

**IN THE HIGH COURT OF PUNJAB AND HARYANA AT
CHANDIGARH**

**ITA No. 153 of 2008
Date of decision: 19.8.2015**

Commissioner of Income Tax-I, Ludhiana

.....Appellant

Shri Naveen Bhatia

.....Respondent

**CORAM: HON'BLE MR. JUSTICE AJAY KUMAR MITTAL
HON'BLE MR. JUSTICE RAMENDRA JAIN**

1. Whether Reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporters or not?
3. Whether the judgment should be reported in the Digest?

Present: Mr. Rajesh Katoch, Advocate for the appellant-revenue.

Mr. S.K.Mukhi, Advocate with Mr. Rajiv Sharma, Advocate for the respondent.

Ajay Kumar Mittal,J.

1. The revenue has preferred this appeal under Section 260A of the Income Tax Act, 1961 (in short, "the Act") against the order dated 17.5.2007, Annexure A.III passed by the Income Tax Appellate Tribunal Chandigarh Bench 'A', Chandigarh (in short, "the Tribunal") in ITA No.469/CHD/2006 for the assessment year 2003-04, claiming following substantial question of law:-

“Whether on the facts and in law, the Hon'ble Income Tax Appellate Tribunal was justified in reckoning the period for long term capital gains from the date of purchase of convertible

debentures instead of actual date of allotment of shares on conversion from debentures?”

2. A few facts relevant for the decision of the controversy involved as narrated in the appeal may be noticed. The respondent-assessee is an individual. He filed his return of income for the assessment year 2003-04 on 27.11.2003 declaring total Income of ₹ 4,13,110/- including long term capital gain amounting to ₹ 25,97,147/- which was claimed by him as exempt under Section 54F of the Act. He was allotted 27160 convertible debentures of TELCO Limited on 20.12.2001 which were converted to 27160 shares on 31.3.2002. Such shares were held by the assessee for a period of less than 12 months and were sold between 23.12.2002 to 10.3.2003 in different lots. The Assessing Officer vide order dated 25.10.2005, Annexure A.1 assessed the capital gain from sale of these shares as short term capital gain and disallowed the deduction under Section 54F of the Act amounting to ₹ 25,97,147/- claimed by the respondent. Aggrieved by the order, the respondent preferred appeal before the Commissioner of Income Tax (Appeals)-I, Ludhiana [(CIT(A)]. Vide order dated 31.3.2006, Annexure A.II, the CIT(A) partly allowed the appeal observing that the period of 12 months had to be reckoned from the date of acquisition of the fully convertible debentures. Not satisfied with the order, the revenue went in appeal before the Tribunal. Vide order dated 17.5.2007, Annexure A.III, the Tribunal dismissed the appeal. Hence the instant appeal by the revenue.

3. We have heard learned counsel for the parties.

4. Learned counsel for the revenue relied upon Section 2(42A) and also clause (f) to Explanation I (i) appended thereto to urge that the date

of acquisition of convertible debentures had to be from the date of conversion of convertible debentures into shares and not from the date of original allotment. Support was drawn from the judgment of the Calcutta High Court in *Mrs. A. Ghosh vs. Commissioner of Income Tax*, (1983) 141 ITR 45 (Cal) and pronouncement of Bombay High Court in *Commissioner of Income tax vs. Santosh L. Chowgule and others*, (1998) 234 ITR 787 (Bom.).

5. Conversely, learned counsel for the assessee placed reliance on Sections 47(x) and 49(2A) of the Act to contend that in case of secured convertible debentures, the date of acquisition of the shares received on conversion would be the date when originally convertible debentures were allotted to the assessee.

6. It would be expedient to reproduce the relevant statutory provisions which read thus:-

Section 2(42A)

“2(42A) short- term capital asset means a capital asset held by an assessee for not more than thirty- six months immediately preceding the date of its transfer:

Provided that in the case of a share held in a company or any other security listed in a recognised stock exchange in India or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of a Mutual Fund specified under clause (23D) of section 10, the provisions of this clause shall have effect as if for the words "thirty- six months", the words "twelve months" had been substituted.

Explanation 1-- In determining the period for which any capital asset is held by the assessee--

(a) to (e) xx xx xx xx xx xx xx x

(f) in the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset;”

Section 47(x)

“47. Nothing contained in [section 45](#) shall apply to the following transfers : —

xxx xxx xx xx xx xx xx xx xx

(x) any transfer by way of conversion of bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company”.

Section 49(2A)

“(2A) Where the capital asset, being a share or debenture of a company, became the property of the assessee in consideration of a transfer referred to in clause (x) or clause (xa) of [section 47](#), the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture-stock, bond or deposit certificate in relation to which such asset is acquired by the assessee.”

7. Section 2(42A) of the Act defines a short term capital asset and in case of shares where the assessee holds the said shares for 12 months or less than 12 months, it shall be short term capital asset. Clause (f) of Explanation I(i) to Section 2(42A) of the Act states that in case of capital asset being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset. Section 47(x) and 49 (2A) were inserted by the Finance (No.2) Act, 1961 with retrospective effect from 1.4.1962. Section 47(x) provides that any transfer by way of conversion of

bonds or debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company shall not mean transfer within the meaning of Section 45 of the Act. Further, Sub section 2A of Section 49 provides that the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture-stock, bond or deposit certificate in relation to which such asset is acquired by the assessee. In other words, the original cost at the time of allotment would be taken to be cost of acquisition.

8. A plain reading of Section 47(x) would indicate that the conversion of convertible debentures into shares would not constitute transfer for the purposes of computation of income under the head 'capital gains'. Similarly, Section 49(2A) of the Act clarifies that for computing the capital gains on sale of shares received on conversion of convertible debentures, the cost of acquisition of shares shall be the cost of convertible debentures and thus it shall be deemed to be the cost of such shares received on conversion. In such a situation, as a necessary corollary, it would be but logical to reckon the date of acquisition of the convertible debentures as the date of acquisition of such shares received on conversion of convertible debentures. Now examining the factual matrix herein, the assessee was allotted 27160 convertible debentures of TELCO Limited on 20.12.2001 which were converted into equal number of shares on 31.3.2002. The assessee sold the said shares between 23.12.2002 to 10.3.2003 in different lots. This shall result in long term capital gains as the shares shall be deemed to have been held for a period exceeding 12 months by the assessee.

9. The Tribunal while rejecting the contention of the revenue and

upholding the order of the CIT(A) had recorded in its order dated 17.5.2007, Annexure A.III as under:-

“3. We have considered the rival submissions and perused the material available on the file. The assessee declared total income of ₹ 4,13,110/- in its return filed on 27.11.2003 alongwith copy of audit report. The assessee is a share broker, showed capital gains of ₹ 25,97,147/- on the sale of 27,147 shares of TELCO Ltd which were claimed exempt under section 54F of the Act. In order to justify the claim of such exemption, the assessee was asked to furnish the proof of allotment of shares alongwith investment so made for such shares. The assessee in its reply enclosed the copy of transaction statement as on 20.12.2001 issued by the D.P. i.e. LSE Securities Limited revealing to be issued in favour of the depository participant. It further revealed that 27160 TELCO secured convertible debentures were credited to his account as on 20.12.2001. The learned Assessing Officer invoked Explanation 1(i)(f) to Section 2(42A) by holding that the date of allotment of shares (converted from debentures) is relevant date for reckoning the period of 12 months by opining that the date of investment is of no consequence and the period of 12 months is to be reckoned from the date of allotment of shares and not the convertible debentures. However, Explanation 1(i)(f) to Section 2(42A) is very clear.

In determining the period for which any capital asset is held by the assessee -

(f) In the case of capital asset being a financial asset allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of allotment of such financial asset.

However, the conclusion of the Assessing Officer and the contention of the learned DR is that the period of 12 months is to be reckoned from the date of allotment of shares and not

from the date of conversion. The Explanation was introduced by the Finance Act, 1995 with effect from 1.4.1996 to clarify the provision in the case of bonus shares, the date of acquisition should be taken as date of allotment of such shares and computation of capital gains accordingly. Circular No.717 dated 14.8.1995 makes the provision very clear. The cost of acquisition of convertible debenture is deemed to be the cost of shares by virtue of deeming provision of Section 49(2A) and such fiction has to be taken its logical end. Therefore, the period of 12 months under Section 2(42A) proviso has to be reckoned from the date of acquisition of convertible debenture. Our view is further fortified by the decision of the Ahmedabad Bench of the Tribunal in the case of Smt.Roda vs. ITO (ITA No.1069/AHD/96) wherein it was held that the period of 12 months has to be reckoned from the date of acquisition of the convertible debentures.

Bonus shares are issued to an existing share holder without making payment in cash. Therefore, the period of holding of the bonus asset will be reckoned from the date of allotment of such asset. No contrary decision has been brought to our notice by the revenue and no specific mistake has been pointed out in the conclusion of the learned CIT(A). Therefore, the order of the learned first Appellate authority is upheld.”

10. In view of the above, contention raised on behalf of the revenue cannot be accepted. It may also be noticed that reliance on the judgment in *Mrs. A.Ghosh's* case (supra) was relating to a case where the assessee had acquired debentures. However, subsequently, the debentures were converted into equity shares and sold. At the time of allotment, there was no stipulation that the shares were convertible into equity shares. In such a situation, Calcutta High Court held that in computing the capital gains, the

debentures as on the date of its conversion on which they were exchanged for shares. Similarly, Bombay High Court in *Santosh L.Chowgule and others'* case (supra) was dealing with a case where the assessee originally held equity shares in a company which by a subsequent resolution were converted into a new set of four different shares including irredeemable preference shares. Further, the equity shares held earlier and the preference shares acquired in exchange thereof were not the same. It was held that in such circumstances, irredeemable preference shares issued to the assessee being different from the equity shares issued in lieu thereof shall be deemed to have been held by the assessee from the date of their issue and not from the date of issue of the equity shares. Thus, the pronouncements cited by the revenue do not come to its rescue as those cases related to conversion of financial asset into another form of asset where there was no right accruing on the date of acquisition, whereas in the case of convertible debentures, a right is appended to the debenture for the debenture holder to receive shares on conversion after the stipulated period. Thus, in such circumstances, cases relied upon by the revenue shall be on different footing vis-a-vis case of secured convertible debentures.

11. In view of the above, the substantial question of law is answered against the revenue and in favour of the assessee. Consequently, the appeal is dismissed.

(Ajay Kumar Mittal)
Judge

August 19, 2015
'gs'

(Ramendra Jain)
Judge