DCIT vs. M/s Vrindavan Services Pvt Ltd

(2018)(I.T.A No.235/Mum/2015)

Write back of preference shares, being a capital receipt, is not taxable as business income despite assessee's admission during the course of search

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1. **Facts:**

    a. During FY 2003-04, the assessee (**VSPL**) issued 2.5% redeemable non-cumulative preference shares (**RCPS**) worth Rs. 8.75 cr to M/s South India House Investments Ltd. (**SIHIL**), a JSW group company. RCPS were compulsorily redeemable in FY 2023-24 as per Section 80 of the Companies Act, 1956[1].

    b. Separately, during the course of search and seizure action carried out on JSW group of companies, the Revenue found books and documents of the assessee. During the course of search, the Managing Director and Group CFO of M/s JSW group of companies, gave a declaration that the assessee had offered Rs. 8.75 cr as undisclosed income towards write back of preference shares. However, in the return of income, the assessee had not admitted any income in respect of undisclosed income on the ground that the assessee had not written back the preference share capital in its books and that in any case, such write back, is not chargeable to tax, being a capital receipt.

    c. The Assessing Officer, however, relying on the statement during search, taxed Rs. 8.75 cr. in the hands of assessee u/s 28(iv) of Income tax Act, 1961 (**ITA**).

2. **Issue under consideration before the Tribunal**

    a. Whether write back of RCPS is taxable u/s 28(iv) as benefit arising out of business activity, based only on the admission made during the search operations?

    b. Whether RCPS can be reversed or redeemed in violation of provisions of Companies Act, 1956?

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[1] Section 55 of Companies Act, 2013

c. Whether reduction of preference shares capital is on capital account?

3. Revenue's contentions

a. Based on declaration letter filed during the search action, the Revenue was of the opinion that the assessee has, in principle, admitted that the sum of Rs.8.75 crores is no longer payable to SIHIL.

b. Since the amount is no longer payable, it is a benefit directly arising out of business activity of the assessee and, therefore, chargeable to tax u/s 28(iv).

4. Assessee's contentions

a. Owing to search action, to buy peace and avoid litigation, it was agreed for disclosure of undisclosed income of Rs.8.75 crores.

b. However, as per section 80 of the Companies Act, 1956:
    a. RCPS cannot be redeemed before the specified period;
    b. RCPS can be redeemed only out of accumulated profits available for distribution of dividend or proceeds of fresh issue of shares.

    Thus, the assessee claimed that the law forbids it from writing back RCPS even if the same are considered as no more redeemable.

c. Even otherwise, preference share capital is capital receipt and not chargeable to tax.

d. Admission during the course of search is of mistaken understanding of facts, therefore, without any further evidence found during the course of search, only on the basis of admission, a receipt in the nature of capital receipt cannot be taxed u/s 28(iv) of ITA.

5. **Held :**

The ITAT held a capital receipt cannot be taxed either u/s 28(iv) or 41(1) of ITA and accordingly, write back of preference share capital cannot be taxed u/s 28(iv) of ITA. While rendering the decision, the ITAT held as under:

a. The taxability of an amount as income in the hands of an assessee should be decided purely on its merits and strictly in accordance the ITA and not based on admissions made by assessee during the course of search. The assessee cannot be always made bound by its 'admissions'. The position of law remains unchanged and the legal position is not altered even on the basis of consent of an assessee especially when the consent is subsequently withdrawn. It is because of the fact, that as per the constitutional framework of our country, no tax can be collected except as per authority of law, as has been clearly laid down under Article 265 of Constitution of India.

b. The Bombay High Court has, in Vodafone India Services Ltd (WP) No. 871 of 2014, held that amounts received on issue of share capital including the premium is on capital account.

c. Accordingly, a capital receipt cannot be brought to tax solely on the basis of alleged admission by the assessee.

Conclusion

The premise of addition in said case i.e., taxability on write-back of preference share capital is itself flawed since the same can happen only through the process of capital reduction, which requires approval from NCLT. Nevertheless, this decision reiterates the legal position that a capital receipt cannot be brought to tax under section 28(iv). Besides, the language employed by section 28(iv) clearly suggests that it applies only to benefits received in kind. The said legal position has been settled by various decisions. Hence, even for said reason, section 28(iv) cannot be invoked in case of write-back of preference shares.