Conversion of CCPSs into equity shares couldn't be considered as transfer within meaning of sec. 2(47): ITAT

Summary – The Mumbai ITAT in a recent case of Periar Trading Company (P.) Ltd., (the Assessee) held that Conversion of cumulative compulsory convertible preference shares (CCPS) into equity shares could not be considered as transfer within meaning of section 2(47)

Facts

- The assessee-company was engaged in the business of investment activities and was also a partner in a registered partnership firm. During the previous year relevant to assessment year, the assessee-company held 51,634 number of cumulative and compulsory convertible preference shares (CCPS) of Company, TL. As per the terms of the scheme for issue of CCPS, CCPS of a series would compulsorily and automatically get converted into one fully paid up equity share. Accordingly, in terms of the above scheme, the assessee was allotted one equity share of TL for every preference share held in TL. Such conversion was compulsory and automatic.
- According to Assessing Officer, the conversion of CCPS into equity shares was transfer within the meaning of the definition provided in section 2(47)(i) and that profit accrued from such conversion was taxable as capital gain. The Assessing Officer added the same to income of the assessee as taxable long term capital gain.
- On appeal, the Commissioner (Appeals) also upheld the addition made by the Assessing Officer.
- On second appeal:

Held

- One has to consider whether any transfer of a capital asset has taken place or not. The provisions of section 45(1) bring into tax the profits or gains arising from transfer of a capital asset under the head 'capital gains' in case there is a capital asset, there is transfer of such capital asset and there is gain arising out of such transfer of such capital asset. The Assessing Officer relying on the definition of 'exchange' as per the Black's Law Dictionary, deluxe fourth edition held that conversion of preference shares into equity shares will be treated as 'transfer' within the meaning of section 2(47), whereas the assessee argued from the beginning that there has been a conversion of one type of share into other type of share and, as such, same cannot be stated as an 'exchange' of assets within the meaning of section 2(47) as held by the Assessing Officer.
- The assessee relied on the CBDT Circular F. No. 12/1/84-IT(AI) dated 12-5-1964 which states that where one type of share is converted into another type of share, there is no 'transfer' of capital asset within the meaning of section 2(47). The circular also states that the same has been issued to clarify that there is no capital gain under section 45(1) or under section 45(2) on conversion of one

type of share into another. It also states that where the newly converted share is transferred at a later date, then, the cost of acquisition of such share for the purpose of computing the capital gain tax shall be calculated with reference to the cost of acquisition of the original share from which it is derived.

- The provisions of section 48 specifies the mode of computation of capital gain, makes it clear that the provision regarding computation of capital gain contemplates ascertainment of the full value of consideration received or accruing as a result of transfer of capital asset. The word 'received' means actually received and the word 'accruing' means the debt created in favour of the assessee as a result of the transfer. In any case, both the terms are used as actual and not estimated amounts. The provision does not contain words to the effect 'fair market value'.
- Another aspect argued by the assessee is that in case the assessee sells the equity shares of TL received pursuant to CCPS, then, as per the provisions of section 55(2)(b)(v)(e), the cost of acquisition would be the original cost of CCPS. He further submitted that as the Assessing Officer has also taxed the difference between the original cost of CCPS and the fair market value in the captioned year, thus, on actual sale of shares it would tantamount to double taxation considering the provisions of the Act. It was also explained that the CBDT *vide* its circular (*supra*) has explained that legislature has chosen to ignore the intermediate event of conversion for taxation purposes. If there arises any capital gain event upon such conversion, then, the cost of acquisition would be the consideration adopted while computing such capital gain and the exercise in regard to such conversion will be tax-neutral.
- The CBDT *vide* its Circular dated 12-5-1964 (*supra*) has clarified the position that where one type of share is converted into another type of share, there is no transfer of capital asset within the meaning of section 2(47). The present case is not a case where one form of share has been exchanged, bartered, swapped for other form of share. In the present case, one type of share has been converted into other type and the earlier type of share has ceased to exist. Thus, there is no exchange of any share as the pre-conversion security has ceased to exist. From the above, it is evident that mere conversion of one type of share to other type of share will not be a transfer of a capital asset within the meaning of section 2(47). The factum of conversion does not make any material difference in calculating the capital gain. The Tribunal relying on the circular held that there is no transfer when one type of share is converted into any type of share.
- There is no leakage of revenue if such interpretation is adopted. Not only this interpretation would be in furtherance to the legislative intention but would also make the competition provision of capital gain work smoothly, in synchronization with other provisions, without any conflict with other provisions. On the other hand, if the view is adopted that capital gain tax liability arose upon conversion, the same would be not only against the legislative intention but also would make the composition of capital gain unworkable and would bring conflict with other provisions of the Act. In fact, the contrary interpretation would lead to double taxation inasmuch as, having taxed the capital gain upon such conversion, at the time of computing capital gain upon sale of such converted

shares, the assessee would be still taxed again, as the cost of acquisition would still be adopted as the issue price of the CCPS and not the consideration adopted while levying capital gain upon such conversion. By no stretch of imagination, such interpretation process is permissible.

- In view of the above factual discussion and legal propositions, conversion of CCPS into equity shares cannot be treated as 'transfer' within the meaning of section 2(47) and hence, the addition is deleted.