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Mumbai ITAT explains the applicability of specific provisions for taxation of capital gains on disposal of unlisted shares by non-residents

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Summary

The Mumbai Income Tax Appellate Tribunal (ITAT), in a recent case, has held that capital gains on disposal of unlisted shares by non-residents should be computed under section 112(1)(c)(iii) of the Income-tax Act, 1961 (the Act), being the specific provision as against the general provisions of section 48 (read with the first proviso to section 48) of the Act.

The taxpayer[1] in this case was a non-resident who had sold unlisted shares of an Indian private limited company. It had claimed long-term capital loss in its return of income basis the computation mechanism provided in section 48 read with the first proviso to section 48 the Act.

Facts of the case

- The taxpayer, a company incorporated in the UAE, was primarily involved in investment activities. It sold unlisted shares of an Indian private limited company and declared long-term capital loss after availing the benefit of foreign exchange fluctuation, as prescribed by the first proviso to section 48 of the Act.
- The tax officer was of the view that computation should be done under section 112(1)(c)(iii) of the Act, which would result in long-term capital gains.
- The taxpayer argued that the mechanism for computation of capital gains has been provided only within section 48 of the Act. Section 112(1)(c)(iii) merely provides the rate of tax. Since the mode of computation results in a long-term capital loss, the provisions of section 112(1)(c)(iii) of the Act will not be applicable.

  The pre-requisite for the applicability of section 112(1)(c)(iii) of the Act is that there should be long-term capital gains.
- The tax officer did not agree with the taxpayer and contended that the term 'income' also includes 'loss'[2]. The tax officer also held that in case special provisions are in place, the taxpayer is not given an option to choose the general provision as per its convenience.
- Accordingly, the tax officer computed long-term capital gains without giving the benefit of the first proviso of section 48 of the Act. This was also accepted by the Dispute Resolution Panel (DRP), and the tax officer accordingly passed the final assessment order.
- The matter went to Mumbai ITAT.

[1] Legatum Ventures Limited (ITA no.1627/Mum./2022)
[2] CIT vs. Gold Coin Health Food Private Limited (2008) 304 ITR 308 (SC); CIT vs. Har Prasad & Co Ltd. (1975) 99 ITR 118 (SC)

The Tribunal's observations and ruling

- The Tribunal observed that section 112(1)(c)(iii) of the Act is a special provision for the computation of capital gains in case of transfer of unlisted shares and securities by non-residents. 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.

- Agreeing with the revenue authorities, the Tribunal held that where all the ingredients of section 112(1)(c)(iii) are fulfilled, as in the present case, capital gains are required to be computed under the said section only.

- It further held that if the contention of the taxpayer is for it to be accepted that capital gains is to be computed under section 48 of the Act, then the same would render section 112(1)(c)(iii) of the Act to be completely otiose and redundant.

Our comments

Non-resident investors may need to track further developments on this issue to assess the impact on their tax liability. It will be interesting to see how this issue is dealt with by the higher judicial forums.

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