

# Gift of shares can be taxed in absence of bona fide purpose – Delhi ITAT

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## Summary

The provisions of the Income-tax Act, 1961 (Act) exclude a 'gift' from the definition of 'transfer' and hence gift of an asset is not subjected to capital gains taxation. The Delhi Bench of the Income-tax Appellate Tribunal (ITAT) in a recent case<sup>1</sup> has directed the transferor to prove the genuineness of the gift to be eligible for capital gain exemption.

## Facts of the case

- The taxpayer transferred shares, held as investments in a public limited company, to another company without any consideration. The taxpayer claimed the transferee company as a sister concern and that the transfer was a 'gift' under an internal family realignment arrangement.
- Treating the 'gift' as a transaction to avoid payment of taxes, the tax officer held that the transaction was a transfer of shares liable to tax<sup>2</sup> under the Act.

## Taxpayer's contention

- The shares were transferred as a gift under an internal family realignment without any consideration and therefore the transfer of shares was exempt from capital gains under the provisions<sup>3</sup> of the Act.
- The Memorandum of Association (MOA) of the company authorised such gifts. Also, the gift was made pursuant to the board's resolution and special resolution passed by members at the extraordinary general meeting.
- As per the provision<sup>4</sup> of the Gifts Tax Act and Transfer of Properties Act, 'natural love and affection' is not a precondition for the purpose of making gift.

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<sup>1</sup> Gagan Infraenergy Ltd v DCIT (ITA 1031/Del/2018 A.Y. 2014-15)

<sup>2</sup> Transfer under section 2(47) of the Act which was liable to tax (capital gain) under section 45 of the Act

<sup>3</sup> Under section 47(iii) of the Act, which excludes from the purview of capital gains any transfer of a capital asset under a gift or will or an irrevocable trust

<sup>4</sup> Section 5 of the Gift Tax Act and section 122 of the Transfer of Property Act

- Relying on judicial precedents<sup>5</sup>, the taxpayer submitted that the transaction cannot be taxed on a hypothetical or notional income as there is no accrual of income.

## Revenue's contention

- No evidence was placed to prove the need of family realignment by way of a family settlement or in any other manner as per the directions of any court etc.
- Questioning the genuineness and purpose of the transaction, Revenue submitted that the taxpayer had failed to establish the commercial expediency of the transaction.
- The transaction is not supported by the taxpayer's Articles of Association, a requirement as per the provisions<sup>6</sup> of Companies Act, 1956.
- With the taxpayer being an artificial person, there cannot be any question of natural love and affection, which is the prime requirement for dealings with such as gifts, settlements, inheritance etc. Therefore, the transfer cannot be considered as a gift eligible for exclusion from capital gains.

## ITAT ruling

- The ITAT held that the taxpayer has to establish the factum, genuineness and bona fide nature of such transaction, especially when Revenue challenges its genuineness.
- The ITAT noted that no agreement/document had been executed between group companies forming part of the family realignment to substantiate the transfer of equity shares as 'gift'.
- The ITAT distinguished on the decisions relied upon by the taxpayer and observed that in the absence of documentary evidence, the transfer of shares can only be seen as a dubious attempt at avoiding tax payable on capital gains.
- The ITAT set aside the appeal and directed the taxpayer to produce all relevant information/documents to assist the tax officer to determine the genuineness and validity of the transaction, failing which the tax officer was directed to compute the taxpayer's income as per the Act.

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<sup>5</sup> CIT v Excel Industries Ltd (2013) 38 Taxmann.com 100 SC

<sup>6</sup> Section 82 of the Companies Act, 1956

## **Our comments**

The ITAT has laid out important aspects to be kept in mind during the gifting of asset by a person to another. It has held that the genuineness and validity of the transaction need to demonstrate by way of adequate documentation. Importantly, this view has been taken in a pre-GAAR era. While this view might be challenged at higher appellate forums, caution should still be exercised to demonstrate the purpose and bona fide nature of such transaction to mitigate disputes. Interestingly, Revenue also raised questions on the commercial expediency of the 'gift', though this aspect was not included in the ITAT's observations or ruling.

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