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CLARIFICATION BY CBDT ON TAXABILITY OF INCOME ARISING OUT OF TRANSFER OF SHARES

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The Central Board of Direct Taxes ("**CBDT**") with the objective to reduce litigation and to maintain consistency in approach on the issue of treatment of income derived from transfer of shares and securities, has issued circular no. 6/2016 dated February 29, 2016 (**"Circular**"), and a follow up letter no. F.No.225/12/2016/ITA.II dated May 2, 2016, ("**the CBDT Letter**").

Taxability of surplus generated from sale of listed shares or other securities

A majority of transactions in shares and securities take place in respect of listed shares and securities. Therefore, CBDT has instructed the Assessing Officers, vide its Circular, to consider the following principles for determination whether the surplus generated from sale of listed shares or other securities would be treated as capital gain or business income:

i) If the taxpayer himself opts to treat the listed shares or other securities as stock-in-trade, then irrespective of the period of holding of these listed shares and securities, the income arising from transfer of such shares/securities would be treated as its business income.

ii) In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the taxpayer desires to treat the income arising from the transfer thereof as capital gain, the same shall not be put to dispute by the Assessing Officer. However, once this stand is taken by the taxpayer in a particular assessment year, then the taxpayer will be bound by the same stand in the subsequent assessment years also and the taxpayers will not be allowed to adopt a different/contrary stand in the subsequent years.

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iii) In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the earlier circulars issued by the CBDT (Instruction No. 1827, dated August 31, 1989 and Circular No.4 of 2007 dated June 15, 2007).

The Circular further clarified that the above principles for categorization will not apply for those transactions, where there is a question on the genuineness of the transaction, such as bogus claims of long term capital gain/short term capital loss or any other sham transactions.

Taxability of income arising from transfer of unlisted shares

The CBDT Letter further brings clarity towards assessment pertaining to income arising from transfer of unlisted shares and provide that income arising from transfer of unlisted shares would be considered under the head 'Capital Gain', irrespective of the period of holding to minimise disputes.

The above assumption would however not apply to situations where:

i) the genuineness of the sale of unlisted shares is questionable; or
ii) the transfer is related to an issue pertaining to lifting of corporate veil; or
iii) the transfer of unlisted shares is made along with the control and management of underlying business.

The Assessing Officer in the aforesaid cases will take a view depending on the facts and circumstances of each case.

Period of holding for transfer of unlisted shares

Interestingly, the Lok Sabha has passed the Finance Bill, 2016 in the current budget session, whereby a third proviso has been inserted in Section 2 (42A) which deals with *Short Term Capital Assets*. In accordance with the amendment, for the purposes of transfer of unlisted shares to be considered as a short-term capital asset, the period of holding of unlisted shares has been reduced to 24 months (from the current 36 months period) **with effect from April 1, 2017**. This Finance Bill is yet to be passed by the Rajya Sabha.

Conclusion

The characterisation of income arising from transfer of listed and unlisted shares is a welcome step. The clarification may bring uniformity in treatment and hopefully, reduce tax disputes and litigation. Even though certain discretion has been granted to the Assessing Officers in certain situations (which may leave room for confusion and potential disputes), it is expected that in majority of security sale purchase transactions, the assessment of applicable tax would be simpler and non-contentious.

	Feedback