the face value of each equity

share from Rs.10/- to Rs.5/-. After reduction of capital, two equity shares of Rs.5/- each, were consolidated into one equity share. Thus, it resulted in reduction by way of reducing initially the face value of each share of Rs.10/- to Rs.5/- each and then by consolidating such equity shares of Rs.5/- each into one equity share of Rs.10/- fully paid. He adverted our attention to explanatory notes (page 61 of PB) which shows that carried forward loss of Rs.42,96,53,000/- was also written off by reducing the amount of reduction of share capital amounting to Rs.8,99,31,495/- and further the balance sum was written off by utilising the share premium account. In fact, TGL had suffered loss and the whole proposal and purpose of reduction in share capital was to write off the losses. Learned counsel referred to pages 62 to 71 of the paper book, which is copy of the order of the Hon'ble High Court through which the High Court allowed the petition for reduction of the capital. Then he referred to page 73 which is a copy of intimation letter issued by TGL through which assessee company was intimated regarding the reduction of share capital and it was pointed out that assessee's holding in TGL before reduction which was 13474799 has been reduced to 6737399 and the same has been credited in the demat form in assessee's demat account. Then he referred to page 74 which is a copy of the Schedule E reflecting the investments by the assessee company as on 31-03-2001 where again TGL shares were shown at 1,34,74,799 and the book value of the investment has been shown at Rs.24,84,01,810/-. This has been reduced in the year ending 31-03-2002 for which he referred to page 75 of the paper book, wherein the investment in TGL shares at 6737399 has been shown at Rs.12,42,00,905/-. He argued that this fact clearly shows that share capital is reduced by the company (TGL) in terms of sec.100 of the Companies Act, 1956 which has been approved by the Hon'ble High Court. The company was accordingly allotted 67,37,399 new shares in place of old shares at 1,34,74,799. He also filed a copy of the transaction statement issued by the HDFC Bank Ltd. which is a copy of the demat account of the assessee with the bank wherein first on 20-11-2001 67,73,799 shares have been reduced from the opening balance of 1,34,74,799 shares. Further, 67,37,399 shares have been shown as credit. He pointed out that even ISIN No. has changed from INE 289C01025 to INE 289C01017, which basically means that new shares are different shares because different ISIN INE No. has been allotted. On a query by the Bench he filed a copy of the clarification issued by the SEBI and pointed out at para-29 wherein it has been clarified as under:

> "ISIN [International Securities Identification Number] is a unique identification number allotted for a security [E.g –INE 383C01018]. Equity-fully paid-up, equity partly paid up, equity with differential voting/dividend rights issued by the same issuer will have different ISIN."

Thus, Learned counsel contended that old shares have been replaced with new shares which is a reduced number and this should be treated as exchange of shares which is clearly covered by the definition of 'transfer' and once the shares have been transferred it is a basic condition for attracting sec.45, then the loss incurred on the same should be treated as capital loss.

7. Ld. Counsel Shri Sonde submitted that the decisions of Hon'ble Supreme Court in the cases of Kartikeya V. Sarabhai [supra], CIT vs. G. Narsimhan (Decd) And Ors. [supra] and Anarkali Sarabhai vs. CIT [224 ITR 422] have been distinguished by the Assessing Officer as well as the CIT(A) mainly on the ground that these decisions relate to reduction in face value of preference shares and, therefore, they are not applicable to the facts of assessee's case.

He submitted that Hon'ble Supreme Court, in the case of Kartikeya V. Sarabhai [supra], observed that definition of transfer given in sec.2[47] is an inclusive definition and, inter alia, provides that relinquishment of an asset or extinguishment of any right therein would also amount to transfer of a capital asset. Apex court further noticed that to invoke of the provisions of section 45 r/w 2(47) sale of a capital asset is not a necessary condition.. After referring to various observations of the court he pointed out that even reduction in the value of preference shares was held to be a case of transfer. He then submitted that similar view was taken in the case of Anarkali Sarabhai vs. CIT [supra].

8. The ld. Counsel further submitted that even if it is assumed that the principles laid down by the Hon'ble Supreme Court in the case of preference shares are not applicable, the principle laid down in the case of CIT vs. G. Narsimhan (Decd) And Ors., squarely applies since the issue therein was regarding reduction of equity share capital. He filed paper book No.2 in which copies of the assessment order as well as copy of the order of the Tribunal in the case of CIT vs. G. Narsimhan (Decd) And Ors. were annexed. He referred to the assessment order and order of the Tribunal and pointed out that in this case also equity share capital of the company was reduced and when the matter finally travelled to Hon'ble Apex Court it was held that in view of the decision of Hon'ble Supreme Court in the case of Kartikeya V. Sarabhai [supra] even reduction in equity share capital would amount to transfer and by applying this decision the loss claimed by the assessee is allowable because same has arisen from reduction of equity share capital.

9. He further referred to the decision of Hon'ble Supreme Court in the case of CIT vs. Grace Collis & Ors. [248 ITR 323]. He carried us through the facts and the question raised before the Hon'ble Court and submitted that the court, after considering another decision of that court in the vas of Vania Silk Mills Pvt. Ltd. vs. CIT [191 ITR 647], observed that the definition of transfer clearly contemplates extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof. The court further observed that the expression 'extinguishment of any right therein' can be extended to mean extinguishment of right independent of or otherwise than on account of transfer. Thus, even extinguishment of right in a capital asset would amount to transfer and in the case before us since assessee's right got extinguished proportionately, to the reduction of capital, it would amount to transfer. Reliance was placed on the following three decisions of the Tribunal wherein similar view was expressed; Following the decisions of Kartikeya V. Sarabhai [supra] CIT vs. G. Narsimhan (Decd) And Ors., Anarkali Sarabhai vs. CIT and of CIT vs. Grace Collis & Ors. [supra]**,** it was held that reduction of capital would amount to transfer and accordingly capital loss was held to be allowable.

i. Zyma Laboratories Ltd. Vs. Addl. CIT 7 SOT 164 [Mum]
ii. DCIT vs. M/s Polychem Ltd. ITA No.4212/M/07 [Mum] and
iii. Ginners & Presser Ltd. vs. ITO ITA No.398/M/07 & 4193/M/07

10. During the course of hearing it was pointed out that the capital loss has not been disallowed by the Assessing Officer on the only ground that it did not amount to transfer but mainly on the point that assessee had not received any consideration i.e., by applying the principle laid down by the

Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [128 ITR 294] wherein it was held that if computation provision fails, capital gains cannot be assessed u/s.45.

10. Bench pointed out to the decision of Hon'ble Gujarat High Court in the case of CIT vs. Mohanbhai Pamabhai [91 ITR 393] and the decision of Hon'ble Bombay High Court in the case of The Bombay Burmah Trading Corporation Ltd. vs. CIT [147 Taxation Reports 570].

11.To clarify the doubts posed by the bench the Ld. Counsel submitted that the Hon'ble Supreme Court, in the case of B. C. Srinivasa Setty [supra], was concerned with the transfer of goodwill and held that it was not possible to ascertain the cost of goodwill and therefore it was not possible to apply the computational provision. He stressed that the proposition was not that if no consideration was received then no gain can be computed but the proposition was that if any of the element in computation provision could not be ascertained then computation provision would fail and such gain could not be assessed to capital gains tax. In this regard he further referred to the decision of the Hon'ble Bombay High Court in the case of Cadell Weaving Mill Co. P. Ltd. & Ors. Vs. CIT [249 ITR 265] wherein the issue was whether surrendering of tenancy rights would be taxed as casual income or it can be subjected to capital gains tax. He invited our attention to page 285 of the report and pointed out that ultimately court observed that full value of the consideration of the tenancy rights could not be assessed because then the tax is not levied on capital gain but it is being levied on capital value of the asset which is not permissible. Hon'ble Court, in turn, relied upon the decision Hon'ble Supreme Court in the case of CIT vs. B. C. Srinivasa Setty [supra] to hold that if cost of acquisition is not ascertainable, computation provision fails and amount received on surrender of tenancy rights is not taxable. On further appeal, this decision has been confirmed by the Supreme Court in the case reported at 273 ITR 1. He also referred to the decision of the Hon'ble Karnataka High Court in the case of DCIT vs. BPL Sanyo Finance Ltd. [312 ITR 63]. In this case the assessee was holding shares of IDBI which were partly paid-up and assessee did not pay the call amount called by the company and, therefore, the shares were forfeited. This was claimed as short term capital loss which was not allowed by the AO. The Hon'ble High court however held that forfeiture of shares would amount to transfer in terms of sec.2[47] because assessee would be deemed to have acquired rights in shares when same were allotted and once such shares were forfeited then such right got extinguished, which would amount to transfer

12. The Ld. Counsel of the assessee also referred to the decision of Hon'ble Gujarat High Court in the case of CIT vs. Mohanbhai Pamabhai [supra], and pointed out that in this case also what the court meant was that when consideration was not ascertainable, then the provisions for charging the capital gains would fail. However, in the case of the assessee consideration was ascertainable, in the sense that same should be taken as zero. While addressing the Bench on the decision of Hon'ble Bombay High Court in the case of The Bombay Burmah Trading Corporation Ltd. vs. CIT [supra], he submitted that since it was a very short judgment and facts are not discussed, therefore, he would not like to comment. However, he submitted that if in the case of zero consideration if transfer of a particular asset did not attract the levy of capital gain, then why clause [iii] was inserted

to sec.47 [which provides that transactions provided in that provision shall not be considered as transfer] by which any transfer of a capital asset by way of a gift is exempt because in case of gift no consideration would be involved. If the idea was not to subject zero consideration transaction to capital gain tax u/s.45, then there was no need for clause [iii] for gifts in sec.47. He concluded his arguments by submitting that during the process of reduction of share capital, transfer has definitely taken place and consideration received by the assessee should be considered as zero and, therefore, capital loss should be allowed.

13. On the other hand Ld. Sr. DR Shri Pavan Ved, submitted that in this case capital has been reduced by the company in two phases. The face value of shares was reduced from Rs.10/- each to Rs.5 each, which means the capital was reduced by 50% and then such two shares of Rs.5/- each were consolidated into one share and such new share has been allotted to the company. However, the value of the assets of the company remained same before and immediately after such reduction and therefore no loss was caused to the assessee. He further argued that after all a share means proportionate share of an asset of the company. In this regard he referred to sec.84 of the Companies Act, 1956 which defines that a share certificate shall be prima facie evidence of the members to such share. Since share of the assessee in the company's assets have not gone down, therefore, no loss can be said to have been incurred by the assessee. He further explained this proposition by pointing out that when a person is owner of a house the same is evidenced by the title deed. He posed a query whether it can be said with reference to the title deed that a person is only owner of that deed the

obvious answer would be no. The answer would be that through that title deed the particular person is holding ownership of the house. Similarly through ownership of shares assessee is holding proportionate share in assets of the company which have not gone down and, therefore, no loss has been suffered. Mere reduction of share capital at best can lead to a notional loss.

14. The Ld. Sr. DR further invited our attention to clause [v] of sub section (2) to section 55 which defines cost of acquisition in case of shares in the event of consolidation, division or conversion of original shares; as per this clause, original cost has to be taken as cost of present acquisition. In case before us, therefore, the cost of acquisition would remain same to the assessee in terms of this provision and if the loss on reduction of share capital is allowed at this stage and in future if such shares are sold, then the assessee can again take the original cost as cost of acquisition which would mean double benefit to the assessee, which is not permissible under the law and in this regard he referred to the decision of the Hon'ble Supreme Court in the case of Escorts Ltd. Vs. UOI [199 ITR 43].

15. He further submitted that whenever a company issues bonus shares no capital gain is chargeable on the same on mere receipt of such bonus shares and capital gain, if any, can be charged only at the stage when such bonus shares are sold by such assessee. Similar principle needs to be applied in the case when assessee's shareholding is reduced on reduction of such capital. He also argued that at best in case bonus shares are sold by an assessee, cost of the same has to be taken on the basis of average cost as held by the Hon'ble Supreme Court in the case of CIT vs. Dalmia Investment Co. Ltd. [52 ITR 567]. This means that in case of bonus shares, the cost of share gets

adjusted and ultimately cost of acquisition is taken at average value and same principle would apply on reduction of share capital and in that case the average cost of balance holding after such reduction of capital would increase and the loss can be reckoned only when such shares are transferred for a consideration. He submitted that this principle has been further affirmed by the Hon'ble Supreme Court in the case of Miss Dhun Dadabhoy Kapadia vs. CIT [63 ITR 651]. In this case when the assessee was allotted right shares the assessee instead of subscribing to such right shares sold such rights in the market at a premium. A question arose whether such premium would be taxable or the reduction in the value of shares which are held by the assessee has to be considered for the purpose of computing the capital gains tax. The Hon'ble court ultimately held that gain has to be understood in the similar way as understood by the commercial world and ultimately it was held that the particular receipt of sale of right to subscribe to right shares, is required to be reduced by fall in the value of existing shareholding. Following the same principle, at best in assessee's case the value of reduced shareholding can be increased i.e. cost of acquisition can be increased but the loss cannot be allowed, because at the stage of reduction of capital, it is only a notional loss.

16. In the rejoinder, Ld. Counsel referred to page 77 of the paper book which gives computation of capital loss incurred on reduction of share capital of TGL shares and pointed out that cost has been taken on the basis of cost to the assessee which has been indexed as per the provisions of sec.48 and, therefore, no double benefit had been obtained by the assessee and such cost has been further reduced from the value of investment as pointed out earlier. Therefore, there is no question of further double benefit. He gain

emphasized that it is a simple case of transfer in terms of decisions of Hon'ble Supreme Court in the cases of Kartikeya V. Sarabhai [supra], CIT vs. G. Narsimhan (Decd) And Ors., and Anarkali Sarabhai vs. CIT [supra] and of CIT vs. Grace Collis & Ors. [supra] and, therefore, loss should be allowed.

17. We have considered the rival submissions in the light of material on record as well as the decisions cited by both the parties. Initially the Ld. Counsel argued that share capital of TGL was reduced from Rs.17,98,62,990/- divided into 17986299 equity shares of face value of Rs.10/- each to Rs.8,99,31,495/- divided into 17986299 of Rs.5/- each paid up. This means basically the capital was reduced by reducing the face value of Rs.10/- paid up of each share to Rs.5/- paid up of each share. As a second step such shares(Rs 5/- per share) were again consolidated into Rs.10 paid up share and number of shares were reduced to 89,93,149. The Ld. Counsel had argued that basically the original shares got extinguished and, in fact, new shares have been issued by TGL. If the argument is that earlier shares have been replaced or substituted by new shares then the same would not amount to transfer at all. In that case, it would be merely a case of substitution of one kind of share with another kind of share which has been received by the assessee because of its rights to the original shares on the reduction of capital. This position was clarified by the Hon'ble Supreme Court in the case of CIT vs. Rasiklal Maneklal (HUF) [177 ITR 198] In that case, the assessee was holding 90 shares in one S. company of face value of Rs.100/- each. Pursuant to the scheme of amalgamation sanctioned by the High Court, the holders of the shares in S. company were to be allotted one share of Rs.125/- each of NS Company for two shares in S. company and S. Company was to

be dissolved. The assessee in that case was allotted 45 shares in N.S company. A question arose, whether this would amount to transfer and the Hon'ble Supreme Court held that there was neither an 'exchange' nor a 'relinquishment' in this transaction. The Hon'ble Supreme Court observed as under:

> *"An "exchange" involves the transfer of property by one person to another and reciprocally the transfer of property by that other to the first person. There must be a mutual transfer of ownership of one thing for the ownership of another.*
>
> *A "relinquishment" takes place when the owner withdraws himself from the property and abandons his rights thereto. It presumes that the property continues to exist after the relinquishment. Where, upon amalgamation, the company in which the assessee holds shares stand dissolved, there is no "relinquishment" by the assessee."*

The apex court had also observed that in case of exchange that one person transfers a property to another person in exchange of another property, the property continues to be in existence. In that case, shares of S. company had ceased to be in existence and therefore the transaction did not involve any transfer. Similarly in the case before us if argument of assessee is accepted then the older shares with different ISIN number ceases to exist and new shares with a different ISNI numbers have been issued and, therefore, it cannot be called a case of extinguishment or relinquishment and it is a mere case of substitution of one kind of share with another. In case before us also assessee got the new shares on the strength of its rights with the old shares and, therefore, same would not amount to transfer.

18. However, the main thrust of the argument on behalf of the assessee is that the reduction of capital would amount to transfer in view of the decisions of the Hon'ble Supreme Court in the cases of Kartikeya V. Sarabhai [supra], and Anarkali Sarabhai vs. CIT [supra], CIT vs. G. Narsimhan (Decd) And Ors.

[supra] and of CIT vs. Grace Collis & Ors. [supra]. It may be necessary to outline the factual matrix and the conclusion reached in the case of CIT vs. G. Narsimhan (Decd) And Ors., because that was also a case of reduction of share capital and that too in respect of equity shares.

19. In that case the court was concerned with the issue whether reduction of face value of equity share from Rs.1000/- each to Rs.210/- each after reduction of share capital which was duly approved by the High Court would amount to transfer. It is important to note that in this case **on reduction of capital, certain assets were also given to the shareholders in the form of property, payment of cash and/or adjustment of debit balances**. When the matter travelled to Hon'ble Supreme Court, following the decision of Kartikeya V. Sarabhai [supra] **the apex court held that such reduction of capital would constitute transfer** and any profit or gain arising from the transfer of capital asset is liable to be taxed u/s.45. In the above mentioned case 90 non-cumulative preference shares, of the face value of Rs.1000/-, were purchased at a price of Rs.420/- per share from a company called Sarabhai Limited. In 1965, a sum of Rs.500/- per preference shares was paid to the assessee upon reduction of share capital and the face value of preference shares was reduced to Rs.50/- per share and further payment of Rs.450/- per share was made to the assessee. The ITO was of the opinion that the sum of Rs.450/- per share which was received now was liable to be taxed under the head 'capital gain'. However, assessee contended that since no transfer had taken place in terms of sec.2 [47], no tax could be imposed. When the matter travelled to Hon'ble Supreme Court it was held that definition of transfer u/s.2 [47] was inclusive and would include

relinquishment of an asset or extinguishment of any right therein. It was further observed that even preference shareholders have right to vote on resolutions which would effect the right of preference shareholder u/s. 87(2)(a), 87(2)(b) and 87(2)(c). Therefore the rights of preference shareholders are curtailed to that extent. A careful analysis of the above decision indicates that whenever there is reduction of shares and upon payment by company to compensate the value equivalent to reduction, apart from the effect on shareholders' rights to vote etc., a transfer can be said to have taken place. However, the question is whether the same can still attract sec.45? The answer is given by the Hon'ble Gujarat High Court in the case of CIT vs. Mohanbhai Pamabhai [supra]. In this case the issue was whether there is a transfer if a particular partner retired from the firm and his share in the partnership was worked out by taking the proportionate value of his share in the net partnership assets after deduction of liability and prior charges. The ITO was of the opinion that the amount received by the assessee to the extent which included his proportionate share in the value of the goodwill is liable to be taxed as capital gain. When the matter travelled to the High Court their lordships observed, at pages 404 & 405, as under:

> But, even if we are wrong in taking this view and the correct view is that when a partner retires from the partnership his interest in the partnership assets is extinguished and there was, therefore, in the present case, "transfer" of interest of each of the assessees in the goodwill when the assessees retired from the firm, the amount received by each assessee in respect of his share in the value of the goodwill must still be held to be outside the pale of chargeability to capital gains tax. **It is not every transfer of a capital asset which attracts the charge of capital gains tax. Section 45 which is the charging section, undoubtedly, provides that any profits or gains arising from the transfer of a capital asset shall be chargeable to income tax under the head "capital gains". But, section 48 shows that the transfer that is contemplated by section 45 is a transfer as a result of which consideration is received by the assessee or accrues to the assessee. Section 48 provides the**

> **mode of computation of capital gains by enacting that the income chargeable to tax as capital gain shall be computed by deducting from the "full value of the consideration received or accruing as a result of the transfer of the capital asset" the following amounts, namely: (i) expenditure incurred wholly and exclusively in connection with such transfer ; and (ii) the cost of acquisition of the capital asset and the cost of any improvement thereto. The amounts specified in clauses (i) and (ii) are to be deducted from the " consideration received or accruing as a result of the transfer of the capital asset " for the purpose of determining the profits or gains chargeable to tax. It is, therefore, clear that the transfer of a capital asset, in order to attract the capital gains tax, must be a transfer as a result of which consideration is received by the assessee or accrues to the assessee. If there is no consideration received or accruing to the assessee as a result of the transfer, the machinery section enacted in section 48 would be wholly inapplicable and it would not be possible to compute profits or gains arising from the transfer of the capital asset. The transaction in order to attract the charge of tax as capital gains must, therefore, clearly be such that consideration is received by the assessee or accrues to the assessee as a result of the transfer of the capital asset. Where transfer consists in extinguishment of a right in the capital asset, there must be an element of consideration for such extinguishment, for then only it would be a transfer exigible to capital gains tax.**

Thus, it becomes absolutely clear that even if a transfer had taken place, unless and until some consideration is received, the transfer of such asset would not attract the provisions of sec.45. The Revenue has challenged this position in appeal before the Hon'ble Supreme Court and the court dismissed the appeal of the Revenue in Addl. C.I.T. vs. Mohan Bhai & Pama Bhai [165 ITR 166] in view of the decision of Hon'ble Supreme Court in the case of Sunil Siddharthbhai vs. CIT [156 ITR 509]. Decision of Hon'ble Gujarat High Court was not approved by the Hon'ble Supreme Court, while adjudicating the case of B. C. Srinivasa Setty, on another point i.e. whether building of goodwill in a business which did not cost anything could still be regarded as capital asset for the purpose of charging the same under the head 'capital gains'. However, as far as proposition that a transfer cannot be subjected to provisions of sec.45 in the absence of consideration still remains valid. It may not be out of place to refer to the commentary on Income Tax Law, Fifth Edition, Volume-2 page 2772, by Chaturvedi & Pithisaria wherein it has been observed as under:

> "**Transfers not chargeable**.- It is not every transfer of a capital asset which attracts the charge of capital gains tax. Although section 45 provides the generality of the charge, it is followed by several sections exonerating the charge under stipulated circumstances. Section 48 provides the mode of computation and in doing so, it excludes expenditure incurred wholly and exclusively in connection with the transfer as also the cost of acquisition of, as well as any improvement to, the capital asset concerned.
> **The transfer of a capital asset, in order to attract the capital gains tax, must be a transfer as a result of which consideration is received by the assessee or accrues to the assessee. Without the element of consideration, no transfer will attract capital gains tax [CIT v. Mohanbhai Pamabhai, (1973) 91 ITR 393, 404 (Guj), not approved, on another point, in (1981) 128 ITR 294 (S.C)]"**

In any case, to understand the matter further we shall go through the decision of the Hon'ble Supreme Court in the case of Sunil Siddharthbhai vs. CIT [supra]. In this case, the issue involved was whether transfer of personal capital assets to the firm towards contribution of capital, would constitute transfer and whether such transfer would attract capital gain tax? The court held that such contribution of capital asset of a partner into the firm would definitely constitute a transfer because in that case the partner's interest in such asset is reduced from exclusive interest to a shared interest. In respect of taxability of this transfer, three arguments were made before the Hon'ble court which are being extracted from page 515 of the report of the above judgment in the case of Sunil Siddharthbhai vs. CIT [supra] as under:

1. There must be a "transfer" of a capital asset either under the general law or within the definition in clause [47] of section 2 of the Income-tax Act.
2. Consideration must be received or must accrue as a result of the transfer and the consideration must be capable of being determined in monetary terms in order that the computation of capital gains may be made as required by section 48.
3. Profits or gains must arise from the transfer and must be embedded in the consideration.

Since the point raised in the first argument is not material regarding the issue involved before us, therefore, it would suffice to point out that the Hon'ble court held that such contribution of the capital by way of transfer of personal capital assets into the firm would constitute transfer. In respect of the 2nd and 3rd arguments the Hon'ble Supreme Court observed at pages 520 to 522 as under:

> "On the basis of that proposition learned counsel for the assessee has urged that s.45 is not attracted in the present case because to compute the profits or gains under s.48 the value of the consideration received by the assessee or accruing to him as a result of the transfer of the capital asset must be capable of ascertainment in monetary terms. The consideration for the transfer of the personal assets is the right which arises or accrues to the partner during the subsistence of the partnership to get his share of the profits from time to time and, after the dissolution of the partnership or with his retirement from the partnership, to get the value of a share in the net partnership assets as on the date of the dissolution or retirement after a deduction of liabilities and prior charges. The credit entry made in the partner's capital account in the books of the partnership firm does not represent the true value of the consideration. It is notional value only, intended to be taken into account at the time of determining the value of the partner's share in the net partnership assets on the date of dissolution or on his retirement, a share which will depend upon a deduction of the liabilities and prior charges existing on the date of dissolution or retirement. It is not possible to predicate before hand what will be the position in terms of monetary value of a partner's share on that date. At the time when the partner transfers his personal asset to the partnership firm, there can be no reckoning of the liabilities and losses which the firm may suffer in the years to come. All that lies within the womb of the future. It is impossible to conceive of evaluating the consideration acquired by the partner when he brings his personal asset into the partnership firm when neither the date of dissolution or retirement can be envisaged nor can there be any ascertainment of liabilities and prior charges which may not have even arisen yet. **In the circumstances, we are unable to hold that the consideration which a partner acquires on making over his personal asset to the partnership firm as his contribution to its capital can fall within the terms of s.48. And as that provision is fundamental to the computation machinery incorporated in the scheme relating to the determination of the charge provided in s.45, such a case must be regarded as falling outside the scope of capital gains taxation altogether.**
>
> The third contention of learned counsel for the assessee is that no profit or gain can be said to arise to a partner when he brings his personal asset into a partnership firm as his contribution to its capital. It is urged that the capital gains chargeable under s.45 are real capital gains computed on the ordinary principles of commercial accounting and that the capital gains must be

> embedded in the capital asset. In Miss Dhun Dadabhoy Kapadia v. CIT (1967) 63 I.T.R.. 651, the appellant held by way of investment some ordinary shares in a limited company. An offer was made by the company to her by which she was entitled to apply for an equal number of new ordinary shares at a premium with an option of either taking the shares or renouncing them in favour of others. The appellant renounced her rights to all the shares and realised Rs. 45,262.50. When this amount was sought to be wholly taxed as a capital gain the appellant claimed that on the issue of the new shares the value of her old shares depreciated and that as a result of the depreciation she suffered a capital loss in the old shares which she was entitled to set off against the capital gain of Rs. 45,262.50. In the alternative she claimed that the right to receive the new shares was a right which was embedded in her old shares and consequently when she realised the sum of Rs. 45,262.50 by selling her right, the capital gain should be computed after deducting from that amount the value of the embedded right which became liquidated. This Court upheld the claim of the appellant that she was entitled to deduct from the sum of Rs. 45,262.50 the loss suffered by way of depreciation in the old shares. The Court proceeded on the basis that in working out capital gain or loss, the principles which had to be applied are those which are a part of commercial practice or which an ordinary man of business would resort to when making computation for his business purposes. It will be noticed that this principle was applied by the Court in a case where a capital gain was sought to be taxed under the Income Tax Act. That profits or gains under the Income Tax Act must be understood in the sense of real profits or gains, that is to say, on the basis of ordinary commercial principles on which actual profits are computed, a sense in which no commercial man would misunderstand, has been regarded as a principle of general application, and there is a catena of cases of this Court which affirms that principle. Reference may be made to Calcutta Co. Ltd. v. CIT (1959) 37 I.T.R. 1 (S.C), CIT v. Bai Shirinbai K. Kooka, (1962) 46 I.T.R. 86 [S.C], Poona Electric Supply Co. Ltd. v. CIT (1965) 57 I.T.R. 521 [S.C], (1973) 89 I.T.R. 266 [s.c] and Bafna Textiles v. ITO (1975) 98 I.T.R. 1 [Kar].

Thus, from the above it is clear that the court relied on the principles laid down in the case of B. C. Srinivasa Setty [supra] and held that unless and until the consideration was present the computation provision of sec.48 would not be workable and, therefore, such transfer could not be subjected to tax. The court further went on to hold that unless and until the profits or losses are real, same cannot be subjected to tax.

20. In the case of B. C. Srinivasa Setty [supra] a partnership firm was carrying on the business of manufacturing and selling of agarbattis vide instrument of a Partnership Deed dated 28th July, 1954 and no valuation was made for the goodwill and it was provided that goodwill will be valued only on

dissolution. The period of partnership was extended and when the firm was dissolved in 1965 goodwill of the firm was valued at Rs.1,50,000/- and a new partnership by the same name was constituted which took over all assets including the goodwill and liabilities of the dissolved firm. This goodwill was not included as capital gain in the hands of the dissolved firm by the ITO but a revisionary order was passed by the Commissioner in which it was directed to make fresh assessment after taking into account the capital gain arising on the sale of goodwill. The head note of the above judgment reads as under:

> All transactions encompassed by s. 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by s. 45 to be the subject of the charge. **What is contemplated by s.48[ii] is an asset in the acquisition of which it is possible to envisage a cost: it must be an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it.** None of the provisions pertaining to the head "Capital gains" suggests that they include an asset in the acquisition of which no cost at all can be conceived. When goodwill generated in a new business is sold and the consideration brought to tax, what is charged is the capital value of the asset and not any profit or gain. Further, the date of acquisition of the asset is a material factor in applying the computation provisions pertaining to capital gains; but in the case of goodwill generated in a new business it is not possible to determine the date when it comes into existence.

Thus, it is clear that unless and until a particular transaction leads to computation of capital gains or loss as contemplated by sections 45 and 48, the same would not attract capital gain tax.

21. Now in the case before us the assessee has not received any consideration for reduction of share capital. What has happened is that ultimately the number of shares held by the assessee has been reduced to 50% and nothing has moved from the side of the company to the assessee. The Ld. Counsel of the assessee submits that the decision of the Hon'ble Gujarat High Court in the case of CIT vs. Mohanbhai Pamabhai [supra] is not

applicable because, in the case before us, it was possible to ascertain the consideration by envisaging the same as zero. In this regard he relied on the decision of the Hon'ble Bombay High Court in the case of Cadell Wvg. Mill Pvt. Ltd. vs. CIT [supra] and, in particular, referred to the observations at pages 284 and 285 of the report wherein it was observed that whole of the value of the capital asset transferred could not be brought to tax because that would amount to taxing the value of asset and not profit as contemplated in sec.45. In this case the issue involved was whether the compensation received on surrender of statutory tenancy rights is chargeable as casual income u/s.10[3] or it should be charged u/s.45. The court, after examining the issue in detail, held that amount received on such surrender is chargeable only u/s.45. The court observed that whole value of the compensation could not be charged u/s.56 because same was chargeable u/s.45 and the decision of the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] was applied. It was also noted that, in fact, sec.55 [2][a] itself was amended by Finance Act, 1994 w.e.f. 1-04-1995 and the cost of acquisition of tenancy rights was to be taken at nil, therefore, this provision could not be applied retrospectively. Thus, it is clear that the decision of Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] was followed in principle wherein it has been held that if computation provision of sec.48 fails, then such transaction cannot be brought to tax u/s.45. The court specifically declined to entertain the argument that cost of tenancy right should be taken at zero because that would amount to charging of capital value of the asset and not capital gain. In the case of reduction of capital nothing moves from the coffers of the company and, therefore, it is a simple case of no consideration which cannot be substituted to zero. It is pertinent to note that after the decision of Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra], the legislature has introduced specific provision wherein cost of acquisition of goodwill was to be taken at nil. Similar amendments were made to specify the cost with reference to trademark, cost of right to manufacture or produce or process any article or thing etc. Therefore, wherever Legislature intended to substitute the cost of acquisition at zero, specific amendment has been made. In the absence of such amendment it has to be inferred that in the case of reduction of shares, without any apparent consideration, that too in a situation where the reduction has no effect on the right of shareholder with reference to the intrinsic rights on the company, it is always possible to argue that cost of acquisition cannot be ascertained and, therefore, provisions of sec.45 would not be applicable. Since no amendment has been made in respect of consideration, principles laid down by the Hon'ble Gujarat High Court in the case of CIT vs. Mohanbhai Pamabhai [supra]- later confirmed by the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] and also in the case of Sunil Siddharthbhai vs. CIT [supra]- are applicable.e., if the consideration cannot be ascertained, then provisions of sec.45 would not apply. No doubt Learned counsel forcefully submitted that the legislature has listed out all transactions which are not regarded as transfer such as gifts etc, (sec.47-iii) and per contra any other transfer even without specific or zero consideration should be considered for taxation U/s 45 but we find no force in it. The situation regarding non ascertainment of any of the element of sec.48 came to light only after the pronouncement of the decision of the Hon'ble

Supreme Court in the case of B. C. Srinivasa Setty [supra]. Perhaps legislature intended to exempt only gifts from subject matter of capital gains and that is why clause (iii) to sec.47 must have been put in the statute. In any case, the decision of the Hon'ble Bombay High Court in the case of The Bombay Burmah Trading Corporation Ltd. Vs. CIT [supra] is directly on the issue wherein third question referred before the Court reads as under:

> "3. Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that where in a case of compulsory acquisition by Government without compensation no capital loss will ensure?"

This question was answered by the Hon'ble court vide para which reads as under:

> "4. So far as the third question is concerned, the same is covered by the ratio of the decision of the Supreme Court in B. C. Srinivasa Setty [1981] 128 ITR 294. The answer to the question is, therefore, self-evident. Questions Nos.1, 2 and 3 are not preferable questions of law."

Thus, from the above it is clear that when no consideration is received, no loss can be allowed in view of the principles laid down by the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] which was followed in above decision. In fact, assessee has not suffered any loss on reduction of share capital which we shall see little later.

22. Reliance was also placed before us on the decision of DCIT vs. BPL Sanyo Finance Ltd. [supra]. In this case the court was concerned with the issue where assessee had applied for one lakh equity shares of IDBI Ltd. in response to the public issue. The assessee was allotted 89,200 shares against the application of one lakh shares and share application money was appropriated accordingly. The assessee was asked to remit the balance sum of Rs.83,46,000/- for issuance of the shares and since the allotment money was not paid, IDBI Ltd. cancelled the allotment and forfeited the shares. A

question arose whether such forfeiture would amount to capital loss. The Hon'ble Karnataka High Court observed that a binding contract existed between the assessee and IDBI Ltd. and once shares were cancelled, this would amount to transfer and accordingly the capital loss was allowed. As observed earlier, in the case before us shares have not been cancelled but only number of shares has been reduced and assessee at best would suffer only a notional loss. Further, in this case the principles laid down by the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] have not been considered. Moreover, the Hon'ble Karnataka High Court decided this issue on the basis of decision of Hon'ble Supreme Court in the case of CIT vs. Grace Collis & Ors. [supra]. In that case, the facts were that assessees were shareholders of Ambassador Seamen Ship Pvt. Ltd. and that company got amalgamated with Collis Lines Pvt. Ltd. with the approval of Hon'ble Kerala High Court. As per the scheme of amalgamation, all assets and liabilities of the amalgamating company were to vest in the amalgamated company and in consideration of that the amalgamated company was to issue to shareholders of the amalgamating company 14 equity shares of Rs.100/- each credited as fully paid-up in the amalgamated company for each share held in the amalgamating company. During the relevant year, assessee sold the shares of amalgamated company and the gain arising on the same was charged by the ITO as capital gain. The assessee contended that same could not be charged because the cost of shares obtained by amalgamation could not be determined as there was no transfer involved during the amalgamation. The assessee had not furnished the details of cost of the shares of the amalgamated company. However, the ITO noted that under the scheme assessees had received 14 shares of the face value of Rs.100/- each in the amalgamated company for one share of the face value of a share in the amalgamating company. He multiplied the number of shares of the amalgamated company that assessee had sold by their face value of Rs.100/- each and divided by 14 to arrive at their cost. After reducing this cost from the sale price the balance was subjected to capital gains tax. The ITO rejected the contention of the assessee that sections 49(2) and 47(iii) were not attracted as the assessee had not become the owner of the shares of the amalgamated company in consideration of the transfer of their share in the amalgamated company. Before the Hon'ble apex court another decision in the case Vania Silk Mills Pvt. Ltd. vs. CIT [supra] was relied. The Hon'ble court after detailed discussion in CIT vs. Grace Collis & Ors. [supra] held as under:

> "We have given careful thought to the definition of "transfer" in section 2(47) and to the decision of this court in Vania Silk Mills Pvt. Ltd.'s case [1991] 191 ITR 647. In our view, the definition clearly contemplates the extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof. We do not approve, respectfully, of the limitation of the expression "extinguishment of any rights therein" to such extinguishment on account of transfers or to the view that the expression "extinguishment of any rights therein" cannot be extended to mean the extinguishment of rights independent of or otherwise than on account of transfer. To so read the expression is to render it ineffective and its use meaningless. As we read it, therefore, **the expression does include the extinguishment of rights in a capital asset independent of and otherwise than on account of transfer."**

Thus, from the above it is clear that even extinguishment of rights in a particular asset would amount to transfer. The chargeability of the capital gain was upheld because on extinguishment of shares in the amalgamating company, the assessee got the new shares and, therefore, the question whether any cost of acquisition could be ascertained was answered in favour of the Revenue. **In the case before us, as pointed out by the Ld. DR,**

the assessee's rights have not been extinguished. We had asked during the hearing that how much percentage assessee was holding in TGL and it was submitted that it was more than 51%. On verification of the details, it is seen that after reduction, TGL is having 89,93,149 equity shares of Rs.10/- each [after reduction and consolidation] and assessee is holding 67,37,399 shares which comes to about 74.9% i.e 75% for easy calculation. Let us examine whether assessee's rights have been extinguished or not.

23. As pointed out by Ld. DR, assessee's percentage of share holding, immediately before reduction of share capital and immediately after such reduction, remained the same. **Therefore, assessee was holding 74.9% shares of TGL immediately before the reduction of capital and also immediately after the reduction of capital.** Such capital has been reduced not only in the case of assessee by TGL but the same has been reduced for all the shareholders of the TGL. Though under the concept of joint stock company, the joint stock company is having independent legal entity but for all practical purposes the company is always owned by the shareholders. Therefore, sum total of 100% shareholders would own the net assets of the company. Now let us say a company started with a capital of Rs.100/- and had assets of Rs.100/-, then 75% shareholders would own 75% of such assets i.e. Rs.75. If after few years, this company suffers a loss and the assets are reduced to Rs.50, then share of the assessee in the assets of the company would be only Rs.37.50. If the capital of the company is reduced by 50%, even then the share of the assessee would be 75% and it would remain same at Rs.37.50. Therefore, the effective share of assessee, in the assets of the company, would remain the same immediately before and after

reduction of such capital. In other words, the loss suffered by the company would belong to the company and that cannot be allowed to be set off in the hands of the assessee. This position is further supported by another example. If, in the above illustration, after few years, instead of assets becoming Rs.50/- , it increases to Rs.200/-, because of profit, and in turn this company issued bonus shares, even then the profit would remain in the books of the company and mere allotment of such bonus shares cannot be subjected to tax. This position was accepted even by the Ld. Counsel of the assessee. Therefore, when the profits of the company which have been distributed to the shareholders by way of bonus shares cannot be assessed, on the same principle losses of the company which have been adjusted by reducing the capital cannot be allowed.

24. Now let us examine the issue from another angle. Let us assume that Mr. 'A' holds 100% shares of a company, and the company, in turn, has invested its entire funds in a property. If the value of this property falls and the company decides to reduce its capital and if the capital is reduced by 50% and Mr. A 's holding is reduced to 50 shares, it will not make any difference, because he is still holding 100% shares and the fall in the value of the property in the hands of the company is only a notional fall or notional loss which would not effect the shareholding. Let us take another illustration. A company known as 'Z' started with an equity capital of Rs.1,000/- divided into 100 shares of Rs.10 each. The company borrowed another Rs.4,000/- and after 10 years the value of assets and liabilities of the company changes. Such changes would occur differently in the case of a profitable company and in case of a loss making company. Let us assume that the company incurs a

loss of Rs.10,000/- or alternatively earns the profit of Rs.10,000/-, then the balance-sheet of the company after 10 years would read as under:

In case of the loss Company
Balance Sheet as on 31-3-xxxx

	Rs.		Rs.
Share capital	1000	Assets	5000
Loan liabilities	14000	Debit balances in P&L A/c.	10,000
	---------		------------
	15000		15,000
	======		=======

In case of the profitable Company
Balance Sheet as on 31-3-xxxx

		Rs.		Rs.
Share capital	1000		Assets	15,000
Loan liabilities	4000	5000		
Credit Balance in P&L A/c Profit carried forward		10000		
		--------		-----------
		15000		15,000
		=====		======

Let us further assume that no dividend was paid by the profit making company. Now, it can be said that in case of loss making company the value of shares has gone down because of the loss, but the shareholder's rights would not be affected because such loss belongs to the company and is assessable in the hands of the company. If such loss making company reduces the capital, such proportionate shareholding would still remain and entitled to the same proportion of asset and assessee's interest is not effected. Same situation would prevail in case of profit making company and if such profit making company issues bonus shares they cannot be taxed in the hands of such shareholders and they can be taxed only when such shares are sold by the shareholders. Therefore, whether the company suffers loss or earns profit, the proportionate interest of the shareholder is not affected.

25. Now let us further understand the exact effect of the reduction of share capital with the following illustration:

Position prior to reduction in capital

Liabilities	Rs.	Assets	Rs.
Share Capital	1000	Assets	2500
Loans	2000	P&L A/c. Bal (Loss)	500
	3000		3000
Net worth of the company (2500 – 2000)			Rs.500

Now, let us assume further that share capital is reduced by 50% and the same is adjusted against loss, then following position would emerge:

Position after to reduction in capital

	Rs.		Rs.
Share Capital	500	Assets	2500
Loans	2000		
	2500		2500

Net worth of the company (2500 – 2000) = Rs.500

As can be seen from the above example, even after reduction of capital from Rs.1000/- to Rs.500/-, the net worth of the company remains the same and the share of every shareholder also remains the same. For example, suppose 'X' was holding 50 shares out of total 100 shares prior to reduction, he will hold 25 shares out of total 50 shares after reduction of 50%, but his share in the total share capital of the company as well as in the net worth of the company would remain the same i.e., at 50%. Thus, in this illustration, share of 'x' in the net worth remains at Rs.250/- i.e. 50% of Rs.500/- before and after reduction of the number of shares. There is thus no change in the intrinsic value of his shares and even his rights vis-à-vis other shareholders as well as vis-à-vis company would remain the same. There is thus no loss that can be said to have actually accrued to the shareholder as a result of reduction in the share capital. There would be no change even in the cost of acquisition of shares which the shareholder would be entitled to claim as deduction in computing the gain or loss as and when the said shares are transferred or sold in future as per sec.55(v). Similarly, in the case before us the percentage of holding of the assessee remains at 74.9 even after the reduction of its capital and assessee has the right to share 74.9% net worth of TGL and no loss has been caused to the assessee.

26. The Ld. Counsel of the assessee had also relied on the following decisions of the Tribunal-

a) Zyma Laboratories Ltd. Vs. Addl. CIT 7 SOT 164 [Mum]
b) DCIT vs. M/s Polychem Ltd. ITA No.4212/M/07 [Mum] and
c) Ginners & Presser Ltd. vs. ITO ITA No.398/M/07 & 4193/M/07

But in all these cases the principle laid down by the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra] was neither cited, nor considered and, therefore, these decisions are distinguishable and in any case, not binding on the Special Bench. In fact such profit or loss arising out of issue of bonus shares or reduction of capital is only a notional profit or notional loss and this concept has been approved by the Hon'ble Supreme Court in the case of Miss Dhun Dadanbhoy Kapadia vs. CIT [supra] and further confirmed by the Hon'ble Supreme Court in the case of Sunil Siddharthbhai vs. CIT [supra]. In the case of Dhun Dadanbhoy Kapadia vs. CIT [supra] the facts noted by the Hon'ble apex court are as under:

> The appellant was holding 710 ordinary shares of the Tata Iron and Steel Company Ltd. (hereinafter referred to as " the company "), which she had inherited some tine prior to 1st January, 1954, as an investment. It was admitted that she was not a dealer in shares. Under a special resolution passed at an extraordinary general meeting of the company oil 12th March, 1956, the appellant, as holder of 710 ordinary shares, became entitled to purchase new ordinary shares issued in the ratio of one new ordinary share for one existing ordinary share as held on 26th April, 1956. In pursuance of this resolution, an offer was made to the appellant by the company by its circular letter dated 15th May, 1956, that she was in terms of the resolution, entitled to apply for 710 new ordinary shares to be paid for at the rate of Rs. 105 per new ordinary share. This payment was to represent Rs. 75 as the face value of the share and Rs. 30 as premium. She was also given the option of either taking the shares wholly or partly, or renouncing them either wholly or partly, in favour of any other person or persons. The appellant chose to renounce her right to all the 710 ordinary shares instead of taking the shares herself, and when renouncing the shares, she sold them in the open market on 12th June, 1956, as a result of which she actually realised a sum of Rs. 45,262,50P. It was common ground before the income-tax authorities as well as the Tribunal that this amount received by her was a capital gain and the whole of this amount was sought to be taxed as capital gain received by the appellant. On behalf of the appellant the plea was that, on the issue of the new ordinary shares, the value of her old ordinary shares depreciated, because ***the assets of the company remained stationary***, while the number of shares increased. It was in consideration of this depreciation in her original holdings that she was given the right to purchase these new ordinary shares, or to renounce them in favour of some other person and make up the loss which she would suffer on her original shares. The board of directors of the Native Stock and Shares Association Ltd. had passed a resolution that the transactions in these shares were to be cum-right up to and including 1st June, 1956, and were to be ex-rights from 4th June, 1956, onwards. The intervening days, 2nd and 3rd June, being official holidays, there were to be no transactions on those days. The market quotation of the old Tata ordinary shares was Rs. 253 per share on 1st June, 1956, and fell to Rs. 198.75nP. On 4th June, 1956. There was, thus, a fall in the market quotation of old shares of Rs. 54.26P. per share. It was claimed by the appellant that, as a result of this depreciation in the price of her old ordinary shares, she suffered a capital loss in those shares to the extent of Rs. 37,630, and she was entitled to set off this loss against the capital gain of Rs. 45,262.50P. which she realised on selling her right to take the new ordinary shares. In the alternative, the case was put forward on the basis that the right to receive these new ordinary shares was a right which was embedded in her old ordinary shares, and, consequently, when she realised the sum of Rs. 45,262,50P by selling her right, the capital gain should be computed after deducting from this amount realised the value of the embedded right which became liquidated. The value of that right, according to the appellant, should be calculated in accordance with the principles of accountancy, as laid down by various authors on the subject to be applied in such Situations. Even if this principle be accepted, the amount taxable as

capital gain in her hands would have to be reduced by at least a sum of Rs. 37,630, if not more.

The contention of the assessee was rejected by the income tax authorities as well as by the Tribunal and the High Court confirmed the decision of the Tribunal. When the matter travelled to Hon'ble Supreme Court, the apex court observed as under:

"In order to answer the question referred to the High Court, it appears to us that the nature of the transaction, which resulted in this receipt of Rs. 45,262.50P. by the appellant, must be analysed and properly understood. The amount, it is the agreed case of the parties, was a capital gain. The capital asset which the appellant originally possessed consisted of 710 ordinary shares of the company. There was already a provision that, if the company issued any new shares, every holder of old shares would be entitled to such number of ordinary shares as the board may, by resolution, decide. This right was possessed by the appellant because of her ownership of the old 710 ordinary shares, and when the board of directors of the company passed a resolution for issue of new shares, this right of the appellant matured to the extent that she became entitled to receive 710 new shares. This right could be exercised by her by actually purchasing those shares at the shares Plus this right to take 710 new shares. At the time of her transaction, her old shares were valued at Rs. 253 per share, so that the capital asset in her possession can be treated to be the cash value of 710 multiplied by Rs. 253 of the old shares Plus this right to obtain new shares. After she had transferred this right to obtain new shares, the capital assets that came into her hands were the 710 old shares, which became valued at Rs. 198.75P. per share, together with the sum of Rs. 45,262.50P. The net capital gain or loss to the appellant obviously would be the differ ence between the value of the capital asset and the cash in her hands after she had renounced her right and realised the cash value in respect of it, and the value of the capital asset including the right which she possessed just before these new shares were issued and before she realised any cash in res pect of the right by renouncing it in favour of some other person. As we have indicated above, the value of the capital asset, after renouncement, would be 710 multiplied by Rs. 198.75P. Plus the sum of Rs. 45,262.50P while the value of the asset, immediately before the renouncement, would be 710 multiplied by Rs. 253, there being no cash value at that time of the right to be taken into account. Thus, the capital gain or loss would be worked out at Rs. 45,262.50P. after deducting from it the sum worked out at 710 multiplied by the difference between Rs. 253 and Rs. 198.75P. This last amount comes to a little more than the sum of Rs. 37,630 which the appellant claimed should be deducted from Rs. 45,262.50P. in computing her capital gain. The claim made by the appellant was thus clearly justified because the net capital gain by her in the transaction, which consisted of issue of new shares together with her renouncement of the right to receive new shares and make some money thereby, could only be properly computed in the manner indicated by us above.

In the alternative, the use can be examined in another aspect. At the time of the issue of new shares, the appellant possessed 710 old shares and she also

> got the right to obtain 710 new shares. When she sold this right to obtain 710 new shares and realised the sum of Rs. 45,262.50P., she capitalised that right and converted it into money. The value of the right may be measured by setting off against the appreciation in the face value of the new shares the depreciation in the old shares and, consequently, to the extent of the depreciation in the value of her original shares, she must be deemed to have invested money in acquisition of this new right. A concomitant of the acquisition of the new right was the depreciation in the value of the old shares, and the depreciation may, in a commercial sense, be deemed to be the value of the right which she subsequently transferred. The capital gain made by her would, therefore, be represented only by the difference between the money realised on transfer of the right, and the amount which she lost in the form of depreciation of her original shares in order to acquire that right. Looked at in this manner also, it is clear that the net capital gain by her would be represented by the amount realised by her on transferring the right to receive new shares, after deducting therefrom the amount of depreciation in the value of her original shares, being the loss incurred by her in her capital asset in the transaction in which she acquired the right for which she realised the cash. This method of looking at the transaction also leads to the same conclusion which we have indicated in the preceding paragraph."

In the above case, Hon'ble court has made it clear that capital gain on account of sale of rights shares has to be understood similarly as understood in the commercial world. It has to be noted that while stating the facts, the Hon'ble Supreme Court noted and stressed that assets of the company remained stationary and that is why depreciation has accrued in the value of old ordinary shares, because same assets would be represented by old ordinary shares plus the new rights shares. Thus, when there was no change in the value of assets of the company on the date of issuance of rights shares, then such reduction in the value of new shares has to be reckoned because assets remained the same. Similarly, in the case before us the value of asset of a company immediately before and after reduction of share capital remained the same and therefore by reducing the amount and number of shares the assessee's proportionate share in such assets remained the same. In the case before us also the value of assets even after reduction of capital remained the same and, therefore, loss, if any, at best can be called notional loss which cannot be allowed as observed by the Hon'ble Supreme Court in the case of Sunil Siddharthbhai vs. CIT [supra] at pages 521 & 522 which we have reproduced earlier.

.. It was noticed that perhaps during the earlier hearing of this case, reliance has been placed by the department on the decision of the Ahmedabad Bench of the Tribunal in the case of Ajay C. Mehta vs. DCIT 305 ITR (AT) 155. In that case also assessee had claimed short term capital loss. The assessee had applied for 2,00,000 warrants and paid Rs.2.70 per warrant as upfront payment. Later on, assessee exercised the option only in respect of 40,000 warrants and the right with respect to 1,50,000 warrants was extinguished, which was claimed as short term capital loss. This claim of loss was rejected by the Tribunal because no consideration was received by following the decision of the Hon'ble Supreme Court in the case of B. C. Srinivasa Setty [supra]. In any case, in addition to the above detailed discussion, the issue is squarely covered by the decision of the Hon'ble Bombay High Court in the case of The Bombay Burmah Trading Corporation Ltd. Vs. CIT [supra] wherein it is clearly held that if no compensation is received, then capital loss cannot be allowed. It was argued by the Ld. Counsel of the assessee that detailed facts are not available, but we find that the Hon'ble Madhya Pradesh High Court in the case of National Textile Corporation vs. CIT [171 Taxman 339] has clearly held that a decision of jurisdictional High Court cannot be ignored by the Tribunal simply because it is assumed that certain aspects of the issue might not have been considered by the jurisdictional high court. In the case of National Textiles Corporation, it was observed as under:

> "**It is neither permissible nor legal for any Court and Tribunal to comment upon the decision of Supreme Court/High Court**. Similarly, it is also not permissible for the Tribunal to comment upon the manner in which a particular decision was rendered by Supreme Court/High Court. It is also not permissible for Tribunal to sidetrack or/and ignore the decision of High Court on the ground that it did not take into consideration a particular provision of law. If such approach is resorted to by subordinate Courts/Tribunals then it is held to be not in conformity with the law laid down by Supreme Court. It was deprecated by Supreme Court as being improper.
> When the High Court has no jurisdiction to comment upon any decision of Supreme Court nor High Court has a power to ignore such decision by virtue of mandate contained in Article 141 of Constitution then on the same reasoning, the Tribunal being subordinate to High Court has to follow the decision of jurisdictional High Court without making any comment upon the said decision or/and without ignoring it on any ground except those which are well recognized as indicated hereinbelow. In other words, when law laid down by Supreme Court is binding on all Courts/Tribunals in the country by virtue of Article 141 of Constitution of India then law laid down by High Court is equally binding on Courts/Tribunals they being subordinate to High Court by virtue of powers conferred by Articles 215, 226 and 227 of Constitution of India and by judicial precedents."

Therefore, in our view, the decision of Hon'ble Bombay High Court is binding and has to be applied.

27. Further, recently the Authority For Advancing Rulings (Income-Tax), New Delhi, presided over by Hon'ble Justice P.K.Balasubramanyan, Chairman, in the case of Goodyear Tire & Rubber Company, In re* (2011) 199 Taxman 121, also took the same view in almost identical circumstances. In this case, the applicant Goodyear Tire & Rubber Co., USA which is incorporated in USA was holding shares in Goodyear India Limited. As part of the global strategy, it was contemplating re-organising all its investments and, therefore, proposed to enter into Share Contribution Deed to contribute voluntarily entire 74% of its holdings in Goodyear India Ltd., to Goodyear Orient. (P) Ltd., Singapore without consideration and voluntarily. The following question was referred for consideration of the Hon'ble authority-

> "Whether the Applicant is liable to tax in India under the provisions of section 45 read with section 48 or under A.Y other provisions of the Income-tax Act, 1961 ("Act") in relation to the proposed contribution of its shares in Goodyear

> India Limited ("GIL") to Goodyear Orient Company (Private) Limited ("GOCPL") without consideration?"

The Authority after detailed discussion observed at para-8 as under:

> "8. It is settled law that section 45 must be read with section 48 and if the computation provision cannot be given effect to for any reason, the charge under section 45 fails. The Hon'ble Supreme Court has explained the interplay and relative scope of the two sections in the cases of B. C. Srinivasa Setty [1981] 128 ITR 294 and Sunil Siddharthbhai vs. CIT [1985] 156 ITR 509 (S.C)."

And further observed at para-10 as under:

> "10. As no consideration will pass on transfer of shares of GIL by GTRC, no income will arise. The provision of sections 92 to 92F of the Act will not be applicable in the absence of liability to pay tax."

28. We also find force in the submissions of the Ld. DR that as per sec.55(v) the cost the cost of acquisition of shares even after conversion etc. has to be taken with reference to the cost of original shares. Therefore, after reduction of share capital the cost of acquisition of the remaining shares would be reckoned with references to the original cost. Though at this stage assessee has not obtained any benefit because loss has been computed with reference to the actual cost, but,in future, if assessee decides to sell its shareholding in TGL then assessee has the right,U/s 55[v], to substitute the cost of acquisition with reference to the original shareholding and in that case it may amount to double benefit later on which is not permissible under the law.

29. Therefore, in the light of the above discussion, we are of the opinion, that the loss arising on account of reduction in share capital cannot be subjected to provisions of sec.45 r.w.s. 48 and, accordingly, such loss is not allowable as capital loss. At best such loss can be described as notional loss

and it is settled principle that no notional loss or income can be subjected to the provisions of the I.T.Act.We hold accordingly.

30. The other grounds of appeal raised are as under:

1. On the facts and in the circumstances of the case and in law, the Learned CIT(A) has erred in confirming the disallowance of Rs.48,60,835/- towards obsolete/non moving material written off.
2. On the facts and in the circumstances of the case and in law, the Learned CIT(A) erred in not allowing deduction u/s.80IB of Rs.1,68,11,086/- in respect of Chennai Industries undertaking.

31. The Ld. Counsel Shri Venkatraman, submitted that the issues raised in both these appeals are covered by the earlier order of the Tribunal in I.T.A.Nos.5741 & 5665/M/2007, copy of which has been filed on record.

32. On the other hand, Ld. DR relied on the order of the AO.

33. The issue raised in ground No.1 came up for consideration of the Tribunal in A.Y 2003-04 in I.T.A.Nos.5741 & 5665/M/2007 and the same had been adjudicated vide paras 4 and 5. In para 4 the contentions of both the parties have been considered and ultimately the issue had been adjudicated vide para-5 which is as under:

> "5. We have also heard the Learned D.R. on this issue. As submitted by the Learned Counsel, the identical issue has been considered by the Tribunal in assessee's own case for the A.Y 2000-01 and the operative part of the findings is in para No.4 which reads as under:
>
> > "4. The ground of appeal No.6 of the assessee is as under:
> >
> > "6. On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the disallowance of Rs.31,33,240/- being obsolete/non-moving material written off."
> >
> > This ground of appeal consists of two parts i.e. with regard to the addition of Rs.17,11,240/- on account of Times Music Pop albums and the other addition of Rs.14,22,000/- on "Planet M". Learned Counsel for the assessee has not pressed the ground of appeal with regard to the addition of Rs.14,22,000/- of "Planet M" and the ground of appeal of the assessee with regard to this addition of Rs.14,22,000/- is dismissed. With regard to the other addition of Rs.17,11,240/- of times music, the Ld. Counsel for the assessee submitted that the assessee has the method of accounting by which one year it values the obsolete music cassettes of over three years and over one year at

Rs.1/- per casette, which has resulted in the loss of Rs.17,11,240/-, during the relevant period and is allowable nature. The Ld. D.R. has relied on the orders of the Assessing Officer and CIT(A). We have considered the rival submissions. We find that the cassettes becomes obsolete after expiry of considerable time and there is nothing wrong in the method of accounting of the assessee in valuing the obsolete cassettes at Rs.1/- per cassette resulting in loss to the assessee during the relevant period. The loss being genuine and very much incidental to the business is of allowable nature and is accordingly allowed and the ground of appeal No.6 with regard to the amount of Rs.17,11,240/- of time music is allowed.

The order of the Tribunal for the A.Y 2000-01 is also followed in the subsequent A.Y 2002-02. as the facts are identicla in this year, therefore following the order of the Tribunal in assessee's own case cited [supra], we delete the addition confirmed by the Ld. CIT(A). Accordingly, ground No.1 is allowed."

Following the above order, this issue is decided in favour of the assessee.

34. The issue raised in ground No.2 has been adjudicated vide paras 15, 16 & 17 and para 17 reads as under:

"17. We have heard the Learned D.R. on this issue. it is seen that the issue for allowability of the deduction u/s.80IB in respect of Chennai Unit has been dealt with by the Tribunal while deciding the order passed by the CIT u/s.263 for the A.Y 1986-87 being I.T.NO.3125/M/2001, order dated 30-11-2004 and it is held that Chennai unit is an "Industrial Undertaking' within the meaning of Section 80IA. The operative part of the order reads as under:

"Regarding Chennai unit we find that the Board Circular No.347 as reported in 37 (Stat.) 14 has approved the view of the Hon'ble Madras & Calcutta High Courts in 107 ITR 822 117 ITR 718 respectively. As per these Judgments and as per this circular, book publishing company even if not printing or binding of books themselves are to be treated as industrial company. In the present case also, the objection of the CIT is based on this fact that the assessee is not printing the paper and hence is not an industrial unit. We are of the considered opinion that the assessee has to be treated as an industrial unit for Chennai also in view of this Circular, otherwise also, as per section 80IA[12], Industrial undertaking shall have the same meaning assign. Such Explanation to section 33B is reproduced below:
Explanation: In this section, "industrial undertaking" means any undertaking which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining.

From the above, we find that any undertaking which is mainly engaged in processing of goods is also an industrial undertaking and in the present case, the Chennai unit is mainly engaged in gathering the news and procurement of advertisements and then processing the same to result in a news paper.

> These activities fulfil the condition of processing of goods and hence has to be treated as an industrial undertaking”
>
> The said order has been followed by the Tribunal in the other assessment years. As the facts are identical, we confirm the order of the Ld.CIT[A] in this year also and dismiss Ground No.4 taken by the Revenue.

Following the above order, we decide this issue in favour of the assessee and direct the AO to allow deduction u/s.80IB in respect of profits of Chennai industrial undertaking.

35. In the result, appeal is partly allowed.

Order pronounced in the open Court on this day of 30/09/2011.

Sd/-		**Sd/-**
(D.MANMOHAN)	**(R.S.SYAL)**	**(T.R.SOOD)**
VICE PRESIDENT	**ACCOUNTANT MEMBER**	**ACCOUNTANT MEMBER**

Mumbai: 30/9/2011.
P/-*

Per R. S. Syal, AM:

36. I have gone through the order proposed by ld. colleagues on the special bench. I fully agree with and endorse the view taken on ground nos. I and 2 in such order.

37. Despite my best persuasion, I could not convince myself to concur with the conclusion and also the reasoning in the proposed order *qua* the other grounds involving one issue, for which this special bench has been constituted. As such I am constrained to write my separate order as follows.

38. The Hon'ble President of the Income Tax Appellate Tribunal has constituted this Special Bench to hear the appeal and to give opinion on the following question:-

"Whether on the facts and in the circumstances of the case, the CIT (A) was justified in declining (sic - declaring) long term capital loss of RS.22,21,85,693 on account of reduction in paid up equity share capital?"

The facts apropos this issue, as per the assessment order, are that the assessee declared capital loss of Rs.18,59,18,668 vide Note No. 10 of Anncxure-F to the computation of total income, reading as under.-

*"The amount of net capital loss made during the year is Rs.18,*59,18,668. *The working of short term and long term capital gains/ loss is attached in Annexure F. ….*

Pursuant to the reduction of 50% of share capital of times Guaranty Limited (TGL) as approved by the court, the Company's investment therein ofRs.2484.02Iacs has been reduced by 50% to 1242.01 lacs. The amount of 1242.01 lacs has been shown as "investments written off in the accounts ". The same has been treated as long term capital loss. Copy of the Court order is enclosed along with Annexure F."

40. The Assessing Officer observed that the assessee had an investment of Rs.2484.02 lakh in equity shares of a group company, viz. Times Guaranty Limited (hereinafter called "TGL"). All the shares were of the face value of Rs.10 each. Under section 100 of the Companies Act, 1956 (hereinafter called "the Companies Act"), TGL applied for reduction of its equity share capital and approached the Hon'ble Bombay High Court for the approval of the same. The Court approved the petition of TGL and allowed reduction in its share capital by 50% thereby reducing face value of each equity share of Rs. 10 each to Rs.5 each. Consequently the assessee company's investment in TGL, which originally stood at Rs.2484.02 lakh, was reduced to Rs.1242 lakh post capital reduction of TGL. By applying the cost inflation index, the assessee worked out the loss due to reduction of share capital of TGL at Rs.22.21 crore. On being called upon to justify the loss under the head 'Capital Gains', the assessee relied on the judgement of the Hon'ble Supreme Court in the case of *Kartikeya V.Sarabhai Vs. CIT [(1997) 228 ITR 163 (SC)}* to contend that the reduction in the share capital would amount to 'transfer' within 'the meaning of section 2(47) of the Income-tax Act, 1961 (hereinafter called 'the Act'). To strengthen its point, the assessee also relied on the judgments of the Hon'ble Supreme

Court in *CIT Vs. G. Narasimhan (died)* [(1999) 236 *ITR 327 (SC)* and *Anarkali Sarabhai Vs. CIT {(I* 997) *224ITR* 422 *(SC)}*

41. The Assessing Officer did not agree with the submissions advanced on behalf of the assessee and gave the following reasons for not applying the ratio in the case of *Kartikeya V. Sarabhai (supra)* :-

i) There has been reduction of capital by reducing the face value of equity shares from Rs.10/- each to Rs.5/- each but in the case of Kartikeya Sarabhai (supra), the issue of preference shares was involved.

ii) This distinction is material between preference shares and equity shares as in the case of preference shares, the right to vote to the share holder is limited only to the extent of resolution placed before the company which directly affect the rights attached to his preference shares.

iii) In assessee's case, even though reduction in the entire share capital has taken place, the right of voting of the assessee is not affected in any way which remains the same.

iv) In the present case, the assessee has not received any consideration for reduction in the value of shares. The assessee has not given away or passed on its right in the shares to anyone as there has been no change in the rights of the assessee vis-a-vis other shareholders.

It was, therefore, held that there was no "transfer" of the capital asset within the meaning of section 45 so as to result into any loss under the head 'Capital Gains'. The AO further opined that if at all any capital loss is there that shall arise to the assessee on this account only when he sells the remaining shares.

43. The assessee remained unsuccessful at the first appellate stage also as it could not convince the ld. CIT(A) to its line of reasoning. Resultantly no relief was allowed in the first appeal on this count.

44. The question for consideration is to decide as to whether the assessee incurred any loss within the meaning of section 45 on account of reduction in the paid up equity share capital in TGL. It is observed from the assessment order that the *A.O.* canvassed the opinion that there was no "transfer" of the capital asset on the ground that there was only reduction in the face value of the equity shares from Rs. 10 each to Rs.5 each and the assessee's rights in the company were not affected in any manner with the reduction in the share capital.

45. Before I proceed further it is imperative to note that there is no reduction in the 'face value' of equity shares from Rs. 10 each to Rs.5 each as has been made out by the Assessing Officer. At this juncture it would be relevant to consider the resolution passed by TGL in its Annual General Meeting held on 1st of June, 2000. Notice dated 27th April,

2000 was issued by TGL for the Annual General Meeting requiring the passing of following resolution with or without modification,:-

"RESOLVED THAT:

1) *Subject to approval of the Hon'ble High Court of Bombay under Section 100 of the Companies Act*, 1956 *and any other applicable provisions of the Act, if any, and pursuant to Article* 47 *of the Articles of the Association of the Company, the Subscribed Equity* share *Capital of the Company be reduced from Rs.17,98,62,990/ (Rupees Seventeen Crores Ninety Eight Lakhs Sixty Two Thousand Nine Hundred and Ninety Only) divided into* 1,79,86,299 *(One Crore Seventy Nine Lakhs Eighty Six Thousand Two Hundred and Ninety Nine) Equity shares of Rs.10/- (Rupees Ten Only) each to Rs.8,99,31,495/- (Rupees Eight Crores Ninety Nine Lakhs Thirty One Thousand Four Hundred and Ninety Five Only) divided into 1,79,86,299 (One Crore Seventy Nine Lakhs Eight Six Thousand Two Hundred and Ninety Nine Only) Equity Shares of Rs.10/- (Rupees Ten Only) each, Rs.5/- (Rupees Five Only) each paid up, by cancelling the capital to the extent ofRs.5/- (Rupees Five Only) per equity share.*

2) Forthwith upon reduction of capital taking effect, 2 *(Two) Equity Shares ofRs.10/- (Rupees Ten Only) each, Rs.5/- (Rupees Five Only) each paid-up be consolidated into* I *(One) equity share of Rs.1O/- (Rupees Ten Only) each fully paid-up so that the total number of equity shares does not exceed* 89,93,149 *(Eighty Nine Lakhs Ninety Three Thousand One Hundred Forty Nine Only) equity shares of Rs.1O/- (Rupees Ten Only) each fully paid up. Correspondingly the paid up capital shall also stand reduced and consolidated*

3) No fractional certificate shall be issued pursuant to such reduction and consolidation of share capital of the company in favour of any member, all such fractions shall be consolidated into equity shares ofRs.101- (Rupees Ten Only) each fully paid up.

4) The existing certificate of shares be called back and cancelled and in place thereof new certificates of shares be issued in terms of Companies (Issue of Share Certificates) Rules, 1960.

*5) The carried forward loss of Rs.42,*96,53, *0001- (Rupees Forty Two Crores Ninety Six Lakhs Fifty Three Thousand Only) be written off by reducing the paid up share capital to the extent of Rs.8,99,31,4951- (Rupees Eight Crores Ninety Nine Lakhs Thirty One Thousand Four Hundred and Ninety Five Only) as mentioned hereinabove and the balance sum ofRs33,97,21,5051- (Rupees Thirty Three Crores Ninety Seven Lakhs Twenty One Thousand five Hundred and Five Only) be written off by utilizing the share premium account of the Company. "*

46. Such proposed reduction by TGL received the assent of its shareholders by way of Special Resolution in the Annual General Meeting and the Hon'ble Bombay High Court approved this reduction, which is in conformity with section 100 of the Companies Act. A copy of High Court order is placed on pages 62 to 71 of the paper book from where it is apparent that resolution extracted above has been approved by the Hon'ble High Court. Coming back to the Resolution it is seen that "the subscribed equity share capital of the company" has been reduced from Rs.17.98 crore divided into 1,79,86,299 equity shares of Rs.10 each to Rs.8.99 crore divided into 1,79,86,299 equity shares of Rs.10 each, Rs.5 each paid up. It is further borne out from Resolution-1 that the subscribed equity share capital to the extent of Rs.5 per equity share has been cancelled. Thus there is reduction in the “subscribed/paid up capital” and not the “face value” of equity shares. On examination of Resolution No. 2 it can be seen that forthwith upon reduction of capital taking effect, 2 equity shares of Rs.10 each (Rs.5 each paid up) have been consolidated into 1 equity share of Rs. 10 each fully paid up so that total number of shares has come down to 89,93,149 equity shares of Rs. 10 each fully paid.

47. From the above two resolutions, it is manifest that there were two steps in the overall exercise, viz., first step, being the reduction of subscribed / paid up value of share by Rs.5, keeping the face value of each equity shares at Rs. 10 each and second step, being the consolidation of 2 equity shares of Rs.10 each (Rs.5 paid up on each share) into 1 equity share of Rs. 10 each fully paid up: Whereas the first step dealt with the reduction in capital (Resolution No. 1), the second step with the consolidation (Resolution No.2). Reduction has taken place only in the subscribed / paid up value of equity share and not its face value. After keeping the facts straight, I shall now deal with various aspects of the issue.

I. WHETHER REDUCTION OF CAPITAL IS 'TRANSFER' U/S 2(47)?

48.1. Section 100 of the Companies Act, dealing with the reduction of share capital, is as under:-

"100. Special resolution for reduction of share capital

(1) Subject to confirmation by the Tribunal, a company limited by shares or a company limited by guarantee and having a share capital, may, if so *authorised by its articles, by special resolution, reduce its share capital in any way; and in particular and without prejudice to the generality of the foregoing power, may-*

(a) extinguish or reduce the liability on any of its shares in respect of share capital not paid-up;

(b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost, or is unrepresented by available assets; or

(c) either with or without extinguishing or reducing liability on any of its shares, pay offany paid-up share capital which is in excess of the wants of the company;

and may, if and so *far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly*"

48.2. A cursory look at this provision divulges that a company limited by shares, subject to other condition, may reduce its share capital in any way. The power of reduction of the share capital is general and applies to every possible mode by which capital reduction can be effected. It is not restricted to three modes specified in the section. The first mode as enshrined in clause (a) of section 100(1) of the Companies Act, refers to reducing the liability on any of its shares in respect of share capital not paid up. This touches upon reducing the share capital which has not been paid up so far. The second mode specified in the section is cancelling any share capital which is lost or is unrepresented by available assets and the third mode is to pay off any paid up share capital which is in excess of the wants of the company.

48.3. A need to reduce capital may arise due to variety of positive or negative reasons. The negative reasons may include incurring of heavy revenue or capital losses, necessitating the rationalization of capital structure so as to exclude the effect of such losses by eradicating the amount of losses from the asset side of the balance sheet with the simultaneous obliteration of the capital or share premium account etc from the liability side. The positive reasons may include a company finding itself in excess of resources than it can profitably employ. In such a situation, the company may contemplate discharging of its liability, fully or partly, towards the shareholders, by paying back the paid up amount on shares.

48.4. Thus it is apparent that the reduction of capital, by any mode, either by way of paying back to the shareholders or writing off losses etc., has the effect of reducing the liability of the company to its Shareholders. Reduction relieves the company from its liability to pay to the shareholders in future to the extent of the capital reduced, in the event of the winding up of the company; and also to pay dividend on such amount of share capital during the subsistence of the company. Coming to the other side, the shareholder whose capital has been reduced, is deprived of his right to receive that part of the share capital which has been so reduced in the event of winding up of the company; and also the amount of dividend on such share capital during the continuance of the company. The above consequences follow irrespective of the fact, whether the reduction of capital takes place by paying off any paid-up share capital which is in excess of the wants of the company or by cancelling any paid-up share capital which is lost or is unrepresented by available assets. In both the situations, there is reduction in the rights of the shareholders on one hand and the liability of the company on the other.

48.5. In the first situation, reduction takes place pursuant to repayment by the company to the shareholders of a definite amount, which results in transferring back the shares, fully or partly, depending upon the scheme of reduction, by the shareholders to the company by way of sale, relinquishment or extinguishment of rights in the shares. In the case of *Anarkali Sarabhai (supra)* the assessee held 297 redeemable preference share of Universal Corporation Private Limited with face value of Rs. 1000 each. These shares were purchased by the assessee for Rs. 2,66,550. The company decided to redeem the preference share and the assessee received a sum of Rs.2,97,000 being the face value of the shares held by her, The value of shares received by the assessee exceeded the value by which she had purchased by Rs.30,450. The ITO held the differential amount as chargeable to tax *u/s* 45 of the Act. The assessee opposed the move of the Assessing Officer by contending that there was no 'transfer' within the meaning of section 2(47) and hence on the redemption of the preference shares, the profit ofRs.30,450 could not be said to have arisen from the transfer of the capital asset. The first and second appellate authorities accepted the Assessing Officer's view. The Hon'ble High Court also upheld the view point of the Assessing Officer. When the matter came up before the Hon'ble Supreme court, it was contended for the assessee that there was no question of applicability of section 45 as no "transfer" of the preference shares had taken place because of the redemption of the shares. Repelling this contention, the Hon'ble Apex Court held that the definition of "transfer" U/S 2(47) is not exhaustive but inclusive and further it does not refer only to 'sale'. Considering the other ingredients of clause (i) of section 2(47), being, 'exchange or relinquishment' of the assets also, the Hon'ble Supreme Court held that the redemption of preference shares by the company resulted into 'transfer' of such shares from the assessee to company by 'relinquishment'. It was held that the transaction also resulted in "sale", Resultantly the difference between the purchase price paid by the assessee and the price at which the shares were redeemed by the company, was held to be taxable as capital gain.

48.6. In the case of *Kartikeya V. Sarabhai (supra)* the assessee 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 reduction of the share capital 'of the company. This was done by reducing the face value of each share from Rs. 1,000 to Rs.500 by paying off Rs.500 in cash. Further reduction in the face value of the shares took place in the year in question. The company paid off Rs.450 per share which reduced its liability on the preference share from Rs. 500 to Rs.50 per share. The ITO formed the view that the sum of Rs.450 per share received by the assessee in the year was liable to capital gain tax. The assessee's contention that there was no 'transfer' within the meaning of section 2(47) did not find favour with him. The Hon'ble High Court held that the assessee made capital gain on reduction of preference share capital and the same was exigible to capital gain tax. It was contended on behalf of the assessee before the Hon'ble Supreme Court that there was no 'transfer' within the meaning of section 2(47) as the assessee continued to be shareholder of the company even after receipt of the amount. Rejecting this contention, the Hon'ble Summit Court observed that the reduction in the face value of shares amounted to 'extinguishment' within the meaning of section 2(47) and hence the amount received on such reduction was taxable as capital gain.

48.7. In the case of *G. Narasimhan (Decd) And Others (supra)* the assessee was a shareholder in a private company holding 70 shares with the face value of Rs. 1,000 each. The company passed resolution to reduce its capital. With that, the face value of shares in the company was reduced from Rs. 1,000 each to Rs.210 each. There was pro-rata distribution of some properties of the company and payment of money to the shareholders. When the matter finally reached the Hon'ble Supreme court, the question was raised as to whether the Tribunal was right in holding that no capital gain was assessable in the hands of the assessee as there was no extinguishment of any right of the assessee and consequently there was no transfer within the meaning of section 2(47) of the Act by the assessee of any capital asset. The Hon'ble Supreme Court considered the provisions of section 45(1) r.w.s. 2(47) and also section 2(22)(d) of the Act. It was observed that on the reduction in the face value of the share, the share capital stood reduced; the right of the shareholder to the dividends and his right to share in the distribution of the net assets upon liquidation was extinguished proportionately to the extent of reduction in the capital. In the facts of that case and in the light of question before the Hon’ble Supreme Court, it was noticed that there were two factors in the amount distributed to the assessee on reduction of the share capital, viz., distribution attributable to accumulated profits and distribution attributable to capital (except capitalized profit profit). It was finally held that to the extent of the accumulated profits in the hands of the company, the return to the assessee on reduction of his capital was taxable as dividend u/s 2(22)(d) and the balance as capital gain.

48.8. It can be easily noticed that in the cases of *Anarkali Sarabhai (supra)* and *Kartikeya V.Sarabhai (supra)* there was reduction in the face value of 'preference shares' from Rs. 1,000 to Nil and Rs. 1,000 to Rs.50 respectively. In *G .Narasimhan (Decd.) And Others (supra)* there was reduction in the face value of equity shares' and not the preference shares as was the case in other two cases. The fact that the case of *G. Narasimhan (Deed)* is based on 'equity shares' becomes amply clear when the judgment of the Hon'ble Supreme court is perused which does not use any prefix to the shares. The word "share" not preceded by the word "preference" makes it "equity". However the fact that the shares in the case of *G. Narasimhan* were 'equity shares' has been ably demonstrated on behalf of the assessee by placing on record a copy of the assessment order passed by the ITO dated 23.01.1968 in that case and also the Tribunal order, which in unequivocal terms, describes the shares as ' equity shares'. Thus it is manifest that the case of *G. Narasimhan* is based on the reduction in the face value of equity shares which has been held as "transfer" resulting into chargeability of tax U/S 45 of the Act.

48.9. Coming back to section 100 of the Companies Act it has been noticed above that clause (c) of section 100(1) deals with the reduction of capital by way of extinguishing or reducing liability on any of its shares by paying off any paid up share capital. All the three Supreme Court cases in *Anarkali Sarabhai (supra), Kartikeya V. Sarabhai (supra)* and *G. Narasimhan (Decd) (supra)* fall in clause (c) of section 100 in as much as the reduction in the share capital took place by way of paying off the paid up capital.

48.10. Section 100(l)(b) of the Companies Act deals with reduction in capital by cancelling any paid up capital which is lost or unrepresented by the available assets. It refers to a situation in which the company has accumulated losses over the period which has led to the eradication of the capital base. It is axiomatic that the profits increase the capital base and losses reduce it. Though the erosion in capital actually takes place as a result of losses, but the same gets reflected in the accounts by showing such losses as 'Fictitious asset' on the asset side of the balance sheet, thereby keeping the figure of ‘capital’ intact on the liability side. The amount of such loss can be removed from the asset side only when equal amount is withdrawn from the shareholders funds on the liability side. This reduction in the liability side may take place by cancelling the share capital and/or adjusting share premium account etc. so as to show the true and fair view.

48.11. Adverting to the facts of the instant case it is noticed that the reduction in the capital of TGL took place as per clause (b) of section 100 of the Companies Act. Special Resolution No.5 indicates that TGL was running into losses and had carried forward loss of Rs.42.96 crore. This loss was sought to be written off by reducing the paid up share capital to the extent of Rs.8.99 crore as per first Resolution and the balance sum of Rs.33.97 crore by utilizing the Share premium account of the company. After the High Court approving the Resolution passed by TGL in its Annual General Meeting, the brought forward loss of Rs.42.96 crore was written off with the share capital so reduced and the amount lying in the share premium account written off. Thus it can be seen that the reduction in the share capital in the instant case is covered u/s *100(1*)(b) of the Companies Act by which TGL cancelled its paid up share capital to the extent it was lost and was unrepresented by available assets.

48.12. As per the mandate of section 45(1) of the Act any profits or gains arising from the 'transfer' of a capital asset effected in the previous year shall, save as otherwise provided in certain sections, 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 takes place. The charge under this section is attracted when there is a "transfer" of a capital asset. The word "transfer" in relation to the capital asset has been defined u/s 2(47). This section has clauses (i) to (vi) and defines the word "transfer" in an inclusive manner. Clause (i) of section 2(47) explains transfer to mean "the sale, exchange or relinquishment of the asset" and clause (ii) refers to "the extinguishment of any rights therein". Other clauses of section 2(47) are not relevant in the facts and circumstances of the present case. A rapid look at the definition of word "transfer" u/s 2(47) makes it palpable that the charge *u/s* 45 is attracted not only on the 'sale' of a capital asset but also *inter alia* on 'exchange or relinquishment of the asset' or 'extinguishment of any rights in' the capital asset. Ordinarily the word "sale" implies that there is a transfer of property with consideration, which is normally money or its worth. The second ingredient of clause (i) of section 2(47) is "exchange", which takes place on the transfer of one property for another. The last element is "relinquishment", which takes place when the owner of the property pulls away from of the property in terms of ownership but such property continues to exist even after such pulling out. The Hon'ble Supreme court in the case of *CIT Vs. Rasiklal J Maneklal (HUF) {(1989) 177 ITR 198 (SC)}* has held that: "relinquishment takes place when the owner withdraws himself from the property and abandons his right thereto". Thus it can be seen that clause (i) of section 2(47) covering sale, exchange or relinquishment of capital asset contemplates the continuation of property even after transfer and it is only a matter of changing hands. Thus 'transfer' as per clause (i) pre-supposes the existence of property even after transfer.

48.13. Clause (ii) of section 2(47) refers to transfer by "extinguishment of any “rights therein". The Hon'ble Supreme Court in the case of *Vania Silk Mills (P.) Ltd {(1999) 191 ITR* 647 *(SC)}* considered the meaning of the phrase “extinguishment of any rights therein" in the context of section 2(47) and held that this expression would take the colour from associated words and will have to be restricted to the sense analogues to them. It was held that the expression "extinguishment of any rights therein" will have to be confined to the extinguishment of a right on account of transfer and cannot be extended to mean any extinguishment of rights independent of or otherwise than on account of transfer. This judgment rendered by two Hon'bIe Judges came up for consideration before a Larger Bench (of three Hon'ble Judges) of the Hon'ble Supreme Court in the case of *CIT Vs. Mrs. Grace Collis And Others {(200I) 2481TR* 323 *(SC)]*. In the later case of *Mrs. Grace Collis And Others,* the Hon'ble Supreme Court disapproved the judgment in *Vania Silk Mills P. Ltd* by holding that the expression "extinguishment of any rights therein" cannot be limited to such extinguishment on account of transfers. It was held that this expression would also extend to extinguishment of rights independent of or otherwise than on account of transfer. In this case it has been held that the rights of the assessee in the capital asset, being the shares in the amalgamating company stood extinguished upon the amalgamation of the amalgamating company with the amalgamated company and there was a transfer of shares in the amalgamating company within the meaning of section 2(47) of the Act.

48.14. Reverting to the facts of the instant case it is seen that by way of Step-I of the overall exercise, the reduction in the share capital of TGL took place in terms of section 100(l)(b) of the Companies Act by which the paid up value of equity shares of Rs. 10 was reduced to paid up value of Rs.5. There was extinguishment of the rights of the assessee in the shares at that stage. Going by the judgment in the case of M*rs. Grace Collis And Others (supra)* the transaction of reduction of capital fell within the domain of 'extinguishment of any rights therein' as per section 2(47)(ii) as such extinguishment of rights is otherwise than on account of transfer of shares. The same view follows when I examine the judgment of the Hon'ble Supreme Court in the case of *G. Narasimhan (Deed) (supra)* in which case also there was a reduction in the face value of equity shares and the Hon'ble Supreme Court held it to be transfer u/s 2(47) attracting capital gain. I, therefore, hold that 'transfer' of equity shares took place on the reduction of the share capital by TGL

II. CONSEQUENCES OF NIL FULL VALUE OF CONSIDERATION

49.1. The learned Departmental Representative contended that in this case the assessee did not receive any consideration from TGL on the reduction of capital. He submitted that in the absence of any consideration, the computation provision has failed. He relied on the judgment of the Hon'ble Supreme Court in the case of *B. C. Srinivasa Setty* [(1981) *128ITR* 294 *(SC)]* in which case it was held that where computation provision cannot apply at all, the case cannot fall within the charging section. The learned Departmental Representative stated that since there was no consideration received by the assessee against the reduction of share capital, the computation of capital gain became impossible and resultantly there could not have been any gain or loss from the reduction of capital. In tlle opposition, the learned Counsel for the assessee submitted that the judgment in the case of *B. C. Srinivasa Setty (supra)* is not applicable because in that case the cost of acquisition was not capable of ascertainment.

49.2. Having heard the rival submissions and perused the relevant material on record it is noted that the expression "profits or gains" as employed in section 45(1) gets its meaning from section 48, which in turn provides the mode of computation of income chargeable under the head 'Capital gains'. As per this section income chargeable under this head shall be computed by deducting – the expenditure incurred wholly and exclusively in connection with the transfer of a capital asset, the cost of acquisition of the asset and the cost of any improvement thereto – from the full value of the consideration received or accruing as a result of such transfer. In a nutshell, the value of following four ingredients is needed for computing capital gains u/s 45:-

(i) Full value of consideration
(ii) Cost of acquisition
(iii) Cost of improvement
(iv) Expenditure incurred in connection with transfer

49.3. In the instant case the cost of improvement and expenditure in connection with transfer is Nil and as such these two components are irrelevant, leaving with cost of acquisition and full value of consideration received or accruing as a result of transfer of the shares. There is no dispute on the aspect of cost of acquisition of 6737399 equity shares. The total investment made by the assessee in 1.34 crore equity shares of TGL was Rs.24.84 crore and half of the shares at 67.37 lakhs which have been transferred as a result of capital reduction have been assigned purchase cost of Rs.12.42 crore, being half of the total purchase cost. It has been indexed at Rs.22.21 crore. Thus the indexed cost of acquisition of the shares transferred by way of reduction of capital comes to Rs.22.21 crore. The manner of computing such indexed cost has been given on page 77 of the paper book. Neither the AO nor the learned CIT has disputed this figure. The full value of consideration has been shown as Nil because no amount was received by the assessee from TGL on reduction of capital. Resultantly, loss under the head 'Capital gains' was worked out at Rs.22.21 crore. The view point of the learned Departmental Representative is that since the full value of consideration is zero, section 48 cannot apply. The sum and substance of his submission is that as computation u/s 48 has become impossible because of Nil value of full value of consideration, there cannot 'be any income u/s 45 of the Act. The main reliance of the learned Departmental Representative in support of this proposition is on the judgment of the Hon'ble Supreme Court in *B. C. Srinivasa Setty (supra).* I shall examine the facts of this case. The assessee in that case did not disclose goodwill of the firm in its accounts. Subsequently the firm was dissolved and at that time the goodwill of the firm was valued at Rs.1,50,000. A new partnership by the same name was formed, which took over all assets including the goodwill and liabilities of the dissolved firm. The ITO made an assessment on the dissolved firm without including any amount on account of the gain arising on the transfer of the goodwill. The CIT, exercising his power U/S 263, directed the ITO to make a fresh assessment after taking into account the capital gain arising on the sale of goodwill. It was argued before the Tribunal that this transaction did not attract tax on capital gain u/s 45, which found favour with the Tribunal. The Hon'ble High Court also upheld the view taken by the Tribunal. The Revenue preferred appeal before the Hon'ble Supreme Court contending that section 45 was applicable. The Hon'ble Supreme Court noted that section 45 is a charging section and all transactions encompassed by section 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by section 45 to be the subject of the charge. If there is a case to which the computation provisions cannot apply at all, the Hon'ble Supreme Court held that such case could never be considered as intended to fall within the charging section. Thereafter it looked into the provisions of section 48 dealing with the mode of computation. It was observed that the income chargeable under the head shall be computed by deducting from the full value of consideration received, *inter alia,* the cost of acquisition of the capital asset. The Hon'ble Apex Court found that what is contemplated is an asset in the acquisition of which it is possible to envisage a cost and it should be an asset which possesses the inherent quality of being available to a person seeking to acquire it. Rejecting the contention raised on behalf of the the revenue, the Hon'ble Supreme Court held that : "None of the provisions pertaining to the head 'Capital gains' suggests that they include an asset in the acquisition of which *no cost at all can be conceived.* Yet there are assets which are acquired by way of production in which *no cost element can be indentified or envisaged."* It was further observed that goodwill denotes the benefit arising from connection and reputation. A variety of elements go into its making, and its composition varies in different trades and in different businesses in the same trade. Its value may fluctuate from one moment to another depending on changes in the reputation of the business. It is affected by everything relating to the business, the personality and business rectitude of the owners, the nature and character of the business, its name and reputation, its location etc. etc. Since goodwill is generated as the business is carried on and may be augmented with the passage of time, it is impossible to predicate the moment of its birth. It was, therefore, finally held that section 45 cannot apply because of the inapplicability of section 48(ii), being the impossibility to envisage its cost of acquisition of goodwill.

49.4. The view point of the learned Departmental Representative is that the computation provision u/s 48 shall fail to apply in the present case also for the reason that there is no full value of consideration as it was in the case of *B. C. Srinivasa Setty (supra)* where there was no cost of acquisition. Once computation provision u/s 48 ceases to be workable, the learned Departmental Representative submitted that there cannot be any question of profit or loss arising from the transfer of shares U/S 45(1).

49.5. There cannot be any doubt that if a computation provision cannot be applied, charging section shall also not be attracted. I have to test the applicability or inapplicability of section 48 in the present case. In the case of *B.*C. *Srinivasa Setty (supra)* it has been held that there cannot be any charge U/S 45 because section 48(ii) cannot be applied on account of cost of acquisition of goodwill becoming impossible to conceive or envisage. Goodwill is made over a period of time and it is not possible to ascertain with exactitude any particular sum leading to the generation of goodwill. Various factors over the time contribute to the making or *spoiling of go*odwill of a concern and one cannot attribute a specific amount going into the generation of goodwill. The principle, therefore, is that the cost of acquisition of goodwill is not capable of ascertainment and since such cost cannot be conceived, the prescription of section 48 fails. A line of distinction needs to be drawn between the cases in which the cost of acquisition or for that matter any other component of sec. 48 is incapable of ascertainment and the cases in which it is ascertained as zero. The judgment of the Hon'ble Supreme Court in *B C. Srinivasa Setty (supra)* applies with full force to the cases were either the cost of acquisition or any other component such as the full value of consideration cannot be ascertained. But where the value of each of the components is ascertainable but is Nil, the *ratio decidendi* of the decision becomes inapplicable. If this general presumption that in case the cost of acquisition or the value of any other variable is nil, section 48 can never apply is accepted, then the provisions of sec. 55(2)(a) shall become redundant. This provision provides that for the purposes of sections 48 and 49, cost of acquisition in relation to capital asset being goodwill of a business or a trademark or brand name associated with their business or a right to manufacture, produce or process any article or things etc. shall mean the amount of purchase price and where no purchase price has been paid it should be taken as Nil. On a look at the nature of capital assets referred to in section 55(2)(a), such as goodwill of business or trademark or brand name etc., it comes to notice that these are the capital assets which come into existence over a period and no particular cost can be directly identified with such capital assets, unless purchased. Despite the fact that it is not possible to envisage cost of such capital assets, the legislature has made it clear that on transfer of such capital assets, which were not purchased by the assessee from a previous owner, the cost of acquisition shall be taken as Nil and full value of consideration received on their transfer shall be considered for computing capital gains, Thus it can be seen that if a capital asset, whose cost *cannot be* identified or conceived due to the nature of such capital asset, its transfer does not lead to any profits or gain arising u/s 45(1) except where such capital asset is covered u/s 55(2), In this way, two categories of the capital assets become glaring. The first category in which the cost of acquisition cannot be conceived or envisaged, and the second category in which the cost of acquisition is Nil. Whereas the transfer of the first category of the capital assets would escape charge u/s 45(1), unless such asset is specifically covered U/S 55(2), the transfer of the second category of the capital assets would attract the applicability of section 45. When the judgment of the Hon'ble Supreme Court in *B. C. Srinivasa Setty (supra)* is considered in juxtaposition to section 55(2), the picture which clearly emerges is that section 45 is not attracted when it is not possible to conceive or envisage the cost of acquisition or full value of consideration etc., subject to the other provisions of this Chapter. The *ratio* of this judgment shall have no role to play or in other words charge u/s 45 shall be attracted in all other cases in which the cost of acquisition or full value of consideration etc. is conceivable or ascertainable but is Nil.

49.6. Adverting to the facts of the instant case it is noted that on the reduction of capital, TGL did not pay anything to the assessee. Thus the assessee received Nil consideration and it is not a case in which the full value of consideration is incapable of ascertainment. The full value of consideration is fully ascertained and identified as Nil. In that view of the matter I am of the considered opinion that the judgment of the Hon'ble Supreme Court in the case of *B. C. Srinivasa Setty (supra)* is not applicable to the facts of the instant case.

49.7. The other case which has been hotly discussed during the course of hearing is *CIT Vs. Mohanbhai Pamabhai* [(1973) 91 *ITR* 393 *(Guj.)]*. In this case the assessee and seven other persons carried on the business in partnership firm. There were disputes between partners of the firm and accordingly the assessee along with some other partners retired from the firm leaving other seven as continuing partners of the firm. The assessee received certain amount which included an amount representing the proportionate share in the value of the goodwill. The ITO took the view that the amount received by the assessee, to the extent it represented proportionate share in the value of goodwill, represented capital gain chargeable to tax u/s 45 of the Act. The Tribunal decided the issue in assessee's favour. When the matter came up before the Hon'ble High Court, two fold submissions were made on behalf of the assessee in support of its case, which have been discussed and adjudicated by the Hon'ble High Court as under.-

"So far as the second question is concerned, there were two contentions urged on behalf of the assessees in support of the decision of the Tribunal that the amount representing the proportionate share of each assessee in the value of the goodwill of the firm was not liable to be assessed to tax as capital gain. One contention was that the proportionate-share in the value of the goodwill was received by each assessee as part of the amount representing his share in the net partnership assets after deduction of liabilities and prior charges and this last amount having been received by him in satisfaction of his share in the partnership and not by way of consideration for transfer of his interest in the goodwill or other assets of the firm, there was no transfer of capital asset which would attract liability to capital gains tax. This contention was at no time urged before the revenue authorities or even before the Tribunal and it was raised for the first time at the hearing of the references before us, but since it does not involve a new question and represented merely a different aspect of the same question, we allowed the assessees to raise it and it must be said in fairness to the counsel for the revenue that he rightly did not contend that it should not be allowed to be raised.

The other contention urged on behalf of the assessees was that having regard to the scheme of the provisions relating to capital gains tax and particularly section 48, *clause (ii), the capital asset contemplated by section* 45 *is a capital asset, acquisition of which has cost something to the assessee in terms of money, and since goodwill of the firm in the present case admittedly cost nothing to the firm and its partners in terms of money, transfer of his interest in the goodwill by each of the assessees did not attract the charge of* capital *gains tax. Of these two contentions, the first is, in our opinion, well-founded while the second must be rejected Our reasons for saying so are as follows:"*
(Emphasis supplied by us)

It can be seen from the above para on page No.398 of the report that the assessee made dual submissions. The first that the value of goodwill received by the assessee represented the part of the amount of his share in the net partnership assets after deduction of liabilities etc. and it was not by way of consideration for transfer of his interest in the goodwill or other assets of the firm. The second that since the goodwill of the firm did not cost anything to the firm and hence the receipt by the assessee did not attract charge to the capital gain tax because there was no cost of acquisition. The Hon'ble High Court accepted the first contention and rejected the second. The main reasoning on which the Hon'ble High Court rendered its judgment in assessee's favour was by way of accepting the first contention that the value of goodwill received was his share in the value of the assets of the firm and not by way of transfer of goodwill. In order to support its conclusion based on the main reasoning, the Hon'ble High Court also gave ancillary reasoning by presuming that even if its main reasoning holding that there was no transfer was wrong and it was to be held that the transaction involved 'transfer', still the amount received by the assessee in respect of his share in the value of goodwill must beheld to be outside the pale of chargeability to capital gain tax. The reason given was that in order to attract the capital gain tax, there must be a transfer as a result of which consideration is received by or accrues to the assessee- and if there is no consideration received or accruing as a result of transfer, the machinery section enacted in section 48 would be inapplicable and it would not be possible to compute profits or gains arising from the transfer of capital asset. I am calling second reasoning as ancillary because in that case there was, in fact, some consideration received by the assessee for goodwill and was not a case of Nil consideration. It is settled legal position that the remarks of a Court must be viewed in the backdrop of the facts present before it. The observations of the Court deciding the controversy in the light of the prevailing facts constitute *ratio* dec*idendi* of the judgment, whereas the other observations which are de hors *the facts* or legal position under consideration, constitute only the passing remarks and are considered as *obiter dicta.* The character of binding precedent, subject to other conditions, is assigned only to the *ratio decidendi* and not the *obiter dicta* of a decision.

49.9. As the second contention raised on behalf of the assessee was rejected by the Hon'ble High Court and the decision was given in favour of the assessee on the first contention, the Revenue preferred appeal before the Hon'ble Supreme Court. In *Addl.C1T Vs. Mohanbhai Pamabhai* [(1987) *1651TR* 166 *(SC),* the judgment of the Hon'ble High Court has been affirmed by a brief judgment reading as under.-

"Having regard to the view taken by this court in *Sunil Siddharthbhai* v. *CIT and Karthikeya V.Sorabhat* v. *CIT* [(1985) 156 *ITR 509 (SC}), these appeals must be dismissed Accordingly, we dismiss these appeals. There is no order as to costs."*

49.10. From the above judgment it is manifest that the Hon'ble Supreme Court has upheld the High Court judgment by following its view in *Sunil Siddharthbhai (supra)* without making any discussion. I shall examine the factual matrix in the case of *Sunil Siddharthbhai.* The assessee in that case was a partner in a firm. As his contribution to the capital of the firm, he contributed certain shares of limited companies which were held by him as his capital assets. The book value of those shares in his account books was shown as Rs. 1,49,819. However, on the date when he contributed those shares to the partnership firm, he revalued the shares at the market value of Rs. 1,60,279 and credited the resulting difference of Rs. 10,460 to his capital account. The Income-tax Officer did not include such difference in the assessable income. The CIT, vide his order U/S 263, held that the difference between the market value of the shares and the cost of acquisition of the shares to the assessee should have been brought to tax as capital gains in view of section 45 of the Act. The Tribunal held that while the transaction did amount to a transfer within the meaning of clause (47) of section 2 of the Act, but it did not result in capital gains liable to tax. When the matter came up before the Hon'ble Supreme Court, it held that there was a transfer of the shares when the assessee made them over to the partnership firm as his capital contribution. It was noticed that position as subsisting before it was different from a situation when a partner receives his share on the dissolution of the firm. As that later situation did not result into transfer, it was held that no capital gain could arise. In recording this finding, the Hon'ble Supreme Court, *inter alia*, considered the judgment of the Hon'ble Gujarat High Court in CIT v. Mohanbhai Pamabhai (supra), which is evident from the following para of the judgment :-

"Learned counsel for the assessee has attempted to draw an analogy between the position arising when a personal asset is *brought by a partner into a partnership* as *his contribution to the partnership capital and that which arises when, on dissolution of the firm or on retirement, a share in the partnership assets passes to the erstwhile partner. It has been held by this court in CIT* v. *Dewas Cine Corporation [1968]* 68 *ITR 240 (SC) and the Gujarat High Court in CIT* v. *Mohanbhai Pamabhai [1973] 9i ITR 393, that when a partner retires or the partnership* is *dissolved, what the partner receives* is *his share in the partnership. What* is *contemplated here is a share of the partner qua the net assets of the partnership firm. On evaluation, that share in a particular case may be realised by the receipt of only one of all the assets. What happens here is that a shared interest in all the assets of the firm is replaced by an exclusive interest in an asset of equal value. That* is *why it has been held that there* is *no transfer. It* is *the realisation of a pre-existing right."*

49.11. Eventually in *Sunil Siddharthbhai (supra)* it was held that when a partner brings his personal asset into the partnership firm as his contribution to its capital, there is' transfer. But as the assessee received no consideration within the meaning of section 48 of the Income-tax Act, 1961, it was held that no profit or gain accrued to him for the purposes of section 45.

49.12. From the judgment of *Sunil Siddharthbhai (supra)* it is abundantly clear that the view of the Hon'ble Gujarat High Court in *Mohanbhai Pamabhai (supra), that when a partner receives anything from the firm either on its retirement or on* the dissolution, there is no transfer and the amount received cannot be charged to tax u/s 45, has been approved. Now eventually when the Hon'ble Supreme Court in the case of *Mohanbhai Pamabhai (supra)* dismissed the Departmental appeal by following its judgment in *Sunil Siddharthbhai (supra)*, which had already considered and approved the Gujarat High Court judgment in *Mohanbhai Pamabhai (supra)*, it simply approved the view of the Hon'ble High Court on the point that the amount received by the assessee by way of his share in the goodwill of the firm did not involve transfer and hence no capital gain was chargeable. It is only up to this extent that the judgment of the Hon'ble Gujarat High Court in *Mohanbhai Pamabhai (supra)* got approval from the Hon'ble Supreme Court. There is no discussion by the Hon'ble Supreme Court either in *Sunil Siddharthbhai (supra)* or *Mohanbhai Pamabhai (supra)* about the ancillary reasoning given by the Hon'ble High Court, which I have categorized above as o*biter dicta* of the judgment. By no stretch of imagination can it be said that the above discussed *obiter dicta* of the Hon'ble High Court also got the seal of approval from the Hon'ble Supreme Court, either expressly or by necessary implication.

49.13. The second contention for the assessee before the Hon'ble High Court in *Mohanbhai Pamabhai (supra)* that since goodwill did not cost anything to the firm and its partners in terms of money, transfer of interest in the goodwill by the assessee did not attract the charge of capital gains tax, was rejected by the Hon'ble Gujarat High Court. It is interesting to note that subsequently this very issue came up for consideration before the Hon'ble Supreme Court in *B.*C. *Srinivasa Setty* (supra) wherein the Department pressed into service the judgment of the Hon'ble Gujarat High Court in *Mohanbhai Pamabhai (supra)* in support of its stand. The Hon'ble Supreme Court in *B.C. Srinivasa Setty (supra)* held that as the cost of acquisition of goodwill was not capable of ascertainment, its transfer would not attract charge u/s 45. The view taken by the Hon'ble Gujarat High, Court in *Mohanbhai Pamabhai (supra)* to the extent of rejecting the assessee's contention, has been specifically overruled by the Hon'ble Supreme Court in the case of *B.C. Srinivasa Setty (supra).*

49.14. Thus it can be seen that the judgment of the Hon'ble Gujarat High Court in the case of *Mohanbhai Pamabhai (supra)* has been partly approved in *Sunil Siddharthbhai (supra)* and *Mohanbhai Pamabhai (supra)* and partly not approved by the Hon'ble Supreme Court *B.C.Srinivasa Setty (supra).* The only part of the judgment which has been approved is to the effect that on retirement or dissolution, what a partner receives is his share in the partnership and not any consideration for transferring his interest in the firm to continuing partners. Nothing more and nothing else than it can be construed as having been approved by the Hon'ble Supreme Court. The reliance of the learned Departmental Representative on the *obiter dicta* of the judgment of the Hon'ble High in *Mohanbhai Pamabhai (supra)* for the proposition that the absence of any consideration on the reduction of capital would make section 48 and resultantly sec. 45 inapplicable is therefore, not capable of acceptance. It is more so for the detailed discussion made by me in para 49.5 of this order.

49.15. Another case which has been debated during the course of hearing is *Bombay Burma Trading Corporation Ltd Vs. CIT* [(1998) 147 *Taxation 570 (Bom)]* in which the question whether the Tribunal was right in law in holding that where in a case of compulsory acquisition by Government without compensation no capital loss will arise, has been held to be not a referable question of law as the same being covered by the ratio of the decision of the Hon'ble Supreme Court in the case of *CIT Vs. B. C. Srinivasa Setty (supra).* An argument was put forth that in this case also no compensation was allowed by the Government on the compulsory acquisition and the capital loss was held to be not arising, in the instant case also since there is no consideration the provisions of section 45 shall not apply because of the inapplicability of section 48.

49.16. I am not convinced with this submission for the reason that in the case before the Hon'ble Bombay High Court, the assessee sought a direction to refer *inter alia* this question in addition to the questions already referred by the Tribunal u/s 256(2) of the Act. Sub-section (2) of section 256, at the material time, empowered the aggrieved party to approach the High Court against the refusal by the Tribunal to make a reference of a question to the Hon'ble High Court. Seen in this light of the fact that this judgment is simply an order u/s 256(2) refusing to allow the additional reference in the given circumstances, cannot be held as laying down a proposition of law. Be that as it may, there is no discussion worth the name about the facts of the case in this case and the notice of motion moved by the assessee seeking direction to refer the said question was rejected. From the question one can possibly infer either of the two situations, viz., first when no consideration was received by the assessee during the year in appeal against compulsory acquisition but was received in a late year and second when no consideration at all was received either in the year in appeal or thereafter. Going by the first situation when the assessee did not receive any compensation on the compulsory acquisition from the Government in the year under appeal, naturally the question of earning any income from transfer of such property cannot arise in such year. It may be a matter of time when the award is made and compensation is awarded in a later year. It is in this later year(s) that the income under the head 'Capital gains' shall arise. The second situation does not appear to be likely for the reason that the possibility of the Government acquiring property and not sanctioning any compensation at all, is not capable of acceptance. In view of these facts I am not persuaded to take this case as the authority for the proposition that if full value of consideration IS Nil, there cannot be any loss under the head capital gains.

49.17. From the above discussion it can be seen that the judgment in the case of *B. C. Srinivasa Setty (supra)* has laid down a principle that if cost of acquisition of a capital asset cannot be envisaged or is incapable of determination or is unascertainable, the provisions of section 45 shall not apply. What is true for cost of acquisition shall also be true for the full value of consideration as contended by the ld. DR and also for other components given in section 48. The two situations cannot be compared, viz., first in which cost of acquisition or full value of consideration etc. is incapable of ascertainment or cannot be envisaged and second, in which the cost of acquisition or full value of consideration etc. is Nil and there is no difficulty *in* finding out the zero value. Whereas the former situation will not result into any income u/s 45, the latter will lead to determination of the income chargeable under this head. Further it *is* beyond my comprehension as to how anyone can argue that if the full value of consideration is a minuscule part of the cost of acquisition there will arise loss under the head 'Capital gains'; but if it is Nil then there cannot be any loss. To put it simply the contention is that if a capital asset with cost of acquisition of Rs.100 is transferred for a full value of consideration of say Re. 1, there will be capital loss u/s 45 of Rs.99; but if nothing is realizable or the full value of consideration is Nil, the entire loss of Rs.100 would go out of reckoning. This proposition is totally absurd. It may happen that the outside liabilities of any company exceed the available assets. If such company goes into liquidation and only the outside liabilities are discharged to a particular extent leaving nothing for shareholder, can anyone say that the assessee who purchased the shares of the company has not incurred any loss u/s 45 simply for the reason that 'it is a case of total loss of the investment? In my considered opinion the answer to this question has to be given in negative alone. If in such situation the company in liquidation after discharge of the outside liabilities manages to pay, say Paisa **1**0 against the face value of share of Rs. 100, the shareholder suffers loss of Rs. 90 per share, which will be computed u/s 45. It cannot be contemplated that where the company could not pay even Paisa 10, the loss of Rs.100

as against Rs.99.90 in the earlier case, would assume a different character and lose the right to be computed u/s 45. In view of the foregoing discussion I am of the considered opinion that the sale consideration of Nil in this case is liable to be taken into consideration for the purposes of computing loss U/S 45 at Rs.22.21 crore.

49.18. My view can be supported from another angle also. The contention of the Id. DR is that since 'full value of consideration', which is an essential component of section 48 is Nil, the computation shall become impossible. If this interpretation is true for one component of sec. 48, then it shall also be true for the remaining three components as discussed in para 49.2 above. Proceeding with such interpretation, it would become essential that all the four components must be present in all circumstances in order to enable the computation of income under the head 'Capital gains'. If this logic is upheld then illogical results will follow. In several cases one can find that either there is no cost of improvement of a capital asset or no expenditure is incurred wholly and exclusively in connection with its transfer. Going by this interpretation, then in all such cases, the computation provision u/s 48 shall fail because of the lack of the presence of such component(s) and all the transfers shall escape chargeability u/s 45. It is simple and plain that it is not and can never be the intention of the legislature. The interpretation given by the Hon'ble Supreme Court to section 48 read with section 45 in *B.C. Srinivasa Setty (supra)* should be understood to the extent of impossibility to envisage or conceive the value of any of the components of section 48 so as to make it unworkable and not where it is ascertainable but is Nil. It cannot be understood to mean that if the value of any of these four factors is Nil, the computation provision shall fail and as such section 45 shall not apply.

IS THERE ANY LOSS TO ASSESSEE ON REDUCTION OF CAPITAL?

50.1. The learned Departmental Representative strongly argued that the capital reduction in the instant case should not be treated as causing loss to the assessee for the reason that there is no change of its right in the net assets of TGL pre and post reduction of capital. It was exemplified by stating that if TGL has net assets of Rs. 1,000 with pre-reduction equity share capital of 100 shares, the value of the right of each shareholder in the properties of the company shall remain same even in the post-reduction period as the entire equity share capital would proportionately come down leaving Rs. 1,000 untouched. He argued that an original shareholder holding 50 shares in company having right over Rs.500 of its net asset would have the same right even when total 100 equity shares are reduced to 50 and the shareholder holding 50 equity shares becomes shareholder of 25 equity shares. Drawing strength from this example, it was stated that there was no change in the net worth of the assessee's share in the net assets of TGL after reduction of capital. To buttress this view, he relied on the judgment of the Hon'ble Supreme Court in the case of *CIT Vs. Dalmia Investment Co. Ltd [(1964) 521TR* 567 *(SC)]* in which the assessee holding shares as stock-in-trade was allotted bonus shares in proportion to the original share. In that case it was held that the bonus shares be valued by spreading cost of old shares over old shares and new shares taken together as such shares would rank *pari passu.* It was explained by the ld. DR that the issuance of bonus shares does not lead to any income to the shareholder as net worth of the shareholder in the company remains the same pre and post issuance of bonus shares. Applying the same in the reverse direction, the learned Departmental Representative contended that if the issuance of further bonus shares does not attract any charge to tax on the ground that there was no net increase in the net worth of the shareholder, the reduction in the equity share also not leading to any depletion of the net worth should meet same fate. On this analogy it was argued that the reduction of capital should also not be construed as resulting into any loss to the assessee.

50.2. In so far as the question of determining income from asset is concerned, it depends upon the point as to whether such asset is held as 'stock in trade' or 'Investment'. Whereas income resulting from capital assets held as 'Investments' is taxable under the head 'Capital gains', the income resulting from the assets held as 'stock in trade' is taxable under the head 'Profits and gains of business or profession'. This is the reason for which the definition of 'Capital assets' given in section 2(14) excludes *inter alia,* stock in trade as per clause (i). The parameters for taxing the income under both the heads are different. As far as stock in trade is concerned, the income may arise from its transfer and also from its retention in terms of increase or decrease in its value as on the balance sheet date, when the assessee values its stock at Market price, which is one of the recognized methods. But income from ' capital assets' arises only on its transfer and not during its retention. It is so because of the wording of section 45(1), which clearly provides in the opening part, that any profits or gains arising from -the 'transfer' of a capital asset, shall subject to other provisions be chargeable to tax under this head. Same mandate is discernible from the later part of this provision, which stipulates that it “shall be deemed to be the income of the previous year in which transfer took place.” On the other hand income from the stock in trade arises when it is transferred or there is increase or reduction in the value of closing stock. When stock is valued at 'Market price' method, its value has to be reflected accordingly irrespective of the purchase price. In such a case there will arise business income if the value of stock in hand at the end of the year moves northwards and on the other hand, business loss if its value move southwards.

50.3. Coming to the income (which also includes loss) in respect of assets in the form of shares, it is found that the same arises from their transfer irrespective of *the* fact whether such shares are held as 'stock in trade', or 'investment'. But when the assessee is following Market price method of valuing the inventory, and such shares are held as stock in trade, there can be income from their retention, which will depend upon the going up or coming down of the market price of such shares as at the end of the year *vis-a-vis* the purchase price or its value in the opening stock, if these were purchased in an earlier year. However, there cannot be any income (neither positive nor negative) from retention of shares held as Investment, because of sec. 45, which provides that income shall arise only on the 'transfer' of capital asset. It thus follows that any increase or decrease in the market value of shares held as 'Investment' will not result into computation of any capital gain on mere retention. In other words, neither increase in the market value of shares held as investment shall generate capital gain nor its reduction shall result into loss under this head. To put it simply, the market value of shares has no role to play in the computation of capital gains so long as such shares are in holding and are not transferred. Any increase or decrease in the market value of such shares is a totally irrelevant consideration.

50.4. Returning to the present case, it is found as an undisputed fact that the assessee held the shares of TGL as Investment and not as stock in trade. The contention of the Id. DR that after the reduction of capital, the net worth per share shall proportionately go up and the assessee's interest in TGL shall remain unaffected on overall basis not resulting into loss at the time of reduction of capital, is devoid of merits. It is obvious that the reduction of capital has left the assessee with fifty per cent of its holding in terms of number of shares. On the other hand the increase in the book value of the remaining shares in holding has no effect since such remaining shares have not been sold by the assessee simultaneously so as to absorb the loss on account of reduction of capital. It has been seen above the increase in the market value of shares is of no consequence when these are held as investment, unless these are sold. Even if the market value of the share shoots up or crashes there cannot be any question of capital gain unless the shares held as investment are transferred.

50.5 The contention of the Id. DR, in simple words, is that albeit there is a transfer on reduction of capital, but no loss can result due to simultaneous equal increase in the book value of the remaining shares. If increase in the book value of the remaining shares is considered as a relevant factor to negate the loss on transfer due to reduction of capital, then every increase or decrease in the book value of the shares should also be considered as resulting into income or loss under the head 'Capital gains'. It is seen that the assessee's total investment in TGL, before reduction of capital, was Rs.24.84 crores. TGL had suffered losses over the period and as on the date of reduction of capital it had accumulated losses of Rs.42.96 crores which were written off out of capital reduction and share premium account. In that view of the matter, the assessee should have been allowed to compute loss under the head 'Capital gains' on every incurring of loss by TGL. The figures are apparent that assessee is holding around 75% of TGL's capital and the accumulated loss of TGL is almost double the amount of assessee's investment in its share capital. Obviously the contention of the Id. DR has no force as the increase or decrease in the book value of shares has nothing to do with income or loss under the head 'Capital gains'. The relevant criteria to produce income or loss under the head 'Capital gains' is transfer of capital asset, which has taken place in the present case due to reduction of TGL's capital. Neither any increase in the market price of shares, while in holding, results into any income nor the decrease in their market price results into loss.

50.6. Here is a case in which the share-holding of the assessee has come down by fifty per cent. If it had earlier 100 shares at its disposal for sale at any time, now it is left with only 50 shares. Its right over the 50 shares, which have been cancelled by the company, has come to a naught and it has resulted into transfer. Now after the reduction, it cannot go to market to sell 100 shares but has only 50 shares at its disposal. The capital asset to the extent of 50 equity shares has disappeared from his holding. The transaction of reduction into capital has come to an end, making the assessee poorer by 50 shares without any corresponding inflow of consideration. The increase in the book or market value of the remaining shares in hand is not determinative of the capital loss resulting from the transaction of transfer on reduction of capital, which got completed in the year in question. It would be altogether different transaction when remaining shares become subject matter of transfer. At that point of time the question of capital gain would arise by considering the market price of such shares *vis-a-vis* the cost of acquisition of the remaining shares. If the market price further goes up at the time of transfer of the remaining shares, there will result still higher income. But if unfortunately, say TGL's future has more adverse time in store and that the market price of its shares further plunges, the assessee will stand to lose at the time of the transfer of the remaining shares as well. In that case, the fact that on reduction of capital there was some increase in the book value of the remaining shares will not come to mitigate the loss to the assessee subsequently at the time of second transaction of transferring remaining shares. Conversely, if the market price' of the remaining shares goes up at the time of their transfer, it shall lead to higher amount of capital gain. But that event shall arise only at the second stage, that is, when the remaining shares are transferred. The favourable or adverse factors having bearing on the potential increase or reduction in the price of the remaining shares, cannot reduce the loss that has actually resulted to the assessee because of the first transaction, being the transfer on reduction of capital without any consideration. The proposition put forth by the learned Departmental Representative could have had some force if simultaneous with the reduction of the capital or immediately thereafter TGL had gone into liquidation, in which case the assessee would have realized the amount against its total shareholding from the company. In that case**,** both the transactions, namely the reduction of capital and transfer of the remaining shares, would have taken place in close proximity to each other. Still in that case, capital gain, if any, could have been considered from the second transaction, being the transfer of remaining shares, leaving the loss from the first transaction intact on capital reduction. Since TGL has not gone into liquidation and is an existing company and the assessee has neither realized its proportionate share in the assets of TGL nor the remaining fifty per cent shares have been transferred in the current year, there cannot be any question of considering the increase in book value or the probable higher market price of the remaining shares in TGL cutting out the loss arising at the time of reduction of share capital.

50.7. The Id. DR has focused his argument on the point that the value of the assessee's share in the net worth of TGL has remained same and as such there is no loss. It has been noticed above that it is the market price of the shares which matters at the time of transfer. The book value or the net worth of a company may not have any direct nexus with the market price of its shares. One can find innumerable cases in which the market price of a share may be much higher than its book value or vice *versa* and as such both the book value and market value need not necessarily follow the same course. Market price of a share depends upon variety of factors including the sentiment of market. Other things, including the book value, remaining the same, the market price of a share may zoom or dwindle intra-day or within the same settlement period. Given the same book value, the market price of the shares of two companies may be quite different intra industry or inter industries. It is thus vivid that the increased or reduced or static book value of the shares of a company has no relation either with its market price or computation of capital gain, either at the time of transfer on reduction of capital or when the remaining shares in possession are transferred. This contention raised on behalf of the Revenue is thus repelled.

50.8. Now I shall examine the facts of *Dalmia Investment Co. Ltd (supra),* which has been put forth as trump card of the Revenue. In that case the assessee was holding shares as stock-in-trade. It purchased some shares and was allotted equal number of bonus shares in the year 1945. In A.Y. 1949-50 it liquidated both the original as well as bonus shares. On the question of business income from this transaction, the Hon'ble Supreme Court held that the purchase cost of the original shares was to be spread over the original as well as the bonus shares and that was how the business income was to be determined. Thus it can be seen that this judgment is not applicable primarily for the reason that it was rendered in the context of shares which were held as stock-in-trade. The receipt of bonus shares improves the share holding and if the market price method of valuing stock is followed, there may arise income on account of receipt of such shares at the end of the year by valuing such shares simultaneously with the reduction in the market value of original shares. Presently the situation under consideration is the one in which the shares are investment. In such a case no income can arise at the time of receipt of bonus shares as the event resulting into capital gains can arise when capital asset is parted with and not when it is received. Secondly, the question before the Hon'ble Supreme Court was to find out the cost of the bonus shares for ascertaining the amount of business profit from the sale of such stock of shares at the time of their sale. One most important factor to be noted is that this judgment was rendered under the Indian Income-tax Act, 1922 and now it is the regime of the Income-tax Act, 1961 and the assessment year under consideration is 2002-03. Position under the 1961 Act is quite different inasmuch as specific provision has been incorporated to deal with the question of cost of acquisition of bonus shares and right shares in section 55(2) for the purposes of sec. 45. Clause (aa) of subsection (2) of section 55 clearly provides that in a case where, by virtue of holding a capital asset, being a share or any other security, the assessee becomes (A) entitled to subscribe to any additional financial asset (i.e. right shares) or (B) is allotted any additional financial asset without any payment (i.e. bonus shares), then the cost of acquisition for the purposes of secs 48 and 49 shall (i) in relation to the original shares, on the basis of which the assessee becomes entitled to any additional financial asset, means the amount actually paid for acquiring the original financial asset; (iii) in relation to the financial asset to which the assessee has subscribed on the basis of the said entitlement (i.e. right shares) , means the amount actually paid by him for acquiring such asset ; (iiia) in relation to the financial asset allotted to the assessee without any payment and on the basis of holding of any other financial asset (i.e. bonus shares), shall be taken to be nil. It is, therefore, obvious that under the Act, the cost of acquisition of the original shares remains at the amount actually paid for acquiring such shares and the issuance of bonus shares does not result into spreading over the cost of original shares over the original plus bonus shares. In such a situation the cost of bonus shares becomes nil. When the shareholder goes to sell the original shares, the total cost spent at the time of acquiring such shares shall be considered as its cost of acquisition and there will not be any question of spreading it over the bonus shares as well. Similarly when he transfers the bonus shares, either with or without as also before or after the original shares, the cost of acquisition of bonus shares shall be nil. If the receipt of bonus shares does not lead to reduction in the cost of original shares under the 1961 Act relevant to the assessment year under consideration, how the reduction in the capital, which is a reverse proposition of bonus shares, can go to increase the cost of the remaining shares. If I accept the contention of the ld. DR that on the issuance of bonus shares, the original cost has to be spread over the original and bonus shares, then unintended consequences will follow. At the time of transfer of original shares, their cost of acquisition shall get reduced as contended by the ld. DR, but when the bonus shares are transferred, the cost of acquisition shall become Nil as per section 55(2). Obviously it cannot be the case. As such it is clear that the judgment in the case of *Dalmia Investment (supra)* is not applicable to the present case. Similar is the position regarding the reliance of the Id. DR on another judgment of the Hon'ble Supreme Court in the case of *Miss Dhun Dadabhoy Kapadia Vs CIT [(1967) 63lTR* 651 *(SC)}* which has also been rendered in relation to the A.Y. 1957-58. This judgement is also not applicable to the present case as having been given under the old Act.

50.9. Once a capital asset is transferred, the natural consequence which follows is that there is either gain or loss unless full value of consideration equals the cost of acquisition. As the reduction of capital has been held to result into 'transfer', the excess of cost of acquisition of such shares over the full value of consideration will lead to loss. For the foregoing reasons I am not inclined to accept this contention raised on behalf of the Revenue. Thus it is held that the reduction of capital by TGL has caused loss to the assessee in terms of sec. 45.

IV. IS ASSESSEE DERIVING DOUBLE ADVANTAGE?

51.1. The learned Departmental Representative also submitted that the assessee was trying to draw a double advantage, firstly, by showing loss in the instant year with the purchase cost of Rs.12.42 crore as relatable to 50% of the purchase cost of its reduced shareholding and thereafter again when it would sell the remaining 50%, it will consider the purchase cost at full value of Rs.24.84 crore. In order to strengthen this view he relied on section 55(2)(iv). In the opposition, the learned Counsel for the assessee contended that the balance sheet of the assessee for the year in question, copy placed at page 75 of the paper book, clearly demonstrates that the value of Investment together with the number of shares in the preceding year i.e. pre-reduction period has been reduced by the assessee-company in the current year i.e. post-reduction period both in terms of number of shares and value. It was argued that simultaneous with the claiming of loss, the assessee has itself reduced its value of investment and number of shares in its balance sheet and such reduced value shall constitute the purchase cost of the remaining shares:

51.2 A bare perusal of the balance sheet of the assessee indicates that the shareholding of the company along with the purchase cost has been reduced by the assessee to 50% post-reduction in the share capital of TGL. Whereas on 31.3.2001 the assessee had shown 1,34,74,799 shares in TGL valued at Rs.24.48 crore, in the year ending as on 31.3.2002 the number of shares have been shown at 67,37,399 with the figure of Investment at Rs.12.42 crore. Having reduced the figure of investments in the remaining shares to one half, there should not be any apprehension of the assessee adopting purchase cost of remaining 67,37,399 shares at Rs.24.84 crore in the subsequent years when such shares undergo transfer.

51.3. Further the reliance by the learned Departmental Representative on section 55(2)(b)(v) is not applicable in the instant case. As I have noticed above that TGL not only reduced the subscribed/paid up value of Rs. 10 each to Rs.5 each by step-I, but also forth with upon such reduction taking effect, consolidated 2 equity shares of Rs.10 each (Rs.5 each paid up), into 1 equity shares ofRs.1O each fully paid up under step-2. It is only step-l which has resulted into capital reduction thereby involving transfer u/s 2(47) of the Act. The second step involving consolidation of 2 equity shares into one equity share is tax neutral. The consolidation of capital asset from one denomination to other denomination does not result into any capital gain. I have noticed above that reduction of capital is covered u/s 100 of the Companies Act. Consolidation of the share capital into shares of larger amount is subject matter of section 94 of the Companies Act. Further sub-section (3) of section 94 of the Companies Act specifically provides that a cancellation of shares in pursuance of this section shall not be deemed to be a reduction of share capital within the meaning of this Act. It is thus obvious that consolidation of shares does not amount to reduction of capital.

51.4. Now I shall take up the contention of the learned Departmental Representative about section 55(2)(b)(v) which reads as under:

"Section 55

(2) For the purposes of sections 48 *and* 49, *"cost of acquisition"—*

……..

(b) in relation to any other capital asset,-

………

(v) *where the capital asset, being a share or a stock of a company became the property of the assessee on—*

(a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares, means the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived."

51.5. A perfunctory look at this provision divulges that where the shares of a company are consolidated into shares of larger amount than the existing shares, the cost of acquisition of the consolidated shares shall mean the cost of acquisition of the shares which have been so consolidated. From the above provision it is abundantly clear that the act of consolidation in itself does not amount to transfer and that is why the cost of acquisition of the consolidated shares is taken with reference to the cost of acquisition of the shares which have been consolidated. This section gets attracted when the consolidated shares become subject matter of transfer and at that stage the question of computation of the cost of acquisition of such consolidated shares arises, which has been addressed to by providing that the cost of such consolidated shares shall be the cost of acquisition of the shares which have been consolidated. This section nowhere provides that if before consolidation some shares have been transferred, the cost of such transferred shares shall also continue to be included in the shares not transferred. It is natural that when on the transfer of such shares, the proportionate cost has been taken into consideration for computing capital gain on their transfer, that cost shall cease to be available with the assessee for the remaining shares. Reverting to the facts of instant case it is clear that reduction has taken place in the paid up value of equity shares before consolidation and this reduction has resulted into transfer of share capital. It is but natural that on such transfer of the shares, the proportionate part from the total cost was sliced away. It is only the remaining cost of the shares in the hands of the assessee which shall continue to be the purchase price of the consolidated shares. Going by the prescription of section 55(2)(b)(v), the cost of acquisition of the consolidated 6737399 shares shall be Rs.12.42 crore.

51.6. I, therefore, hold that the assessee cannot derive double advantage by firstly claiming deduction of Rs.12.42 crore at the stage of reduction of share capital and again assuming the cost of acquisition of the remaining shares at the full value of Rs.24.84 crore. The cost of acquisition of the remaining consolidated shares in TGL shall stand reduced u/s55(2)(b)(v) to Rs.12.42 crore.

52. Coming back to section 45(1) which is charging section for the income under the head .Capital gains', it can be seen that the charge is attracted when any profit or gain arises from the transfer of a capital asset effected in the previous year subject to the fulfillment of other conditions. It is patent that all the relevant conditions for the applicability of section 45(1) are fulfilled inasmuch as there is (a) "transfer" (on reduction of capital by TGL - As per discussion in paras 48.1 to 48.14); (b) of capital asset (equity shares which have been cancelled by TGL); (c) resulting into profits or gains (that is full value of consideration at Nil as reduced by the indexed cost of acquisition at Rs.22.21 crore - As per paras 50.1 to 50.9).

It can be seen from the orders of the authorities below that the only reason assigned by them for not allowing the capital loss of Rs.22.21 crore in this case is the reduction of share capital of TGL did not amount to "transfer of the capital asset”. There is no finding given by the authorities that section 45 is not applicable for the reason that the full value of the consideration is Nil. In order to provide completeness to the issue, apart from examining as to whether or not there is any transfer on reduction, I have dealt with all other relevant aspects germane to the issue, which have been argued before the Bench.

54. I, therefore, hold that the learned CIT(A) was not justified in refusing to deny the long term capital loss amounting to Rs.22.21 crore. The question before the Special

Bench is, therefore, answered in negative and in favour of the assessee. Consequently two grounds raised on this issue are allowed.

55. In the result, the appeal is allowed

Order pronounced in the open Court on this 30th day of September, 2011.

Sd/

(R. S. Syal)

Accountant Member