

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O. O. C. J.**

INCOME TAX APPEAL NO.5372 OF 2010

Commissioner of Income Tax—4.

...Appellant.

Versus

Enam Securities Private Limited.

...Respondent.

.....

Mr.Vimal Gupta for the Appellant.

Mr.Sanjiv M.Shah for the Respondent.

.....

**CORAM : DR. D.Y. CHANDRACHUD &
MRS.MRUDULA BHATKAR, JJ.**

April 27, 2012.

ORAL JUDGMENT (PER DR.D.Y.CHANDRACHUD, J.) :

This appeal arises from a decision of the Income Tax Appellate Tribunal dated 19 December 2008. The issue raised by the Revenue in the appeal which is under Section 260A of the Income Tax Act, 1961, arises from the assessment proceedings for Assessment Year 2002-03. The Revenue has raised the following questions of law:

“A. Whether on the facts and in the circumstances of the case the Tribunal was right in law in deleting the addition of Rs.70,60,209/- made by the Assessing Officer on account of outstanding brokerage payable by the Assessee Company of earlier years by holding that neither there was any remission nor cessation of the said liability during the assessment year under appeal even though the Assessee Company had failed to establish before the Assessing Officer and the CIT (Appeals) that the said liability existed in Assessment Year 2002-03 being the year under appeal;

B. Whether on the facts and in the circumstances of the case the Tribunal was right in holding that there was absolutely no

basis whatsoever about the Assessing Officer coming to the conclusion that the redemption of preference shares was a sham even though the management of the Company whose preference shares were redeemed and the Assessee Company belonged to the same group of persons and were also by the same group of persons;

C. Whether on the facts and in the circumstances of the case the Tribunal was right in holding that redemption of non-cumulative preference shares results in 'transfer' of assets as contemplated by section 2(17) of the Income Tax Act;

D. Whether on the facts and in the circumstances of the case and in law, the Tribunal is right in allowing indexation benefit on redemption of non-cumulative preference shares to the Assessee Company even though such non-cumulative preference shares are in the nature of 'debt' and therefore fall into the category of bonds and debentures as envisaged by the third proviso of section 48 of the Income Tax Act."

2. The appeal is admitted on Question (D) and is taken up for hearing and final disposal with the consent of Counsel.

Re: Question A:

3. The assessee is engaged in the business of share-broking and also deals in shares. For the Assessment Year, the assessee filed its return of income on 29 October 2002 declaring an income of Rs. 22.60 crores. During the course of Assessment Years 1994-95, 1995-96, 1996-97 and 1997-98 the assessee had outstanding brokerage in the amount of Rs. 62.87 lakhs. For Assessment Year 1999-2000, the brokerage liability outstanding was Rs. 7.74 lakhs. During the course of the assessment proceedings, the Assessing Officer sought confirmation of these liabilities. The assessee pointed out that during

the course of the Assessment Year 2004-05 an amount of Rs. 62.87 lakhs was written back into the profit and loss account. The amount was offered as income for Assessment Year 2004-05 and taxes were paid thereon. The Assessing Officer came to the conclusion that the liability did not exist for Assessment Year 2002-03 and brought the amount to tax for that year. The CIT(A) agreed with the Assessing Officer. The Tribunal has noted that the only ground on which the addition was made was that the liability never existed in Assessment Year 2002-03. The Tribunal has on the other hand come to the conclusion that there was an error on the part of the Assessing Officer and the CIT(A) in making an addition under Section 41(1) as there was no remission or cessation of liability in question during Assessment Year 2002-03. The order of the Tribunal is evidently correct. There was no remission or cessation of liability during Assessment Year 2002-03. In these circumstances, Question (A) will not give rise to any substantial question of law.

Re: Questions (B), (C) and (D).

4. The assessee had subscribed to the purchase of 4 lakh preference shares each of Rs.100/- of an aggregate value of Rs.4 crores from a company by the name of Enam Finance Consultants Pvt. Ltd. in 1992. The preference shares were to carry a dividend of four percent per annum and were to be redeemable after the expiry of ten years from the date of allotment. During the course of Assessment Year 2001-02, the assessee redeemed three lakh shares at par and claimed a long term loss of Rs. 2.73 crores after availing of

the benefit of indexation. The Assessing Officer disallowed the claim of set off of long term capital loss that arose on redemption against long term capital gain on the sale of other shares on the ground that (i) Both the assessee and the Company in which the assessee held the preference shares, were managed by the same group of persons; and (ii) There was no transfer and that the assessee was not entitled to indexation on the redemption of non-cumulative redeemable preference shares. The CIT(A) on the other hand, allowed the benefit which was claimed by the assessee. The Tribunal has affirmed the view of the CIT(A) holding that the genuineness and credibility of the capital transaction was not disputed for the previous ten years. Both the Companies were juridical entities; the fact that the Companies were under common management would not indicate that the transfer was sham and that the view of the Appellate Authority was purely based on surmises and conjectures. The Tribunal has followed the judgment of the Supreme Court in **Anarkali Sarabhai vs. CIT**,¹ in holding that the redemption of preference shares results in a transfer within the meaning of Section 2(47). Finally, the Tribunal has held that the non-cumulative redeemable preference shares cannot be equated with debentures or bonds. According to the Tribunal, share capital issued in the form of non-cumulative redeemable preference shares can never be regarded as debentures or bonds. A debenture is a loan taken by the Company. The Companies' Act, 1956 envisages two types of capital, equity share capital and preference share capital. Hence, the Tribunal came to the conclusion that since redeemable preference shares are not bonds or debentures, the assessee

1 (1997) 224 ITR 422 (SC)

would not be deprived of the benefit of indexation under Section 48 of the Income Tax Act, 1961.

5. As regards question (B), there is a finding of fact that the transaction was not questioned by the Revenue for over ten years; that both the assessee and the Company of which the assessee held redeemable preference shares were juridical entities and the mere fact that both were under common management would not necessarily indicate that the transaction was not genuine. There is no reason for this Court to differ with the finding of the Tribunal. The Revenue did not bring any material on record whatsoever to substantiate the contention that the transaction was sham. The Tribunal has adduced sufficient reasons for not doubting the authenticity and genuineness of the transaction. Question (B) will, therefore, not give rise to any substantial question of law.

6. As regards question (C), the judgment of the Supreme Court in **Anarkali Sarabhai** (supra) concludes the issue that a redemption of preference shares by a Company squarely comes within the ambit of Section 2(47) of the Income Tax Act, 1961, since it amounts to a transfer. Question (C) will, therefore, not give rise to any substantial question of law.

7. As regards question (D), Section 48 provides that the income chargeable under the head “capital gain” shall be computed by deducting

from the full value of the consideration received or accruing as a result of the transfer of a capital asset: (i) The expenditure incurred wholly and exclusively in connection with such transfer; and (ii) The cost of acquisition of the asset and the cost of any improvements thereto. The second proviso to Section 48 provides for indexation where long term capital gain arises from the transfer of a long term capital asset. The third proviso, however, stipulates that nothing contained in the second proviso shall apply to long term capital gain arising from the transfer of a long term capital asset being bonds or debentures other than capital indexed bonds issued by the Government. The Assessing Officer was of the view that the principal characteristic of a bond is a fixed holding period and a fixed rate of return. According to him, the four percent non-cumulative redeemable preference shares which the assessee redeemed also had a fixed holding period and a fixed rate of return and on this basis denied the benefit of cost indexation to the assessee.

8. The entire basis on which the Assessing Officer denied the benefit of cost indexation was in our view flawed and was justifiably set right in the order of the Tribunal. The Income Tax Act, 1961, does not contain a definition of bonds or debentures. Both those concepts have a well settled connotation in law, particularly in the provisions of the Companies' Act, 1956. Section 2(12) of the Companies' Act, 1956 defines the expression "debenture" to include debenture stock bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. Under Section

80(1) 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. Section 85 provides that 'preference share capital' means, with reference to any company limited by shares, whether formed before or after the commencement of the Act that part of the share capital which fulfills the following requirements, namely:

“(a) that 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) that as respects capital, it carries 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

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

Explanation.- Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either of both of the following rights, namely:-

(i) that, as respects dividends, in addition to the preferential right to the amount specified in clause (a), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;

(ii) that, as respects capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in clause (b); it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid.”

Section 86 provides that the share capital of a company limited by shares shall be of two kinds only namely : (i) Equity share capital; and (ii) Preference share capital.

9. There is fundamentally as a matter of first principle and in law a clear distinction between bonds and debentures on the one hand, and preference share capital on the other. A bond includes “any instrument whereby a person obliges himself to pay money to another on condition that the obligation shall be void if a specified act is performed, or is not performed, as the case may be”.² Debt securities typically are regarded as consisting of notes, debentures and bonds. Technically, a 'debenture' is an unsecured corporate obligation while a 'bond' is secured by a lien or mortgage on corporate property. However, in commercial parlance, the expression “bond” is often used indiscriminately to cover both bonds and debentures. As a matter of fact, the Companies' Act, 1956 in Section 2(12) defines 'debenture' to include debenture stock bonds and any other securities of a company, whether or not they constitute a charge on the assets of the Company. A bond is a formal document constituting the acknowledgement of a debt by an enterprise and normally contains a provision regarding repayment of principal and interest. There is a clear distinction between bonds and share capital because a bond does not represent ownership of equity capital. Bonds are in essence interest bearing instruments which represent a loan. This distinction has been

2 P.Ramanatha Aiyar's Advanced Law Lexicon, 3rd Edition 2005 page 565

accepted by the Supreme Court in **R.D. Goyal vs. Reliance Industries Ltd.**³

The Supreme Court noted that a debenture is simply an instrument of acknowledgement of debt by a company whereby it undertakes to pay the amount covered by it and till then it undertakes to pay interest to the debenture holders. The expression “share” has been defined in Section 2(46) of the Companies' Act, 1956 to mean share in the share capital of a company. On the other hand, a debenture is an instrument of debt executed by the Company acknowledging its liability to repay the amount represented therein at a specified rate of interest. In other words, a debenture is a certificate of a loan or a bond evidencing the fact that the Company is liable to pay an amount specified with interest. Though the amount which is raised by a Company through debentures becomes a part of its capital structure, it does not become part of share capital.

10. Section 48 denies the benefit of indexation to bonds and debentures other than capital indexed bonds issued by the Government. The four percent non-cumulative redeemable preference shares were not bonds or debentures within the meaning of that expression in Section 48 of the Income Tax Act, 1961. In these circumstances, the Tribunal was correct in its decision to that effect.

11. We accordingly, answer question (D) in the affirmative and in favour of the assessee. The appeal shall accordingly stand disposed of in the

aforesaid terms. There shall be no order as to costs.

(Dr.D.Y.Chandrachud, J.)

(Mrs.Mrudula Bhatkar, J.)