Legal Decisions[1]

DIRECT TAXES

Income-tax Act

Aditya Birla Nuvo Ltd
Vs.
Deputy Director of Income-tax (International Taxation)
July 14, 2011 (BOM)

Section 9, read with Section 163 of the Income-tax Act, 1961 - Income – Deemed to accrue or arise

Where US company invested in shares of Indian Joint Venture(JV) and RBI permitted shares to be issued in name of its 100 per cent Mauritius subsidiary, on sale of shares to Indian JV partners, gains accrued in India would give rise to tax liability in hands of US company and not in hands of Mauritius company

Under a joint venture agreement (JVA) the US company AT&T-USA (which was AT&T Wireless group company and later on known as NCWS) and Indian Birla and Tata group companies became shareholders of Indian Joint Venture Company (JVC) (later on named as ICL). From 1996 onwards equity shares of JVC subscribed to and owned by AT&T-USA were allotted from time to time in name of its 100 per cent Mauritius subsidiary AT&T-Mauritius with approval of RBI. However, all rights in the shares i.e., rights of voting, management, sale or alienation were absolutely vested in US Company AT&T-USA.

When offered by the USA partner Birla group company Indian Rayon and Tata Group company TIL purchased equity shares of the US partner and Indian Rayon deposited money in bank account of AT&T-Mauritius and one same day, AT&T-Mauritius paid same amount to USA company.

Since the equity share amount was paid by AT&T Mauritius and the equity shares were allotted in the name of AT&T Mauritius with the approval of the RBI, it was contended by Indian Rayon, that the beneficial ownership in those shares vested in AT&T Mauritius and not in the US partner. The question, therefore, to be considered was whether, AT&T Mauritius paid the amount for acquiring the equity shares of the JVC in its own name or paid the amount for and on behalf of the US partner and whether sale of shares of JVC jointly by AT&T Mauritius and US partner amounts to sale by AT&T Mauritius alone.

The argument of Indian Rayon was that since the shares of the JVC purchased by Indian Rayon stood in the name of AT&T Mauritius, the legal owner of the said shares would be AT&T Mauritius and, therefore, on sale of the said shares, capital gains would accrue to AT&T Mauritius which as per DTAA between India and Mauritius could not be taxed in India and, consequently, the tax on capital gains arising from the transfer of shares of JVC could not be recovered from Indian Rayon as a representative assessee.

The Bombay High Court held that the fact that AT&T Mauritius made payments to the JVC towards the equity shares would not make it to be owner of the equity shares, because, firstly, under the JVA, the joint venture partners alone were to subscribe and own 100 per cent equity shares of JVC and admittedly AT&T Mauritius was not a joint venture partner and, therefore, there was no obligation on AT&T Mauritius to pay for the shares. The shares could be allotted in the name of AT&T Mauritius as a permitted transferee of AT&T USA. There was no document on record to suggest that the AT&T Mauritius had agreed to subscribe/purchase the shares of JVC. In these circumstances, the payments made by AT&T Mauritius could not be said to be payments for subscribing/purchasing the shares of the JVC in the name of AT&T Mauritius. The payment was for and on behalf of AT&T USA. Further, it is AT&T USA (not AT&T Mauritius) which had entered into the Shareholders Agreement (for sale of its shares) with the Birla Group and the Tata Group. Moreover, in the Shareholders Agreement, it was specifically recorded that (AT&T USA) was carrying on the telecommunication business in India through its wholly owned subsidiary – AT&T Mauritius. Though the shares were allotted in the name of AT&T Mauritius the said shares were held by AT&T Mauritius as a permitted transferee of the owner of the shares namely, AT&T USA.

Even in respect of the shares of the JVC issued after the execution of the Shareholders Agreement, the ownership in the shares vested in AT&T USA, because, the Shareholders Agreement did not make any departure in the ownership of the shares already issued or to be issued after the Shareholders Agreement. Thus, 74,35,61,480 equity shares allotted in the name of AT&T Mauritius were allotted as per the terms of the JVA and the Shareholders Agreement under which the ownership of the shares were to vest in AT&T USA. That is why (successor to AT&T USA) offered to sell the shares of ICL to the Birla Group Company Indian Rayon and said the Birla Group Company intimated its acceptance of the offer to the US successor of AT&T USA. Moreover, the US successor of AT&T USA was a party to the Sale and Purchase Agreement. If AT&T Mauritius was the beneficial owner of the shares, then the Sale and Purchase Agreement would have been solely with AT&T Mauritius and not jointly with AT&T Mauritius and the US successor of AT&T USA. Therefore, the argument of India Rayon that since the shares of the JVC stood in the name of AT&T Mauritius, it must be treated as beneficial owner of the shares could not be accepted. Similarly, the argument that the US successor of AT&T USA became a party to the Sale and Purchase Agreement on account of the warranties given by the US successor of AT&T USA was without any merit, because, as per the

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.*

clauses in the JVA and the Shareholders Agreement, shares of the JVC allotted in the name of AT&T Mauritius could not be sold by AT&T Mauritius without the consent of AT&T USA (now NCWS). Thus, sale of shares could be effected by AT&T Mauritius only if the US successor of AT&T USA consented to the sale. The US successor of AT&T USA could give consent only if it wanted to get out of the joint venture partnership. Therefore, the argument that the US successor of AT&T USA was a party to the Sale and Purchase Agreement, because of the warranties given by it could not be accepted.

Even while granting approval for allotment of shares in the name of AT&T Mauritius, the RBI recorded that AT&T Mauritius was the wholly owned subsidiary of AT&T USA and that the allotment of equity shares of the JVC in favour of AT&T Mauritius would not exceed 49% of the paid up capital of the JVC. These facts noted by RBI clearly suggested that the RBI approval was in terms of the JVA, wherein the ownership of the shares allotted in the name of AT&T Mauritius was to vest in AT&T USA. Thus, the approval granted by RBI for allotment of shares in the name of AT&T Mauritius supported the contention of the Revenue that the equity shares of the JVC were issued in the name of AT&T Mauritius under the JVA as a permitted transferee of AT&T USA.

Similarly, the approval granted by RBI to the effect that the allotment of shares of the JVC in the name of AT&T Mauritius was in accordance with the provisions of FERA did not make AT&T Mauritius legal owner of the said shares, because, the said approval simply meant that according to RBI the allotment of shares in the name of AT&T Mauritius as permitted transferee did not violate the provisions of FERA. The RBI approval did not elevate the status of AT&T Mauritius from that of a permitted transferee to a party shareholder.

The fact that in the Shareholders Agreement it was recorded that AT&T USA represented the AT&T Wireless Group and that the Shareholders Agreement permits AT&T Mauritius as a member of the AT&T Wireless Group to pay for the balance equity shares of the JVC, did not in any way alter the ownership rights over the shares in question subscribed to by AT&T USA and allotted in the name of AT&T Mauritius as a permitted transferee of AT&T-USA.

In the facts of the present case, the capital gains was sought to be taxed in the hands of NCWS (successor to AT&T USA) not as a shareholder of AT&T Mauritius but on account of the direct investment in India made by AT&T USA as a joint venture partner under the JVA.

In the present case, transfer of impugned shares constituted transfer of a capital asset situate in India and income from such transfer of capital asset even if accrued or was received in India within the meaning of Section 5, such income being specifically enumerated under Section 9, would be income deemed to accrue or arise in India.

Thus, the income accruing or arising in India to AT&T USA (now NCWS) on transfer of a capital asset situate in India, (sale of shares of JV Company ICL to Indian Rayon) would be income deemed to accrue or arise in India to US Company NCWS and could be assessed in the hands of the US Company or in the hands of Indian Rayon as agent of the nonresident under Section 163.

Patni Computer Systems Ltd.
Vs.
Dy. Commissioner of Income-tax,
June 30, 2011 (ITAT-PUNE)
[Assessment Years 2002-03 & 2003-04]

Section 10A of the Income-tax Act, 1961 - Free Trade Zone

Set-off of losses of section 10A eligible units is to be allowed against normal business income of assessee while computing income as per normal provisions of the Act. ■

Section 10A of the Income-tax Act, 1961 - Free Trade Zone

Where a number of units were separate and independent production units and same could not be treated as expansions of existing undertakings, mere fact that requisite permissions from Software Technology Park of India (STPI) referred them as expansions of existing units, would not disentitle assessee from claiming of deduction under section 10A

In the approvals granted by STPI, the three units of the assessee had been referred to as an expansion of the corresponding old units. The moot question was as to whether such a situation was potent to effect the assessee's entitlement for deduction under section 10A.

The Pune Tribunal held that the manner in which the approval had been granted was not relevant to examine the assessee's case for claim of deduction under section 10A of with respect to a number of units. What was really to be examined was as to whether the units were independent units and that they fulfilled the conditions prescribed under section 10A(2). There was no prohibition that an expansion in the same line of business achieved by setting up a new independent unit would lead to denial of deduction under section 10A. Since a number of units were separate and independent production units and the same could not be treated as mere expansions of the existing undertakings, the mere fact that the requisite permissions from STPI referred them as expansions of the existing units, would not disentitle the assessee from the claim of deduction under section 10A. In this view of the matter, claim of assessee was to be allowed for the benefits under section 10A on the three units treating the same as independent units. ■

Section 70 of the Income-tax Act, 1961 - Losses - Set off of from one Source against income from another source under the same head of Income

An assessee having foreign branch is entitled to set off loss arising out of its foreign branch against other business income declared

The assessee company had a branch office at Sweden which incurred a loss for the assessment year under consideration. The said loss was not allowed to be set off against other business income by the Assessing Officer. The plea of the assessee was that in terms of para 1 of Article 7 of Double Taxation Avoidance Agreement between India and Sweden the entire profit of the Sweden branch office was liable to be taxed in India as well as in Sweden. If the assessee was to pay any income-tax in Sweden it would be entitled to claim credit as per the DTAA for such taxes paid in Sweden. As per the assessee, it was resident in India and, hence, the profit of Sweden branch was taxable in India and, therefore, the loss of the branch was also liable to be considered for set off against the other business income. The Commissioner (Appeals) considering this aspect held that the assessee was entitled to set off the loss arising out of its Sweden branch against other business income declared.

The Pune Tribunal held that following the order of the Tribunal on identical facts for the preceding assessment year, the order of the Commissioner (Appeals) was to be affirmed on this issue. ■

Section 80HHE of the Income-tax Act, 1961 – Deduction - Profits from Export of Computer Software, etc

Where turnover of Japan and Australia branches of assessee-company had been reduced from "export turnover" by Revenue, same was also excludible from figure of "total turnover" for purposes of computing deduction under section 80HHE

While examining the computation of deduction under section 80HHE done by the assessee, the Assessing Officer made certain changes which inter-alia included inclusion of the turnover of the Japan and Australia branches as a part of the 'total turnover'. The assessee challenged this aspect before the Commissioner (Appeals) pointing out that reduction of turnover of Japan and Australia branches only from the export turnover and not from the total turnover for the purposes of computing deduction under section 80HHE was not justified. The Commissioner (Appeals) upheld the action of the Assessing Officer.

The Pune Tribunal held that the Tribunal in the case of ITO *v*. Servion Global Solutions Ltd. 308 ITR (AT) 375 (Chennai) opined that for the purposes of section 10A, the expenditure incurred in foreign currency was liable to be excluded from the figure of "export turnover" as well as from the figure of "total turnover" although the exclusion from the total turnover was not specifically contained in section 10A. The Tribunal explained that the same provided that what is excluded from the export turnover is also liable to be excluded from the total turnover. Therefore, the assessee was justified in contending that if the turnover of Japan and Australia branches had been reduced from the "export turnover" by the Revenue, the same was also excludible from the figure of "total turnover" for the purposes of computing deduction under section 80HHE. ■

Section 80HHE of the Income-tax Act, 1961 - Deduction - Profits from Export of Computer Software, etc

In computation of deduction under section 80HHE, 10 per cent of profit of business of undertakings covered under section 10A is eligible for claim of deduction under section 80HHE

The Assessing Officer noted that in the computation of deduction under section 80HHE, the assessee had considered 10 per cent of the profit of the business of the undertakings covered under section 10A as eligible for the claim of deduction under section 80HHE. The Assessing Officer has denied such a claim of the assessee. It was explained that for the assessment year 2003-04 as per the proviso inserted by Finance Act, 2002 deduction under section 10A was restricted to 90 per cent of the profits and gains derived by an undertaking from export of computer software. In other words, 10 per cent of such profits and gains of the undertaking eligible for deduction under section 10A were taxable. This element of profit was included by the assessee in its claim of deduction under section 80HHE. The Assessing Officer denied the same on the ground that under section 10A units are entitled for a tax exemption and that, section 80HHE prescribed for a deduction for profits in respect of export of computer software. As per the Assessing Officer, the assessee was taking benefit of both the sections in relation to same unit which was not permissible.

The Pune Tribunal held that following the parity of reasoning given by the Madras High Court in the case of CIT *v.* Ambatture Clothing Ltd. 194 Taxman 79 (Mad), which is squarely applicable to section 80HHE, the plea of the assessee was to be allowed. ■

Section 92 of the Income-tax Act, 1961 - Transfer Pricing

In absence of any mutual agreement or arrangement between Associated Enterprises, apportionment of cost of study for purpose of organisational structure amongst those Associated Enterprises is not permissible

The assessee had paid a sum of Rs 6.03 crores to McKinsey & Co (M) for undertaking a study for the purpose of restructuring the assessee's organisational structure. As per the Transfer Pricing Officer (TPO), an

arm's length allocation of cost of consultancy expenses paid to M was required to be made. According to the TPO, the growth of the assessee could not be divorced from the growth of the Associated Enterprises and vice-versa. Since the changes proposed in the study conducted by M would also give benefits to the Associated Enterprises, allocation was to be made. The Revenue further held that it was imperative for the assessee to have recovered such costs from the Associated Enterprises as the benefits of the studies also extended to them and since the assessee had not done so, certain expenditure was allocated by the TPO on this score.

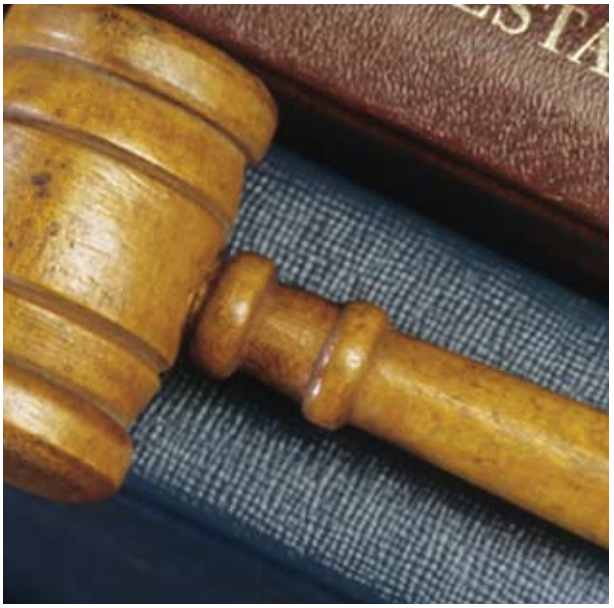
The Pune Tribunal held that it is to be noted that the apportionment of impugned cost is permissible only in a situation where there exists a "mutual agreement or arrangement" between two or more Associated Enterprises for apportionment of cost incurred in connection with a benefit, service or facility provided to any one or more of such Enterprises. The aforesaid position is amply clear on a bare reading of section 92B(1). There existed no agreement or arrangement between the assessee and its Associated Enterprises to incur the cost on the studies conducted by M. In fact, there was nothing to suggest that the assignments by M were carried out on the basis of any arrangement or agreement between the assessee and the Associated Enterprises. In this context, other than asserting that the benefits received by the Associated Enterprises "are specific and identifiable benefits", the TPO had not given any basis to infer the same. There was no material or evidence to support the aforesaid assertion by the TPO and, therefore, the same was based on a mere presumption. Even otherwise, the study reports furnished by M might have a potential use for the Associated Enterprises but same had to be viewed in the context that any study conducted on the business strategies by a specialised agency might bring certain intangible benefits in the form of enhanced productivity to the businesses of the Associated Enterprises, however, this would not *ipso facto* justify the apportionment of the cost incurred on the conduct of the studies, where the use of such studies by the Associated Enterprises was not obligated in terms of any mutual agreement or arrangement between the assessee and the Associated Enterprises, but the use was only discretionary on the part of the foreign Associated Enterprises. Moreover, there would not be any justification for apportioning the expenditure unless it was shown that the expenses incurred on such activities was dis-proportionate and the benefit which accrued to the Associated Enterprises in the form of increased business productivity was not merely incidental, but was tangible and concrete. In the present case, there was no material to show that any tangible and concrete benefit had accrued to the Associated Enterprises as a result of the expenditure incurred by the assessee in obtaining consultancy from M. Therefore, under these facts and circumstances, the order passed

by the TPO on this aspect was based on no evidence and the same was liable to be set aside.

Apart therefrom, even if one went along with the Revenue and accepted the proposition that certain benefits accrued to the Associated Enterprises and, therefore, the Associated Enterprises were liable to compensate the assessee in terms of the above transaction. It was indeed imperative for the TPO to determine the Arm's Length Price (ALP) in respect of such "international transaction" made by the assessee company, by taking into consideration all the rights obtained and obligations incurred by the two entities, including the advantages obtained by the foreign Associated Enterprises. In order to ascertain whether the expenses incurred by the assessee company, which was an Associated Enterprise of the foreign subsidiaries, on the consultancy charges paid to M were more than what a similarly situated and comparable independent domestic entity would have incurred or not. It would be necessary to identify the appropriate comparables for the purpose of comparison of their expenditure with the expenditure incurred by the assessee company in this regard. If such a comparison would justify an adjustment in the impugned "international transaction", only then the TPO's action could be upheld. In the present case, no such exercise had been carried out and, therefore, on this count also the approach of the TPO was untenable. ■

Section 92B of the Income-tax Act, 1961 - Transfer Pricing - International Transaction

Extension of credit to Associated Enterprises beyond stipulated credit period cannot be construed as an international transaction for purposes of section 92B(1) so as to require adjustment for ascertaining ALP. [*See* also digest under section 92] ■



Section 234B of the Income-tax Act, 1961 - Interest - For defaults of payments of Advance tax

Credit is allowable in relation to taxes paid in country outside India while computing assessed tax for purposes of section 234B(1)

As per the amended provisions of *Explanation 1* below to section 234B(1) as inserted by the Finance Act, 2006 with effect from 1.4.2007, credit is allowable in relation to the taxes paid in country outside India while computing assessed tax for the purposes of section 234B(1). The Bombay High Court in the case of CIT *v.* Apar Industries Ltd. 323 ITR 411 (Bom) has interpreted the said amendment as clarificatory in nature so as to have a retrospective application even for assessment years prior to 1.4.2007.

Commissioner of Income-tax
Vs.
Cosmo Films Ltd.
July 18, 2011 (DEL)
[Assessment Year 1996-97]

Section 32 of the Income-tax Act, 1961 - Depreciation

Where Haryana State Electricity Board (HSEB) had decided to go in for tapping system of sale and lease back assets as a mode of raising finance at a lower cost and assessee purchased and leased out said assets, depreciation allowance was to be allowed to assessee

The Assessing Officer disallowed the claim of the respondent/assessee with regard to 100 per cent depreciation on the equipment purchased by it from the HSEB, which was already installed at the said Board's Thermal Power Station at Faridabad and immediately leased back to the HSEB. HSEB, in order to raise finance for its day-to-day needs, had decided to go in for tapping the system of sale and lease back assets as a mode of raising finance at a lower cost. Hence, such transaction was entered into.

The Delhi High Court held that the sale of the equipment by HSEB to the respondent/assessee resulted in the transfer of title from HSEB to the assessee. The lease evidences the fact that the right of purchase and use of the equipment in question was transferred from the respondent / assessee to the lessee (HSEB), for which purpose, a security deposit was taken and the lessee-HSEB had covenanted to pay the lease rentals for the duration of the lease. When the lease agreement was entered into, the possession of and the right to use the equipment was transferred to the lessee and the lessor (respondent/assessee) retained its title and ownership over the said equipment as also the right of reversion of possession at the end of the lease period.

A plain reading of the sale deed made it clear that the property in the said equipment passed on to the assessee/ respondent on date of sale itself as the documents themselves indicated that the vendor (HSEB) conveyed and transferred its title, interest rights and privileges in the equipments sold completely and irrevocably in favour of

the purchaser (respondent/assessee). Further, the lease clearly mentioned in a clause of the lease agreement that the lessee (HSEB) confirmed that it had received possession of the said equipment in good order and condition. Thus, this is an acknowledgement from HSEB that it had received the equipment pursuant to the lease in its favour from the respondent / assessee. All these circumstances point in the direction that the ownership of the equipment was of the respondent/assessee and this fact had also been acknowledge by the HSEB which was the erstwhile owner of the same.

Further, what was the intention of HSEB in going in for the transaction in question (in this case raising funds) cannot be transposed onto the respondent/assessee. Insofar as the respondent/assessee was concerned, it had purchased the equipment which was already installed at HSEB's Thermal Power Plant at Haryana and immediately thereafter, it had leased back the said equipment to HSEB for a period of 72 months on condition of the payment of lease rentals as well as an interest free security deposit. If, in doing so, it was attracted by the prospect of availing 100 per cent depreciation on the value of the equipment (₹2,30,40,000), the respondent/assessee could not be denied the benefit merely because it did so. In order to deny the claim of depreciation, it would have to be held that the transaction was not genuine and that the same was a subterfuge. Merely because an assessee gets a commercial advantage because of the factoring in of a tax benefit, it cannot be said that the transaction is not genuine.

There is no finding in the present case or evidence to indicate that the transaction was not genuine. Hence, the claim of depreciation was to be allowed to the assessee.

Commissioner of Income-tax
Vs.
Raychem RPG Ltd.
July 4, 2011 (BOM)

Section 37(1) of the Income-tax Act, 1961 – Business Expenditure – Allowable as

Software being not form part of profit making apparatus of assessee, expenditure thereon will be allowed as revenue expenditure

When by applying functional test, if impugned software is found to be not forming part of the profit making apparatus of the assessee, the same will be allowed as revenue expenditure.

The business of the assessee company was that of manufacturing of telecommunication and power cable accessories and trading in oil retracing system and other products and impugned software was an Enterprises Resources Planning (ERP) package and, hence, it facilitated the assessee's trading operations or enabling the management to conduct the assessee's business more efficiently or more profitably but it was not in the

nature of profit making apparatus. Therefore, the software expenditure was allowable as revenue expenditure.

Kanubhai M. Patel (HUF)
Vs.
Hiren Bhatt of His Successors to Office
July 13, 2011 (GUJ)
[Assessment Year 2003-04]

Section 149 of the Income-tax Act, 1961 - Income Escaping Assessment - Time limit for issue of notice

Merely signing notices cannot be equated with issuance of notice as contemplated under section 149; date of issue would be date on which same were handed over for service to proper officer

On a plain reading of section 149, it is apparent that under the said provision, the maximum time limit for issuance of notice under section 148 is six years from the end of the relevant assessment year. In the instant case, the relevant assessment year in each of the petition was 2003-2004. The impugned notices were dated 31.03.2010 and the said notices were sent for booking to the Speed Post Centre on 07.04.2010. According to the petitioners, the notices were clearly time barred as the date of dispatch would be the date of issue of the notices. Whereas, according to the revenue the notices were actually signed on 31.3.2010, hence, the said date would be the date of issue and as such, the impugned notices had been issued within the time limit prescribed under section 149.

The Gujarat High Court held that the expression to issue in the context of issuance of notices, writs and process, has been attributed the meaning, to send out; to place in the hands of the proper officer for service. The expression "shall be issued" as used in section 149 would therefore have to be read in the aforesaid context. In the present case, the impugned notices had been signed on 31.03.2010, whereas the same were sent to the speed post centre for booking only on 07.04.2010. Considering the definition of the word issue, it was apparent that merely signing the notices on 31.03.2010, could not be equated with issuance of notice as contemplated under section 149. The date of issue would be the date on which the same were handed over for service to the proper officer, which in the facts of the present case would be the date on which the said notices were actually handed over to the post office for the purpose of booking and for the purpose of effecting service on the petitioners. Till the point of time the envelopes were properly stamped with adequate value of postal stamps, it could not be stated that the process of issue is complete. In the facts of the present case, the impugned notices having been sent for booking to the Speed Post Centre only on 07.04.2010, the date of issue of the said notices would be 07.04.2010 and not 31.03.2010, as contended on behalf of the revenue. In the circumstances, the impugned notices under section 148 in relation to assessment year 2003-04, having been issued on 07.04.2010, were clearly beyond the period of six years from the end of the relevant assessment year and, hence, were clearly barred by limitation and as such, could not be sustained.

Income-tax Act, R.C.S. 1985 (Canada)

Triad Gestco Ltd
Vs.
Her Majesty the Queen
July 12, 2011 (Canada Tax Court)
[Taxation Year 2001 & 2002]

Section 245 of the Income-tax Act, R.C.S. 1985 - General Anti Avoidance Rule (GAAR)

Where appellant-company obtained tax benefit from a transaction or part of a series of transactions and transactions undertaken by appellant clearly circumvented application of specific Anti-avoidance Rules as well as different legal provisions enacted to prevent tax avoidance (e.g., by creation of an artificial capital loss between parties with same economic affiliations and creation of loss on disposition of common shares of two companies established for benefit of sole director), such transactions forming part of Reverse Freeze would result in an abuse of the Act making it necessary to apply GAAR

The appellant, a Canadian company was controlled by its sole director Peter Cohen. A new company Rcongold was incorporated by Peter Cohen. The appellant-company subscribed for shares. Subsequently, the new company Rcongold paid stock dividend. A trust PCT was created for benefit of said Peter Cohm. Subsequently, the appellant company sold to the Trust its shares of Rcongold for a huge capital loss. The revenue alleged that the series of transactions were only (i) to obtain tax benefit, (ii) the transaction was avoidance transaction and (iii) there was misuse or abuse of legal provision. The revenue denied claim of deduction of capital loss.

The Court held that tax benefit was achieved by appellant in the instant case. There was no dispute between the parties that the series of transactions to be considered consists of the five transactions forming part of the Reverse Freeze namely: (i) the incorporation of a new company Rcongold, (ii) the subscription for shares of Rcongold by the appellant company, (iii) the declaration of a stock dividend by Rcongold, (iv) the creation of a trust PCT for the benefit of director of these two companies, and (v) the sale by the appellant of shares of Rcongold to the PCT at huge loss.

Where a deduction against taxable income is claimed, the existence of a tax benefit is clear since a deduction results in a reduction of tax. In the absence of the transactions forming part of the Reverse Freeze, the appellant would have had to pay huge tax on capital gain. Instead, huge capital loss was created and made available to the appellant company to apply against its capital gain. The tax benefit arose from the offsetting of the capital gain against the capital loss and the

reduction to nil of the tax that would otherwise have been payable on that gain.

Further, there was avoidance transaction. The incorporation of Rcongold and the issuance of common shares of Rcongold were not avoidance transactions in and of themselves. They were legally effective transactions having the economic substance they purported to have. However, they were necessary steps taken in furtherance of the Reverse Freeze and, for that reason, they were part of the series of transactions.

The declaration by Rcongold, the day after the common shares were subscribed for, of a dividend of $1 on the common shares held by the appellant and the payment of the dividend on the same day by issuing 80,000 high FMV/low PUC Class "E" non-voting preferred shares of the appellant was an avoidance transaction aimed at shifting the value of the common shares to the preferred shares and creating a latent capital loss which the appellant could then realise on the disposition of the common shares to the PCT. The real economic effect of these transactions was the payment of a $1 dividend by means of 80,000 preferred shares having a redemption price and a fair market value of $8,000,000.

The creation of the PCT was also an avoidance transaction since the only purpose of the PCT was to allow the recognition and realisation of the capital loss of $7,999,935 on the disposition of the common shares of Rcongold.

The sale of the common shares of Rcongold to the PCT was an avoidance transaction undertaken primarily to realise a capital loss on the common shares while avoiding the application of the stop-loss rules found in subparagraph 40(2)(g)(i) and to permit the recognition of the capital loss under the technical provisions of the *Act.*

It was reasonable to conclude that the value/shift, the creation of the PCT and the disposition of the common shares to the PCT were not undertaken or arranged primarily for bona fide purposes other than to obtain a tax benefit, and that the primary purpose of the entire series of transactions was to obtain the tax benefit. Consequently, the entire series of transactions is an avoidance transaction.

The manner in which the appellant and Mr. Cohen undertook the series of transactions revealed that the transactions were carried out in that way for the sole purpose of obtaining the tax benefit. In order to realise a capital loss equal to the amount of the gain previously realised, it was essential that the transactions unfold the way they did. The transactions were not required in order to allow Mr. Cohen to access the future growth of the assets of the appellant.

Further, there was misuse or abuse of legal provisions. With the inclusion, as of 1972, of taxable capital gains in the calculation of income and with the existence of the ability to have those gains offset by deductible capital losses incurred in the year, specific anti-avoidance provisions relating to capital losses were enacted. These provisions included former section 55, paragraph 40(2)(g) and section 54.

The transactions undertaken by the appellant amounted to abusive tax avoidance because they defeated the underlying rationale of the capital loss provisions in the Act. Through the manipulation of the fiscal "amount" of the Rcongold common shares, the appellant created artificially devalued property that was transferred to a person within the same economic unit to create an artificial capital loss without incurring any real economic loss.

The transactions undertaken by the appellant, however, clearly did circumvent the application of specific anti-avoidance rules, which were, in this case, the stop-loss provisions. Subparagraph 40(2)(g)(i) and subsection 251.1(1) as it then read were circumvented by the appellant in 2002 in a manner that achieved an outcome that the provisions sought to prevent, namely, the creation of an artificial capital loss between parties with the same economic affiliations. The loss on the disposition of the common shares of Rcongold to the PCT established for the benefit of Mr. Cohen would now be deemed to be nil.

Therefore, the transactions forming part of the Reverse Freeze resulted in an abuse of the Act to which the GAAR should apply.

OTHER ACTS

SEBI

Narendra Ganatra
Vs.
Securities and Exchange Board of India
July 29, 2011 (SAT-MUM)

Regulation 4 of the SEBI (Prohibition of Fraudulent Trades and Unfair Practices relating to Securities Market) Regulations, 2003 – Prohibition of Manipulative, Fraudulent and Unfair Trade Practices

Where no evidence had been brought on record to show role of appellant that he had played in group in executing synchronised or circular trades thereby creating false or misleading appearance of trading in scrip, he could not be penalised

The appellant was said to be an investor carrying on trading and investment in equity shares of different companies at Mumbai. It was alleged against the appellant that he, in collusion with other entities of Ganatra group, indulged in circular and synchronised trades in the scrip of a company and entered into reversal of trades through different brokers using different client codes and created artificial volume and misleading appearance of trades in the scrip of the company which raised its price and enabled promoters/company related entities to offload their shares in the company and thereby violated the provisions of Regulation 4.

The charge against the appellant was of conniving with the group entities in creating false and misleading

appearance of trading in the market and artificially raising the price of the scrip and for such a serious charge, higher degree of probability was required.

The Tribunal held that no evidence had been brought on record to show the role that the appellant has played in the group in executing synchronised or circular trades thereby creating false or misleading appearance of trading in the scrip. The appellant had traded only during the period from November 6, 2006 to January 19, 2007 in the price range of ₹6.90 to ₹17.00. During the investigation period, the price of the scrip rose from ₹2.94 on August 28, 2006 to ₹45.45 on November 12, 2007 and thereafter it came down to ₹14.85 on April 15, 2008 and increased to ₹51.80 on August 21, 2008. The price fluctuation during the period when the appellant traded was small in comparison to market volatility. Therefore, the appellant could not be held guilty of manipulating the price of the scrip. Out of 446 days of trading where 2,55,37,175 shares were traded, the appellant traded only on ten days with a total buy and sell quantity of 25,100 shares. All his transactions were through the trading system and were delivery based. The connection of the appellant with other group entities was also restricted to his brother and one B. The fact that the appellant shares common address with his brother or had introduced B to broker was not sufficient evidence to prove the charge of connivance in executing circular trades. The adjudicating officer had discussed in the impugned order the total shares sold and purchased by the Ganatra group entities but had failed to bring on record the role played by the appellant in executing these trades. As far as individual role of the appellant was concerned, admittedly, his trades had not been considered 'very significant'. In the absence of any evidence on record, direct or circumstantial, against the appellant in manipulating the trades or raising the price of the scrip, he deserved to be given the benefit of doubt.

Kemefs Specialities Pvt. Ltd.
Vs.
Securities and Exchange Board of India
July 21, 2011 (SAT-MUM)

Regulation 3 of the SEBI (Prohibition of Insider Trading) Regulations, 1992 - Prohibition on dealing, communicating or counseling on matters relating to insider trading

Where Managing director of a company, purchased shares when in possession of unpublished price sensitive information and thereby violated Regulation 3, he would be liable to penal consequences

The appellant is a private limited company whose managing director is one RS. He was also a substantial shareholder and promoter of vMoksha group of companies. He was keen to exit from the vMoksha group and wanted to sell his stake therein. While negotiations were going on for the acquisition of three entities of vMoksha group and the stake of RS, the appellant company purchased shares of the company for which RS placed the orders with the broker. The contract notes had been furnished to RS in the name of the appellant company.

The Tribunal held that the appellant company no doubt is a private limited company but it is being controlled and managed by RS. He was the one who was negotiating with the company for the sale of his stake and also for the acquisition of three entities of vMoksha group by the company. The information that the company was in serious negotiations with RS and vMoksha group of companies for the aforesaid acquisition was not in public domain and was only in the knowledge of RS. While in possession of this information he purchased the shares in the name of the appellant company of which he was the managing director and a person managing and controlling its affairs. The information regarding the negotiations between the company and the vMoksha group of companies was price sensitive as it was likely to affect the price of the scrip of the company when published as it was listed on different stock exchanges.

Price sensitive information as defined in the Regulations means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of that company. According to Clause (ha) of Regulation 2, information regarding amalgamations, mergers or takeovers is deemed to be price sensitive information. As already noticed, the negotiations between the parties were in regard to the acquisition by the company of three entities of the vMoksha group of companies and the stake of RS therein.

The negotiations had been going on since three months back when RS was introduced to the company for the aforesaid acquisition. RS on the one hand was negotiating with the company whose shares were listed on different stock exchanges and on the other hand he, as a managing director of the appellant, purchased shares in the name of the appellant. The fact that RS was 'insider' as defined in Regulation 2(e). Information regarding acquisition by the company being price sensitive and RS being an insider, he could not trade in the shares in view of the prohibition contained in Regulation 3 of the Regulations. This Regulation prohibits an insider from dealing in securities of a company listed on any stock exchange when he is in possession of any unpublished price sensitive information. RS purchased the shares at a time when the negotiations were at an advanced stage and even the Term Sheet (memorandum of understanding) had been executed between the parties. RS purchased the shares when in possession of the unpublished price sensitive information and thereby violated Regulation 3. In this view of the matter, he was liable to penal consequences. ■■