A ANARKALI SARABHAI, SHAHIBAG HOUSE, AHMEDABAD

v.

COMMISSIONER OF INCOME TAX, AHMEDAHAD

JANUARY 24, 1997

B [S.C. AGRAWAL AND SUHAS C. SEN, JJ.]

Income Tax Act, 1961—Sections 2(47), 45-Capital gains—Redemption of preference shares by a private limited company—Falls within the phrase "Sale, exchange or relinquishment of asset"—Amounts to transfer within the
C *meaning of Section 2 (47)—Resultant profit or gain to the erstwhile individual shareholder taxable as capital gain.*

Companies Act, 1956-Sections 85, 80, 77(1)(5) Redemption of preference shares-Squarely comes within the phrase-"Sale, exchange or relinquishment" of the asset.

D

The assessee-appellant held some redeemable preference shares of a private limited company. During the accounting year relevant to the assessment year 1969-70, the company redeemed the preference shares and the value of the shares consequently received by the appellant exceeded the
E **amount which she had paid for them. The Income tax Officer sought to tax this amount of difference as capital gains under Section 45 of the Income Tax Act. The assessee-appellant protested contending that redemption of her preference shares by the company would not amount to transfer within the meaning of section 2(47) of the Act and consequently the difference between the value received by her from the company on**
F **redemption of the shares and the price she had paid for the shares was not exigible to tax. The contention was rejected by the Income Tax Officer as well as the Appellate Assistant Commissioner and the tribunal. The High Court also confirmed the same. Hence this appeal by the assessee.**

G **Dismissing the appeal, this court**

HELD 1. The excess amount received by the shareholder on redemption of preference shares was rightly treated as capital gain and exigible to tax accordingly. Section 2(47) of the Income Tax Act, 1961 gives an inclusive definition to "transfer". Clause (i) of sub-section (47) of Section
H **2 speaks of "Sale, exchange or relinquishment of asset". This implies**

**parting with any capital asset for gain which will be taxable under Section A
45. In the instant case, when the shares were redeemed by the, company,
the assessee received more than what she had paid for the shares. In order
to get this amount the assessee had to give up or abandon or surrender
the shares held by her. This comes clearly within the mischief of section 2
(47) (i). [504-H; 505-A-B]** B

**2.1 Moreover, the transaction amounts to sale. In view of the
provisions of sections 85, 80 and 77(i) and (5) of the Companies Act, when
a preference share is redeemed by a company, what a shareholder does in
effect is to sell the share to the company, such a transaction is nothing but
sale of preference shares by the shareholders to the company. That is why** C
**after specifically laying down in Section (77)(1) that no company shall have
the power to buy its own shares, it was necessary to specify in sub-section(5)
that this provision shall not affect the right of a company to redeem any
shares issued under Section 80. If redemption of preference shares did not
amount to sale, it would not have been necessary to specifically provide that
the restriction imposed upon a company in respect of buying its own shares** D
**will not apply to redemption of shares under section 80. Therefore, redemp-
tion of preference shares by the company will squarely come within the
phrase "Sale, exchange or relinquishment" of the asset. [507-B-D; 510-B]**

2.2 The shares held by a member in a company is movable property E
**transferable in the manner provided in the Articles of Association of the
Company and the shares can be held by a member as stock-in-trade or
capital assets. In the instant case, the preference shares were rightly held
as capital assets in view of the provisions of section 2(47) read with Section
45 of the Income Tax Act. [507-F]** F

Sath Gwaldas Mathurdas Trust **v.** *Commissioner of Income Tax*, **165
ITR 620, approved.**

Commissioner of Income Tax, Gujarat **V.** *R.M. Amin*, **106 ITR 368;**
Sunil Siddharathbhai **v.** *Commissioner of Income Tax, Ahmedabad and* G
Kartikeya **v.** *Sarabhai* **v.** *Commissioner of Income Tax*, **156 ITR 509;** *Com-
missioner of Income Tax, Bombay* **v.** *Rasiklal Maneklal (HUF)*, **177 ITR
(198) and** *Vanita Silk Mills P. Ltd.* **v.** *Commissioner of Income Tax*, **191 ITR
647, referred to.**

Anarkali Sarabhai **v.** *CIT*, **(1982) 138 ITR 437 (Guj), affirmed.** H

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 541 of 1983.

From the Judgment and Order dated 18/22.6.82 of the Gujarat High Court in I.T.R. No. 24 of 1978.

G. Ganesh and A.K. Verma for the Appellant.

J. Ramamurthi, B. Krishna Prasad and Dhruv Mehta for the Respondent.

The Judgment of the Court was delivered by

SEN, J. In this case the question of law is :

> Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee was liable to pay tax in respect of capital gains on receipt of the amount equal to the face value of the preference shares of M/s. Universal Corporation Pvt. Ltd. on the company redeeming its preference shares?

The High Court answered the question in the affirmative and against the assessee. The High Court granted a certificate of fitness for appeal under Section 261 of the Income Tax Act in view of the fact that they had taken a view contrary to the view adopted by the Madras High Court on this question.

The facts of the case, as stated in the judgment of the High Court, are as under :-

> "The assessee is an individual and the assessment year under reference is assessment year 1969-70, the year of account being the calendar year 1968. The assessee held 297 redeemable preference shares of M/s. Universal Corporation Private Limited a company incorporated under the Companies Act (hereinafter referred to as the "Company"). The face value of such of these preference shares was Rs. 1,000 and, therefore, the total face value of these shares came to Rs. 2,97,000. The assessee had purchased these shares for Rs. 2,68,550. The Company decided to redeem the preference shares and the assessee received Rs. 2,97,000 face value of the shares held by her in the year of account relevant to

assessment year under reference. Thus the value of the shares received by the assessee exceeded the value which he had paid for these shares by Rs. 30,450. The Income Tax Officer, assessing the assessee sought to tax this amount of difference as capital gains under Section 45 of the Act. The assessee resisted the action proposed by the Income Tax Officer by contending that redemption of her preference shares by the Company would not amount to transfer within the meaning of Section 2(47) of the Act and consequently the difference between the value received by her from the Company on redemption of shares and the price which she had paid for the shares was not exigible to tax. In other words, according to the assessee even if there was any profit or gain, as a result of redemption on shares by the Company, such profit or gain could not be said to have arisen from the transfer of a capital asset. The Income Tax Officer, however, rejected the contentions raised on behalf of the assessee and brought capital gains arising out of the redemption of the shares to tax."

The Appellate Assistant Commissioner as well as the Tribunal upheld the view taken by the Income Tax Officer.

It has been contended by Mr. G. Ganesh appearing on behalf of the appellant that there is no question of applicability of Section 45 of the Income Tax Act in this case because no 'transfer' of the preference shares had taken place because of the redemption of the shares. The capital received by the Company had been returned to the shareholder. The money was not paid by the Company to the shareholder because of any sale, exchange or relinquishment of the capital asset or extinguishment of any right therein. Our attention was invited to the definition of 'transfer' and it was contended that redemption of shares did not come within the mischief of Section 2(47).

Sections 2(47) and 45(1) are as follows :-

"2(47). 'transfer', in relation to a capital asset, includes,-

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

A (iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or

B (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or

C (vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property;

D Explanation.- For the purposes of sub-clauses (v) and (vi), 'immovable property' shall have the same meaning as in clause (d) of section 269UA;

E 45. Capital gains.- (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 and 54G, 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."

F The contention of Mr. Ganesh is that redemption of preference shares cannot be treated as sale, exchange or relinquishment of the asset. It cannot also be regarded as "extinguishment of any rights therein" as contemplated in clause (ii) of Section 2(47), 'Therein' implies the continuing existence of the asset in which right of the assessee has been extinguished. Various case laws were cited in support of this contention. But G before dealing with the case laws, we shall examine the section itself and see how far the argument advanced by Mr. Ganesh is sustainable in law.

Sub-section (47) of section 2 gives an inclusive definition to 'transfer'. This is not an exhaustive definition. Clause (i) of sub-section (47) of Section 2 speaks of "sale, exchange or relinquishment of the asset". This implies H parting with any capital asset for gain which will be taxable under Section

45. In the instant case, what has happened is that the assessee had purchased the preference shares at less than face value. When the shares were redeemed by the Company, she received more than what she had paid for the shares. In order to get this amount the assessee had to give up or abandon or surrender the shares held by her. The meaning of the word 'relinquish' as given in Webster's Comprehensive Dictionary, International Edition 1984, is "1. To give up; abandon; surrender. 2. To cease to demand; renounce; to relinquish a claim. 3. To let go (a hold or something held). " The assessee in this case has given up the shares and has received in lieu thereof a sum of money. This, in our view, comes clearly within the mischief of Section 2(47)(i).

That apart, in our view the transaction amounts to "sale".

Under the provisions of the Companies Act, 1956 the share capital of a company limited by shares may be of two kinds - (a) equity share capital and (b) preference share capital. Section 85 of the Companies Act has defined "preference share capital" to mean that part of the share capital of the company which fulfils both the following requirements :

(a) as respects dividends, it carries or will carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to income-tax; and

(b) with regard to capital, it carried or will carry, on a winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up, whether or not there is a preferential right to the payment of either or both of the following amounts, namely:

  (i) any money remaining unpaid, in respect of the amounts specified in clause (a), up to the date of the winding up or repayment of capital; and

  (iii) any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company.

Section 85(2) of the Companies Act has defined "equity share capital" to mean "all share capital which is not preference share capital." Section 80

A of the Companies Act lays down that a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. This section, however, lays down that preference shares must not be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the B purposes of the redemption. They cannot be redeemed unless they are fully paid. The premium, if any, payable on redemption must have been provided for out of the profits of the company or out of the company's share premium account before they are redeemed.

C There are other provisions in Section 80 which are not necessary for the purpose of this case. But, it has to be noted that it has been specifically provided in sub-section (3) that the redemption of preference shares shall not be treated as reduction of the amount of the authorised share capital. The balance sheet of the company which has issued redeemeable preference shares must specify any part of the issued capital of the com- D pany that consists of such shares, the earliest and latest dates on which the company has power to redeem them, whether they must be redeemed in any event or are liable to be redeemed at the option of the company, and whether any (and, if so, what) premium is payable on redemption.

E The other provision of the Companies Act which is important in this connection is Section 77 which is as under :

> "77. Restrictions on purchase by company, or loans by company for purchase, of its own or its holding company's shares. -
>
> F (1) No company limited by shares, and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of capital is effected and sanctioned in pursuance of sections 100 to 104 or of section 402.
>
> G (2) ... ...
>
> (3) ... ...
>
> (4) ... ...
>
> H (5) Nothing in this Section shall affect the right of a company to

redeem any shares issued under Section 80 or under any corresponding provision in any previous companies law."

This section clearly implies that redemption of its preference shares by a company would have come within the bar of purchasing its own shares by a company. This specific provision of sub-section (5) was necessary to get over the bar. The company redeemed its preference shares only by paying the preference shareholders the value of the shares and taking back the preference shares. In effect, the company has bought back the preference shares from the shareholders. It may have been done at a date set by the terms of the issue. When a preference share is redeemed by a company, what a shareholder does in effect is to sell the share to the company. Such a transaction is nothing but sale of the preference shares by the shareholders to the company. That is why after specifically laying down in Section 77(1) that no company shall have the power to buy its own shares, it was necessary to specify in sub-section (5) that this provision shall not affect the right of a company to redeem any shares issued under Section 80. If redemption of preference shares did not amount to sale, it would not have been necessary to specifically provide that the restriction imposed upon a company in respect of buying its own shares will not apply to redemption of shares issued under Section 80.

Therefore, in my judgment, the redemption of preference shares by the company will squarely come within the phrase "sale, exchange or relinquishment of the asset".

There can be no dispute that the shares held by a member in a company is movable property transferable in the manner provided in the Article of Association of the company. There can also be no dispute that the shares can be held by a member as stock-in- trade or capital assets. In the instant case, the preference shares were held as capital assets. The excess amount received by the shareholder on redemption of these shares will have to be treated as capital gain in view of the provisions of Section 2(47) read with Section 45 of the Income Tax Act.

I shall now refer to the various cases that were cited at the bar.

In the case of *Commissioner of Income Tax, Gujarat* v. *R.M. Amin,* 106 ITR 368, the company went into voluntary liquidation. The assessee as a shareholder received an amount from the liquidator which was in excess of the amount that he had paid for those shares. It was held that there was no transfer of any capital asset within the meaning of Section 2(47) of the Income Tax Act. When a shareholder receives money representing his share on distribution of the net assets of the company in liquidation, he receives that money in satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounted to sale, exchange or relinquishment of the capital asset or extinguishment of any right in the capital asset.

This was a case dealing with distribution of assets on liquidation of a company among the contributors which is not the case here.

In the case of *Sunil Siddharthbhai* v. *Commissioner of Income Tax, Ahmedabad* and *Kartikeya V. Sarabhai* v. *Commissioner of Income Tax,* 156 ITR 509, this Court held that where a partner of a firm made over capital assets which were held by him to a firm as his contribution towards capital, there was a transfer of capital asset within the meaning of Section 45 of the Income Tax Act, 1961 because an exclusive interest of the partner in personal assets was reduced into a share interest. It was pointed out in that case that in a general sense, the expression "transfer of property" meant the passing of rights in property from one person to another. In one case, there may be passing of the entire bundle of right from the transferor to the transferee. In another case, the transfer may consist of one of the estates only out of all the estates comprising the totality of rights in the property. In the third case, there may be reduction of the exclusive interest in the totality of the rights of the original owner into a joint or a share interest with others. An exclusive interest in property was a larger interest than a share in that property. To the extent to which the exclusive interest was reduced to share interest, there was a transfer of property.

This again, has no bearing on the question whether redemption of preference shares will come within the mischief of Section 2(47) of the Income Tax Act.

The Bombay High Court in *Sath Gwaldas Mathuradas Mohata Trust* v. *Commissioner of Income Tax,* 165 ITR 620, dealt with the question which has now arisen in this case. There the question was whether the amount received by the assessee on redemption of preference shares was liable to tax under the head "capital gains". After referring to the meaning given to "transfer" by Section 2(47) of the Income Tax Act, the Court held :

> "Here, a regular "sale" itself has taken place. That is the ordinary concept of transfer. The company paid the price for the redemption of the shares out of its fund to the assessee and the transaction was clearly a purchase. As rightly observed by the Tribunal, if the company had purchased a valuable right, the assessee had sold a valuable right. "Relinquishment" and "extinguishment" which are not in the normal concept of transfer but are included in the definition by the extended meaning attached to the word are also attracted in the transaction. The shares were assets and they were relinquished by the assessee and thus relinquishment of assets did take place. The assessee by virtue of his being a holder of redeemable cumulative preference shares had a right in the profits of the company, if and when made, at a fixed rate of percentage. Quite obviously, this was a valuable right and this right had come to an end by the company's redemption of shares. Thus, the transaction also amounted to "extinguishment" of right. Under the circumstances, viewed from any angle, there is no escape from the conclusion that section 2(47) was attracted and that the amount of Rs. 50,000 received by the assessee was liable to be taxed under the head "Capital gains".

The view taken by the Bombay High Court accords with the view taken by the Gujarat High Court in the judgment under appeal. In the judgment under appeal, it was pointed out that the genesis of reduction or redemption of capital both involved a return of capital by the company. The reduction of share capital or redemption of shares is an exception to the rule contained in Section 77(1) that no company limited by shares shall have the power to buy its own shares. When it redeems its preference shares, what in effect and substance, it does is to purchase preference shares. Reliance was placed on the passage from Buckley on the Companies Acts, 14th Edn., Vol. I, at p. 181 :

> "Every return of capital, whether to all shareholders or to one, is pro tanto a purchase of the shareholder's rights. It is illegal as a reduction of capital, unless it be made under the statutory authority, but in the latter case is perfectly valid."

Reference was also made to Pennington's Company Law, 4th Edn. at p. 192 :

A "The general rule is that a company cannot issued shares on terms that it shall or may redeem them at an agreed future date, because the redemption would amount to a purchase by the company of its own shares, which is illegal."

We are of the view that the High Court has come to a right decision B in this case. The redemption of preference shares in the facts of this case will squarely come within the meaning to the phrase "sale, exchange or relinquishment of the asset".

We were also referred to decision of Madras High Court which was C a case of reduction of share capital and also the decision in *Commissioner of Income Tax, Bombay* v. *Rasiklal Maneklal (HUF),* 177 ITR 198, which again was a case of amalgamation of two companies. In the facts of that case, it was held that there was neither any exchange nor any relinquishment of an asset by the assessee. Consequently, there was no transfer within the meaning of Section 12B of the Indian Income Tax Act, 1922.

D

The case of *Vania Silk Mills P. Ltd.* v. *Commissioner of Income Tax,* 191 ITR 647, is also not of any assistance for the purpose of this case. That was a case where insurance money was paid for loss of machinery. It was held that the amount received in replacement of machinery could not be treated as capital gain because payment of insurance claim was not in E consideration for machinery taken over. This was not a case of extinguishment of right in the property on account of destruction or loss of asset.

Mr. Ganesh also strenuously argued that this is not a case where the extinguishment of any right in the preference shares had taken place. The F preference share itself stood extinguished by redemption. Therefore, clause (ii) of Section 2(47) could not be invoked in the facts of this case to bring the surplus amount received by the assessee to tax as capital gains under Section 45 of the Income Tax Act.

In our view, the case squarely comes within clause (i) of Section G 2(47). Therefore, it is not necessary to express any opinion on the last contention of Mr. Ganesh.

The appeal is dismissed. The judgment under appeal dated 18/22.8.1992 is affirmed. There would be no order as to costs.

H.K. Appeal dismissed.