8 Capital Gains

Extra provisions for detailed and comprehensive study

146. REFERENCE TO VALUATION OFFICER TO DETERMINE FMV [*S. 55A, R. 111AA*][1]

With a view to ascertaining the FMV of a capital asset for the purposes of computing capital gain, the Assessing Officer (AO) *may* refer the valuation of capital asset to a Valuation Officer, in the following circumstances:

Circumstance	When can AO refer the valuation to the Valuation Officer?
Where the value of the asset as claimed by the assessee is in accordance with the estimate made by a **registered valuer**	If the AO is of the opinion that the value so claimed is at **variance** with its FMV (i.e., less or more).
In any other case	If the AO is of the opinion that: (a) FMV of the asset **exceeds** the value of the asset as claimed by the assessee by more than 15% of the value so claimed **OR** by more than Rs. 25,000, OR (b) Having regard to the nature of the asset and other relevant circumstances, it is **necessary** so to do.

For meaning of FMV u/s 2(22B), see para 130.

157. TRANSFER OF GOVERNMENT SECURITY OUTSIDE INDIA [*S. 47(viib)*]

Any transfer of a capital asset, being a Government Security (carrying a periodic payment of interest), made outside India through an intermediary dealing in settlement of securities, by a *non-resident* to another *non-resident*, is **not liable** to capital gain.[2]

158A. CAPITAL GAIN ON TRANSFER OF SHARES OR DEBENTURES OF INDIAN COMPANY BY A NON-RESIDENT [1st *proviso to S. 48*][3]

Special provisions for currency conversion are made for computing capital gain arising to a non-resident from the transfer of shares/debentures of an Indian company that were purchased by utilizing foreign currency. Following conditions should be satisfied for the special provisions to apply:

1. A **non-resident** transfers a capital asset being **shares** in, or **debentures** of, an **Indian** company.
2. Such capital asset has been purchased by utilizing **foreign** currency.

In such case, the capital gain arising from such transfer is first computed in terms of the foreign currency and then reconverted into Indian currency as per the following mechanism:

[1] Objective is to ensure that FMV of capital asset taken by the assessee is not understated or overstated so as to reduce the capital gain.

[2] Objective is to facilitate listing and trading of Government securities outside India

[3] Non-residents who invest in shares and debentures of Indian companies in foreign exchange are adversely affected when they sell such securities. This is due to the fall in value of Indian Rupee vis-à-vis foreign currency in which investment was made. Purpose of these provisions is to give special protection to non-residents from fluctuation in the rupee value in terms of the foreign currency utilised for purchase of shares or debentures while computing capital gain on their transfer.

Step 1: Compute capital gain in terms of the same <u>FC</u> as was initially utilised in the <u>purchase</u> of shares or debentures	**Rs.**	**FC**	**Rate applicable for conversion into FC**
FVC	xx	xx	Average of TTBR & TTSR of FC as on the date of **transfer**
Less: Expenditure incurred wholly and exclusively in connection with transfer	(xx)	(xx)	
Net consideration		xx	
Less: COA	(xx)	(xx)	Average of TTBR & TTSR of FC as on the date of **acquisition**
Capital gain in **foreign** currency		**xx**	
Step 2: <u>Reconvert</u> capital gain in foreign currency (computed above) into Indian currency	**FC**	**Rs.**	**Rate applicable for conversion into Rs.**
Capital gain in **Rs.**	**xx**	**xx**	TT**B**R of FC as on the date of **transfer**

FC = Foreign currency; **TTBR** = Rate of exchange adopted by the State Bank of India for buying such currency where such currency is made available to that bank through a telegraphic transfer; **TTSR** = Rate of exchange adopted by the State Bank of India for selling such currency where such currency is made available by that bank through telegraphic transfer.

Aforesaid manner of computation of capital gains is applicable in respect of capital gains accruing or arising from every **reinvestment** thereafter in, and sale of, shares in, or debentures of, an Indian company.

The aforesaid currency conversion provisions apply whether the capital gain is short-term or long-term.

For these provisions to be applicable, assessee should be a non-resident at the time of transfer of capital asset.

Indexation is **<u>not</u>** available even if the capital gain is long-term.

Only shares and debentures of an Indian company are covered by these provisions, whether listed or non-listed. Thus, any other capital asset is not covered (for example, units of a Mutual Fund).

Expenditure on transfer is converted to FC by applying the average of TTBR and TTSR as on the date of transfer, not as on the date of incurring the expenditure.

If shares/debentures are purchased by utilizing Indian currency, regular provisions apply and indexation can be availed in case of shares. However, it still cannot be availed in case of debentures (see para 155).

Note: Provisions regarding tax on capital gain are given in para 165. You may note that the currency conversion provisions **do not apply** to long-term capital gains from transfer of equity shares referred u/s 112A (taxable @ 10%) or from transfer of unlisted securities or shares of a CHC referred u/s 112 (taxable @ 10%).

***ILLUS 158A.1**: John is a citizen of USA and a non-resident in India. He purchased 100 shares in ABC Ltd., an Indian company, on 1.6.2018 at the rate of Rs. 150 per share. Such purchase was made by utilizing US dollars remitted by him to India. He sold these shares on 1.5.2024 at the rate of Rs. 250 per share. He paid brokerage @ 5% on purchase (paid on 1.6.2018) and sale (paid on 5.5.2024). Compute the capital gain assuming the following exchange rates.*

Date	*TTBR (1 USD)*	*TTSR (1 USD)*	*Average of TTBR & TTSR*
1.6.2018	*70.50*	*71.20*	*70.85*
1.5.2024	*80.00*	*82.40*	*81.20*
5.5.2024	*80.60*	*83.00*	*81.80*

John is a non-resident who purchased shares in an Indian company by utilizing foreign currency. Hence, capital gain on transfer of such shares will be computed as per the 1st proviso to section 48, as given below:

Step 1: Compute capital gain in terms of USD initially utilised in the purchase of shares or debentures	**Rs.**	**USD**	**Rate applicable for conversion into USD**
FVC (100 shares @ Rs. 250)	25,000	307.88	Average of TTBR & TTSR of USD as on the date of transfer, i.e., 81.20
Less: Expenditure incurred wholly and exclusively in connection with transfer (5% of Rs. 25,000)	1,250	(15.39)	
Net consideration		292.49	
Less: COA (100 shares @ 157.50 (cost + brokerage); indexation is not applicable	15,750	(222.30)	Average of TTBR & TTSR of USD as on the date of acquisition, i.e., 70.85
Long term capital gain (USD)		70.19	
Step 2: Reconvert capital gain in USD (computed above) into Rs.	**USD**	**Rs.**	**Rate applicable for conversion into Rs.**
Long term capital gain (Rs.)	70.19	**5,615.20**	TTBR of USD as on the date of transfer, i.e., 80.00

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160. AMALGAMATION [*S. 2(42A); 47, 49*]

Amalgamation is a form of business reorganization. It is defined u/s 2(1B) whereby it means the merger of one or more companies with another company or the merger of two or more companies to form one company, subject to certain conditions. The company (or companies) which merge are called *amalgamating* company (or companies) and the company with which they merge or which is formed as a result of the merger is called the *amalgamated* company. For example, Company A and Company B are amalgamated to form Company C. Companies A and B are amalgamating companies and Company C is amalgamated company. Special provisions are made in the case of amalgamation if the **amalgamated company is an Indian company**. The following transactions take place in the scheme of amalgamation:

1. Transfer of capital asset by the amalgamating company to the amalgamated company.
2. Transfer of shares held by the shareholder in the amalgamating company to the amalgamated company in consideration of allotment to him of shares in the amalgamated company.

The aforesaid transactions are made tax neutral u/s 47, i.e., capital gain does not arise in case of such transfers. However, capital gain arises when the capital asset or the shares are subsequently transferred by the amalgamated company or the shareholder. We have noted in para 136 that aforesaid transfer of capital asset is listed u/s 49(1). Thus, while computing the capital gain upon subsequent transfer of the capital asset by the amalgamated company, computation is made with reference to the previous owner, i.e., the amalgamating company. Further, while computing capital gain upon subsequent transfer of shares by the shareholder, COA of shares is deemed to the COA of shares in the amalgamating company and POH includes the period for which shares were held in the amalgamating company.

In effect capital gain does not arise on amalgamation. It arises on subsequent transfer of capital assets or shares.

These special provisions **do not** apply if the amalgamation does not satisfy the conditions referred u/s 2(1B) or the amalgamated company is not an Indian company.

Provisions are tabulated below for better understanding.

Computation	**Event 1A: Transfer of capital asset by A-ing Co to A-ted Co**	**Event 1B: Subsequent transfer of such capital asset by A-ted Co**		**Event 2A: Transfer by shareholder of shares in A-ing Co against allotment of shares in A-ted Co**	**Event 2B: Subsequent transfer of such shares by shareholder**	
FVC			xx			xx
Less: COA/ICOA	Capital gain does not arise [S. *47(vi)*]	COA POH and indexation is determined with reference to the previous owner (i.e., **A-ing Co**)	(xx)	Capital gain does not arise [S. *47(vii)*]	*COA:* It is deemed to be the COA of shares in **A-ing Co** *POH:* It includes the POH of shares in **A-ing Co** *Indexation:* It runs from the date of acquisition of shares in **A-ing Co**	(xx)
Capital gain			**xx**			**xx**

A-ing Co = Amalgamating company; A-ted Co = Amalgamated **Indian** company

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ILLUS 160.1*: X Ltd. is amalgamated with Y Ltd., an Indian company, with effect from 15.6.2024, under an approved scheme of amalgamation. Z, a shareholder of X Ltd., is allotted 1,000 shares in Y Ltd., in lieu of 2,000 shares in X Ltd. He had acquired shares in X Ltd. on 15.6.2016 for Rs. 100 each. He sells all the shares in Y Ltd. on 15.1.2025 for Rs. 300 per share. Compute the capital gain liability in the hands of Z. STT is not applicable.* – Capital gain does not arise in the hands of Z on transfer of shares in X Ltd. in consideration of allotment of shares in Y Ltd., in view of section 47(vii). Capital gains arises at the time of sale of shares in Y Ltd. for AY 2025-26. ICOA = 2,00,000 cost (2,000 shares in X Ltd. × 100 per share) × (CII of 2024-25, i.e., 363 / CII of 2016-17, i.e., 264) = 2,75,000. LTCG (POH is determined from 15.6.2016) = 3,00,000 FVC (1,000 shares × 300 per share) – 2,75,000 ICOA = 25,000.

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161. DEMERGER [*S. 2(42A); 47, 49*]

Demerger is a form of business reorganization. It is defined u/s 2(19AA) whereby it means the transfer, pursuant to a scheme of arrangement under the Companies Act, by a demerged company of one or more of its undertakings to any resulting company, subject to certain specified conditions. The company whose undertaking is transferred is called the *demerged* company. One or more companies to which the undertaking of the demerged company is transferred is called the *resulting* company. For example, Company A, having Undertakings I and II, transfers Undertaking I to Company B. Company A is the demerged company and Company B is the resulting company. Special provisions are made in the case of demerger if the **resulting company is an Indian company**. The following transactions take place:

1. Transfer of capital asset by the demerged company to the resulting company.
2. Transfer or issue of shares by the resulting company to the shareholders of the demerged company made in consideration of demerger of the undertaking.

The aforesaid transactions are made tax neutral u/s 47, i.e., capital gain does not arise in case of such transfers. However, capital gain arises when the capital asset or the shares are subsequently transferred by the resulting company or the shareholder. We have noted in para 136 that aforesaid transfer of capital asset is listed u/s 49(1). Thus, while computing the capital gain upon subsequent transfer of the capital asset by the resulting company, computation is made with reference to the previous owner, i.e., the demerged company. Further, while computing the capital gain upon subsequent transfer of shares by the shareholder, COA of the shares is taken to be the proportionate COA of shares held by the shareholder in the demerged company and POH includes the period for which the shares were held in the demerged company. Consequently, COA of original shares which continue to be held by the shareholder in demerged company (after such demerger) is reduced to that extent. Thus, COA of original shares is split and apportioned amongst shares now held in resulting company and shares still held in demerged company post the demerger.

In effect capital gain does not arise on demerger. It arises on the subsequent transfer of capital assets or shares.

These special provisions **do not** apply if the demerger does not satisfy the conditions referred u/s 2(19AA) or the resulting company is not an Indian company.

Provisions are tabulated below for better understanding.

Computation	**Event 1A: Transfer of capital asset by DCo to RCo**	**Event 1B: Subsequent transfer of such capital asset by RCo**		**Event 2A: Transfer or issue of shares by RCo to shareholder of DCo in consideration of demerger**	**Event 2B: Subsequent transfer of such shares by shareholder**	
FVC			xx			xx
Less: COA/ICOA	Capital gain does not arise [S. *47(vib)*]	COA POH and indexation are determined with reference to the previous owner (i.e., **DCo**)	(xx)	Capital gain does not arise [S. *47(vid)*]	*COA* = COA of shares in **DCo** × [Net book value of assets transferred in a demerger ÷ Net worth of DCo immediately before the demerger]* *POH:* It includes the POH of shares held in **DCo** *Indexation:* It runs from the date of acquisition of shares in **DCo**	(xx)
Capital gain			**xx**			**xx**

DCo = Demerged company; RCo = Resulting Indian company

*COA of original shares held by shareholder in DCo is deemed to have been reduced by the amount so calculated.