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Issue Of Shares for a Consideration in Kind: Section 68 & Section 56(2)(viib)

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In this article

The issue of shares at a premium has always been the transaction which has invited close attention of the tax authorities, particularly, when the shares were issued at a premium for a consideration in kind i.e. when the transaction was in the nature of barter exchange. The question that typically arose was whether these transactions would attract the envy of Section 68 of the Income-tax Act, 1961 (Act) and of Section 56(2)(viib) of the Act, or not.

In the past, there were few interesting decisions of the Income Tax Appellate Tribunal (ITAT) and of the High Court (HC), looking at the complex provisions of Section 68 of the Act and of Section 56(2)(viib) of the Act, with respect to the issue of shares at a premium for a consideration in kind.

In this article, we have tried to discuss these decisions in light of the specific wordings of these Sections for the reader's ready reference.

Sections under consideration

Section 68	Section 56(2)(viib)
Where **any sum** is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year.	Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, **any consideration** for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares.

One can observe that Section 68 of the Act uses the expression 'any sum' while Section 56(2)(viib) of the Act uses the expression 'any consideration'. Now, when the shares are issued at a premium for a consideration in kind, the question that arises is:

> **Whether these expressions are wide enough to cover such transactions within their ambit, or not? In other words, can one say that the transaction in the nature of barter exchange is also hit by the rigours of these Sections?**

It is pertinent to mention here that both these expressions are not defined in the Act. Thus, it becomes important to look at the dictionary meaning of these expressions and the judicial precedents dealing with the same.

Let us look at first what the ITAT said:

On Section 68 of the Act:

Decision of the Kolkata Bench of the ITAT[Refer endnote 1] in the case of ITO v M/s Pansu Commercial Pvt Ltd (ITA No. 1859/ Kol/ 2017):

ITO v M/s Pansu Commercial Pvt Ltd (ITA No. 1859/ Kol/ 2017):

Background

The assessment year (AY) under appeal was the first year of operation of the assessee. During the year, the assessee had issued 5,000 shares having face value of ₹ 10, to each of the two initial shareholders being Anita Agarwal and Suresh Agarwal.

Apart from this, the assessee had also issued 4,320 shares having face value of ₹ 10 at a premium of ₹ 4,990 per share, totalling to ₹ 2,15,56,800, to Gajvani Merchandise Pvt Ltd, for acquiring shares of four private limited companies from it.

During the course of assessment proceedings, the tax authorities requested the assessee to produce directors of Gajvani Merchandise Pvt Ltd and also justify the share premium of ₹ 4,990 per share. However, the assessee failed to produce anyone but submitted the response to the show cause notice, saying that there was no bar on the amount of share premium as per the instructions of the Institute of the Chartered Accountants of India, Companies Act, 1956 or the Act.

The tax authorities rejected the said contention of the assessee and assessed ₹ 2,17,00,000 being value of the shares issued to two initial shareholders being Anita Agarwal and Suresh Agarwal of ₹ 1,00,000 and to Gajvani Merchandise Pvt Ltd of ₹ 2,16,00,000 (4,320 shares issued at ₹ 5,000), as per Section 68 of the Act.

The assessee filed an appeal before the CIT(A) who deleted the said disallowance. Aggrieved by this order of the CIT(A), the tax authorities filed an appeal before the ITAT.

ITAT Ruling

The ITAT held that Section 68 of the Act applies only when 'any sum' of money or cash is credited in the books of accounts of the assessee and there is no satisfactory explanation from the assessee against the said credit about the nature and source.

In the given case, since the assessee did not receive any money and shares were received against the allotment of shares to Gajvani Merchandise Pvt Ltd, application of Section 68 of

the Act is not correct and therefore, action of the tax authorities cannot be sustained.

In arriving at its conclusion, the ITAT relied on the decision of the Calcutta wherein it was held that the provisions of Section 68 of the Act are not applicable to the transactions in the nature of barter exchange. The relevant extract is reproduced as under:

> *"We have perused the assessment order carefully. We find that cash did not pass at any stage though entries were made in the cash book showing payments and receipts; but since the entries made a complete round, no passing of cash was necessary for the purpose of making the entries. That there was no passing of cash is also admitted by the Income-tax Officer himself. We have already extracted the observation of the Income-tax Officer in paragraph 14 of his assessment order. The Income-tax Officer has clearly opined that all the respective parties did not receive cash nor did pay cash as none had any cash for the purpose. The only point in the assessment order is that the entries not involving the passing of cash should not have found a place in the cash book, but in the ledger account through journal entries. There is another self-contradiction in the Income-tax Officer's finding that, if there was no real cash entry on the credit side of the cash book, but merely a notional or fictitious cash entry, as admitted by him, there is no real credit of cash to its cash book ; the question of inclusion of the*

> *amount of the entry as unexplained cash credit cannot arise.*
>
> *One of the grounds of the Tribunal for disbelieving the assessee's case is that the adjustment entries were made by notional cash entries with a view to bringing down the debt-and-capital ratio, i.e., that while being discharged of the debt the said companies also jettisoned their assets, i.e., the shares held by them of equivalent sum without achieving the avowed purpose. Here the Tribunal certainly misdirected itself. The ratio to be reduced is of the loan in relation to the share capital and the reserves. Jettisoning the shares had the desired effect of reducing the borrowed capital.*
>
> *Again, as regards the Tribunal's refusal to take notice of the directions of the Reserve Bank, it is not correct for the Tribunal to hold that the said document was a new evidence in the true sense of the term. The assessee has been consistently pleading before the lower authorities that the entries had to be made in order to bring the companies in conformity with the said direction. Moreover, the direction of the Reserve Bank is a public document within the meaning of section 74 of the Evidence Act, 1872. Documents of a public nature and public authority are generally admissible in evidence subject to the mode of proving them as laid down in sections 76 and 78 of the Evidence Act.*
>
> *In our view, the effect and import of the transactions is that the*

> *In our view, the effect and import of the transactions is that the assessee took over the liability of the aforesaid non-financial companies to GB and Co. in exchange for the shares as aforesaid. In the premises, we answer all the questions, in the affirmative and in favour of the assessee and against the Revenue."*
>
> **Jatia Investment Co vs CIT** (1994) 206 ITR 718 (Cal)

Further, the ITAT noted that the addition was also made as per Section 68 of the Act, at the ends of the Gajvani Merchandise Pvt Ltd and 4 other private limited companies.

In relation thereto, the ITAT said that the addition, if any, as per Section 68 of the Act, is required to be made then it can only be made in the hands of these companies, as has been rightly done and no addition can be made in the hands of the assessee, as the assessee never received cash.

Accordingly, the ITAT, by merely, referring the provisions of Section 68 of the Act, held that the expression 'any sum' appearing in Section 68 of the Act means any sum of money or cash and does not bring within its ambit, the transactions in the nature of barter exchange.

Contrary decision of the ITAT Amritsar Bench

Davinder Singh v ACIT [2007] 104 ITD 325 (ASR)

Background

The assessee had earned income from Dami, being a commission agent, for sale of agricultural produce, like cotton and narma.

For the AY, though the assessee had a meagre capital, the balance sheet showed credits aggregating to ₹ 62,55,097 under the head ‘sundry creditors’, against the ‘sundry debtors’ amounting to ₹ 22,95,676 in the names of certain concerns that belonged to the assessee’s close relations.

During the course of assessment proceedings, the tax authorities requested the assessee to furnish the details of the creditors who had sold their agricultural produce to the assessee.

The tax authorities then issued enquiry letters to some of these creditors by registered post. However, these letters returned unserved with the remarks ‘not known’. Thus, the tax authorities issued show-cause notice to the assessee requesting him to produce these creditors and also issued summons to these creditors through inspectors. But again none of the creditors were found existing at the given address.

On being confronted with all these materials, the assessee expressed his inability to produce or even identify the creditors, contending that most of the transactions were not frequent and regular and as on the date, the assessee did not owe any money to these creditors.

The tax authorities disregarded the submission of the assessee and concluded that the assessee had failed to discharge the onus cast on him to establish the identity of the creditors and the source and genuineness of the credits. Accordingly, the tax authorities assessed those credits as unexplained credits as per Section 68 of the Act.

The assessee filed an appeal before the CIT(A) who confirmed the said assessment. Aggrieved by this order of the CIT(A), the assessee filed a second appeal before the ITAT.

ITAT Ruling

The ITAT held that the expression used in Section 68 of the Act is 'any sum' and it does not say that credit should be only in the nature of cash receipt. The expression 'any sum' is very wide and general in nature. It covers all credits, including loan, receipts and any other amount of similar nature, be that of cash or kind. These may be in the name of the assessee i.e. capital account or in the name of a third party.

On Section 56(2)(viib) of the Act:

Decision of the Bangalore Bench of the ITAT in the case of M/s Flutura Business Solutions Pvt Ltd v ITO (ITA No. 3404(Bang)/ 2018):

The assessee was in the business of providing specialist solutions in the areas of decisions science & analytics. The assessee filed the return of income for the AY 2013-14 declaring a loss of ₹ 14,38,104.

During the AY, the assessee had issued the equity shares at a premium of ₹ 146.17 per share as under:

Allotted to residents

Name of the share holder	No. of shares	Date of allotment of shares	Face value of shares @ ₹ 10	Premium received at ₹ 146.17 per share
Mr. Krishnan Raman	20,277	28.01.2013	2,02,770	29,63,897
Mr. Thaiparambil Jude Derick Jose	20,277	28.01.2013	2,02,770	29,63,896
Mr. Srikanth Muralidhar	20,277	28.01.2013	2,02,770	29,63,897
M/s. Krishnan Muthukumar & Group	64,033	09.05.2012	6,40,330	93,59,670
Total	**1,24,864**		**12,48,640**	**1,82,51,360**

Allotted to non-residents

Name of the share holder	No. of shares	Date of allotment of shares	Face value of shares @ ₹ 10	Premium received at ₹ 146.17 per share
Mr. Krishna Hegde – NRI	16,008	09.05.2012	1,60,080	23,39,920
Ms. Priya Karnik – NRI	16,008	09.05.2012	1,60,080	23,39,920

Total	32,016		3,20,160	**46,79,840**
Grand Total				**2,29,31,200**

The tax authorities assessed ₹ 2,29,31,200 as per Section 56(2)(viib) of the Act.

The assessee filed an appeal before the CIT(A) who deleted the assessment of ₹ 46,79,840, with respect to the shares issued to non-residents, as per Section 56(2)(viib) of the Act. Aggrieved by this order of the CIT(A), the assessee filed a second appeal before the ITAT.

Before the ITAT, the assessee reiterated the submission made before the CIT(A) that it had issued shares to Mr. Krishnan Raman, Mr. Thaiparambil Jude Derick Jose and Mr. Srikanth Muralidhar at a premium for acquiring intellectual property rights owned by them. It thus argued that Section 56(2)(viib) of the Act was not applicable as the premium was not received in cash.

The ITAT without deliberating on the wordings of the said Section i.e. the expression 'any consideration', simply agreed with the comments of the CIT(A), which were as under:

> *"………….. As regards the claim of the appellant that the promoters had not paid anything in cash and as such the provisions of* section 56(2)(viib) *of the act are not applicable, the same is also without any merit as the provisions of this section it is the 'consideration' received for issue of shares that exceeds the face value of such shares, which is to be considered and not the payment received only in cash or by cheque etc. So this argument of the appellant is also rejected………."*

Conclusion:

Meaning of the word 'any' *[Refer endnote 2]*

'Any' as explained in *State of Kerala v Shaju [1985] Ker L T 35* (as extracted in Aiyar's Judicial Dictionary, Eleventh Edition), means:

> *"The word 'any' is expressive. It indicates in the context, 'one or another', or 'one or more', 'all on every', 'in the given category'; it has no reference to any particular or definite individual, but to a positive but undermined at number in that category without restriction or limitation of choice"*

In CIT v. Smt. Vandana Verma (2011) 330 ITR 533 (All), the word 'any' was explained as follows:

> *"The word 'any' has diversity of meanings and may be employed to indicate 'all' or 'every' as well as 'some or one' and its meaning in a given statute depends upon the context and the subject-matter of the statute. It is often synonymous with 'either', 'every' or 'all'. Its generality may be restricted by the context" [Para 15]*

Meaning of the expression 'sum':

As per Merriam-Webster dictionary, 'sum' means **indefinite or specified amount of money**.

Further, the Hon'ble Supreme Court (SC) in the case of Shri H. H. Rama Varma vs. CIT [1991] 187 ITR 308 (SC), in the context of Section 80G of the Act, held that 'any sum' means 'sum of money'.

The Kolkata Bench of the ITAT in the case of M/s Saffron Comtrade Pvt. Ltd. (ITA No. 2029/ Kol/ 2016) has relied on this decision of the SC while arriving at a conclusion that the provisions of Section 68 are not applicable to the issue of shares for a consideration in kind i.e. the transactions in the nature of barter exchange.

Meaning of the expression 'consideration': *[Refer endnote 2]*

In the context of the Indian Income-tax Act, 1922, the Patna HC in *Rai Bahadur H.P. Banerjee v. CIT [1941] 9 ITR 137* stated as under:

> *"In my judgment the word 'consideration' appearing in this sub-section is used in its legal sense as it is used in connection with the transfer of assets. A transfer of assets may be gratuitous or wholly without consi-deration or it may be with consideration, that is for some return moving from the transferee to the transferor. The word 'consideration' is not defined in the Transfer of Property Act, and in my judgment it must be given a meaning similar to the meaning which it has in the Indian Contract Act. Section 2(b), Indian Contract Act, defines 'consideration' in these words 'When at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise"*

In the context of the Gift-tax Act, 1958, the Full Bench of the Kerala HC in CGT v. Smt. C.K. Nirmala [1995] 215 ITR 156 stated as under:

> *“Within the framework of the above finding what is required to be decided by this court is whether the transfer of property involved in this case would come within the meaning of the word ‘gift’ in section 2(xii) of the Act. One of the essential ingredients constituting the gift under this provision is that the transfer of property by one person to another must be ‘without consideration in money or money’s worth’. However, the word ‘consideration’ is not defined in the Act and, therefore, it must carry the meaning assigned to it in section 2(d) of the Indian Contract Act, 1872. In Keshub Mahindra v. CGT [1968] 70 ITR 1, the Bombay High Court, in a similar situation, adopted the said course.*
>
> *Section 2(d) of the Indian Contract Act reads as under :*
>
> *“When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing or promises to do or to abstain from doing, something, such act or abstinence or promise is called a consideration for the promise”.*

According to the SC in the case of *Sonia Bhatia v State of U.P. (1981) 2 SCC 585:*

> *"Consideration" means a reasonable equivalent or other valuable benefit passed on by the promisor to the promisee or by the transferor to the transferee."*

Impact:

From the above, it can be said that the expression 'any sum' refers to any sum of money. The heading of Section 68 – 'Cash Credits', also seems to suggest that the scope of this Section is restricted to cash credits and does not bring within its ambit any credits in kind.

However, the Karnataka HC in the case of Smt. Rekha KrishnaRaj v ITO (2013) 261 CTR (Kar) 79 while dealing with the applicability of provisions of Section 68 of the Act to the transaction involving supply of goods, has categorically said that the heading is to be regarded as giving the key to the interpretation of the clauses arranged under it. The Courts are entitled to look at the headings in an Act of Parliament to resolve any doubt that they may have as to ambiguous words. The headings cannot be used to give a different effect to clear words in the Section where there cannot be any doubt as to the ordinary meaning of the words. The Karnataka HC finally said that there is nothing in Section 68 of the Act that suggests 'any sum credited in the books of an assessee' should be a cash credit.

Thus, keeping all these contradictory decisions in mind, the readers will have to look at the substance of the transaction in detail and then evaluate the impact of the provisions of Section 68 of the Act.

Though, based on the strict interpretation, one may say that the decision of the Kolkata Bench of the ITAT is a better view than the view taken by the Amritsar Bench of the ITAT, specifically when the Amritsar Bench of the ITAT was not dealing with the transaction in the nature of barter exchange and accordingly argue that provisions of Section 68 of the Act are not applicable to the transactions in the nature of barter exchange.It is imperative that the taxpayers offer satisfactory explanation about the nature and source of credits in their books of accounts, to overcome the rigours of Section 68 of the Act.

But nonetheless the transactions in the nature of barter exchange may get caught by the rigours of Section 56(2)(viib) of the Act simply because a promise to transfer any asset in exchange of the issue of shares, can be treated as a consideration for the issue of shares.

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[1] Please note that for the sake of brevity, we have only discussed the facts relating to ITO v M/s Pansu Commercial Pvt Ltd.

The readers can also refer the decision of the Kolkata Bench of the ITAT in the case of ITO v M/s Saffron Comtrade Pvt Ltd (ITA No. 2029/ Kol/ 2016) and in the case of DCIT v M/s Alishan Steel Pvt Ltd (ITA No. 2246/ Kol/ 2017).

All the decisions of the Kolkata Bench of the ITAT has relied on the decision of the Calcutta HC in the case of Jatia Investment Co v CIT [1994] 206 ITR 718 (Cal).

[2] Extract taken from the commentary available on www.taxmann.com

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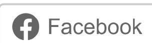

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