

De Jure

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VALIDITY OF GIFT TRANSACTIONS AMONGST CORPORATE ENTITIES



"Traditionally speaking, Gift transactions involves the element of natural love and affections, and thus Gift, as perceived, can be made only by natural persons"

INTRODUCTION AND BACKGROUND

The term 'Gift', as defined in the Transfer of Property Act 1882 ("**TOPA**"), implies transfer of any property or asset, either being moveable or immovable, by one person to another person, where the former is regarded as a 'donor' and the later the 'donee'. Traditionally, such transfer is attributed to the rationale being that of *natural love and affection* and thus it was perceived that a gift can only be given by one living entity to another living entity as only living entities can have 'love and affection' as they being capable of having feelings as opposed to any non-natural/ artificial person, viz. a corporate entity.

In the earlier Orient Case (*Orient Green Power Pte Limited (AAR 973 of 2010)*) Authority for Advance Ruling ("**AAR**") held that gift by one company to another company is not permissible to avail the relaxation provided under Section 47 (iii) of the Income Tax Act, 1961 ("**ITA**") and termed such transaction as 'strange' transaction. It further contended that in the event a corporation gives away its assets free to another can only be aiding dubious attempts at avoidance of tax payable under the ITA. Further, it seems in that instant case, the assessee had also failed to show transfer by way of "gift" was authorised under its articles of association. In view of the failure of the assessee to show that the alleged transfer in question was effected in the manner prescribed by its articles of association, AAR held that it would not be proper to accept the assertions in the said application and in the submissions about the genuineness and validity of the transaction.

Interestingly, in another case, the Karnataka High Court in Nadatur Holdings case (*CIT v/s Nadatur Holdings and Investments Private Limited – TS-656-HC-2012 (Karn)*) has, *inter alia*, upheld a gift of shares by the shareholders to the company as a genuine transaction thereby reiterating the fact that company being separate legal entity which is distinct from its shareholders. This judgment clarifies the position

that the said gift transaction is a genuine transaction, in the absence of a specific legal bar on such transactions. Whereas, it was also held in this case that an isolated transaction of sale of shares by Nadatur Holdings would be liable to tax as capital gains and not as business income.

In another recent case of scheme of arrangement under Sections 391 to 394 of the Companies Act, 1956 ("**Companies Act**"), the division bench of Gujarat High Court in case of Vodafone Essar Gujarat Ltd. v. Department of Income-tax (*O.J. Appeal No.81 of 2010*) overruled the decision of the single judge (*Judgment dated December 09, 2010 in Company Petition No.183 of 2009*) rejecting a Scheme of Arrangement filed by Vodafone Essar Gujarat Limited for demerger of its passive infrastructure assets to Vodafone Essar Infrastructure Limited, since the transfer by way of demerger was in the manner of a gift, a tax planning devise. The Division Bench held that in its commercial wisdom if the company has decided to have a particular arrangement by which there may be even benefit of saving income tax or other taxes, that itself cannot be a ground for coming to the conclusion that the sole object of framing the Scheme is to defraud the Income Tax Department or other taxing authorities.

However, while sanctioning the above scheme of arrangement, the Division Bench has also reserved the right of the Income Tax Department to take out appropriate proceedings regarding recovery of any tax from the transferor or transferee company, as the case may be, and pending cases before the Tribunal shall not be affected in view of the sanction of the scheme of arrangement. Further, recently in this case, the Income Tax Department has challenged the order of the Division Bench of Gujarat High Court in the Supreme Court

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DP WORLD CASE

Recently, Income Tax Appellate Tribunal, Mumbai ("ITAT") in the DP World case (*DP World Private Limited v/s DCIT (ITA 3627/ Mum/2012)*), inter alia, held that gift transactions amongst the corporate entities is a valid transaction, as the same being authorised under the Articles of Association ("AoA") of DP World Private Limited ("DP World"), and not just a colourable transaction merely framed for tax avoidance.

"In this case, ITAT had to decide whether transfer of shares, without consideration, was whether a Gift or Income in the hands of Taxpayer (DP World)"

FACTS OF THE DP WORLD CASE

British India Steam Navigation Co., a company based in UK ("**BISNC**") held shares in the company Hill Park Limited, an Indian company ("**Hill Park**") and by virtue of this BISNC was entitled to use three residential flats of Hill Park. BISNCL transferred its shareholding in Hill Park to one of its group companies, being DP World and the same being without any consideration.

It was contended by DP World that the transfer of shares of Hill Park by BISNCL to DP World was without consideration and such is a 'gift' thereby coming under the ambit of Section 47(iii) of the ITA.

The tax authorities contended that considering that both the donor as well as the donee, being artificial persons/ legal persons, the aforesaid transfer of shares cannot be made on the premise of 'gift' as there is absence of the element of 'natural love and affection' between the donor as well as the donee (*which being two corporate entities i.e. BISNCL and DP World*).

As the transfer was devoid of any consideration, the Assessing Officer ("**AO**") considered the value of the aforesaid three flats as a benefit element in the hands of DP World and concluded the same as income from other sources pursuant to Section 56(2)(vii)(a) of the ITA.

On an appeal before the Commissioner of Income Tax, Appeals, it held that the value of the aforesaid three flats should be treated as business income within the provisions of Section 28 of the ITA as being part of the business rather than being counted as income from other sources.

"It was contended by DP World that the transfer of shares was a Gift transaction, being eligible for exemption u/s 47(iii) of ITA"

"Definition of Gift not provided under ITA, thus ITAT referred to the definition as the one provided under TOPA"

ISSUES THAT HAD TO BE ADDRESSED BY THE ITAT

- Whether the transaction of transfer of shares, without consideration, is gift or income in the hands of DP World, being the taxpayer?
- Whether the instant transaction was entitled to an exemption under Section 47 (iii) of the ITA?

WHAT THE ASSESSEE, BEING DP WORLD, CONTENDED

It was contended by the assessee that the aforesaid transfer of shares without consideration is a transaction of gift of shares and thus the same being not liable to tax.

CONTENTIONS OF THE INCOME TAX DEPARTMENT

- Gift has to be only between two natural persons and not artificial legal person, such as a corporate entity, considering that generally the gift is effected out of the feeling of natural love and affection
- The ITA does not provide for any express exemption for the said transaction.
- The transaction has only been structured with a view to avoid tax

AND THE ITAT HAD TO SAY THE FOLLOWING

- the transaction involved in the present appeal is nothing but a "gift" and thus it is a capital receipt not taxable under the alleged provisions of the ITA.
 - Section 47(iii) of the ITA provides for an exemption pertaining to transaction made under gift, irrevocable trust or will.
 - 'Gift' has not be defined under the ITA. However, the said term has been defined under TOPA as well as under the Gift Tax Act, 1958. The reason being Gift Tax Act, 1958 has been long abolished; the ITAT thought fit to rely on the definition as the one provided under TOPA.
 - ITAT further observed that the definition of gift, as provided under TOPA (Section 122), does not require presence of 'natural love and affection' and thus any corporate entity is eligible to enter into any gift.
- transactions, authorised by the AoA of the company Further, Section 5 of TOPA also provides for transfer of property among living persons and where such 'living person' includes a corporate entity.
- ITAT also noted that Section 82 of the Companies Act describes shares of a company as a moveable property which is capable of being transferred in a manner as provided under the AoA of such company. But, the donor (i.e. BISNCL), being a foreign company, the said section of the Companies Act was not applicable.
 - A combined reading of Section 82 of the Companies Act, Section 5 and Section 122 of the TOPA suggest that a company can validly transfer the shares by way of gift, provided where articles of association of the donor company permits the same.

OUR VIEW

As can be understood from the case under review (DP World), the ITAT duly grants recognition to gift transactions involving corporate entities as a genuine and bonafide transaction that could be part of a group restructuring exercise. In the process the ITAT has also provided the exemption to DP World under Section 47(iii) of the ITA.

The ITAT, in the process, has virtually over-ruled the decision of AAR in Orient Case, as being discussed above. On the other hand, the ITAT verdict has also upheld in Vodafone Case and Nadatur cases (as discussed above) thereby providing authority to gift transactions among corporate entities.

Considering that the ITA till date does not provide for any kind definition or explanation for the term 'gift', ITAT was very pertinent in borrowing the definition of the term as provided under TOPA and recognised gift transactions amongst corporates. By straight jacketing all the similar transactions and presuming that the same have been devised for tax avoidance would only regard having a myopic view. This has adequate recipe to cause lot of hardship for the corporates considering that such inference could only be seen by one as a prejudicial stand to a bonafide corporate re-organisation, which could never have been the intent of the legislation.

It also remarked that as the income in the DP World case (being the value of the three flats) was not liable to tax under Section 56(2)(vii)(a) of the ITA as the instant transaction was consummated prior to the effectiveness of the said section (June 1, 2010). In other words, any company (not being the company in which public are substantially interested) receives shares of the company (not being the company in which public are substantially interested) on or after June 1, 2010 and for without any consideration or for consideration which is less than fair market value to the certain amount as set out Section 56(2)(vii)(a) of the IA will be subject to computation of income from other sources as per applicable rate.

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