# HACspeak

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Issue: Transfer of shares in a company between two existing shareholders at less than the Fair Market Value and applicability of section 56(2)(vii) of the Income Tax Act, 1961.

1. Mr. A and Mr. B are the two shareholders in a private limited company. Mr. B intends to transfer his shareholding to Mr. A. The agreed consideration falls short of the FMV. The issue is how best to overcome the provisions of section 56(2)(vii) of the Act.

2. Section 56 deals with income from other sources

   2.1. Section 56(2)(vii)(c) reads as under:

   Where an **individual or a Hindu undivided family** receives, in any previous year, from any person or persons on or after 1st day of October 2009,-

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   (c) any property, other than immovable property, -

   (i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;

   (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

2.2. *Second proviso* Following exclusions to the clause are provided in second proviso which prescribes that this clause shall not apply to any sum of money or any property received-

(a) From any relative, or
(b) On the occasion of the marriage of the individual, or
(c) Under a will or by way of inheritance, or
(d) In contemplation of death of the payer or donor, as the case may be, or
(e) From any local authority as defined in the Explanation to clause (20) of section 10, or
(f) From any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause 23C of section 10, or
(g) From any trust or institution registered under section 12AA

2.3. *Explanation (d)* defines property to mean the following capital assets of the assessee, namely:-
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(ii) Shares and securities

2.4. Likewise by virtue of sub-section (viia) the provisions apply pari material to a case where the recipient is either a firm or a company.

2.5. For valuation of the FMV one would have to take into account Rule 11U and 11UA

3. Whether issue of Rights share by the company and renunciation of Rights by Mr. B in favour of Mr. A would also attract provisions of section 56(2)(vii)?

3.1. ***ITAT Mumabi's dealt with the issue in Sudhir Menon's case*** – implications of the judgment:

Right Issue by a company –

a. Suppose upon right issue by a Company at less than FMV, the individual shareholders renounce the right in favour on New shareholder, being firm. As a result firm applied and was allotted shares by listed company. This has resulted in disproportionate allotment. However firm will not be taxable on receipt of property at less than FMV, since section 56(2)(vii) does not apply to firm and under section 56(2)(viia), listed company's share are not covered.

b. Suppose in above case, individual shareholders renounce their right in favour of new shareholder, being Individual. In such case going by above said Tribunal Judgement, the new Individual shareholder, getting disproportionate allotment, will be subjected to provision of section 56(2)(vii).

3.2. It is also pertinent to point out that the given facts in Sudhir Memon's case were considered by the ITAT in light of Companies Act, 1956 wherein a private company was not permitted to issue Rights shares. The fact finds mention in para 4.3 of the judgement.

3.3. In view of the aforesaid, the issue is not free from controversy.

4. Other Alternatives:

4.1. Please consider the proposed transaction falls within the exclusionary clause provided in second proviso? OR

4.2. Whether the shares can be transferred to an investment trust wherein trustees can be the intended transferees? If this option is exercised, in our considered opinion the provisions of section 56(2)(vii) and (viia) do not apply to transfer for inadequate consideration to a trust and yet the control and management of the company can be transferred to Mr. A and his family.