Scouting the Overhaul of Deemed Income Provisions A Critical Analysis of S.56(2)(X) & S.50CA of the Income Tax Act, 1961

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ABSTRACT:

Finance Act, 2017 brought major changes in Income Tax Act, 1961 for the purpose of creating new ways through which government can tax the assessees to overcome demonetization drive. Point worth noting is government has followed a very consultative approach by asking for opinions from public regarding implementation of new provisions. For this purpose, Section 50CA & 56(2)(x) was inserted in the Act. In this paper we have examined and analyzed these Sections and the loopholes which existed before the amendment and why there was a need to bring the amendment. As there were various ambiguities resided regarding the computational formulas of Fair Market Value (FMV) of certain assets, for this we have studied problem subsisted in erstwhile laws and examined the solution given by the government to encounter those problems and to tackle the void which still remains we have given some suggestive measures. We have also analyzed that the new approach of the legislature is focused to enhance the revenue of the government as it tax both buyer and seller in a single transaction and thus results in the double taxation. This approach of the government hurts the property transfer and immediate amendments are needed to address this problem. This paper delves into impact created difference for minorities, capital assets, and discuses the retrospective application of new provisions. We have also tried to explain the broad meaning of words in the bare provisions of the income tax act through leading judgements related to them.

I. INTRODUCTION

Two new provisions, Section 56(2)(x) and Section 50CA were introduced by the Finance Act, 2017 in the Income Tax Act 1961. The **Section 50 CA** provides for adoption of the value to be determined as per the Rules, as the consideration received from transfer of shares of a company which are not quoted shares, where the actual consideration is lower than that.[1] The difference shall be subjected to tax in the hands of the transferor under the head "capital gains". Previously, the receipt of only unquoted shares of a private company in hands of firm or partnership firm was covered by deemed gift provisions whereas the new amendment covers all the defined properties and assets.

The new Section 56(2)(x) which came to play from April 1st 2017 which has substantially broaden the scope of provisions which tax gifts received as deemed income. "*where any person receives, in any previous year, from*

[1] PWC, *Valuation norms for unquoted stock – Book value no longer "fair"*, TAXSUTRA (Jan. 28, 2019, 1:25 PM), http://www.taxsutra.com/expertspwc/column?sid=780.

any person or persons on or after the 1st day of April, 2017- any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum". Addition of clause (x) in Section 56(2) which provides that "*receipt of money or specified property by any person for inadequate consideration or without consideration from any person shall taxable*". The new clause (x) brings certain defined properties/assets as deemed gift in the ambit of tax in the hands of every assessee receiving such property subject to some exceptions as provided therein.

Fair market value computation for the purpose of clause(x) is to be determined as per Rule 11U and Rule 11UA of Income Tax Act. Under the said clause read with Rule 11UA of the Income-tax Rules, 1962, "*if a person receives jewellery or artistic work or shares and securitie**s** for without or inadequate consideration, the fair market value (FMV) of the same is taken into account for computing taxable income under the said clause*". Difference between FMV and consideration is taxable under the head of Income from other sources. Similarly, in the case of immovable property**,** the Stamp Duty Value (SDV) is taken into consideration for calculating the tax under aforesaid Section. The notification ensures that the value of unquoted shares of a company is based on fair value of underlying asset.[2]

II. Reasons For The Institution Of Section 50ca & Section 56(2)(X) In The Income Tax Act

Before the amendment of the Income Tax Act in 2017, Assessees used to evade tax through various tactics. One such was through investing their money in Start-ups. The reason behind this was because the shares of the maximum start-ups are unlisted/unquoted and these shares were exempted from the scrutiny of Income Tax as there was no existing provision in the Income Tax Act and when the share is quoted, the value quoted in the stock exchange will be the Fair Market Value (FMV) of the shares and little or no scope is left for the assessees to manipulate such value. The said value (FMV) is therefore taken as the sale consideration under Section 48 for the purpose of calculating the capital gains. This benefit is not available to unquoted shares because unlike quoted shares, which are freely traded on the stock exchange, unquoted shares are by large not regulated or manipulated and there existed no control on the pricing and valuation of these shares. This led the assessees to utilize the lenient Income Tax provisions in their abusive practices and through this they tried to avoid capital gains tax on transfer of unquoted shares by valuing them very low to their actual value and hence escaping tax. Section 50CA was added to the Income Tax Act to curb such practice, and hence will help in reducing the window dressing of the investors' amount, whose main intention was to evade tax through investing in startup or in any other area where the transfer of unquoted shares is usually done.

[2] *Press Information Bureau, CBDT seeks the stakeholders' comments/suggestions on the Draft Rules*, (Jan. 28, 2019, 11:25 PM), http://pib.nic.in/newsite/PrintRelease.aspx?relid=161587.

Before the introduction of Section 50CA in Income Tax Act, when shares were sold or transferred by the assessee for a consideration less than the fair market value of the shares, there was no mechanism present under the act to substitute the full value of consideration as disclosed by the assessee by any other value, for the purpose of computation of capital gains. Though there was Section 50C, but it only dealt with transfer of capital asset being land or buildings or both and hence was not applicable in case of shares. Therefore, to fill this void Section 50CA was introduced.[3] The new Section has a wide coverage on all assessees i.e. Residents, Non-Residents and non-related entities. Applies to all kinds of shares whether equity or preference Share. The essential condition being that the unquoted share must be a capital asset not as stock-in--trade. There exists no tolerance band, therefore according to new formula the FMV shall be full value of consideration, even in case where distinction in FMV and consideration from transfer is minute.

Before the Finance Act, 2017 was introduced, Indian tax laws as an anti-abuse measure (specifically Section 56(2)(vii) & 56(2)(viia)) taxed only an individual or a Hindu Undivided Family (HUF) and firm or company respectively in certain cases when specific assets were received for inadequate or no consideration. Therefore, receipt of sum of money or property without consideration or for inadequate consideration does not attract these anti-abuse provisions in cases of other assessees.[4] The Finance Act, 2017 has amended Income Tax Act by inserting 56(2)(x) in place of 56(2)(vii) & 56(2)(viia) to broaden the scope of anti-abuse provision by covering all taxpayers or assesses. Hence, through the insertion of 56(2)(x) in the Income Tax Act scope of taxability has increased.[5]

III. Analysis Of Section 50CA

The Union budget of 2017 was one of the most anticipated budgets of recent times. The expectations of the finance act were very high because of the demonetization drive witnessed in our country, and as there was a major loss in revenue to the government, there was a dire need to introduce some anti-abusive provisions to increase revenue. One of the anti-abuse provisions is 50CA. This was intended to curb the practice of avoiding the tax through transfer of unquoted shares and came to effect from 1st April, 2017. The Section says - "*Where the consideration received or accruing as a result of the transfer by an assessee of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such*

[3] ICMAI, *Valuation of Unquoted Shares -CBDT Issued Amended Rule*, (Jan. 28, 2019, 1:25 PM), http://icmai.in/TaxationPortal/upload/DT/Article/13.pdf.

[4] C.A. Devendra Jain, *Section 56(2)(x) of Income Tax Act, 1961*, (Jan. 28, 2019, 12:25 PM), https://ctconline.org/documents/income/CA-Devendra-Jain-Sec-56-9-6-2018.pdf.

[5] Parveen Kumar, *Deemed Gift and Deemed Capital Gains – Section 56(2)(x) and Section 50CA*, (Jan. 28, 2019, 1:25 PM), http://dpncindia.com/blog/deemed-gift-and-deemed-capital-gains-Section-562x-and-Section-50ca/

manner as may be prescribed, the value so determined shall, for the purposes of Section 48, be deemed to be the full value of consideration received or accruing as a result of such transfer."[6]

"*For the purposes of Section 50CA, the fair market value of the share, not being a quoted share, shall be determined in the manner provided in sub-clause (b) of clause (c) of sub-rule(1) of Rule 11UA*."[7] Method for valuation of equity shares is provided in Rule 11UA(1)(c)(b) and preference share valuation rule is provided in Rule 11UA(1)(c)(c) which shall be valued according to price it will yield in open market.

BROAD MEANING OF TERMS "ACCRUE" AND "RECEIVE" AS USED IN SECTION 50CA

According Section 50CA, consideration should be "received" or "accrued" against the transfer of unquoted shares. In this regard, in number of stances definition was debated:

In *CIT v. Annamalais Timber Trust*[8], regarding the terms meaning "accrue" and "receive", the Court ruled that "accrue" is "to arise or spring as a natural growth or result" and may be deciphered as "right to receive income & profits or gains" and which is capable of "being enforced or converted into money by actual receipt." On the other hand, "the word 'receive' means actual receipt income, profits or gains."

Further, in *CIT v. Ashokbhai Chimanbhai*[9], the Court pronounced that "income is said to be received when it reaches the assessee, whereas when the right to receive the income becomes vested in the assessee, it is said to accrue or arise."

Therefore, it can be said that the court on various occasions have confirmed that the meaning of these terms has broad meaning.

WHO MAY VALUATE UNQUOTED SHARES

Earlier, the fair market value of unlisted equity shares was calculated by a merchant banker or a CA and the option resided with company the value either on the book value on the valuation date or by the discounted cash flow method but on 24th May,2018 Notification No. 23/2018 was released which stated that only a merchant banker may do valuation of unquoted equity shares and the unlisted shares transferred under Employee stock ownership schemes as per Rule 3 under DCF method (Discounted Free Cash Flow) and The income tax has barred all Chartered accountants (CAs) from the list of authorized professionals for valuing shares of closely-held companies.

[6] Income Tax Act, 1961 § 50CA.

[7] *Income Tax Draft Notification*, (Jan. 28, 2019, 1:55 AM), https://www.incometaxindia.gov.in/news/draft-rules-relating-to-valuation-of-unquoted-equity-share.pdf.

[8] C.I.T. v. Annamalais Timber Trust, [1950] 18 I.T.R. 333 (Mad.).

[9] C.I.T. v. Ashokbhai Chimanbhai, [1965] 56 I.T.R. 42 (S.C.).

It is fascinating that the valuation of shares under the Companies Act may still be done by Chartered accountants. Hence, unlisted shares may be valued by Chartered accountants, but for Income Tax purposes, a merchant banker's valuation report[10] will be required.

The ICAI chairman wrote a letter to chairman of CBDT requesting to amend the notification regarding omission of "Accountant" for valuation of unquoted equity shares, emphasizing the excellence of Chartered accountants in field of valuation and stated several consequences like scarcity of Merchant bankers may lead to increase in cost of assessment and suggested that contrary implications of this act to government's campaign of "ease of doing business".[11]

IV. Analysis Of Section 56(2)(X)

The aforementioned reasons led to introduction of clause (x) in 56(2) to widen the scope of taxability so as to provide that "*receipt of the sum of money or the property by any person without consideration or for inadequate consideration in excess of 50,000 shall be chargeable to tax in the hands of the recipient under the head Income from other sources*". The newly inserted clause also proposes to remove certain exceptions which existed earlier like, "receipt by certain trusts or institutions and receipt by way of certain transfers" not regarded as transfer for purpose of Section 47.

For the new clause some more amendments were made like, in Section 49(4), to provide cost of acquisition of property reference of clause (x) is inserted, value will be taxable under Section 56(2)(x).

There are some exceptions on which this clause shall not apply like receipt of sum of money or property from any relative,[12] received on marriage occasion, received through any will or through act of inheritance, received because of death of the payer or donor, remittance by any local authority,[13] received fund from any institution/educational university/hospital etc.,[14] or by an malicious act of any individual of forming a trust just to enrich himself or his relative.[15]

If we closely analyze Section 56(2)(x) we can encounter some interesting points such as:

a) If A's maternal uncle gifts him a property of any amount that will be exempt in hands of A, in the case where A gifts his maternal uncle a property, which will be taxable in hands of his uncle as he is not covered under the definition of relative. This goes to show that the definition of relative is narrow and does not work both ways. The sole intention of this narrow definition is to maximize the tax from the transactions relating to gift.

[10] *Id* at 3.
[11] I.C.A.I., *Letter to CBDT*, (Jan. 30, 2019, 1:25 PM), http://taxlawsinindia.com/wp-content/uploads/2018/05/tax-laws.pdf.
[12] *Id* at 4.
[13] Income Tax Act § 10(20) (1961).
[14] Income Tax Act § 12A & 12AA (1961).
[15] Income Tax Act § 47 (1961).

b) In case of Section 47A which provides for taxation in the hands of Transferor Company when the transferee company converts the capital asset to stock-in-trade or the transferor company ceases to hold the whole of share capital of the transferee. It shows that even 47A is triggered, the transferee company is not taxed under Section 56(2)(*x*).

c) In case of Section 2(*22*)(*a*) which provides that "any distribution by a company shall be regarded as dividend if such distribution is of accumulated profits and it entails the release by the company to its shareholders of any asset of the company." This aspect has to be kept in mind whenever making any distribution from a subsidiary company to holding company. While the holding company will not be liable to tax under 56(2)(*x*), the distribution could be taxed under Section 2(*22*)(*a*).

THE BROAD MEANING OF TERM "MONEY" AS USED IN SECTION 56(2)(x)

The word "sum of money" as per Section 56(2)(x)(a) means a quantity of money of a specified amount. In the case of *CIT v. Kasturi & Sons Ltd.*[16] court held that "When the Legislature has instead of using any word such as "benefit" used only the term "money", it can refer only to money as understood in the ordinary common parlance." The Court ruled that "the word money has to be interpreted only as actual money or cash and not as any other thing which could be evaluated in terms of money." The Court further said that "money" cannot be interpreted as "money's worth".

In the case of *H.H. Sri Rama Verma* v. *CIT* [17] the court observed "The use of the expression 'any sum' paid under Section 56(2) contemplates payment of an amount of money." One of the dictionary meanings of the expression 'sum' means any definite amount of money.

In case of *ITO* v. *Komal Kumar Bader*[18] ITAT held that "money cannot be understood in a wider sense to include wealth or "total value of property" as held by the AO". The ITAT cited definition of "money" includes - "any circulating medium of exchange, including coins, paper money, and demand deposits, gold, silver, or other metal in pieces of convenient form stamped by public authority and issued as a medium of exchange and measure of value. any article or substance used as a medium of exchange, measure of wealth, or means of payment, as checks on demand deposit, a particular form or denomination of currency."[19]

In case *The Commissioner of Income-Tax v Kasturi And Sons Ltd* [20] ITAT held that "what is meant by money in simple sense is that it is a medium of exchange in a particular form or denominated in currency. It cannot be of the nature where value has to be derived. Thus, the term "sum of money" shall include cash, cheques, drafts, etc. Money does not include stocks, jewellery, immovable properties."

[16] C.I.T. v. Kasturi & Sons Ltd., [1999] 103 Taxman 342 (S.C.).
[17] H.H. Sri Rama Verma v C.I.T., [1991] 187 I.T.R. 308 (S.C.).
[18] I.T.O. v Komal Kumar Bader, [2009] 33 S.O.T. 58 (Jp.).
[19] *Id.*
[20] The Commissioner of Income-Tax v. Kasturi And Sons Ltd., Civil appeal No.5536 of 1990.

A new amendment was done in Section 56(2)(x) with effect from year 2019-2020 which made two major changes in specified Section such as:

1) Section 56(2)(x) is applicable if SDV of any immovable property exceeds 105% of consideration, previously it was just "Stamp duty value is more than consideration." This implies that a tolerance band of 5% is provided by department to assessees.

2) Section 56(2)(x) is not applicable in transactions between holding and 100% subsidiary companies - Fourth proviso to Section 56(2)(x) is amended taking effect from the AY 2018-19. Following this amendment, Section 56(2)(x) shall not be applied if a capital asset is received by a holding company from its subsidiary company which should be 100% subsidiary (and vice versa) provided the transferee company must be an Indian company.[21]

V. RULES OF VALUATION

Rule 11UA provides unquoted equity shares valuation pertinent for Section 56(2)(x) and newly introduced Rule-11UAA provides rules for determination of Fair Market Value for unquoted shares for Section 50CA of the act. Through Notification No. 620 dated 12.07.2017 by Central Board of Direct Taxes ('CBDT') The notified rules removed various ambiguities which earlier, confused the taxpayers regarding the valuation method of unquoted equity shares.

CBDT also issued the Rule 11UA(1)(c)(b) which was substituted with existing rule lays down calculation of Fair Market Value of the unquoted equity shares as follows:

"*FMV of unquoted equity shares = (A+B+C+D-L) x PV/PE, where*

A - Book value of all the assets (except those mentioned at B, C and D below).

B - Fair market value of Jewellery and artistic work based on the valuation report of a registered valuer

C - Fair market value of shares or securities as determined according this rule

D – Stamp duty valuation in respect of any immovable property

L - Book value of liabilities.

PV - Paid up value of equity shares

PE - Total amount of paid up equity share capital as shown in the balance sheet."

VI. BASIS OF DETERMINATION OF FMV

- **In case of listed shares and securities.**

If the Quoted shares and securities are transacted by the way of any recognized stock exchange then the Fair

[21] Act 13 of 2018, S. 23(A)(I) (w.e.f. 1-4-2019).

Market Value of the said assets will be as per transaction details stored in that particular stock exchange.

In case where the quoted share and securities are transacted through a stock exchange which is not recognized, trading on valuation date will be observed of at particular share or securities, in that case also if no trading is found, the lowest price of shares will be FMV on the date proceeding to the date of valuation when trading happened.

- **In case of Unquoted shares and securities.**

Unquoted Equity Shares – the computation of the shares and securities will done using formula "*(A – L) X (PV)/(PE)*

Where, A = Asset book value.

less (i) Advance tax/ TCS/ TDS.

(ii) Unamortized value of expenditure.

L= Liability Book value (As appeared on Balance sheet).

Less (i) Undeclared dividend amount.

(ii) Total Paid-up Equity Capital.

(iii) Provision for tax.

(iv) Reserves and surplus apart of depreciation.

(v) any provision for uncertain liability.

(vi) Contingent liabilities other than Dividend arrears in respect of cumulative preference shares."

- **Valuation of Unquoted Shares other than Equity Shares**

Share and securities of an unlisted company other than equity shares should be valuated at the amount it will be yielding if sold on the date of valuation in open market is proposed to be done. Assessee will also be required to get report from a merchant banker certifying the computed Fair Market Value.[22]

Sub-rule (2) of Rule 11UA of the Rules deals with "*valuation of shares in respect of shares and securities of a company in which the public are not substantially received by a similar company*,"[23] which comes under the purview of Section 56(2)(viib). This Rule provides two alternative methods for computation:

[22] C.A. Gautam Nayak & C.A. Vishesh Sangoi, *Regulatory Aspects of Valuation (Part 1- Direct Taxes)*, THE 15 CHAMBER'S JOURNAL (July 2013), (Jan. 26, 2019, 2:55 PM) http://ctconline.org/pdf/chamber-journal/CJ_July_2013/CJ_July_2013_09.pdf.
[23] *Corporate cases, Determination of F.M.V.*, (Jan. 26, 2019, 1:56 PM), https://www.corporate-cases.com/2016/10/rule-11ua-of-income-tax-rules-1962-determination-fmv.html.

Alternative 1.

The Fair market value of equity shares which are unquoted will be calculated simply by ascertaining "(Book value of Assets - Book value of Liabilities)" after Deducting the amount discussed above in point 2.

Alternative 2.

The Fair market value determined by a Merchant Banker as per Discounted Free Cash Flow Method of the unquoted equity shares. DCF model implies the FMV of venture based of amount of the cash flow which is predicted to be generated by business in future.[24]

The Rule 11UA(1)(c)(b) which existed earlier, determined the fair market value wholly on the basis of book value of unquoted equity shares of the company without giving any importance to consequences relating to other assets to which there was particular valuation method existed, therefore there was an immediate and incidental inconsistency in valuation of certain assets.[25]

The new Rule 11UA(1)(c)(b) removed the referred inconsistency by providing specific valuation rules of unquoted equity shares, intangible assets, investments held in LLP/Partnership firm etc, business undertaking and liabilities of company.

FMV of the following assets owned by company will be assessed as under-

(1) Jewellery and artistic work: At the price it will obtain if transacted in fair market.

(2) Immovable property: Stamp duty value of the property.

(3) Shares and securities: Quoted shares- calculated by exchange trading price, unquoted shares- Price it would fetch in open market

Asset other than (1) (2) (3): The addition of values of respective assets will be FMV.

A point worth noting is the final rules have still failed to address some important issues such as: no relaxation has been granted for transactions entered between 01 April and 12 July as the Rule came on 12th July, 2017 having retrospective effect.

VII. SOME INTRIGUING ISSUES RELATED TO SECTION 50CA & 56(2)(X)

(a) Whether Lottery prize amounts to property or amount received without consideration for the purpose of Section 56(2)(x)?

[24] *Income Tax India, determination of F.M.V.*, (Jan. 26, 2019, 1:57 PM), https://www.incometaxindia.gov.in/Lists/Latest%20News/Attachments/218/Determination-fiar-market-value-unquoted-equity-shares-Start-Up-6-2-2018.pdf.

[25] *Lexology, Revised valuation norms*, (20th Jan., 2019, 7:45 PM), https://www.khaitanco.com/PublicationsDocs/Lexology-KCOCoverage10May17DBVinRaghav.pdf.

Suppose, Mr. A bought a lottery ticket of Rs. 10. He won a prize of Rs. 30,000 on it. His other income for the previous year is Rs. 1,30,000. Mr. A argues that this sum of money is received without consideration and hence this amount should not be added to the amount of Rs. 1,30,000 for the purpose of the deduction of TDS. Therefore, this amount should come under the head of gift. He also argues as the amount does not exceed Rs. 50,000, the amount is exempt from tax in terms of Section 56(2)(x)(a). He wants to claim a refund of the TDS deducted on his prize amount. Is he right in arguing so?

The argument of A that he received Rs. 30,000 without consideration is incorrect. The Supreme Court in the case of *Sunrise Associates v Govt. of NCT of Delhi*[26] held that: "The price paid for lottery ticket is consideration paid for chance to win." Thus, it can be concluded that without paying this Rs. 10 consideration, Mr. A stand could not take part in the draw, and hence would stand no chance to win.

Therefore, it can be concluded that any prize whether it is money or money's worth won under the lottery ticket cannot be brought within the scope of Section 56(2)(x) to the benefit of the purchaser.

(b) Whether sum of money won in any game or contest as a prize amounts to sums of money received without consideration so that it can be taxed under Section 56(2)(x)?

Any sum of money won in contest or game amounts to sums of money received with consideration as held in the case of *Robertson* v. *US*.[27] In this case, a philanthropist announced that he would give a music award which includes $25,000, $5,000 and $2,500 for the three best symphonic works written by native-born composers. The term of the offer contains that the composition will remain the property of the composer with certain rights being transferred to Detroit Orchestra Inc. The Petitioner's composition won the first prize *viz.* of $25,000. The Honorable Justice held that,

"In a legal sense, payment of a prize to the winner of a contest is 'the discharge of a contractual obligation'. Further, the discharge of legal obligations - the payment for services rendered or consideration paid pursuant to a contract - is in no sense a gift."

So, it would not come within the purview of 56(2)(x). Thus, taxpayers cannot evade income tax on sum of money less than 50,000 by arguing that, money won in contests are gift hence are only taxable under Section 56(2)(x) if the amount is greater than 50,000.

(c) Whether any sum received in lieu of surrendering the right to contest will amounts to sums of money received without consideration for the purpose of Section 56(2)(x)?

[26] Sunrise Associates v. Govt of N.C.T. of Delhi, (2006) 5 S.C.C. 603.
[27] Robertson v U.S., [52-1U.S.T.C. 9343].

Amount received by assessee in lieu of surrendering the right to contest will in out of court settlement is money received for consideration, because there is a transfer of rights from both the sides. Hence, if the amount is less than Rs. 50,000, Though it'll not be taxable under Section 56(2)(x), but it cannot evade the curb of the other provisions of the act.[28]

VIII. IMPACT OF SECTION 50CA ON SELECTIVE CAPITAL REDUCTION

Capital reduction is a corporate reorganization activity through which a company extinguishes its existing share capital. Companies choose this course for various reasons, for example, paying back excess capital to the shareholders, increasing shareholder value, by allocating assets to the shareholders, losing of original share capital because of accumulated business losses and thus producing a more efficient capital structure.[29]

This type of reorganization process may affect all the shareholders or certain/specific shareholders. If it affects certain or particular shareholders or a class, it is known as selective capital reduction. One case of such type of capital reduction is minority buyouts.

It is important to analyze the provisions of Income Tax Act which are relevant in the case of selective capital reduction. First of these provisions is Section 45 of Income Tax Act,[30] which provides for the "capital-gains". It says that: "*Any profits or gains arising from the transfer of a capital asset shall be taxed under the head of capital-gains*". Taking into account that the shares in the case of selective capital reduction will be considered as capital assets and the definition of "transfer" incorporates "extinguishment of any right", so we can infer that any decrease of share capital in the process of selective capital reduction might tantamount to transfer of capital assets and pertinent capital gains tax may apply in such situations. As per the Section 50CA, the FMV of these shares will be considered as the full value of consideration for the purpose of calculating the capital gains under Section 48. Accordingly, Section 50CA might be applicable to selective capital reduction for determining the full value of consideration, which shall be the amount which is to be paid by a company in conformance to the reduction of share capital for the purpose of computation of capital gains.[31]

IX. SIMULTANEOUS OPERATION OF SECTION 50CA AND 56(2)(X) RESULTS INTO DOUBLE TAXATION

With the institution of Section 50CA and 56(2)(x) in the Income Tax Act, when there is a transfer of unquoted

[28] Purveb A Poonawalla v. I.T.O., [2011] 10 taxmann.com 221/47 S.O.T. 380 (Mum.).

[29] *Selective capital reduction – Applicability of Section 50CA and Section 56(2)(x) of Income-tax Act, 1961*, (Jan. 20, 2019, 4:00 PM), https://www.eserviceshelp.in/income-tax/selective-capital-reduction-applicability-Section-50ca-Section-562x-income-tax-act-1961/.

[30] Income Tax Act § 45(1961).

[31] *Section 56 Not Applicable to Gift In Kind Received Prior to 1st Oct, 2009*, (Jan. 30, 2019, 1:00AM), https://taxguru.in/income-tax/section-56-applicable-gift-kind-received-prior-1st-oct-2009.html.

shares for a consideration below the Fair Market Value (FMV) and if there is a difference of Rs. 50,000 between the actual consideration and FMV, then in the hands of the 'transferor', FMV should be taken as full value of consideration for computing capital gains where transfer is made for inadequate consideration or without consideration (Section 50CA) and in the hands of the 'transferee' difference between FMV and consideration is taxable as Income from other sources. Thus, resulting in double taxation in the single transaction.

Similarly, in case of transfer of any immovable property at a value below its Stamp Duty Value (SDV), double taxation would arise due to the simultaneous operation of Section 50C in the hands of the transferor and Section 56(2)(x) in the hands of the transferee.[32]

X. CRITIQUE OF DOUBLE TAXATION

Though government has the authority to levy and recover fair share of their taxes but double taxation of the same transaction though in the hands of different taxpayers is completely unjustified as it results in hardships to the taxpayers. Therefore, appropriate amendments need to be done in these Sections to do away with the hardships which the taxpayers are facing due to double whammy of taxation. The government should tax only one taxpayer in the same transaction; it can either tax transferor or transferee.

Transfer of capital assets technically falls within the ambit of capital gains and thus, it should be subjected to only Section 50C and 50CA of Income Tax Act to ensure that the differential amount is taxed in the right tax bracket. For instance, in case of long-term capital gains, the differential amount will get taxed at the rate of 20% due to the subjection of Section 50CA; and if in the same situation if the differential amount is subjected to the provisions of Section 56(2)(x), then the applicable tax rate would become 30%. To deal with this problem, government can rule out those transactions which get covered by Section 50C and 50CA from the purview of Section 56(2)(x). Amendment in Section 49 of the Income Tax Act can also be made to link the cost of acquisition in the hands of transferee to Section 50C and 50CA.[33]

XI. IMPACT OF THE INSTITUTION OF SECTION 50CA & 56(2)(X) ON START-UPS

Amendments in the Income Tax Act affect the whole society and as a result start-up also get affected with every amendment which is made to the Act. As the start-ups are in the developing stage, they need investments in way of loans, debentures and share issuance. As already discussed in the head "Reasons for the institution Section 50CA & 56(2)(x)", start-ups shares are not listed anywhere so the shares issued by them are "Unquoted

[32] Aneri Dani, *Valuation Rules for Sections 50CA and 56(2)(x) - So Close Yet So Far!*, (Jan. 22, 2019, 5:00 PM), http://orange.taxsutra.com/articles/eb7d1deb2feb1c0f097079b44a3c4d/expert_article.
[33] *Id*.

/Unlisted Shares" which in turn curbs the impact of Section 50CA & 56(2)(x).

As discussed earlier, simultaneous application of Section 50CA & 56(2)(x) will cause the double taxation in hands of seller as well as buyer for the difference of the amount of Fair Market Value (FMV) and Sales price (if difference is greater than Rs. 50,000). Start-ups seeking for the investments need to calculate the FMV of their shares as per the valuation method prescribed in Rule 11UA so that they do not get affected due to the impact of double taxation.

Any income received from the investor in against of the share issued by the company may attract the provisions of Section 50CA & 56(2)(x). Investor of shares has also to look out the amount which is to be invested by them in start-ups by looking the financials of start-ups for the capital gains by calculating the FMV of shares of the start-ups.

Start-ups must also quote the number of share allotment needed to make in against the investments to be made by the investors. Non-conformity with any of the provisions of Income Tax Act is not good for the start-ups which are looking for the investors.[34]

As we have already discussed under the head "Reasons for the institution of 50CA & 56(2)(x)", assesses used to evade from the curb of taxation by investing in start-ups because unquoted shares were out of the purview of taxation. This became one of the ways of money-laundering. So, through the institution of Section 50CA & 56(2)(x), unquoted shares can also be taxed in the hands of buyers as well as sellers and thus reducing the window dressing of the investments amount if it is intentionally done to evade the curb of taxation.

XII. Receipt Of Sum Of Money Must Be By Any Mode Other Than By Cash In The Event If It Surpasses Rs. 2,00,000 To Avoid Double Whammy Of Tax And Penalty

Section 56(2)(x)(a) does not provide for the mode in which money should be received; Hence as far as Section 56(2)(x)(a) is concerned sums of money received by whichever mode, whether it be by cash or account payee cheque/DD or by debit cards or credit cards or online transfers, it will be taxable if the sums in aggregate exceed the threshold of Rs. 50000 in a financial year. However, the Finance Act, 2017 has inserted 269ST which provides that: "*No person shall receive an amount of two lakh rupees or more—*

a) *In aggregate from a person in a day; or*

b) *In respect of a single transaction; or*

[34] C.A. Yatin Jain, *Impact of Section 50CA of Income Tax Act on Startups*, (Jan. 27, 2019, 6:00 PM), http://startupbuddy.co.in/blog-detail.php?name=Impact-of-Section-50CA-of-Income-Tax-Act-on-Startups.

c) *In respect of transactions relating to one event or occasion from a person,*

Otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account."[35]

Question arises what if a huge cash gift of Rs. 4,00,000 is received from a donor and offered to tax in Income Tax Return filed and tax paid by donee? Or what if four Rs.1,00,000 cash gifts are received from same donor during one Financial year and offered to tax in ITR by donee and tax paid him? Would the consequences of penalty under Section 271DA apply in addition to donee? It would appear that, in addition to tax payable by him, donee would also be liable to penalty under Section 271DA unless the Central Government exempts cash gifts taxable under Section 56(2)(x) by issuing a notification under clause (iii) of proviso to Section 269ST.

Question also arises about the tax-exempted gifts provided in Section 56(2)(x) of money received in cash? Will Section 269ST read with Section 271DA apply here also? Of course, gifts mentioned in *(V)* to *(VIII)* of Section are more likely to be by way of non-cash modes. However, gifts in *(I)* to *(IV)* above and amounts received on total or partial partition of HUF may be in cash. Gifts mentioned in Item (*II*) *i.e.* on the occasion of the marriage of the individual are usually in cash received in sealed envelopes. It is quite possible that gifts received in cash in sealed envelopes from some 200 persons may amount to say Rs. 20,00,000 and no single donor has given more than Rs. 1,99,999. In such a case, it appears that Section 269ST would not trigger as it does not amount to "receive an amount of two lakh rupees or more in respect of transactions relating to one event or occasion from a person". However, if any money gift received from a person on occasion of marriage is Rs. 2,00,000 or more, it has to be accepted by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account.[36]

XIII. SECTION 49(4) DILUTES THE IMPACT OF DOUBLE TAXATION ON BUYER

As it has already been discussed that under Section 56(2)(x), the buyer is charged to tax on the difference between the Fair Market Value (FMV) of the shares and the actual consideration paid by the buyer. But according to Section 50CA the seller is also charged to tax under the head of capital gains if the actual consideration is less than the Fair Market Value. Question arises, if the buyer who has already been charged under Section 56(2)(x) sells his shares; will he also be charged under Section 50CA which applies to seller. Section 49(4) comes to rescue such buyers. According to this Section, whenever this buyer sells these shares,

[35] Income Tax Act § 269ST (1961).

[36] *Update on Section 269ST Inserted by the Finance Act, 2017*, (Jan. 27, 2019, 6:00 PM), http://gstlawindia.in/wp-content/uploads/2017/04/IT-Update-on-Section-269ST.pdf.

the cost of acquisition will be taken to value which has been considered for the purpose of Section 56(2)(x) and hence saving the buyer from the impact of double taxation on the differential amount.[37]

XIV. IMPACT ANALYSIS OF THE RULES OF VALUATION

In the interest of minority: It is highly probable that the minorities may not have access to all the relevant information; it would be difficult for them to determine the value of unquoted equity shares under the new rules. To solve this issue, CBDT could prescribe minimum threshold criteria (in terms of percentage holding or transaction value).

It is in conflict with the subsisting provisions: There might be a disagreement between the new rules and the provisions of tax law which are already there, for example, transfer pricing, or where the relevant provisions such as foreign exchange regulations may prescribe a different FMV determination.

Vagueness regarding valuation of preference shares: There is no doubt that the provisions secure the transfer of both preference and equity shares at less than FMV, the valuation rules only furnish a mechanism for the computation of FMV of unquoted equity shares.

Making mandatory to value specified capital assets at FMV: the draft rule necessitates the valuation of provided capital assets at FMV as against the existing rules to value them at book value. Thus, inviting cumbersome procedure to determine the FMV therefore affecting the inter-se restructuring among group entities and causing distress sale.

Retrospective application: As the valuation rules were made applicable with retrospective effect from April 1, 2017. This would lead to highly uncertain tax region and a higher tax burden. This may also chaos with the standing of current government against the proposal of retrospective amendments.[38]

XV. CONCLUSION

The hypothesis which is tested in this paper shows that though there were many anti-abusive provisions in the Income-Tax Act but they failed to a considerable extant to curb the tax evasion because many assessees whether it be a buyer or a seller used to understate the value of the consideration and hence used to dodge from the deterrence of tax laws or the laws which were prevailing used to apply only to some set of individuals or to some set of cases. To put a restraint on such practice and to extend the scope of taxability of the existing provisions legislature was looking for the ways to scrutinize these assessees. Hence, these anti-abusive

[37] Malay Damania, *India: Sale/Transfer Of Unquoted Shares – Get Your Valuation Right!*, (Jan. 29, 2019, 4:30 PM), http://www.mondaq.com/india/x/738940/Capital+Gains+Tax/SaleTransfer+Of+Unquoted+Shares+Get+Your+Valuation+Right.

[38] Narendra Rohira, *Valuation of Unlisted Equity Shares: Impact Analysis*, BLOOMERANG QUINT OPINION, 3 (Jan. 29, 2019, 1:02 PM), https://www.bloombergquint.com/opinion/2017/05/13/valuation-of-unlisted-equity-shares-impact-analysis-ofdraft-rules.

provisions in the form of Section 50CA and Section 56(2)(x) were enacted in the Act. The main motive of Section 50CA is to tax the difference of fair market value and the sale consideration if it exceeds Rs. 50,000 as capital gains in the hands of "transferor" of such share while Section 56(2)(x) taxes the difference between Fair market value/Stamp duty value and consideration if it exceeds Rs.50,000 as a deemed benefit under the head income from other sources for the "recipient". The main intention was to curb the practice of avoiding the tax through transfer of unquoted shares. The new Section has a wide coverage on all assessees i.e. Residents, Non-Residents and Non-Related entities. Applies to all kinds of shares whether equity or preference Share. Previous Section was valid only on Individual or HUF or Firm/Company in certain cases, therefore, the receipt of money/property for without/inadequate consideration did not attract anti-abuse provisions in cases of other assessees. But now, definition has covered all assessees in its ambit.

As the coin have two faces, in the same way these provisions also have some good implications and some bad implications. Good implications include the impact these provisions have on start-ups because before the enactment of these provisions investor in start-ups used the investment as a way of money laundering because the shares in the start-ups are mostly unquoted which were outside the ambit of taxation. After enactment of Section 50CA unquoted shares are also brought within the ambit of taxation, thus curbing the way for money-laundering. Corporate entity used to evade the capital gains tax through the method of selective capital reduction, but after the amendment this process is also covered by Section 50CA.

These provisions also have some worst implications as they result in double taxation which means both buyer and a seller in a single transaction have to pay tax in certain set of cases and thus it proves to be a hardship for the taxpayers to transfer their property or shares freely which is completely unjustified.