

Wipro crafting artificial losses from sale of subsidiary shares to set off against taxable cap gains: HC

Summary – The High Court of Karnataka in a recent case of Wipro Ltd., (the Assessee) held that where, it was evident that claim of capital loss was a colourable device to evade payment of tax on short term capital gains, capital loss claimed by assessee as against short term capital gains was to be disallowed.

Facts

- The assessee was engaged in the business of software exports, computer peripherals, IT enabled services, manufacture and sale of vegetable oils, soaps, leather products, etc. as well as marketing and support of medical equipments.
- It acquired certain shares of WNL on 31-3-1999 for a consideration of Rs.15.11 crores. Out of the said shareholding in WNL, it sold certain shares on 5-8-1999 to KPN Asia Mauritius Holding, for a consideration of Rs.20.31 crores. Likewise, on 28-12-1999, assessee sold some more shares of WNL to ICICI Ltd., for a consideration of Rs.99.42 crores. In this manner, during assessment year 2000-01, the assessee earned windfall gains on sale of WNL shares. Thus, assessee earned short term capital gains (STCG) of Rs.109.54 crores under section 48 from the sale of WNL shares.
- Further, during same assessment year, the assessee claimed to have incurred long term capital loss (LTCL) of Rs. 107.97 crores on sale of shares of WFL, a non-banking financial company, whose registration before RBI was withdrawn. It was a subsidiary of assessee company.
- The assessee thereafter invoked section 70 and attempted to set-off short term capital gains earned against the long term capital loss incurred.
- The Assessing Officer noted that sale of WFL shares was done on 29-12-1999. Referring to other facts in this regard, Assessing Officer considered the transaction as sham and held that assessee entered into WFL sale transaction only for the purpose of availing set-off under section 70. The Assessing Officer therefore held long term capital loss as a colourable device to avoid tax on short term capital gains earned. He, thus, disallowed claim of long term capital loss made by assessee.
- On appeal, the Commissioner (Appeals) confirmed the order of the Assessing Officer.
- On further appeal, the Tribunal ruled in favour of assessee. The Tribunal held that the transaction of transfer of shares resulting in capital loss was a legal transaction, not tainted by any ulterior motive or dubious method to reduce the tax. Accordingly, capital loss claimed by assessee was allowed and a direction was given to set off against the short term gains earned from other transactions.
- On appeal by revenue to High Court

Issue to be decided

- Whether the Tribunal was correct in law in allowing the capital loss claimed by the assessee as against short term capital gains ignoring the fact that the claim of capital loss was a colourable device to evade payment of tax on short term capital gains?

Held

- It is necessary to keep in mind the clear distinction between a legitimate tax planning and a device to avoid tax. In order to appreciate this point various English Court rulings and also American jurisprudence in cases were referred to. Several judgments of the U.S. Courts are in respect of the proposition that motive of tax avoidance is irrelevant in consideration of the legal efficacy of a transactional situation.
- In India, the Courts have made a clear distinction between Tax evasion and Tax Avoidance. In the case of tax evasion, the Apex Court has held that the Courts would have to pierce the corporate veil and to find out the economic realities behind the legal façade. A corporate entity can be disregarded if it is used for tax evasion or to circumvent tax obligation.
- It is clear that, a citizen is entitled to arrange his affairs as not to attract taxes imposed by the State, so far as he can do so within the law. He is entitled to order his affairs in such a manner that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure the said result, his ingenuity is to be respected and he cannot be compelled to pay an increased tax. The basic proposition underlining this taxation law is that any tax payer is entitled so as to order his affairs in such a manner as to see that his liability to tax is as low as possible. But the arrangement should be real and genuine and not a sham or make-believe. Colourable devices cannot be part of tax planning. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.
- Tax planning may be legitimate provided it is within the framework of law. If the transaction in question is sham or colorable and entered into with the sole intention of evading payment of tax, then such a transaction would not have any legitimacy. Therefore, it is clear as the law as it stands today in India, tax planning is legitimate, provided it is within the frame work of law. The intention of the Legislature in a taxation statute is to be gathered from the language of the provisions particularly where the language is plain and unambiguous. In a taxation statute, it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language.
- The question whether a transaction is sham or colorable and entered into with the sole intention of evading payment of tax is purely a question of fact. On appreciation of the material on record and thereafter keeping in mind the statutory provisions in particular, the charging section and the section under which the tax is exempted, the Court has to record the finding of fact. Unless the statutory provisions provide for exemption from payment of tax, the question of an assessee trying to take advantage of the said provision would not arise. Therefore, in each case, the question is, the way the assessee has avoided to pay tax relying on the statutory provisions is legitimate or not is to be considered by the Court. The Court has to bear in mind that it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. An obligation is cast on every citizen to pay the taxes without resorting to subterfuges. When the statute provides certain rights, which if properly applied would reduce the tax burden on the

assessee or exempts him from the payment of tax, the assessee is entitled to the said benefit. However, if he is invoking the said provisions with the intention of evading payment of tax, then it would be a colorable device to avoid payment of tax, which cannot be entertained by the Court. It is in this context, Court has to find out whether the transaction is real or unreal and then record a finding whether it is a colorable device or sham transaction.

- Referring to facts of the instant case, the assessee held shares in WFL a non-banking financial company. It sold WFL shares to three persons, firstly, legal advisor of the assessee, secondly to an ex-employee for a period of 20 years and thirdly to Ex-CEO of WFL. The total indexed cost of aforesaid shares was valued at Rs. 107.98 crores. However, it was sold for only Rs.75,000. Thus, the assessee incurred a long term capital loss of Rs. 107.97 crores. The said sale was done on 29-12-1999, that is, the day after the assessee earned the short term capital gains.
- On 6-3-1996, the Common Wealth Development Corporation entered into a share subscription agreement with WFL and agreed to subscribe to 11.43 lakh equity shares, face value of Rs.10 each, in all at Rs.17.50 per share. Accordingly, WFL allotted 11.43 lakh equity shares to Common Wealth Development Corporation, which accounted for Rs.1.14 crores with Rs.85.71 lakhs as share premium. They also entered into repayment and settlement agreement dated 12-3-1999.
- It is to be noted here that WFL had entered into a loan agreement with Common Wealth Development Corporation on 31-12-1994 and made available a loan upto Rs.50 lakh UK sterling pounds for its business. Similarly, WFL entered into subscription agreement on 30-3-1998 with ICICI Limited under which ICICI agreed to subscribe 25 lakh convertible preference shares of Rs.100 each face value and accordingly, it paid Rs.25 crores. It is in this background, the assessee company purchased 11.43 lakh shares from Common Wealth Development Corporation in the month of September 1999 at a price of Rs.17.25 per share. The face value of shares being Rs.10 per share. Similarly, the assessee purchased 25 lakh convertible preference shares on 23-12-1999 for a total consideration of Rs.32 crores, out of which 31.69 crores was towards the purchase consideration paid towards ICICI Limited and balance of Rs.31.21 lakhs was pay as prepayment premium on account of early exercise by bank. The said figures evidences the fact that these shares were bought by the assessee on premium when it shows to divest from WFL at nominal price. In other words, the assessee purchased the shares at premium at a price of Rs.17.25 per share on 23-12-1999 and thereafter, sold the shares acquired earlier at a price of Rs.0.086 per share.
- In addition to that, it made a fresh infusion of capital on 30-12-1999 in equity shares aggregating to Rs.45 crores at face value of Rs.10 each, and the assessee company also made fresh infusion of share capital on 31-9-1999 and aggregating to Rs.20 crores. Further it again infused capital on 30-12-1999 in redeemable preference shares crediting to Rs.30 crores.
- The explanation offered by the assessee is prudential norms on income recognition, asset classification and provision applicable to NBFC are mandatory in nature and are applicable irrespective of the fact that they have public deposits or not. The certificate of registration was pending and it would be considered only on Wipro Finance Limited reaching the mandatory

minimum NBFC of Rs.25 lakhs. The company had time upto 8-1-2000 to reach the minimum NBFC preferable share capital although convertible to equity shares are eligible to reckon for the purpose of registration. Therefore, WFL being the subsidiary company of the assessee, the said amounts were infused on 31-12-1999.

- After crediting the said amount in the account of WFL, the WFL has repaid Rs.95 crores to the assessee on the very same day. Section 70 provides for 'set off loss from one source against income from another source under the same head of income'. That means where the net result of any assessment year in respect of any source falling under any head of income other than capital gain is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head.
- The aforesaid undisputed and admitted material on record discloses that the purchase of shares of WFL at premium in one breadth and selling the shares of the said company for a pittance at the rate of less than a paisa in other breadth, which clearly shows the intention behind this arrangement. Secondly, the said shares are sold to the ex-employees who continued to hold the said shares without bringing any fresh capital for conducting the business of WFL. Thirdly, though it is contended that a sum of Rs.95 crores is infused to meet the requirement of company under the RBI Act, as demanded by the Reserve Bank of India, the amount of Rs.95 crores infused is withdrawn on the very same day towards the repayment of the debt by WFL to the assessee clearly demonstrates the intention behind such arrangement. Fourthly, as it is clear from the contention of the assessee that the capital gains was accrued to them because of wind fall profits by selling of shares of WNL, the quantum of short term capital gains disclosed by the assessee was a staggering amount of excess of Rs.100 crores. The loss was generated by disinvestment of assessee's share owned in subsidiary Non Banking Finance Company. The fact that three persons/ex-employees who had rewarding association with the assessee group for a long period of time, cast a shadow on the genuineness of the transaction as the shares were sold at a throw away price, when earlier to the sale, the assessee had purchased the shares of WFL at a premium. Despite disinvesting the shares on such a throw away price under the guise of complying with the legal requirements as directed by RBI, the assessee chose to infuse fresh capital to the extent of Rs.95 crores at par on the same day and took back the amount on the same day under different head. In the end, they did not comply with the procedures of the law. On the contrary, application filed to the RBI was withdrawn. These undisputed facts borne out from the record clearly establishes the real intention underlying this scheme which they have propounded.
- Thus, in the facts and circumstances of the case, it is clear that it is not a real scheme. It is not a legitimate tax planning. It is a device adopted to evade payment of tax on the capital gains earned by the assessee company. Though the proximity of the date between the sale of shares and purchase of shares and disinvestment alone cannot be a criteria to hold the transaction is a sham transaction and the profit earned from sale of shares in WNL is real and loss incurred by the sale of shares is also real and though there was no bar for sale of shares at throw away price and

sometimes, the businessman act in undue exercise and hasty and without any rationale any one of them is not sufficient to hold a transaction as sham transaction. But the cumulative effect of all these instances unequivocally points out the real intention behind this transaction and leads to a irresistible conclusion that this tax planning is done with the intention to avoid payment of tax on capital gains and it is not a case of legitimate tax planning but a devise to avoid payment of tax. Therefore, the Tribunal was not justified in characterizing this transaction as a legitimate tax planning. The observation of the Tribunal that the shares transactions of WFL had happened at different times in the past is not factually correct. It is not a case where the Assessing Authority came to such a conclusion merely because of the proximity of the dates and it was done hurriedly but the Assessing Authority on careful consideration of the entire material on record, in particular, the explanation offered by the assessee for his queries has arrived at the finding that it is a colourable devise and a sham transaction which finding has been affirmed by the Appellate Commissioner on re-appreciation of the entire material on record after making note of the entire case law on the point. It is the Tribunal which has interfered with such a concurrent finding of fact without properly appreciating the mechanism adopted by the assessee to avoid payment of tax. In that view of the matter the finding of the Tribunal on this issue requires interference and accordingly, the same is set aside. The said substantial question of law is answered in favour of the revenue and against the assessee.