Kottayam Branch of SIRC of ICAI

One Day CPE Seminar & ICAI MSME Mahotsav

MSME Compliance & Audit, Capital Gains, Clubbing Provisions & Set-off of Losses

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01

Historical Evolution and Legislative Philosophy

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- ❖ Evolution of Capital Gains Taxation
- ❖ Income vs. Capital – Tax Incidence
- ❖ Transfer-based taxation to anti-avoidance taxation
- ❖ Transformation from 1961 to 2025 Act
- ❖ Significance of Deeming Fictions

02

Essential Components of Capital Gains Computation

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I. There must be a '**Capital Asset**'

II. There must be a 'Transfer' within the meaning of the Act

III. Classification – 'Short Term' vs. 'Long Term'

IV. 'Expenses' in connection with transfer

V. 'Cost of Acquisition' & its improvement

VI. Roll-over benefits

VII. Normal and Special 'Rates of Taxes'

03
Capital Asset

Capital Asset – Sec. 2(14)

- "**Property**" – How wide is the definition?
- Taxability of Transfer of Non-transferable Rights
  - *Chheda Housing Dev. Corp. (2019) 110 taxmann.com 56 (Mum. – ITAT)*
  - *Bhojison Infrastructure (2018) 99 taxmann.com 26 (Ahd. – ITAT)*
- Whether Foreign Currency constitutes a Capital Asset?
  - *Kirloskar Asea (1979) 117 ITR 82 (Kar.)*
  - *EID Parry (1988) 38 Taxman 84 (Mad.)*

Capital Asset – Sec. 2(14)

- Personal effects of movable nature – exposure to CG tax
  - *Narendra I. Bhuva (2025) 177 taxmann.com 540 (Bom.)*
- Dual Portfolios – Investment vs. Stock-in-Trade
  - *Circular No. 4/2007 dt. 15.06.2007*
- Unlisted shares – whether it can be classified as Stock In Trade?
  - *Citadell Agencies (2007) 11 SOT 273 (Mum. – ITAT)*
  - *Board Instruction F. No. 225/12/2016 dt. 02.05.2016*

Judicial Tests – Investment vs. Stock-in-Trade

I. **Source of funds** – Own funds vs. Borrowed funds	VI. **Accounting treatment** in books
II. **Intention at acquisition** – Investment vs. Resale	VII. **Profit motive** vs. **Dividend motive**
III. **Volume & frequency** of transactions	VIII. **Method of valuation - Consistency** in tax treatment
IV. **Quantity** of shares traded	IX. **Tax advantage** as the primary objective
V. **Holding pattern** and supporting evidence	X. **Repeated transactions** in the same scrip

04

Agricultural Land

Agricultural Land

- Judicial Tests for Determining Agricultural Land
  - *Smt. Sarifabibi Mohamed Ibrahim (1993) 70 Taxman 301 (SC)*
- Population Criterion – Municipality vs. Village
  - *G. M. Omer Khan (1992) 63 Taxman 33 (SC)*
- Standing trees – is it a distinct Capital Asset?
  - *Rajagiri Rubber & produce co. (1990) 182 ITR 393 (Ker.)*
  - *Travancore Rubber Ltd. (1990) 183 ITR 417 (Ker.)*

Judicial Tests – Agricultural vs. Non-Agricultural Land

I. Whether the land is classified as agricultural in the revenue records and subject to payment of land revenue?

II. Whether the land has been actually used for agricultural purposes over a substantial period?

III. Whether the land was put to agricultural use on the date of transfer?

IV. Whether agricultural operations were ever carried on, reflecting the owner's intention?

V. Whether the land is situated in a developed or urbanised area?

VI. Whether the land has been developed by plotting, roads or other infrastructure?

VII. Whether portions of the land were previously sold for non-agricultural purposes?

VIII. Whether permission for conversion to non-agricultural use has been obtained?

IX. Whether the land is sold on an acreage basis or plot/yardage basis?

X. Whether an ordinary agriculturist would purchase the land at the consideration for agricultural use?

05

Period of Holding – Key Litigation Issues

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❖ Possession vs. allotment – how to reckon the date?

- *Vinod Kumar Jain (2010) 195 Taxman 174 (P&H)*
- *Circular 471 dt. 17.07.1986*

❖ "Months" vs. "Days" – How should the holding period be computed?

- *Alkaben B. Patel (2014) 148 ITD 31 (Ahd. – ITAT – SB)*
- *Kartick Chandra (2020) 89 (Kol. – ITAT)*

❖ Can Land and Building have Different Periods of Holding?

- *CIT v. Citibank N.A. (2003) 261 ITR 570 (Bom.)*
- *CIT v. Dr. D.L. Ramachandra Rao (1999) 236 ITR 51 (Mad.)*

06

'Transfer' – Taxability of Special Transactions

Family Arrangements – Tax Incidence

Family Arrangement – Legal Characteristics

- ***Existence of a Family Dispute*** *or a Bona Fide Apprehension of* ***Future Dispute***
- Object is to preserve family ***Peace, Harmony and Property***
- Parties should have an ***existing, antecedent or even a possible claim***
- Recognizes or ***adjusts pre-existing rights*** rather than creating new rights
- Arrangement should ***not be in the nature of a commercial transactions***
- ***No colourable device,*** not induced by ***fraud*** or ***tax avoidance*** motive – Bona fide one
  - *Maruti Pullaiah v. Maruti Narasimhan – AIR 1966 SC 1836*
  - *Kale v. DCIT (1976) 3 SCC 119 – SC*
  - *Krishna Biharilal v. Gulabchnad AIR (1971) SC 1041, SCC 837*

Tax Consequences of a Family Arrangement

- No transfer → No Capital Gains
- Broad interpretation of "Family" & thus, generally outside Section 56(2)(x) gift taxation
- Oral settlement valid; registration not always mandatory
- Can LLPs and Closely-held Companies be Parties to a Family Arrangement?

LLPs & Unlisted Companies - NO

- LLP/Company is a separate legal person; it cannot automatically claim the benefit of a family arrangement
- The company/LLP *does not become "family" merely because its shareholders or partners are family members*
- If the LLP/company *transfers or receives assets* in its own right, the transaction *shall be tested independently for taxation*
- A family arrangement cannot override specific charging provisions
  - *B.A. Mohota Textiles Traders (P.) Ltd. v. DCIT 248 Taxman 490 (2017) (Bom.)*

LLPs & Unlisted Companies - YES

- If it is a family-owned entity and it's entire shareholding held by the family
- Lifting of veil is a recognised phenomenon –*Saloman vs. Saloman* + Sec 2(47)(vi), 47(i)
- If the family-owned entities does not participate there could be dissolution of such entities
- Conduit for holding family assets – thus, there is a commercial exigency.
  - *Kay Arr Enterprises – 299 ITR 348 (Mad.)*
  - *A.L. Ramanathan – 245 ITR 494 (Mad.)*
  - ***SKM Shree Shivkumar** – 48 taxmann.com 346 (Chennai – ITAT)*
  - ***Anitha Kumaran** – ITA No. 1164/Chny/2019 dt. 07.09.2022*
  - ***Kavya Sharath Jagannathan** – ITA No. 2676/Chny/2019 dt. 09.09.2022*

Planning Strategy – Buy-out non-family stakeholders before the family arrangement

Reconstitution of Firms – Trigger Point for Taxation

Legislative Rationale for Sections 9B & 45(4)

Memorandum explaining the provisions of Finance Bill, 2021

Rationalisation of provision of transfer of capital asset to partner on dissolution or reconstitution

….

In this regard, it has been noticed that there is uncertainty regarding applicability of provisions of aforesaid sub-section to a situation where assets are revalued or self-generated assets are recorded in the books of accounts and payment is made to partner or member which is in excess of his capital contribution. (Emphasis supplied)

Taxation on Reconstitution of Firms

- Evolution of taxation on reconstitution of firms
  - *SC decision in Malabar Fisheries Case – 1979*
  - *Amendments made in Finance Act, 1992*
- Finance Act 2021 introduced a dual taxation mechanism:
  - *Section 45(4) – Taxes money and/or Capital Asset received by the specified person*
  - *Section 9B – Taxes distribution of Capital Asset or Stock-in-Trade*
- Does simultaneous application of Sections 9B & 45(4) result in double taxation?
  - *Transfer of Partnership Interest*
  - *Transfer of Capital Asset*

Finance Act, 2021 shifted the focus from taxing transfer on dissolution to taxing value extraction on reconstitution by partners.

Interplay between Sec 45(4) & 9B

XYZ Firm underwent reconstitution and the exiting partner was paid money, stock in trade and capital asset, the details are as follows

Money received by Partner	40
FMV of Capital Asset received by Partner (Book Value – 60)	200
FMV of Stock In Trade received by Partner (Book Value – 50)	100
Capital Account balance as on the date of reconstitution	180
Revaluation of assets and self-generated goodwill – Credited to Capital Account	80

Interplay between Sec 45(4) & 9B

Particulars	45(4)	9B
Money received by Partner	40	*NA*
FMV of Capital Asset received by Partner	200	200
FMV of Stock In Trade received by Partner	*NA*	100
Total	**240**	**300**
Less: Adj. Capital – excl. revaluation & self-generated goodwill	100	*NA*
Less: Cost of Acqn. of Capital Asset/ Stock – Firm (60 + 50)	*NA*	110
Income Chargeable in the hands of the Firm u/s. 45(4)	**140**	190
Less: Expenditure u/s. 48(iii) – computed u/s. 45(4) as above	*NA*	140
Income Chargeable in the hands of the Firm u/s. 9B [PGBP – 50; & CG – Nil]	*NA*	**50**

07
Section 50C – Key Judicial Controversies

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- Auction Sales and Distress Sales – Does Section 50C Apply?
  - *H.T.L. Ltd. – (2024) 467 ITR 163 (Del) – Revenue's SLP dismissed by SC*
  - *Shri Sanjay Dubey – ITA Nos. 140 & 141/Ind/2023, dt. 07.12.2023*
- Leasehold Rights, Tenancy Rights and Booking Rights – Whether Section 50C Applies?
  - *Ritz Suppliers (P) Ltd. - (2020) 182 ITD 227 (Kol. – ITAT)*
  - *Atul G Puranik – (2011) 132 ITD 499 (Mum. – ITAT)*
  - *Tejinder Singh – (2012) 19 taxmann.com 4 (Kol. – ITAT)*
  - *Yasin Moosa Godil – (2012) 20 taxmann.com 424 (Ahd. – ITAT)*
- Recent Bombay High Court decision in the case of *Vidarbha Veneer Industries Ltd.* – (2026) 484 ITR 132

08
Section 48 – Controversies in Allowable Deductions

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- Release of Mortgage / Encumbrance
  - *R.M. Arunachalam (1997) 227 ITR 222 (SC) - Allowable*
  - *V.S.M.R Jagadishchandran (1997) 227 ITR 240 (SC) & Attli N Rao (2001) 252 ITR 880 (SC) – Not allowable*
- Escrow / Deferred Consideration
  - *Dinesh Vazirani (2022) 445 ITR 110 (Bom.)*
  - *Chemosyn Ltd. (2015) 64 taxmann.com 219 (Bom.)*
- Professional, Legal, PMS charges
  - *Krishnamurthy Thiagarajan (2024) 164 taxmann.com 550 (Mum. – ITAI)*
  - *Venkata Rajendran 232 Taxman 660 (Kar.)*
- Future Liabilities / Contingent Obligations
  - *A Venkataraman (1982) 137 ITR 846 (Mad.) – Not allowable*

09
Miscellaneous Litigation Issues

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- Whether Delay in CGAS Deposit defeats Exemption?
  - *Umayal Annamalai (2020) 118 taxmann.com 80 (Mad.)*
  - *Venkata Dilip Kumar (2019) 419 ITR 298 (Mad.)*
  - *Wipro Limited (2022) 289 Taxman 621 (SC)*
- Can Borrowed Funds be used for claiming Roll-over Exemptions?
  - *R. Srinivasan (2010) 45 DTR 208 (Mad.)*
  - *Gouli Mahadevappa (2013) 356 ITR 19 (Kar.)*
- Clubbing of Minor's Income – Indian and Foreign Income
  - *F. Y. Khambaty 159 ITR 203 (Bom.)*
- Set-off of Brought Forward Losses – Key Issue
  - *Western States Trading Co. P. Ltd 80 ITR 21 (SC)*

Thank you

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