2025 INSC 38

REPORTABLE

IN THE SUPREME COURT OF INDIA

EXTRAORDINARY APPELLATE JURISDICTION

SPECIAL LEAVE PETITION NO. 63 OF 2025
(Arising out of Diary No. 39934 of 2024)

PRINCIPAL COMMISSIONER OF INCOME TAX-4 & ANR. **....PETITIONER(S)**

VERSUS

M/S. JUPITER CAPITAL PVT. LTD. **....RESPONDENT(S)**

O R D E R

1. Delay condoned.
2. This petition is at the instance of the Revenue, seeking leave to appeal against the judgement and order dated 20.02.2023 passed by the High Court of Karnataka at Bengaluru in Income Tax Appeal (ITA) No. 299 of 2019 by which the appeal filed by the Revenue against the judgement and order passed by the ITAT Bengaluru came to be dismissed and thereby the judgement and order passed by the ITAT came to be affirmed.
3. The appeal was admitted by the High Court on the following substantial question of law:

> *"Whether on the facts and circumstances of the case, the Tribunal is right in law in setting aside the disallowance of capital loss claimed by the assessee of Rs.164,48,55,840/- by holding that there is extinguishment of rights of 153340900 shares when no such extinguishment of rights is made out by*

the assessee as required under section 2(47) of the Act and there is no reduction in the face value of share."

4. It appears from the materials on record that the respondent-assessee is a company engaged in the business of investing in shares, leasing, financing and money lending. The assessee had made an investment in Asianet News Network Pvt. Ltd., an Indian company engaged in the business of telecasting news, by purchasing 14,95,44,130 shares having face value of Rs 10/- each. Thereafter, the assessee purchased 38,06,758 shares from other parties, thereby increasing its shareholding to 15,33,40,900 shares which constituted 99.88% of the total number of shares of the company, i.e., 15,35,05,750.

5. The said company incurred losses, as a result of which the net worth of the company got eroded. Subsequently, the company filed a petition before the Bombay High Court for reduction of its share capital to set off the loss against the paid-up equity share capital. The High Court ordered for a reduction in the share capital of the company from 15,35,05,750 shares to 10,000 shares. Consequently, the share of the assessee was reduced proportionately from 15,33,40,900 shares to 9,988 shares. However, the face value of shares remained the same at Rs. 10 even after the reduction in the share capital. The High Court also directed the company for payment of Rs. 3,17,83,474/- to the assessee as a consideration.

6. During the year, the assessee claimed long term capital loss accrued on the reduction in share capital from the sale of shares of such company. However, the Assessing Officer while disagreeing with the assessee's claim held that reduction in shares of the subsidiary company did not result in the transfer of a capital asset as envisaged in Section 2(47) of the Income Tax Act, 1961. The Assessing Officer took the view that although the number of shares got reduced by virtue of reduction in share capital of the company, yet the face value of each share as well as shareholding pattern remained the same. The relevant observations from the assessment order are extracted hereinbelow:

> *"10. [...] However, the question of extinguishment of rights with relation to the shareholders does not arise. It was only reduction of shares by way of extinguishing the number of shares and not extinguishing the rights of the shareholders. For the reason that the word "extinguished" is mentioned in the Petition or the Court Order, it does not amount to translate the meaning of the word "extinguishment of rights" as per section 2(47) of the Act.*
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> *xxx xxx xxx*
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> *Extinguishment of Rights would mean that the assessee has parted with those shares or sold off those shares to a second party. Here, the assessee has not sold off any shares or has not parted with the shares as the it still holds the proportionate percentage which he initially held is still shown as an investment."*

7. In appeal the CIT(A) *vide* order dated 14.12.2017 while distinguishing the facts of the present case from those involved in the decision of this Court

in ***Kartikeya V. Sarabhai v. Commissioner of Income Tax*** reported in (1997) 7 SCC 524 held that any extinguishment of rights would involve parting the sale of percentage of shares to another party or divesting rights therein. The relevant observations made by the CIT(A) are reproduced as follows:

> *"6.6(ii) The factual position of and the applicability of the judicial decisions in the present case, clearly reveals that the Assessee's claim of capital loss, is not acceptable in view of certain crucial questions, emerging for consideration in the present case. The AO has analysed the Assessee's shareholding pattern, in the impugned order, which has been perused. A comparative-analysis of the opening / closing balances of ANNPL shares and the consequent reduction in numbers / face value and the percentage ratio of share-holding, reveals a clear position that there was no effective transfer, resulting in Long Term Capital Loss…*
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> *(iii) [...] It clearly emerges, that there was no effective transfer, which could result in any real Long Term Capital Loss as claimed by the appellant in the present case. It transpires that the appellant company invested in total equity share of Rs. 153340900/- at face value of (Rs. 10) on different dates, in its subsidiary company (ANNPL). The total number of shares of ANNPL was 153505750 out of which the assessee's shareholding was 99.88%. Pursuant to the share reduction scheme there was reduction in share capital of ANNPL from 153340900 to 10000 and thus the shares of the Assessee were reduced from 153505750 to 9988. The face value of the shares-reduced remained unchanged at Rs. 10, even after the reduction. The shareholding ratio of the assessee company also remained constant even after implementation of the share-reduction scheme. This percentage continued to be at the previous shareholding figures of 99.88%."*

8. However, the ITAT reversed the order passed by the CIT(A) and allowed the appeal filed by the assessee observing that the decision of this Court in ***Kartikeya V. Sarabhai*** *(supra)* is squarely applicable to the facts of the present case. The relevant observations from the order of the ITAT order are extracted hereinbelow:

> *"6. [...] In the present case, the face value per share remains same i.e. Rs. 10 per share before reduction of share capital and after reduction of share capital but the total number of shares has been reduced from 153505750 to 10000 and out of this, the present assessee was holding prior to reduction 153340900 shares and after reduction 9988 shares. In addition to this reduction in number of shares held by the assessee company in ANNPL, the assessee received an amount of Rs. 3,17,83,474/- from ANNPL. Hence it is seen that in the facts of present case, on account of reduction in number of shares held by the assessee company in ANNPL, the assessee has extinguished its right of 153340900 shares and in lieu thereof, the assessee received 9988 shares at Rs. 10/- each along with an amount of Rs. 3,17,83,474/. As per this judgment of Hon'ble Apex Court rendered in the case of Kartikeya V. Sarabhai Vs. CIT (supra), there is no reference to the percentage of share holding prior to reduction of share capital and after reduction of share capital and hence, in our considered opinion, the basis adopted by the CIT(A) to hold that this judgment of Hon'ble Apex Court is, not applicable in the present case is not proper and in our considered opinion, this is not proper. In our considered opinion, in the facts of present case, this judgment of Hon'ble Apex Court is squarely applicable and by respectfully following this judgment of Hon'ble Apex Court, we hold that the assessee's claim for capital loss on account of reduction in share capital in ANNPL is allowable. We hold accordingly."*

9. The Revenue went in appeal before the High Court. The High Court while dismissing the appeal filed by the Revenue and affirming the order passed by the ITAT observed in para 8 as under:

> *"Undisputed facts are, pursuant to the order passed by the High Court of Bombay, number of shares has been reduced to 9988. It is significant to note that the face value of the share has remained same at Rs. 10/- even after the reduction. The AO's view that the voting power has not changed as the percentage of assessee's share of 99.88% has remained unchanged is untenable because if the shares are transferred at face value, the redeemable value would be Rs.99,880/- whereas the value of 14,95,44,130 number of shares would have been Rs.1,49,54,41,300/-. In our considered view, the ITAT has rightly followed authority in Kartikeya V. Sarabhai v. The Commissioner of Income Tax : 1998 2 ITR 163 SC with regard to meaning of transfer by holding that there was no transfer within the meaning of that expression contained in Section 2(47) of the Income Tax Act, 1961."*

10. Having heard Mr. N. Venkataraman, learned ASG appearing for the Revenue, and having gone through the materials on record, we are of the view that no error, not to speak of any error of law, could be said to have been committed by the High Court in passing the impugned order.

11. Whether reduction of capital amounts to transfer is no longer *res integra* in view of the decision of this Court in ***Kartikeya V. Sarabhai*** *(supra)* wherein this Court while elaborating upon Sections 2(47) and 45 of the Income Tax Act, 1961 respectively observed as under:

> *"**9.** It is not possible to accept the contention of Shri Ganesh, learned counsel that reduction does not amount to a transfer of the capital asset. Section 2(47) of the Act reads as follows:*

"2. (47) 'transfer' in relation to a capital asset, includes,

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade or a business carried on by him, such conversion or treatment; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in Section 53-A of the Transfer of Property Act, 1882 (4 of 1882); or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a cooperative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

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

10. *Section 45 of the Act reads as follows:*

"45. Capital gains.—(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 53, 54, 54-B, 54-D, 54-E, 54-F and 54-G, be chargeable to income tax under the head 'Capital gains' and shall be deemed to be the income of the previous year in which the transfer took place."

11. *Section 2(47) which is an inclusive definition, inter alia, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. While, it is no doubt true that the appellant continues to remain a shareholder of the company even with the reduction of share capital but it is not possible to accept the contention that there has been no extinguishment of any part of his right*

as a shareholder qua the company. It is not necessary that for a capital gain to arise there must be sale of a capital asset. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Act. Relinquishment of the asset or the extinguishment of any right in it, which may not amount to sale, can also be considered as a transfer and any profit or gain which arises from the transfer of a capital asset is liable to be taxed under Section 45 of the Act.

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

13. *The Gujarat High Court had in another case reported as Anarkali Sarabhai v. CIT [(1982) 138 ITR 437 (Guj)] followed the judgment under appeal. That was a case where there had been redemption of preference share capital by the company and money was paid to the shareholders. It was held therein that difference between the face value received by the shareholder and the price paid for preference shares was exigible to capital gains tax. In coming to this conclusion, the Gujarat High Court had followed the judgment under appeal in the present case.*

14. *The aforesaid decision of the Gujarat High Court in Anarkali case [(1982) 138 ITR 437 (Guj)] was challenged and this Court in Anarkali Sarabhai v. CIT [(1997) 3 SCC 238 : (1997) 224 ITR 422] upheld the High Court's decision. It had been contended in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] on behalf of the assessee that reduction of preference shares was not a sale or relinquishment of asset and, therefore, no capital gains tax was payable. Repelling*

this contention, this Court considered the definition of the word "transfer" occurring in Section 2(47) of the Act and reading the same along with Section 45, it came to the conclusion that when a preference share is redeemed by a company, what the shareholder does in effect is to sell the share to the company. The company redeems its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. It was observed that in effect the company buys back the preference shares from the shareholders. Further, referring to the provisions of the Companies Act, it held that the reduction of preference shares by a company was a sale and would squarely come within the phrase "sale, exchange or relinquishment" of an asset under Section 2(47) of the Act. It was also held that the definition of the word "transfer" under Section 2(47) of the Act was not an exhaustive definition and that sub-section (I) of clause (47) of Section 2 implies that parting with any capital asset for gain would be taxable under Section 45 of the Act. In this connection, it was noted that when preference shares are redeemed by the company, the shareholder has to abandon or surrender the shares, in order to get the amount of money in lieu thereof.

15. *In our opinion, the aforesaid decision of this Court in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] is applicable in the instant case. The only difference in the present case and Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] is that whereas in Anarkali case [(1997) 3 SCC 238 : (1997) 224 ITR 422] preference shares were redeemed in entirety, in the present case, there has been a reduction in the share capital inasmuch as the company had redeemed its preference shares of Rs 500 to the extent of Rs 450 per share. The liability of the company in respect of the preference share which was previously to the extent of Rs 500 now stood reduced to Rs 50 per share."*

12. The following principles are discernible from the aforesaid decision of this Court:

a. Section 2(47) of the Income Tax Act, 1961, which is an inclusive definition, *inter alia*, provides that relinquishment of an asset or extinguishment of any right therein amounts to a transfer of a capital asset. While the taxpayer continues to remain a shareholder of the company even with the reduction of share capital, it could not be accepted that there was no extinguishment of any part of his right as a shareholder *qua* the company.

b. A company under Section 66 of the Companies Act, 2013 has a right to reduce the share capital and one of the modes which could be adopted is to reduce the face value of the preference share.

c. When as a result of the reducing of the face value of the share, the share capital is reduced, the right of the preference shareholder to the dividend or his share capital and the right to share in the distribution of the net assets upon liquidation is extinguished proportionately to the extent of reduction in the capital. Such a reduction of the right of the capital asset clearly amounts to a transfer within the meaning of section 2(47) of the Income Tax Act, 1961.

13. As observed in ***Commissioner of Income Tax v. Vania Silk Mills (P.) Ltd.*** reported in (1977) 107 ITR 300 (Guj), the expression "extinguishment of any right therein" is of wide import. It covers every possible transaction which results in the destruction, annihilation, extinction, termination, cessation or cancellation, by satisfaction or otherwise, of all or any of the

bundle of rights - qualitative or quantitative - which the assessee has in a capital asset, whether such asset is corporeal or incorporeal.

14. In the present case, the face value per share has remained the same before the reduction of share capital and after the reduction of share capital. However, as the total number of shares have been reduced from 15,35,05,750 to 10,000 and out of this the assessee was holding 15,33,40,900 shares prior to reduction and 9988 shares after reduction, it can be said that on account of reduction in the number of shares held by the assessee in the company, the assessee has extinguished its right of 15,33,40,900 shares, and in lieu thereof, the assessee received 9988 shares at Rs. 10 each along with an amount of Rs. 3,17,83,474. This Court in the case of ***Kartikeya V. Sarabhai*** *(supra)* has not made any reference to the percentage of shareholding prior to reduction of share capital and after reduction of share capital.

15. This Court in the case of ***Kartikeya V. Sarabhai*** (supra) observed that reduction of right in a capital asset would amount to 'transfer' under Section 2(47) of the Act, 1961. Sale is only one of the modes of transfer envisaged by Section 2(47) of the Income Tax Act, 1961. Relinquishment of any rights in it, which may not amount to sale, can also be considered as transfer and any profit or gain which arises from the transfer of such capital asset is taxable under Section 45 of the Income Tax Act, 1961.

16. A Division Bench of the Gujarat High Court in the case of ***Commissioner of Income-Tax v. Jaykrishna Harivallabhdas*** reported in (1998) 231 ITR 108 further clarified that receipt of some consideration in lieu of the extinguishment of rights is not a condition precedent for the computation of capital gains as envisaged under Section 48 of the Income Tax Act, 1961. The relevant observations made by the High Court are reproduced hereinbelow:

> *28. The contention that this provision should apply to actual receipts only also cannot be accepted for yet another reason, because acceptance of that would lead to an incongruous and anomalous result as will be seen presently. The acceptance of this view would mean whereas even in a case where a sum is received, howsoever negligible or insignificant it may be, it would result in the computation of capital gains or loss, as the case may be, but in a case where nothing is disbursed on liquidation of a company the extinction of rights, would result in total loss with no consequence. That is to say on receipt of some cost, however insignificant it may be, the entire gamut of computing capital gains for the purpose of computing under the head "Capital gains" is to be gone into, computing income under the head "Capital gains", and loss will be treated under the provisions of Act, but where there is nil receipt of the capital, the entire extinguishment of rights has to be written off, without treating under the Act as a loss resulting from computation of capital gains. The suggested interpretation leads to such incongruous result and ought to be avoided, if it does not militate in any manner against object of the provision and unless it is not reasonably possible to reach that conclusion. As discussed above, once a conclusion is reached that extinguishment of rights in shares on liquidation of a company is deemed to be transfer for operation of section 46(2) read with section 48, it is reasonable to carry that legal fiction to its logical conclusion to make it applicable in all cases of extinguishment of such rights, whether as a result of some receipt or nil receipt, so as to treat the subjects without discrimination. Where there*

does not appear to be ground for such different treatment the Legislature cannot be presumed to have made deeming provision to bring about such anomalous result.

(Emphasis supplied)

17. This Court in the case of ***Anarkali Sarabhai v. CIT*** reported in (1997) 3 SCC 238 observed that the reduction of share capital or redemption of shares is an exception to the rule contained in Section 77(1) of the Companies Act, 1956 that no company limited by shares shall have the power to buy its own shares. In other words, the Court held that both reduction of share capital and redemption of shares involve the purchase of its own shares by the company and hence will be included within the meaning of transfer under Section 2(47) of the Income Tax Act, 1961. The relevant observations are reproduced hereinbelow:

"21. The Bombay High Court in Sath Gwaldas Mathuradas Mohata Trust v. CIT [(1987) 165 ITR 620 (Bom)] dealt with the question which has now arisen in this case. There the question was whether the amount received by the assessee on redemption of preference shares was liable to tax under the head "capital gains". After referring to the meaning given to "transfer" by Section 2(47) of the Income Tax Act, the Court held:

"Here, a regular 'sale' itself has taken place. That is the ordinary concept of transfer. The company paid the price for the redemption of the shares out of its fund to the assessee and the transaction was clearly a purchase. As rightly observed by the Tribunal, if the company had purchased a valuable right, the assessee had sold a valuable right. 'Relinquishment' and 'extinguishment' which are not in the normal concept of transfer but are included in the definition by the extended meaning attached to the word are also attracted in the transaction. The shares were assets

and they were relinquished by the assessee and thus relinquishment of assets did take place. The assessee by virtue of his being a holder of redeemable cumulative preference shares had a right in the profits of the company, if and when made, at a fixed rate of percentage. Quite obviously, this was a valuable right and this right had come to an end by the company's redemption of shares. Thus, the transaction also amounted to 'extinguishment' of right. Under the circumstances, viewed from any angle, there is no escape from the conclusion that Section 2(47) was attracted and that the amount of Rs 50,000 received by the assessee was liable to be taxed under the head 'Capital gains'. "

22. The view taken by the Bombay High Court accords with the view taken by the Gujarat High Court in the judgment under appeal. In the judgment under appeal, it was pointed out that the genesis of reduction or redemption of capital both involved a return of capital by the company. The reduction of share capital or redemption of shares is an exception to the rule contained in Section 77(1) that no company limited by shares shall have the power to buy its own shares. When it redeems its preference shares, what in effect and substance it does is to purchase preference shares. Reliance was placed on the passage from Buckley on the Companies Acts, 14th Edn., Vol. I, at p. 181:

"Every return of capital, whether to all shareholders or to one, is pro tanto a purchase of the shareholder's rights. It is illegal as a reduction of capital, unless it be made under the statutory authority, but in the latter case is perfectly valid."

(Emphasis supplied)

18. In view of the aforesaid, we are of the view that the reduction in share capital of the subsidiary company and subsequent proportionate reduction in the shareholding of the assessee would be squarely covered within the ambit of the expression "sale, exchange or relinquishment of the asset" used in Section 2(47) the Income Tax Act, 1961.

19.As a result, this petition fails and is hereby dismissed.

…..…….....J.
(J.B. Pardiwala)

…….....J.
(R. Mahadevan)

New Delhi:
2nd January, 2025.