

Brief facts of the case

- Tata Sons Limited ('Taxpayer')¹ held equity shares in Tata Tele-Services Company Ltd. ('TTSL').
- In view of significant losses incurred by TTSL, scheme of arrangement and restructuring was entered into between TTSL and its shareholders. Pursuant to scheme, paid-up equity share capital of TTSL was reduced by way of reduction of the number of equity shares. Further, no consideration was paid by TTSL to its shareholders in respect of such cancelled shares.
- As a result of such capital reduction, Taxpayer's shareholding in TTSL was reduced to half. The Taxpayer claimed long-term capital loss of Rs. 2046.97 crores on account of the reduction of share capital held by it in TTSL and set off the same against other long-term capital gains earned by the Taxpayer.
- The Assessing Officer ('AO') accepted the Taxpayer's claim for long term capital loss in the order passed under section 143(3) of the Income-tax Act, 1961 ('Act').
- Thereafter, the Principal Commissioner of Income-tax ('PCIT') passed revisionary order under section 263 of the Act holding that order passed by AO is erroneous and prejudicial to the interest of the Revenue and rejected claim of long-term capital loss in view of the following reasons:
 - No consideration has been received or accrued to the Taxpayer. Therefore, the provisions of Section 48 of the Act would be inapplicable and it would not be possible to compute the profits, gains or losses arising from the transfer of the capital asset;
 - The loss arising from the capital reduction was not an allowable loss. At best, such a loss was a notional loss;
 - The Taxpayer relying on the Hon'ble Supreme Court's decision² claimed that reduction of right in the capital asset would clearly amount to a transfer within the meaning of that expression in section 2(47) of the Act. However, the said decision was not applicable as the Taxpayer's case was not that of reduction in the face value of shares but an effacement of the entire shares;



- The AO in the case of another taxpayer, Tata Power Ltd., had disallowed capital loss in respect of reduction of share capital / cancellation of shares of TTSL and the AO did not consider the said order in the case of Taxpayer.
- Aggrieved by the decision of PCIT, the Taxpayer filed an appeal before the Mumbai bench of Income-tax Appellate Tribunal ('ITAT').

Key observations of the ITAT



- The ITAT relying on the ratio and principle laid down in the various judgments, held that:
 - The reduction of capital is extinguishment of right on the shares and it amounts to transfer within the meaning and scope of section 2(47) of the Act;
 - The loss on reduction of shares is a capital loss and not notional loss; and
 - Even when Taxpayer has not received any consideration on reduction of capital but its investment has reduced to loss resulting into capital loss and while computing the capital gain, capital loss has to be allowed or set-off against any other capital gain.

