NAVIN JINDAL A

v.

ASSTT. COMMISSIONER OF INCOME TAX

(Civil Appeal No.634 of 2006)

JANUARY 11, 2010 B

[S.H. KAPADIA, H.L. DATTU AND DEEPAK VERMA, JJ.]

Income Tax Act, 1961: C

s. 48 – 'Capital gains' – Offer made to assessee-shareholder to subscribe to Partly Convertible Debentures (PCDs) at par on Rights Basis – Assessee renouncing the right – Loss due to diminution in value of original equity shares on renunciation of right to subscribe to additional D
shares/debentures – HELD: Rightly shown by assessee as 'short-term loss' – Revenue erred in treating the same as 'long-term loss'.

The assessee in Civil Appeal No.634 of 2006 held 1500 equity shares of a Company. The Company, in E
January 1992 announced issue of 12.5% equity share secured PCDs (Partly Convertible Debentures) of Rs.110/- for cash at par to shareholders on Rights Basis. The assessee received an offer to subscribe to 1875 PCDs on Rights Basis. He renounced his right to subscribe to F
PCDs in favour of another Company on 15th February, 1992 at the rate of Rs.30/- per Right. Accordingly, assessee received Rs.56,250/- for renunciation of right to subscribe to PCDs. Against this sale consideration, assessee suffered diminution in the value of the original G
1500 equity shares at the rate of Rs.200/- per share, totalling to Rs.3,00,000/-. Consequently, the capital loss suffered by the assessee was Rs.2,43,750/-. The assessee showed the loss of Rs. 2,43,750/- as short term capital

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A loss whereas the Revenue treated it as long term capital loss and computed assessee's income accordingly. The other appeals were filed in similar circumstances.

The question for consideration before the Court
B was: whether the amount of Rs.2,43,750/- was a 'short term capital loss' as claimed by the assessee, or a 'long-term loss' as assessed by the Revenue?

Allowing the appeals, the Court

C HELD: 1.1. The loss suffered by the assessee amounting to Rs.2,43,750/- was a short-term loss. The computation of income under the head 'capital gains' as submitted by the assesee is correct and the computation of income made by the Department is erroneous. [Para
D 14] [270-C-D]

1.2. The right to subscribe for additional offer of shares/debentures on Rights basis, on the strength of existing shareholding in the Company, comes into existence when the Company decides to come out with
E the Rights Offer. Prior to that, such right, though embedded in the original shareholding, remains inchoate. The same crystallizes only when the Rights Offer is announced by the Company. Therefore, in order to determine the nature of the gains/loss on renunciation of
F right to subscribe for additional shares/debentures, the crucial date is the date on which such right to subscribe for additional shares/debentures comes into existence and the date of transfer (renunciation) of such right. The said right to subscribe for additional shares/debentures
G is a distinct, independent and separate right, capable of being transferred independently of the existing shareholding, on the strength of which such Rights are offered. [Para 8] [264-A-D]

H 1.3. For the purposes of s.48 of the Act, one must

keep in mind the important principle that chargeability and computation has to go hand in hand. Computation is an integral part of chargeability under the Act. It is for this reason that the right to subscribe for additional offer of shares/debentures comes into existence only when the Company decides to come out with the Rights Offer. It is only when that event takes place, that diminution in the value of the original shares held by the assessee takes place. One has to give weightage to the diminution in the value of the original shares which takes place when the Company decides to come out with the Rights Offer. [Para 9] [264-E-G] A B C

Miss Dhun Dadabhoy Kapadia vs. Commissioner of Income-Tax, Bombay **(1967) 63 ITR 651, relied on.**

Case Law Reference: D

(1967) 63 ITR 651	**relied on**	**Para 10**

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 634 of 2006.

From the Judgment & Order dated 11.8.2005 of the High Court of Punjab & Haryana at Chandigarh in Income Tax Appeal No. 55 of 2002. E

WITH

C.A. Nos. 635, 636, 637 and 639 of 2006. F

Ajay Vohra, Kavita Jha, Sandeep S. Karhail, Manoj Swarup for the Appellant.

B.V. Bhattacharya, ASG, Arijit Prasad, Rahul Kaushik, Naresh Kaushik, B.V. Balaram Das for the Respondent. G

The Judgment of the Court was delivered by

S.H. KAPADIA, J. 1. Heard learned counsel on both sides. H

A 2. In this batch of civil appeals, the narrow issue which arises for determination is the nature of the loss suffered by the appellant(s) [assessee(s)] - whether Rs.2,43,750/- was a short-term capital loss, as contended on behalf of the assessee(s), or whether the said loss was a long-term loss, as contended
B on behalf of the Revenue?

3. In the lead matter, being Civil Appeal No.634 of 2006, we are concerned with Assessment Year 1992-1993 corresponding to the Financial Year ending 31st March, 1992.

C 4. The assessee was a shareholder in Jindal Iron and Steel Company Limited [`JISCO', for short]. The said Company announced in January, 1992, issue of 12.5% equity secured PCDs [Partly Convertible Debentures] of Rs.110/- for cash at par to shareholders on Rights Basis and employees on
D Equitable Basis. The Issue opened for subscription on 14th February, 1992, and closed on 12th March, 1992. As the assessee held 1500 equity shares of JISCO, assessee received an offer to subscribe to 1875 PCDs of JISCO on Rights Basis. Assessee renounced his right to subscribe to
E PCDs in favour of Colorado Trading Company on 15th February, 1992, at the rate of Rs.30/- per Right. Assessee received, accordingly, Rs.56,250/- for renunciation of right to subscribe to PCDs. Against the afore-stated sale consideration, assessee suffered diminution in the value of the original 1500
F equity shares in the following manner: the cum-right price per share on 3rd January, 1992, was Rs.625/-, whereas ex-Rights price per share on 6th January, 1992, was Rs.425/-, resulting in a loss of Rs.200/- per share. Consequently, the capital loss suffered by the assessee was Rs.3,00,000/- [1500 x 200] as
G against the receipt of Rs.56,250/- on renunciation of 1875 PCDs.

5. To complete the chronology of events, on 7th August, 1991, assessee sold 8460 equity shares of JSL at Rs.240/- for the total consideration of Rs.20,30,400/-, whose cost of

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acquisition was Rs.3,63,200/- and, consequently, the transaction resulted in a long-term gain for the assessee in the sum of Rs.16,67,200/-. Similarly, on 20th June, 1991, assessee sold 7000 equity shares of Saw Pipes Limited ("SPL", for short) at the rate of Rs.103/- each, for total consideration of Rs.7,21,000/- from which the assessee deducted Rs.70,000/- towards cost of acquisition, resulting in a long-term gain of Rs.6,51,000/-. In all, under the caption, "long-term gain" assessee earned Rs.23,18,200/- [Rs.16,67,200 + Rs.6,51,000]. These figures are not in dispute, though there is a small variation in arithmetical calculations made by the two sides, which is insignificant.

6. The quantum of loss is not in issue in these civil appeals. The only question which this Court has to decide is the nature of the loss. The Assessing Officer accepted the computation of loss on renunciation of right to subscribe to PCDs at Rs.2,43,750/- but treated the same as long-term capital loss. As a consequence, the Assessing Officer reduced the amount of long-term capital loss by the amount of statutory deduction under Section 48(2) of the Income Tax Act, 1961. It is this calculation which is the subject-matter of challenge by the assessee(s) in this batch of civil appeals.

7. To answer the above question, we need to quote hereinbelow the relevant provisions of the Income Tax Act, 1961, [`Act', for short] having a bearing on the issue in dispute:

> "2(29A).`Long-term capital asset' means a capital asset which is not a short-term capital asset.
>
> 2(42A). `Short-term capital asset' means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer.
>
> 45(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, 54B, 54D, 54E, 54F,

54G and 54H, 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.

48(1). The income chargeable under the head `Capital gains' shall be computed,--

[a] 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;

[ii] the cost of acquisition of the asset and the cost of any improvement thereto;

Provided that in the case of an assessee, who is a non-resident Indian, capital gains arising from the transfer of a capital asset being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in, and sale of, shares in, or debentures of, an Indian company.

Explanation: For the purposes of this clause,--

(i) `non-resident Indian' shall have the same meaning as in clause (e) of section 115C;

(ii) `foreign currency' and `Indian currency' shall have the meanings respectively assigned to them in section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973);

(iii) the conversion of Indian currency into foreign currency and the reconversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in this behalf;

[b] where the capital gain arises from the transfer of a long-term capital asset (hereafter in this section referred to, respectively, as long-term capital gain and long-term capital asset) by *making the further deductions specified in sub-section (2).*

(2) The deductions referred to in clause (b) of sub-section (1) are the following, namely:--

[a] where the amount of long-term capital gain arrived at after making the deductions under clause (a) of sub-section (1) does not exceed fifteen thousand rupees, the whole of such amount;

[b] in any other case, fifteen thousand rupees as increased by a sum equal to,--

(i) in respect of long-term capital gain so arrived at relating to capital assets, being buildings or lands or any rights in buildings or lands or gold, bullion or jewellery,--

(A) in the case of a company, ten per cent of the amount of such gain in excess of fifteen thousand rupees;

(B) in the case of any other assessee, fifty per cent of the amount of such gain in excess of fifteen thousand rupees;

(ia) in respect of long-term capital gain so arrived at relating to equity shares of venture capital undertakings,--

(A) in the case of a company, other than venture capital

A company, thirty per cent of the amount of such gain in excess of fifteen thousand rupees;

(B) in the case of venture capital company, sixty per cent of the amount of such gain in excess of fifteen thousand rupees;

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(C) in any other case, sixty per cent of the amount of such gain in excess of fifteen thousand rupees;

C [ii] in respect of long-term capital gain so arrived at relating to capital assets other than capital assets referred to in sub-clauses (i) and

(ia),--

D (A) in the case of a company, thirty per cent of the amount of such gain in excess of fifteen thousand rupees;

(B) in any other case, sixty per cent of the amount of such gain in excess of fifteen thousand rupees:

E Provided that where the long-term capital gain relates to both categories of capital assets referred to in sub-clauses (i) and (ii), the deduction of fifteen thousand rupees shall be allowed in the following order, namely:--

F [1] the deduction shall first be allowed against long-term capital gain relating to the assets mentioned in sub-clause (i);

G [2] thereafter, the balance, if any, of the said fifteen thousand rupees shall be allowed as deduction against long-term capital gain relating to the assets mentioned in sub-clause (ii), and the provisions of sub-clause (ii) shall apply as if references to fifteen thousand rupees therein were references to the amount of deduction allowed in accordance with clauses (1) and (2) of this proviso:

H *Provided further* that, in relation to the amount referred to

in clause (b) of sub-section (5) of section 45, the initial A
deduction of fifteen thousand rupees under clause (a) of this sub-section shall be reduced by the deduction already allowed under clause (a) of section 80T in the assessment for the assessment year commencing on the 1st day of April, 1987, or any earlier assessment year or, as the case B
may be, by the deduction allowed under clause (a) of this sub-section in relation to the amount of compensation or consideration referred to in clause (a) of sub-section (5) of section 45 and references to fifteen thousand rupees in clauses (a) and (b) of this sub-section shall be construed C
as references to such reduced amount, if any.

Explanation: For the purposes of this section,--

[a] `venture capital company' means such company as is engaged in providing finance to venture capital D
undertakings mainly by way of acquiring equity shares of such undertakings or, if the circumstances so require, by way of advancing loans to such undertakings, and is approved by the Central Government in this behalf;

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[b] `venture capital undertaking' means such company as the prescribed authority may, having regard to the following factors, approve for the purposes of sub-clause (ia) of clause (b) of sub-section (2), namely;--

[1] the total investment in the company does not exceed F
ten crore rupees or such other higher amount as may be prescribed;

[2] the company does not have adequate financial resources to undertake projects for which it is otherwise G
professionally or technically equipped; and

[3] the company seeks to employ any technology which will result in significant improvement over the existing technology in India in any field and the investment in such technology involves high risk." H

A 8. We find merit in this batch of civil appeals filed by the
assessee(s). The right to subscribe for additional offer of
shares/debentures on Rights basis, on the strength of existing
shareholding in the Company, comes into existence when the
Company decides to come out with the Rights Offer. Prior to
B that, such right, though embedded in the original shareholding,
remains inchoate. The same crystallizes only when the Rights
Offer is announced by the Company. Therefore, in order to
determine the nature of the gains/loss on renunciation of right
to subscribe for additional shares/debentures, the crucial date
C is the date on which such right to subscribe for additional
shares/debentures comes into existence and the date of
transfer [renunciation] of such right. The said right to subscribe
for additional shares/debentures is a distinct, independent and
separate right, capable of being transferred independently of
the existing shareholding, on the strength of which such Rights
D are offered.

9. For the purposes of Section 48 of the Act, one must
keep in mind an important principle, namely, that chargeability
and computation has to go hand in hand. In other words,
E computation is an integral part of chargeability under the Act.
It is for this reason that we have opined that the right to
subscribe for additional offer of shares/debentures comes into
existence only when the Company decides to come out with
the Rights Offer. It is only when that event takes place, that
F diminution in the value of the original shares held by the
assessee takes place. One has to give weightage to the
diminution in the value of the original shares which takes place
when the Company decides to come out with the Rights Offer.
For determining whether the gains/loss of renunciation of right
G to subscribe is a short-term or long-term gains/loss, the crucial
date is the date on which such right to subscribe for additional
shares/debentures comes into existence and the date of
renunciation [transfer] of such right.

10. Our view is based on the judgement of this Court in

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the case of *Miss Dhun Dadabhoy Kapadia vs. Commissioner of Income-Tax, Bombay*, reported in [1967] 63 I.T.R. 651], which has taken the view that, for computing capital gains on renunciation of right to subscribe for additional shares, diminution in the value of original shares would be regarded as the cost of acquisition for such right [See pages 654-655 of the said judgement]. We quote hereinbelow the relevant portion of the said judgement which further indicates that the right to subscribe for new shares/debentures, is a separate capital asset which comes into existence only when the Company passes Resolution for the issue of new shares:

> *"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 prescribed rate, or by renouncing those shares in favour of another person and obtaining monetary gain in that transaction. At the time, therefore, when the appellant renounced her right to take these new shares, the capital asset which she actually possessed consisted of her old 710 shares plus this right to take 710 new shares.*
>
> ....
>
> In the alternative, the case 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 of 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."

[Emphasis supplied]

11. Section 48 deals with mode of computation of income chargeable under the head "Capital gains". Under that section, such income is required to be computed by deducting from the full value of the consideration received as a result of the transfer of the capital asset, the expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the asset. Under Section 48(1)(b) of the Act, it is further stipulated that where the capital gain arises from the

transfer of a long-term capital asset, then, in addition to the expenditure incurred in connection with the transfer and the cost of acquisition of the asset, a further deduction, as specified in Section 48(2) of the Act, which is similar to standard deduction, becomes necessary.

12. The basic controversv in this batch of civil appeals concerns the stage at which Section 48(2) of the Act becomes applicable. For that purpose, we annex hereinbelow a chart indicating Computation of Income under the head "Capital gains", as projected by the assessee on the one hand and as projected by the Assessing Officer on the other hand.

13. On analysis of the said chart, one finds that, according to the assessee, the net income chargeable to tax under the head "Capital gains" is Rs.6,77,530/-, whereas, according to the Assessing Officer, the net income is Rs.8,28,980/-. According to the assessee, the loss suffered by him, as indicated in the chart, is a short-term capital loss of Rs.2,43,750/-, which occurred to the assessee on sale of right to subscribe to PCDs. The long-term gain, which accrued to the assessee on sale of shares of JSL and SPL, came to Rs.23,18,200/- to which Section 48(2) is applied by the assessee. On application of Section 48(2), the standard deduction comes to Rs.13,96,920/- Accordingly, the long-term gain, as computed under Section 48, accruing to the assessee on sale of shares of JSL and SPL came to Rs.9,21,280/- from which the assessee deducts loss of Rs.2,43,750/- resulting in the net income of Rs.6,77,530/-. On the other hand, according to the Assessing Officer, there is no dispute regarding the long-term gains accruing to the assessee on sale of shares of JSL and SPL amounting to Rs.23,31,200/- [difference in the figures is insignificant]. From the said figure of Rs.23,31,200/-, the Assessing Officer deducts the loss of Rs.2,43,680/- as a long-term loss and applies Section 48(2) deduction to the figure of Rs.20,87,450/-. Consequently, the Assessing Officer works out

COMPUTATION OF INCOME UNDER THE HEAD "CAPITAL GAINS

	As per assessee				As per assessing officer	
Capital gains/Loss:						
a] Short Term:						
Amount of sale proceeds (renouncement of 1875 Right PCDs offer of JISCO from Colorade Trading Co. Ltd. on 15.2.92 @ 30/-.	56,250					
Less : being cost of acquisition of 1875 right PCD offer of JISCO being depleted in the value of existing share holdings of 1500 Equity shares as under:-						
Cum-right price per share on 3.1.92 625						
Less : Ex-right price per share on 6.1.92 425						
Difference 200						
1500 shares @ Rs.200/- per share i.e.1500 x 200 (A)	(-) 3,00,000		(-) 2,43,750	NIL		NIL

b] Long Term:						
I. <u>On 8460 equity shares of JSL:</u>						
sold on 7.8.91 @ Rs.240/- 20,30,400						
Less: Aggregate cost of acquisition <u>3,63,200</u>	16,67,200					
II. <u>On 7000 Equity shares of SAW PIPES LTD.</u>						
Sold on 20.6.91 @ Rs.103/- each 7,21,000				16,80,200		
Less : Cost during 86-87 @ Rs.10/- each <u>70,000</u>	<u>6,51,000</u>	<u>23,18,200</u>		<u>6,51,000</u>	23,31,200	
Less: Long term capital loss due depreciation in the value of 1500 original share of JISCO as a result of right issue of PCDs after adjusting the profit realized on a/c of discussed above		NIL	NIL		<u>2,43,680</u>	
Less : <u>Deduction u/s 48(2):</u>					20,87,450	
On Rs.15000/- @ 100%						
On Rs.2303200/- @ 60% (B)	15,000			15,000		
Net Income under the head "capital gains" (A) + (B)	1,381,920	13,96,920	9,21,280	12,43,470	12,58,470	8,28,980
			6,77,530			8,28,980
			======			======

the net income at Rs.8,28,980/- as against the figure of Rs.6,77,530/- worked out by the assessee. The above analysis shows the controversy between the parties. Assessee treats Rs.2,43,750/- as a short-term loss, and, therefore, he applies the standard deduction under Section 48(2) to the long-term gain of Rs.23,18,200/- from sale of shares of JSL and SPL, whereas the Assessing Officer applies Section 48(2) deduction to the figure of Rs.20,87,450/- which is arrived at on the basis that the loss suffered by the assessee of Rs.2,43,680/- was a long- term loss.

14. As stated above, we have opined that the loss suffered by the assessee amounting to Rs.2,43,750/- was a short-term loss. Therefore, in our view, the computation of income under the head "Capital gains", as projected in the chart submitted by the assessee and as computed by the assessee is correct. In other words, the computation of income under the head "Capital gains" submitted to this Court by the assessee is correct and the computation of income made by the Department is erroneous.

Accordingly, civil appeals filed by the assessees stand allowed with no order as to costs.

R.P. Appeals allowed.