Tax Hotline

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COMPUTATION OF CAPITAL GAINS UPON AMALGAMATION OF COMPANIES

A three-member bench of judges of the Supreme Court of India ("**SC**") recently gave a landmark judgment in the case of Commissioner of Income-tax v. Mrs. Grace Collis [2001] 48 ITR 323 (SC) on the computation of capital gains accruing to a shareholder in the case of an amalgamation of companies. The term "transfer", as defined under Section 2(47) of the Act includes - *inter alia* - the sale, exchange or relinquishment of an asset or an extinguishment of any rights therein. The judgment of the SC in the case of CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198 held that amalgamation does not involve sale, exchange or relinquishment of the asset. The SC has further held, in the case of Vania Silk Mills Private Limited v. CIT [1991] 98 CTR (SC) 153, that the phrase "extinguishment of any rights therein" as mentioned hereinabove, cannot be extended to mean an extinguishment of rights independent of or otherwise than on account of transfer.

The general view so far has therefore been that there is no transfer of capital asset, as prescribed by Section 2(47) of the Indian Income-tax Act, 1961 ("the **Act**"), on amalgamation of one company with another. Therefore, such transactions were not believed to be subject to capital gains tax under the Act.

The SC in the instant case has disapproved of the observations made in the case of Vania Silk Mills in this regard and has held that "extinguishment of any rights in any capital asset" under the definition of "transfer" would include the extinguishment of the right of a holder of shares in an amalgamating company which would be distinct from and independent of the transfer of the capital asset itself. Thus, a merger would be regarded as a taxable event.

The decision of the SC in the instant case is likely to have significant impact on shareholders of companies involved in cross-border amalgamations, particularly for Indian shareholders holding shares in a foreign company.

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