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TRIBUNAL DENIES FOREX BENEFIT AND RESULTANT LOSS ON SALE OF SHARES

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In a first ruling on the issue, the Income Tax Appellate Tribunal, Mumbai (Tribunal) in the case of *Legatum Ventures Limited* (Taxpayer) [ITA No. 1627/2022], ruled that capital gains on sale of unlisted shares by a non-resident must be computed strictly as per Section 112(1)(c)(iii) of the Income Tax Act, 1961 (ITA) without considering the computation provisions under Section 48 of ITA.

Background

- The Taxpayer is a foreign company engaged in investment activities. During the year under consideration, Taxpayer sold the shares of an unlisted Indian company and the computation as per applicable provisions of ITA resulted in capital loss in its hands.

- In terms of relevant provisions, Section 48 provides the "mode of computation" of income in the nature of "capital gains", and Section 112 provides the tax rates applicable to long term capital gains in different scenarios, subject to certain conditions / requirements.

- As per Section 48, income in the nature of "capital gains" shall be computed by reducing cost of acquisition and expenses incurred in connection with the transfer from the total sale consideration. Further, the first proviso to Section 48 of ITA provides that in case of sale of shares by a non-resident, capital gains shall be computed in the same foreign currency that was utilised by the non-resident for purchasing the shares, and the capital gains so computed shall be converted into INR, byapplying the prescribed foreign exchange rates. This proviso essentially neutralises the effect of foreign exchange fluctuations on income earned by non-residents.

- As per Section 112(1)(c)(iii), long term capital gain on transfer of unlisted securities or shares is taxable at 10% on gain computed without giving effect to *inter-alia* foreign exchange fluctuation (as contemplated by first proviso to Section 48 of ITA discussed above).

- Applying the method prescribed under Section 48, the Taxpayer's computation resulted into a long-term capital loss and in the absence of taxable income, it did not apply the provisions of Section 112(1)(c)(iii). Accordingly, it filed its tax return reporting Nil income. The tax return filed by the Taxpayer was selected for audit wherein the tax officer 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 is to

be ignored. This approach resulted into a taxable long term capital gain for the Taxpayer.

- The Taxpayer filed its objections before the Dispute Resolution Panel which were rejected and hence, the Taxpayer appealed the same before the Tribunal.

Taxpayer's contentions

- Section 48 provides for the mode of computation of income chargeable under the head 'Capital Gain'; and Section 112 prescribes applicable tax rates which are relevant if taxpayer has income chargeable under the head 'Capital Gain' arising on transfer of a long-term capital asset.

- In Taxpayer's case, since the computation as per Section 48 resulted in long-term capital loss, the provisions of Section 112(1)(c)(iii) are not relevant or applicable.

Tribunal ruling

The Tribunal affirmed the order of tax officer and dismissed Taxpayer's appeal by ruling that capital gain must be computed only by reference to provisions of section 112(1)(c)(iii) of ITA on the basis of following:

- While Section 112 refers to determination of tax payable by a taxpayer on income arising from transfer of long-term capital assets, it also provides for mode of computation of capital gains earned by non-residents on sale of unlisted shares.

- Section 48 is a general provision whereas Section 112(1)(c)(iii) is a special provision for computation of capital gains earned by non-residents on sale of unlisted shares and securities.

- The Tribunal referring to rule of interpretation expressed by the maxim *"Generallia specialibus non derogant"* held that if a special provision is applicable for a certain matter, that matter is excluded from the general provision. Accordingly, the computation is to be undertaken in accordance with the specific provision of Section 112(1)(c)(iii) of ITA.

- The Tribunal concluded that if Taxpayer's claim that income should be computed only as per Section 48 of ITA is accepted, it would render the computation mechanism under Section 112(1)(c)(iii) of ITA otiose and redundant.

Comment

Section 48 is a computation provision and the interplay between section 48 and section 112 was the subject matter of debate before the Tribunal. The Tribunal concluded that Section 112(1)(c)(iii) is a specific provision applicable on sale of unlisted shares by a non-resident and hence, the computation must be undertaken only as per Section 112(1)(c)(iii) of ITA (i.e. without giving effect to first and second proviso to Section 48).

The scope of section 112 is at the core of the dispute i.e., is it a computation provision or merely a provision prescribing tax rates, albeit with certain conditions, in case the computation results in income / gains. The general tax rate applicable on long term capital gains on unlisted shares is 20%; and for non-residents, a concessional tax rate of 10% was introduced with a condition that forex benefit would not be available to non-residents where such 10% rate applies. Therefore, the question is where one provision allows forex benefit

to non-residents and results in a capital loss, should the provision prescribing tax rate and restricting availability of forex benefit, be applicable in the first place. It will be interesting to see how higher courts rule on the issue considering the scope of the relevant provisions.

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