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Reduction in shareholding in subsidiary company pursuant to a share reduction would be “transfer”: Supreme Court

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Summary

- The Supreme Court (SC) held* that a reduction of share capital qualifies as a "transfer" under section 2(47) of the Income-tax Act, 1961 (the Act). Accordingly, the Apex Court allowed the taxpayer's claim of having incurred a long-term capital loss of INR 164 crores due to the capital reduction.
- The SC reaffirmed the broad and inclusive definition of "transfer" emphasizing that even non-sale transactions leading to a loss or extinguishment of rights in capital assets would be "transfer" for the purpose of the Act.
- This SC clarified that "extinguishment of rights" in a capital asset need not necessary involve the sale of shares but includes any cancellation or reduction of rights in a shareholder's investment. **The Court reiterated that capital reduction involves a proportional surrender of rights, qualifying as a "transfer" irrespective of whether the face value or percentage of shareholding remains constant.**

* Principal Commissioner of Income Tax-4 & Anr. v. M/s. Jupiter Capital Pvt. Ltd (*Special Leave Petition No. 63 Of 2025*)

Facts of the case

- Jupiter Capital (the ‘taxpayer’), engaged in investment, leasing, financing, and money lending, had invested in equity shares of Asianet News Network Pvt. Ltd. (ANNPL) and held 99.88% of its total equity shares.
- Due to significant losses and erosion of net worth, ANNPL application of reduction of shares from 15,35,05,750 to 10,000 shares was approved by the Bombay High Court. Consequently, the taxpayer’s shareholding in ANNPL was reduced from 15,33,40,900 to 9,988 shares. In lieu of the reduction in number of shares, the taxpayer received an amount of ~INR 3.18 crores.
- Accordingly, the taxpayer claimed a long-term capital loss of INR 164 crores in its tax return by claiming sale consideration to be INR 3.18 crore and cost to be the investment amount of the shares. The tax officer disallowed taxpayer’s claim and held that the instant transaction does not qualify to be “transfer” as the percentage of shareholding of the taxpayer in ANNPL remains same even after the capital reduction. The CIT(A) upheld the view taken by the tax officer.
- Interestingly, the taxpayer got a favorable order both from the Income tax Appellate Tribunal as well as the High Court. The tax department filed an appeal before the SC challenging the order of the High Court.

Tax department’s key argument

- Before the SC, the tax department argued that reduction of share capital in a subsidiary company especially when the percentage of shareholding remained same could not be said to result in ‘extinguishment of **rights**” so as to qualify the said transaction as "transfer" under section 2(47) of the Act.

Taxpayer’s key argument

- The taxpayer argued that reduction in shareholding *per se* would be a case of "extinguishment of rights" as despite the unchanged face value, the reduction in the number of shares led to a significant decrease in the overall value of their shareholding. The taxpayer relied on following SC ruling to argue that relinquishment or extinguishment of rights, even without a traditional sale, qualifies as a “transfer”
  - Kartikeya V Sarabhai v. CIT (1997) 7 SCC 524
  - Anarkali Sarabhai v. CIT (1997) 3 SCC 238

Held by the Supreme Court

- The SC reiterated its earlier law for interpreting the term "transfer" under section 2(47) of the Act. It ruled in favor of the taxpayer and held that the reduction in share capital of ANNPL constituted a "transfer" for the purpose of section 2(47) of the Act. The Court observed that the receipt of INR 3.18 crores as consideration for the reduction of shares further validated the transfer.
- The Court emphasized that the expression “extinguishment of rights” in section 2(47) is broad and encompasses all possible scenarios where a taxpayer’s rights in a capital asset are reduced, diminished, or terminated. In this case, the reduction in share capital and the corresponding reduction in the number of shares clearly fell within this definition.
- The Court rejected the tax department’s argument that no transfer had occurred because the face value and proportion of shareholding of the taxpayer remained unchanged. It clarified that the reduction in shareholding constituted an extinguishment of rights, regardless of the unchanged percentage of ownership or face value.

Our comments

Share is a bundle of rights, as professed by the Apex Court in earlier judgements and also evident from the construct of company law, these rights being of voting, dividend and residual participation. Thus, the tax department’s argument that there could be no extinguishment of right in event where percentage of shareholding remains unchanged is ill-founded. Section 66 of the Companies Act 2013 (as did Section 100 of the erstwhile 1956 Act) permits companies to reduce share capital with tribunal approval. The Apex Court decision aligns with this statutory framework by recognizing that a reduction in share capital results in the extinguishment of shareholder rights (not necessarily only the voting rights) in proportion to the reduction.

The Apex Court’s interpretation upholds the principle that a reduction in share capital inherently involves a surrender or relinquishment of certain rights by shareholders. By classifying the extinguishment of these rights as a "transfer" under Section 2(47) of the Act, the Apex Court not only acknowledged that such transactions have tangible economic consequences but also harmonizes the objectives of corporate law and tax law, ensuring that all stakeholders are treated equitably.

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