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SITG
No. 156

Legatum Ventures Limited
Vs.
Assistant Commissioner of Income Tax

Capital gains arising on sale of unlisted shares by a non-resident has to be computed only by reference to the provisions of Section 112(1)(c)(iii) of I.T. Act,1961 without cognizance to the provisions under Section 48 of the Act.

Date: 03.06.2023

ITA no. 1627/Mum./2022 (Mumbai - ITAT)[15.03.2023]

Jain Shrimal & Co.

Facts of the Case

- The assessee is a foreign company, incorporated in the UAE, primarily engaged in investment activities.

- During the Assessment Year 2018-19, the assessee sold the shares of an unlisted Indian private limited company and computed the capital gains as per the first proviso to section 48 of the Act read with Rule 115A of the Income Tax Rules, 1962 (Rules) which resulted in a loss of INR 3,63,87,392.

- Accordingly, the assessee filed a NIL return. The tax return filed by the assessee was selected wherein the learned Assessing Officer ('learned AO') claimed that capital gains on sale of unlisted shares must be computed only as per Section 112(1)(c)(iii) of ITA as per which the first proviso of Section 48 of I.T. Act,1961 is to be ignored.

- Therefore, the learned AO assessed the total income of the Assessee at INR 17,13,59,838.

Assessee's/ Petitioner's Contention

- Section 112 applies only in the case, if the total income includes any income arising from transfer of a long-term capital asset which is chargeable under the head "capital gains" and where such income from transfer of a long-term capital asset forms part of the total income, Section 112 provides for the manner in which the tax payable by the assessee on the total income shall be computed.

- The learned Authorised Representative further submitted that thus for the applicability of section 112 of the Act, there should be long-term capital gains.

- Since, in the present case, there is long-term capital loss after indexation, section 112 is not applicable in the present case and the assessee is entitled to carry forward the said loss to subsequent years as per the provisions of section 74 of the Act.

- It was further submitted that accordingly, the question of payment of tax under section 112 of the Act does not arise in the present case.

Revenue's contention

- The assessing officer referring to the decision of **Hon'ble Supreme Court in CIT vs Gold Coin Health Food Private Limited, [2008] 304 ITR 308 (SC)** held that the term "income" has a wider connotation and even includes negative income.

- The Assessing Officer also referred to the decision of the **Hon'ble Supreme Court in CIT vs Harprasad & Co Ltd. [1975] 99 ITR 118** to support the conclusion that income is understood to include losses also.

- The Assessing Officer further held that provisions of section 112(1)(c)(iii) supplement the provision of section 48, which is a special provision applicable in certain specific circumstances, and therefore the assessee is not given any option to choose the provision as per its convenience.

Revenue's contention

- It was further held that once the special provisions are in place they need to be acted upon. Therefore, capital gains in the present case have to be computed under section 112(1)(c)(iii) without giving effect to the 1st and 2nd proviso to section 48 of the Act.

- Accordingly, the Assessing Officer computed the long-term capital gains of Rs. 17,13,59,838 under section 112(1)(c)(iii) of the Act.

Legal provisions

- Section 112(1)(c)(iii) of the Act provides that the **amount of income-tax on long-term capital gains** arising from the transfer of a capital asset, being unlisted securities or shares of a company not being a company in which the public are substantially interested, calculated at the rate of ten per cent on the capital gains in respect of such asset as computed without giving effect to the first and second proviso to section 48.

- Further, the 1st proviso to section 48 of the Act, reads as under:-

  "*Provided that in case in case of an assessee, who is a non-resident, 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.*"

Legal provisions

- Also, 2nd proviso to section 48 of the Act, states that: -

  "Provided further that where long-term capital gain arises from the transfer of a long-term capital asset, other than capital gain arising to a non-resident from the transfer of shares in, or debentures of, an Indian company referred to in the first proviso, the provisions of clause (ii) shall have effect as if for the words "cost of acquisition" and "cost of any improvement", the words "indexed cost of acquisition" and "indexed cost of any improvement" had respectively been substituted"

Ruling

- It was contended that Section 112 of the Act is a special provision applicable in certain specific circumstances. The taxpayers do not have the option to choose between the applicability of Section 48 and Section 112 of the Act.

- Further, Section 112 of the Act, forming part of Chapter XII- Determination of tax in certain special cases, in the case of a non-resident or a foreign company, sub-clause (iii) of clause (c) to sub-section (1) provides the mode of computation of capital gains.

- As per section 112(1)(c)(iii) of the Act, in case of a non-resident, capital gains arising from the transfer of a long-term capital asset, being unlisted securities or shares of a company in which public are not substantially interested, shall be computed without giving effect to 1st and 2nd proviso to section 48 of the Act. The aforesaid section further provides a tax rate of 10% on the capital gains so computed.

Ruling

- Further, Hon'ble Tribunal is of the opinion that section 112(1)(c)(iii) is a special provision for the computation of capital gains, in case of a non-resident, arising from the transfer of unlisted shares and securities. While, on the other hand, section 48 of the Act is a general provision, which deals with the mode of computation of capital gains in all the cases of transfer of capital assets.

- Since section 112(1)(c)(iii) is the specific provision, therefore, in case the ingredients of the said section, i.e. (i) in case of non-resident or foreign company; (ii) long-term capital gains arise; (iii) from the transfer of unlisted shares or securities of a company not being a company in which public are substantially interested, are fulfilled, capital gains is required to be computed as per the manner provided under the said section.

- The Tribunal also highlighted the fact that it is a well-settled rule of interpretation that if a special provision is made respecting a certain matter, that matter is excluded from the general provision under the rule which is expressed by the maxim ***"Generallia specialibus non derogant".***

Ruling

- Further, Tribunal also observed that when in an enactment, two provisions exist, which cannot be reconciled with each other, they should be so interpreted that, if possible, the effect should be given to both.

- Thus, the Tribunal concluded that if the income chargeable under the head Capital gains is to be computed only as per the mode prescribed under section 48 it will render the computation mechanism provided under section 112(1)(c)(iii) redundant.

- Therefore the question framed was answered in favour of revenue and capital gains arising from the transfer of unlisted securities or shares of a company in which public are not substantially interested has to be computed only by reference to provisions of section 112(1)(c)(iii) of the Act without giving effect to 1st and 2nd proviso to section 48 of the Act.

Our Comments

Let us understand the computation of Long-Term Capital Gains from sale of unlisted shares under Section 48 and Section 112 with the help of an example: -

If a non-resident has invested USD 1,00,000 in 2018 and sold it in 2023 and took home again USD 1,00,000, the calculation of capital gain will be as under:

Particulars	**Section 48**		**Section 112**	
	USD	**INR**	**USD**	**INR**
Sale consideration in USD	1,00,000	-	1,00,000	
Sale consideration in Indian currency (at Rs. 82 per USD)				82,00,000
Less: Cost of Acquisition	1,00,000	-	1,00,000	
Cost of Acquisition in Indian currency (at Rs. 65 per USD)				65,00,000
Long term Capital Gain	**NIL**	-		**17,00,000**

Our Comments

- In the above example, non resident is adversely affected by the fall in the rate of the Indian currency vis-à-vis foreign currency and he is being charged to tax only for depreciation of rupee and without earning any actual gain from his investment in India in terms of it's own currency.

- As per the first proviso to Section 48, the foreign entity has the benefit of computing the capital gains in the same currency which was used for investing in India and then converting the amount of gain into Indian currency.

- In the above example, the amount of capital gains will be **NIL,** if calculated as per **Section 48** of Income Tax Act,1961.

- However, if the capital gains are calculated as per **Section 112** i.e. without the benefit of foreign currency conversion, it will result in capital gains of INR **17,00,000.**

Our Comments

- Having regard to the stated law, Hon'ble Mumbai Tribunal has ruled in favour of the department. However, the point is that the above ruling will result in taxability of receipts earned by non-residents from foreign exchange fluctuations, and not from Long Term Capital Gains.

- Further, the ruling also raises questions on interpretation of section 112 of the Act. The question here is where one provision allows forex benefit to non-residents and results in a capital loss, should the provision prescribing tax rate and restricting the forex benefits, be applicable in the first place and define the manner of computation of Capital Gains?

- Also, the objective to introduce proviso 1 to section 48 of I.T. Act,1961 was to provide protection to non-residents from devaluation of the rupee.

Our Comments

- The Central Board of Direct Taxes (CBDT) has also issued a circular at the time of enactment of this provision. It stated that – "**The non-resident Indians who invest in shares and debentures of Indian companies have been representing that due to the fall in the value of the Indian rupee vis-a-vis the foreign currency in which the investment is made by them, they are adversely affected when they sell such shares or debentures. In order to overcome this situation, sub-section (1) of section 48 of the Income-tax Act has been amended …".**

- Hence, the computation of taxable income should be ideally based on the **real income theory** after neutralizing the effect of income earned by non-residents from foreign exchange fluctuations.

- This may also be right as practically any non-resident would calculate the gains in his home country's currency, and not in Indian currency. The provision in that manner neither benefits him, nor puts him at any disadvantageous position when computed in foreign currency and in case if benefit of foreign currency conversion is not allowed to the non resident, it would be against the "***principle of natural justice***".

Our Comments

- Also, prior to the insertion of the first proviso to section 48 by the Finance Act, 1989, for non-resident Indians, the courts have held that capital gains from the transfer of shares of an Indian company shall be computed by converting the cost of acquisition, exclusively related expenditure and the sale consideration into the same foreign currency as was initially utilised for purchase of shares and the capital gains so computed in such foreign currency shall be reconverted into Indian currency.

- The government may also consider the merit in evaluating appropriateness of both the sections and removing ambiguity. Section 48 of the Act provides for the mode of computation of income chargeable under the head 'Capital Gain' whereas Section 112 provides for the manner in which the tax payable by the assessee on the total income shall be computed. However in the given case the Tribunal has held that capital gains is required to be computed as per the manner provided under section 112 of Income Tax Act,1961.

Our Comments

- In our opinion an alternate point of view can be taken that, assessee being a non-resident, can also offer the Long term capital gain **@ 10%** under **section 115E of the Income Tax Act** and since Section 115E does not restrict the benefit of Proviso 1st and Proviso 2nd to Section 48 of Income Tax Act, whether assessee can claim the benefit of the same??

- As per **Section 115E of the Income Tax Act,1961**, "Where the total income of an assessee, being a non-resident Indian, includes income by way of long-term capital gains, the tax payable by him shall be the amount of income-tax calculated on the income by way of long-term capital gain, at the rate of **ten percent**".

- However, it is pertinent to note that in order to get the benefit of rate concession under section 115E of the Act, the asset will have to fall under the definition of foreign exchange asset which means that the asset should have been purchased or acquired by way of inward remittance of foreign exchange.

Court	Mumbai Tribunal
Date of decision	15.03.2023
Section	Section 112(1)(c)(iii), Section 48, Proviso 1 and Proviso 2 to Section 48 of Income Tax Act,1961

Note: Case law name in Red- in favour of the revenue, Green-In favour of the Assessee, Orange = Partial

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