

No capital gain exemption as transferor-co. failed to prove that it was wholly owned subsidiary of transferee-co.

Summary – The Delhi ITAT in a recent case of Sunaero Ltd., (the Assessee) held that where assessee was unable to prove that it was a wholly-owned subsidiary of holding company it would not be entitled to benefit of section 47(v), because to claim benefit under section 47(v), assessee must be a wholly owned subsidiary of holding company

Facts

- Sunair Hotels Ltd. ('S') was granted the rights to develop a hotel by the New Delhi Municipal Corporation (NDMC) in 1970. 'S' incorporated another group company, namely, the assessee and requested the NDMC to substitute its name with that of the assessee. During the pendency of this request, in the year 1993-94, 'S' transferred its development rights to the assessee for *Nil* consideration. However, the NDMC refused to transfer the licensee rights in the name of the assessee. During the year 1994-95, the assessee transferred the hotel development rights back to 'S' for a consideration of 21 crores. The said amount was claimed as not liable for capital gain on the ground that the assessee-company was a wholly-owned subsidiary of 'S' and transaction of transfer of capital asset by a wholly-owned subsidiary to its Indian holding company is not regarded as transfer in terms of section 47(v).
- The Assessing Officer in block assessment order held that the assessee was not a wholly owned subsidiary of 'S' as it had seven registered individuals as shareholders and 'S' was not holder of even a single share. Further share certificates did not show that shareholders were nominees of 'S'; and that one of the shareholders, *i.e.*, 'R', had denied that he was a nominee of 'S' and stated that he was a shareholder in his individual capacity. Therefore, the benefit under section 47(v) was not available to the assessee.
- However, the Commissioner (Appeals) held that the statement of 'R' was not reliable and sufficient and the Assessing Officer should have made further enquiries. He held that investment in the shares were made by the holding company, 'S' and this position was reflected in the books of both, the assessee and 'S,' and that 'R' had not stated that he had made payment for shares out of his own funds and had not shown or claimed ownership of shares in his balance-sheet. He thus held that the assessee was the wholly-owned subsidiary of 'S' and accordingly deleted the addition of Rs. 21 crore made by the Assessing Officer.
- The Tribunal upheld the order passed by the Commissioner (Appeals).
- On appeal, the High Court found the order of the Tribunal perverse on facts and remitted the issue to the Tribunal for the determination of facts and then decide the issue of capital gain.

Held

- Section 47(v) has excluded transfer of a capital asset by wholly-owned subsidiary company to the holding Indian company from capital gain.
- The ultimate issue that emerges for consideration is that whether the whole of the share capital of the assessee-company was held by 'S' or say, the assessee-company was a wholly-owned subsidiary of 'S'. If it can be established that the assessee is wholly-owned subsidiary of 'S', then the transfer of development rights by the assessee to 'S' falls under exclusion from capital gain as laid down in section 47(v).
- For the purpose of section 47(v), two conditions are required to be fulfilled. The first condition is that whole of the share capital of the subsidiary company is held by the holding company and the second condition is that the holding company is an Indian company. In the instant case existence of first condition is to be decided as whether the whole of the share capital of the assessee-company is held by 'S'. It is submitted by the assessee that all the seven shareholders of the assessee-company were nominee of 'S' therefore whole of the share capital of the assessee-company was held as beneficial owner by 'S' or the assessee was a wholly-owned subsidiary of 'S' and which being an Indian company, the assessee fulfilled both the conditions of section 47(v). In view of above facts, now the issue for deciding is whether all the seven shareholders of the assessee-company were merely nominee of 'S' or shareholders in their individual capacity and if any of one of the shareholder is not nominee of 'S', then the assessee, loses to be a wholly-owned subsidiary of 'S'. The revenue has contested that the shareholders 'R' and 'D' have denied of being nominee of 'S' and, therefore, the assessee is not a wholly-owned subsidiary of 'S'. It is found that the assessee has submitted various arguments to support his point that both 'R' and 'D' were also nominee of 'S'.
- Regarding payment for subscription of shares, the assessee has repeated the arguments made before the High Court. The High Court has held that the payment of share capital was certainly not by cheque.
- The issue before the instant court is whether merely incurring expenditure for registration of the assessee-company by 'S', can automatically acquire the shareholding of the assessee-company through passing a journal entry in its books of account. Just making of journal entry in books of account against the expenditure incurred for registration of the company, cannot authorise 'S' to hold the shares as beneficiary. Undisputedly, the shares have been issued in the name of seven persons and nowhere in the share certificates, it is mentioned that those seven shareholders are nominee of 'S'. There is no other agreement on record between the shareholders and 'S', which could justify the beneficial interest of 'S', thus making only accounting entry in books of account of either the assessee-company or in the books of account of 'S' cannot determine the ownership of the shares. In books of account of the assessee, 'S' should have been reflected as a creditor for expenses. The Apex court in the case of *Kadarnath Jute Mfg. Co. v. CIT* [\[1971\] 82 ITR 363](#) has held that making of entry in the books of account cannot be decisive or conclusive in the matter.

- In view of the above discussion, it is held that by incurring expenditure on behalf of the assessee-company and making adjustment entry in the journal books of 'S', it cannot become beneficial owner of shares unless any agreement to contrary.
- The High Court has taken note of the violation of section 187C or section 49 of the Companies Act and thereafter directed to examine whether the violation of the said provisions would prevent and bar the assessee from claiming that it was wholly owned subsidiary and recorded shareholders were mere nominees.
- The High Court has also directed to examine the evidentiary value of effect of the violation of sections 49 and 187C of the Companies Act and the conduct of the assessee and its relevance in not filing the declaration initially and the subsequent filing has been disputed and contested.
- On consideration of the various provisions of the Companies Act, 1956 and rules made in that regard, it is found that section 49 of the Companies Act has given an option to a person to hold the shares as nominee of a beneficial shareholder and for the purpose of exercising this option, section 187C of the Companies Act has made it mandatory for the nominee, beneficial owners and the company whose shares have been issued, to file the declarations in prescribed form before the Registrar of companies within the prescribed period. It is found that as per the rules made under section 187C, the prescribed form No. I is to be filed by the shareholders with the company within one month of allotment of shares or entry of the name of the shareholder in the Register of members of the company. Similarly, the prescribed Form No. II is to be filed by the beneficial owner of shares with the company within one month of allotment of such shares, and thereafter, the company is required to submit Form No. III along with prescribed Form Nos. I & II to the office of Registrar of the Companies (ROC) within one month from the date of submission of Form Nos. I & II with the company. The assessee-company was incorporated on 23-10-1993 and, therefore, it was required to submit the prescribed forms within the stipulated period to the ROC.
- The facts in respect of the issue in dispute as emerged from the orders of the lower authorities and other records are as under:
 - (i) The Assessing Officer has observed that these prescribed forms were filed by the assessee in the office of the Registrar of the Company in January, 2000. The assessee has also accepted this fact in the written submission filed before the court. The fact of submitting of the Forms in January, 2000 has also been confirmed in the report of the Deputy Director (Inspection) of Company Affairs.
 - (ii) The Assessing Officer has observed that on perusal of the prescribed Form No. I of seven shareholders, he found that signature on these forms were dated 25-10-1993, but in post search investigation carried out by the Deputy Director of Income-tax (Investigation), it was observed that these prescribed forms were printed by Jain Books Agency in the year 1998. The Assessing Officer has further mentioned that during the course of inquiry, statement of Partner and Counter Sale In-charge for Jain Book Agency were recorded on oath on 28-2-

- 2001 and those two persons deposed in their statement that the forms filled by the shareholders of the assessee-company could not have been signed in the year 1993 as those forms were printed for the first time in 1998 only. Further, the Assessing Officer observed that the Deputy Director of Income-tax (Investigation), noted that the fax number stated at the bottom of Form No. I was activated only after 25-10-1993. The Assessing Officer has produced the statement of these two persons in the assessment order.
- (iii) When these facts were confronted to the assessee by the Assessing Officer, it was submitted by the assessee-company that necessary declaration forms from shareholders were obtained on 23-10-1993 on plain paper after getting typed on computer and those declaration forms were lying in the office of the assessee. It was further submitted that when these forms were sent for filing to the ROC, receipt clerk stated that those forms should be submitted in a pre-printed form and subsequently copies of the earlier declaration on record were made on these pre-printed form and, therefore, no adverse cognizance could be taken for the same.
- (iv) . In view of this submission of the assessee, the Assessing Officer made inquiry from the shareholders, 'R' and 'D'. The Assessing Officer observed that 'R' categorically stated that his signature, as appearing on the forms submitted with the ROC under section 187C, were not his signature but forged. Further, the Assessing Officer observed that 'D' stated that he was earlier working as an employee of Vinod Kumar Bindal the Chartered Accountant of the assessee-company and deposed that the signatures appearing on the declaration forms submitted before the ROC with his name, were not his signature. Further, the Assessing Officer observed that both these persons stated that they had subscribed to the shares of the assessee-company in their individual capacity and not as the nominee of 'S'. The Assessing Officer has also reproduced the statement of both 'R' and 'D' in the assessment order.
- (v) Further, the Assessing Officer has noted in the assessment order that the signature of 'R' as appearing in the prescribed form No. I along with his specimen signature were sent to the Government Examiner of Questioned Documents, Police Research & Development Bureau, Ministry of Home, Shimla and the report was obtained, wherein the Examiner of Questioned Documents has opined that signatures on prescribed forms were not tallying with the specimen signatures of the shareholders. Further, the Deputy Director (Inspection), Department of Company Affairs, carried out an inspection under section 209A of the Companies Act, 1956 on 26-2-2001 in the case of the assessee-company and reported that there were contradictory statements in form Nos. II & III filed by the assessee-company.
- (vi) Further, the Deputy Director (Inspection), Department of Company Affairs in its report, mentioned that minutes book of the assessee-company was found to be interpolated by putting fluid on various pages, hence, there was violation of section 193 of the Companies Act. Other violations of the Companies Act were also observed in the said report.

- (vii) Before the Commissioner (Appeals), the assessee contended that section 187C of the Companies Act is a procedural section for the purpose of disclosure of Benamai holding of the shares and cannot be imported into considering for the purpose of examining whether the conditions as laid down under section 47(5) of the Income-tax Act are essentially fulfilled or not.
 - (viii) During the appellate proceedings before the Commissioner (Appeals), the assessee was provided opportunity to cross-examine 'R', however, no questions in respect of signature of 'R' on prescribed form No. I, not tallying with his specimen signature, were asked by Vinod Kumar Bindal, Chartered Accountant of the assessee-company.
- The assessee submitted that the delay in filing of the declaration under section 187C of the Companies Act was not a violation of the provisions and it was not the case that the impugned declarations were filed after the search took place as the said declarations were filed much prior to the date of search and lastly under the compounding provisions of the Companies Act, 1956 the delay stood condoned of by the payment of the delayed fee. The assessee also disputed the claim of the Assessing Officer that the Government Examiner of Questioned Documents held the signature of 'R' as not genuine. According to the assessee, the Government Examiner of Questioned Documents has called for further documents for giving his final opinion in the matter. The assessee also submitted that it was not provided the certified true copies on the prescribed form Nos. I, II & III, which claimed to have been collected by the Deputy Director of Income-tax (Investigation) from the office of the Registrar of the companies.
 - After considering the arguments of both the parties and facts and circumstances of the issue in dispute, it is found that:
 - (i) The assessee submitted that the Assessing Officer did not provide certified copies on prescribed form Nos. I, II & III, which were claimed to have collected by the Deputy Director of Income-tax (Investigation) from the office of the Registrar of Companies (ROC) and therefore he raised doubt on the authenticity of the forms as well as information contained therein. It is found from the assessment order that the Assessing Officer brought inconsistency of signature of 'R' in prescribed forms to the knowledge of the assessee, then the assessee submitted his explanation in respect of those forms stating that the same were obtained on plain paper at the time of incorporation of the Companies Act and subsequently same were reproduced on the prescribed forms. Once, the assessee admitted this fact, it can safely presumed that the assessee was having those copies with it. It could not have been possible to give explanation without having copy of such forms. Further, the Commissioner (Departmental Representative) submitted that the assessee never requested for providing certified true copy of the prescribed forms in first appellate proceedings before the Commissioner (Appeals) and the assessee also could not controvert this fact. It is

- also observed that during the proceeding of cross-examination of 'R' also, no question was asked by the assessee about the signature of 'R' on prescribed form. From the records, it cannot be found that any cross-examination of the Examiner of questioned document was sought by the assessee. Further, as admitted by the assessee, these prescribed forms were filed by the assessee before the Registrar of the Companies, therefore, it was the responsibility of the assessee-company to produce the copy of such forms. The assessee itself could have obtained copy of those forms from the office of the Registrar of the Companies (ROC). In view of the above facts, there is no merit in the argument of the assessee raising doubt on authenticity of the prescribed form Nos. I, II and III as mentioned by the Assessing Officer.
- (ii) Further, 'R' has denied of putting his signature on form No. I and the Government Examiner of Questioned Document has also given his opinion that the signature of 'R' on a prescribed form No. I did not tally with the specimen signature. The Government Examiner of Questioned Document has given a detailed reasoning for his conclusions.
 - (iii) In view of the analysis and reasoning given by the Government Examiner of Questioned Documents, there is no doubt that the signature of 'R' on forms was not tallying with his specimen signature. The report of the Examiner has corroborated the statement given by 'R' that he did not sign the prescribed Form No. I in question.
 - (iv) The Deputy Director (Inspection) of the Company affairs carried inspection of the prescribed forms submitted by the assessee-company and reported inconsistency in the forms. The relevant report of Deputy Director(Inspection) of the Company specifies that Form I in accordance with rule 3(1) of Companies (Declaration of Beneficial Interest in Share) Rules, 1975 in accordance with sub-section 187C declared that they themselves are shareholders and nobody else was holding the beneficial interest in these shares. However, Form No. II, signed by a director of 'S' declares that the beneficial ownership of these 700 shares (Distinctive Nos. 1 to 700) was held by the company itself. On the basis of Forms, in Form No. III filed by the company with ROC the company made an entirely different statement and declared by that the beneficial interest of these very 700 shares was held by 'S'. Hence, the Form No. III, the basis of which are Forms Nos. I & II being contradictory, cannot be relied upon.
- The above facts establish that the claim of compliance of section 187C of the Companies Act, 1956 by the assessee is defective because, firstly, it has not filled the prescribed forms within the prescribed period or during the relevant assessment year and secondly, the forms filed with delay are not found having genuine signature of 'R', therefore, the assessee cannot make a claim of wholly owned subsidiary of 'S'. On the basis of submissions filed, the assessee submitted that delay in filing the declaration under section 187C of the Companies Act was not a violation of the provisions and the said delay has been compounded under the provisions of the Companies Act along with the

payment of late fee. When the signature of 'R' has been found to be not genuine and he himself has denied of putting his signature on such forms and also the assessee has not been able to produce any such prescribed form with the genuine signature of 'R', merely, filing unauthentic form of 'R' in the office of ROC, it cannot be said that the assessee has made compliance of the provisions of section 187C of the Companies Act. As per the Companies Act, for claiming beneficial shareholding, it was mandatory for filing such forms and in the absence of compliance of the provisions of Companies Act, the assessee cannot claim that 'R' was a nominee of 'S'.

- The High Court had directed the assessee to lead sufficient evidence to enable the Authorities/Tribunal that the assessee-company has discharged its onus. The evidence should be such that it can be held that the shares were not held by the shareholder in his individual/personal capacity but as a nominee of the third person.
- In response to the above findings of the High Court, the assessee has filed the following evidence in support of its claim that 'R' was a nominee of 'S':
 - (i) In the balance-sheet and financial statements of the assessee and 'S', the assessee-company has been shown as wholly owned subsidiary company of 'S' and these balance sheets have been filed before the ROC and Income-tax departments.
 - (ii) In the register of the members of company, shareholders have been shown as nominee of 'S'.
 - (iii) In the minutes of meeting of board of directors the fact of the assessee-company being wholly owned subsidiary of 'S'. was duly recorded.
 - (iv) In various letters addressed to the Ministry of Industries (Department of Industrial Policy and Promotion) in respect of collaboration with foreign company, it was claimed by 'S' that the assessee was a wholly owned subsidiary of 'S' and this claim was made in May, 1995. The documents in support of the claims are also made available.
- On consideration of the submissions of the assessee, it is found that the assessee has not been able to submit the evidence which could establish its claim of being wholly owned subsidiary of 'S' because of the following reasons:
 - (i) The balance sheet, financial statements, register of members of the company, minutes of meetings and documents in respect of Department of Industrial Policy and Promotion are all unilateral declaration or act of the assessee or by the persons under the control of the assessee-company or 'S'. No documents containing the signature of 'R' or any agreement between 'R' and 'S' mentioning the fact of 'R' as a nominee of the shareholders, have been produced either before the lower authorities or before instant court.
 - (ii) The prescribed form No. I under section 187C with the genuine signature of 'R' has also not been produced before instant court or before the lower authorities.

- (iii) The register of members of company does not bear the signature of any of the directors of the company and particularly of 'R'.
 - (iv) Regarding the minutes of meeting, 'R' has denied of putting his signature on the minutes of meeting dated 23-10-1993. Further, the Deputy Director (Inspection) of Company Affairs in his letter dated 4-8-2000, has given comments that the minutes books have been interpolated and fluid on page numbers has been put hence, there is violation of section 193. Thus, the minutes of meeting recorded are not reliable.
 - (v) In the documents submitted to Department of Industrial Policy and Promotion, Government of India, 'S' has claimed that the assessee is a wholly owned subsidiary company of 'S'. There is no independent finding as to that the assessee was a wholly owned subsidiary company of 'S' in terms of Companies Act or other laws.
 - (vi) merely finding of share certificates in the premises of 'S' is not sufficient to establish that it was owning all the shares and the shareholders were nominees of the company.
- As regards to the argument that even before the incorporation of the assessee-company, it was the intention of the holding company as well as the promoters to form a wholly owned subsidiary company to exploit the potential of the land development rights for construction of hotels, is concerned, it is found that mere demonstrating the intention of creation of a wholly owned subsidiary is not sufficient. The assessee is required to demonstrate with the help of either any written agreement between the shareholders and 'S' or with the help of copy of form No. 1 prescribed under section 187C of Companies Act, 1956 that the shareholders were nominee shareholders. In view of above, it is apparent that the assessee has not been able to lead the evidence required to establish that the shareholders were in the capacity of nominee of 'S'.
 - Regarding the argument of the assessee that 'R' was not involved in day-to-day working and he could not substantiate the investment of Rs. 1000, the High Court has observed that it is not necessary for the shareholder to be involved in day to day working. Neither does the shareholder become a nominee shareholder if he is not involved in day to day working. Further, the shares were issued in the name of 'R'. The amount involved was only Rs. 1,000 which was not big or substantial amount. The findings recorded by the tribunal that the payment of share capital was made by 'S' by cheque is factually incorrect have already been referred to.
 - Regarding the submissions of the assessee that 'R' failed to report the ownership of the shares in his balance sheet. The High Court has already observed that the onus is on the assessee to show and establish that it was a wholly owned subsidiary of the holding company and the assessee were merely the nominee of the holding company.
 - The assessee has not been able to lead any evidence, which could substantiate that 'R' was nominee shareholder of 'S'.
 - Further, the High Court has observed that failure to mention the shares recorded/standing in the name of nominee of 'S' was a lapse and an error on the part of 'R'. From the said factum, no

inference or legal conclusion can be drawn that 'S' was the beneficial shareholder. High Court held that this kind of conclusions was and would be an erroneous conclusion.

- In view of the above discussion, it is held that the assessee is unable to prove that it is a wholly-owned subsidiary of 'S' and therefore assessee is not entitled to the benefit of section 47(v). Hence, the capital gain of Rs. 21 crores on transfer of development rights by the assessee-company to 'S' is held as taxable in the hands of the assessee-company.
- In the result, appeal of revenue is allowed.