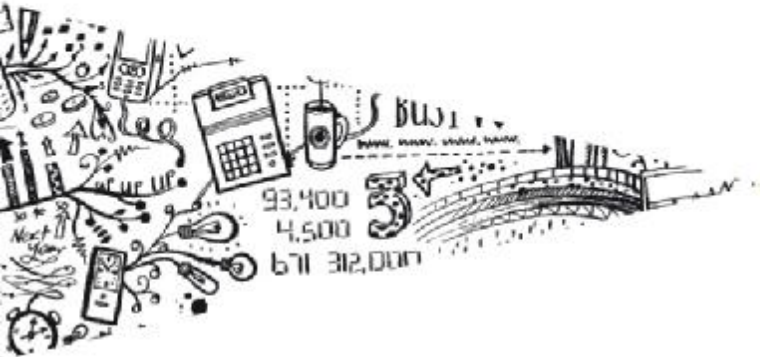


12 July 2011

# EY Tax Alert

Bombay High Court rules on the meaning of full value when assets attached with liabilities are received by shareholders as proceeds from liquidation



## Executive summary

This Tax Alert summarizes a recent Bombay High Court (HC) ruling in the case of Shri Nayan Arvind Shah (Taxpayer) (ITA No. 1856, 1857 & 1858/2009) on the issue of whether the value of the assets, for the purpose of computation of capital gains in the hands of the shareholders in respect of assets received from the liquidator of a company, should be taken at the fair market value (FMV) or at the FMV as reduced by the liabilities attached to it. It was held that the FMV, as reduced by the liabilities attached to it, forms the basis for computation of capital gains.

## Facts

- ▶ The Indian Tax Laws (ITL) contain a special provision for taxation of capital gains in the hands of the shareholder on the assets received on liquidation of a company, where they are distributed in specie to the shareholders. The FMV of the assets is deemed to be the full value of the consideration for the purpose of capital gains taxation in the hands of the shareholders. Capital gains are, thereafter, computed by reducing from such full value the cost of shares of the company under liquidation.
- ▶ The Taxpayer was an individual shareholder of a company that went into liquidation. The Taxpayer received certain assets of the company along with the liabilities attached to it. This distribution of assets was done by the liquidator as he did not

have liquidity to discharge the liabilities. The shareholder later on, discharged the liabilities.

- ▶ For computing capital gains, the Taxpayer reduced the value of the liabilities from the assets for determining 'full value' of the consideration.
- ▶ The Tax Authority argued that, since the special provision contains a deeming provision, the full value of the assets should be taken into consideration without excluding value of the liabilities attached to the assets.
- ▶ The second appellate authority decided the issue in favor of the Taxpayer. Aggrieved, the Tax Authority appealed before the HC.

## Issue for consideration

Whether the value of the assets for the purpose of capital gains computation should be taken at the FMV or at the FMV, as reduced by the liabilities attached to it.

## HC's ruling

- ▶ The finding of fact recorded by the second appellate authority is that the liquidator of the company distributed the assets of the company to the shareholders with the liabilities attached to the assets as liquid funds were not available for discharging the liabilities.

- ▶ As an alternative, it was open to the liquidator to sell the assets and, after discharging the liabilities attached to the assets, distribute only the balance amongst the shareholders.
- ▶ The facts that the assets were transferred to the shareholders with the liabilities attached to them and that the shareholders have, in fact, discharged the liabilities attached to the assets, are not in dispute.
- ▶ Where an asset of a company in liquidation is distributed to its shareholder with a specific liability attached to it, then the value of the asset for the purposes of computation of capital gains should be the full value of the asset as reduced by the amount paid by the shareholder for discharging the liability attached to the asset. Accordingly, the HC decided the issue in favor of the Taxpayer.

## Comments

This ruling of the HC provides useful guidance for computing capital gains in the hands of the shareholders of a liquidating company, where the liquidator undertakes in specie distribution of assets. It concludes that, in case assets are distributed with the liabilities attached to them, the value of the assets less the liabilities attached to them can be considered as 'full value' of the assets for the purpose of computing capital gains.

# Our offices

## Ahmedabad

2nd floor, Shivalik Ishaan  
Near CN Vidhyalaya Ambawadi  
Ahmedabad - 380 015  
Tel: + 91 79 6608 3800  
Fax: + 91 79 6608 3900

## Bengaluru

"UB City", Canberra Block  
12th & 13th floor  
No.24 Vittal Mallya Road  
Bengaluru - 560 001  
Tel: + 91 80 4027 5000  
+ 91 80 6727 5000  
Fax: + 91 80 2210 6000 (12th floor)  
+ 91 80 2224 0695 (13th floor)

## Chennai

TPL House, 2nd floor  
No. 3 Cenotaph Road Teynampet  
Chennai - 600 018  
Tel: + 91 44 6632 8400  
Fax: + 91 44 2431 1450

## Hyderabad

205, 2nd floor  
Ashoka Bhoopal Chambers  
Sardar Patel Road  
Secunderabad - 500 003  
Tel: + 91 40 6627 4000  
Fax: + 91 40 2789 8851

Oval Office, 18, iLabs Centre  
HITECH City, Madhapur  
Hyderabad - 500081  
Tel: + 91 40 6736 2000  
Fax: + 91 40 6736 2200

## Kochi

9th Floor, Abad Nucleus  
NH-49, Maradu PO  
Kochi -682304  
Tel: +91 484 3044000  
Fax: +91 484 2705393

## Kolkata

22 Camac Street  
Block 'C', 3rd floor  
Kolkata - 700 016  
Tel: + 91 33 6615 3400  
Fax: + 91 33 2281 7750

## Mumbai

14<sup>th</sup> floor, The Ruby,  
Dadar, Mumbai - 400 028.  
Tel: + 91 22 6192 0000  
Fax: + 91 22 6192 1000

6<sup>th</sup> Floor, Express Towers,  
Nariman Point,  
Mumbai - 400 021  
Tel: + 91 22 6657 9200  
Fax: + 91 22 2287 6401

Block B-2, 5th Floor  
Nirlon Knowledge Park  
Off. Western Express Highway  
Goregaon (E), Mumbai - 400 063.  
Tel: + 91 22 6749 8000  
Fax: + 91 22 6749 8200

## NCR

Golf View Corporate Tower B  
Near DLF Golf Course Sector 42  
Gurgaon - 122002  
Tel: + 91 124 464 4000  
Fax: + 91 124 464 4050

6th floor, HT House  
18-20 Kasturba Gandhi Marg  
New Delhi - 110 001  
Tel: + 91 11 4363 3000  
Fax: + 91 11 4363 3200

4th & 5th Floor, Plot No 2B, Tower 2,  
Sector 126, NOIDA 201 304  
Gautam Budh Nagar, U.P. India  
Tel: + 91 120 671 7000  
Fax: + 91 120 671 7171

## Pune

C-401, 4th floor Panchshil Tech Park  
Yerwada (Near Don Bosco School)  
Pune - 411 006  
Tel: + 91 20 6603 6000  
Fax: + 91 20 6601 5900

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