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ITAT Mumbai | Legitimate capital appreciation on conversion of Optionally Convertible Cumulative Redeemable Preference Shares (OCCRPS) not taxable under Sec. 56(2)(x) [1]

Under Sec. 47(xb) of the Income-tax Act, 1961 ('the Act'), conversion of preference shares into equity shares is not a taxable transfer. Accordingly, increase in value up to the date of conversion is not taxed as capital gains at the conversion stage. Upon subsequent transfer of the converted equity shares, the cost attributable to the preference shares is deemed to be cost of acquisition under Sec. 49(2AE) for computation of capital gains. Thus, the embedded appreciation in value is brought to tax only at the stage of eventual transfer of equity shares.

Under Sec. 56(2)(x), receipt of a property is taxable at its fair market value if received for NIL or inadequate consideration. While the conversion of preference shares into equity shares is statutorily rendered tax-neutral under the capital gains provisions, the issue whether such conversion can trigger tax under 'Income from Other Sources' has always remained contentious.

In a recent ruling, the Mumbai Tribunal held that conversion of OCCRPS into equity shares, at pre-agreed conversion price and terms, does not result in a taxable receipt under Sec. 56(2)(x) of the Act.

The taxpayer, a Mauritius-based investment holding company, had subscribed to OCCRPS of an Indian listed company. The conversion price was pre-determined on the date of issuance in compliance with SEBI ICDR Regulations. The AO computed a higher FMV under Rule 11UA for equity shares received on conversion and sought to tax the differential value as income from other sources, alleging receipt of shares for inadequate consideration.

The controversy centred on the scope of the term 'consideration' under Sec. 56(2)(x) of the Act and the point of time at which such consideration should be measured in a conversion transaction, and whether natural capital appreciation can be brought to tax under a deeming provision.

Tribunal ruling

Key observations made by Tribunal summarised below:

- **Natural capital appreciation cannot be taxed at conversion stage**

  The Tribunal held that what the Revenue sought to tax was "*a legitimate and natural accretion in the value of a capital asset over time*." Such appreciation lies in the capital field and, under the scheme of the Act, is taxed only upon subsequent transfer of the equity shares, where Sec. 49(2AE) deems the historical cost of OCCRPS as the cost of acquisition. Accordingly, Sec. 56(2)(x) cannot be invoked to tax capital appreciation at the stage of conversion.

- **Conversion price is not "consideration"**

  The pre-determined conversion price is a regulatory benchmark fixed at issuance and serves as the cost of acquisition under Sec. 49(2AE) for computing future capital gains. It does not represent the economic value parted with on the date of conversion.

[1] Fairbridge Capital (Mauritius) Limited v. ACIT [ITA No.1626/Mum/2025]

The Tribunal observed that equating conversion price with "consideration" amounts to substituting the concept of cost of acquisition for that of consideration, thereby conflating two expressions used by the Act in distinct contexts and for distinct purposes.

Sec. 56(2)(x) speaks of "consideration", not cost.

- **Regulatory construct vs. economic value**

The conversion price is a regulatory construct fixed at the time of issuance in compliance with SEBI ICDR Regulations and does not represent the actual economic value parted with on the date of conversion. On conversion, what is surrendered is the OCCRPS, a capital instrument whose value is intrinsically linked to the underlying equity shares.

- **Aggregate comparison required**

Sec. 56(2)(x) mandates comparison of the aggregate fair market value of property received with the aggregate consideration. The Tribunal held that a fragmented per-share arithmetic comparison between historical conversion price and Rule 11UA value is legally unsustainable.

- **No inadequate consideration on exchange**

Since OCCRPS intrinsically derive their value from the underlying equity, surrendering them on conversion does not result in an economic surplus or deficit. Accordingly, there is no economic shortfall or surplus when the preference shares are surrendered for equity on conversion and the premise of "inadequate consideration" fails.

The Tribunal relied on the Supreme Court's ruling in Reva Investment v CGT[2], to hold that adequacy of consideration in an exchange transaction must be assessed in a broad commercial sense and that when property is exchanged for property, the valuation of both sides of the transaction must follow a consistent basis.

- **Rule 11UA cannot expand the charging provision**

The Tribunal clarified that valuation rules are machinery provisions and cannot create or enlarge the scope of a charging provision. Unless inadequacy of consideration is first established on a proper interpretation of Sec. 56(2)(x), Rule 11UA has no application.

Our Comments

While the taxability of convertible instruments at the stage of conversion is specifically excluded from capital gains (i.e., from the transferor's standpoint), no corresponding exclusion has been provided under Sec. 56 in respect of income chargeable under the head "Income from Other Sources" (i.e., from the recipient's standpoint). In the case of conversion of OCCRPS into equity shares, in substance, the transferor and the transferee are the same person, since the OCCRPS held by the investor are extinguished and equity shares are issued in their place. Therefore, exempting the transfer from capital gains while simultaneously taxing the receipt under Sec. 56 would appear anomalous and defeat the legislative intent, effectively rendering the capital gains exemption redundant.

This ruling may assist cases where the conversion ratio is predetermined at the time of issuance of the original convertible instrument. However, in situations where the conversion

[2] Reva Investment (P.) Ltd. v. CGT [2001] 249 ITR 337 (SC)

terms are left open and are negotiated or determined at the time of conversion, the provisions of Sec. 56(2)(x) may arguably continue to apply even upon such conversion.

ITAT Delhi | Additions made without invocation of charging provision not sustainable[3]

In a recent ruling, the Delhi Tribunal held that a mere reference to Sec. 2(24)(iv) which forms part of the definition of "income" under the Act without identifying the charging provision or the head under which the alleged income is taxable, does not create tax liability. A valid assessment requires invocation of a charging section under the appropriate head of income.

Pursuant to a search conducted on companies of a particular group, the Assessing Officer (AO) alleged that the amount received by the group companies from National Spot Exchange Ltd (NSEL) was siphoned off by its director and made addition in his hands under Sec. 2(24)(iv) of the Act[4] without specifying the charging section in the assessment order.

The assessee contended that income can be taxed only if it falls under any of the heads of income specified in Sec. 14 of the Act, i.e. the charging section. Since the AO has made addition under Sec. 2(24)(iv) of the Act without mention of a charging section, the assessment is not valid.

Tribunal ruling

The Tribunal held that the liability to tax is based on a charging section and not on a definition section. Sec. 2 merely explains the meaning of "income" and does not create a legal obligation to pay tax. An item may fall within the definition of income, but it is not taxable unless a charging provision brings it within the tax net. Since the Assessing Officer made the addition by merely referring to Sec. 2(24)(iv) without specifying the head under which such income was chargeable, the addition could not be sustained. Further, even assuming the defect was sought to be cured by invoking Sec. 28(i), the amount could not be taxed as business income in the absence of material establishing that the assessee was carrying on any business or had derived business income.

Our Comments

The Tribunal has reiterated that an addition must be anchored in a charging provision under a specific head of income. Sec. 2(24) is a definition clause that expands the meaning of "income", but taxability arises only when such income is brought within the ambit of a charging section.

Under the scheme of the Act, once a receipt qualifies as "income" under Sec. 2(24), its taxability must be examined under the appropriate head of income as classified in Sec. 14. If it does not fall under any of the specific heads, Sec. 56(1) operates as a residuary charging provision. The language of Sec. 56(1) makes it clear that income of every kind, not excluded from total income and not chargeable under any of the specified heads, shall be taxable under the head "Income from Other Sources".

Viewed in this context, the ruling underscores that taxability must be clearly established under a charging provision. It reinforces that definition provisions must operate in conjunction with an

[3] Jag Mohan v. DCIT [2026] ITA No. 7055/DEL/2017 (Delhi Trib)

[4] value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has substantial interest in the company, or by a relative of the or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid

appropriate charging section and supporting factual foundation.

However, the ruling does not refer to Sec. 56(1) of the Act being a residuary section under the statute, which creates a charge on an income under Sec. 2(24)(iv). Had the provision of Sec. 56(1) been brought forth before the Tribunal, perhaps the outcome of this decision might have been different.

Mumbai ITAT | Assignment of life interest in trust property not 'transfer of land/building[5]

As per Sec. 50C of the Act, the stamp duty value is deemed as the full value of consideration where the capital asset transferred is, land or building or both at a consideration lower than such stamp duty value.

In a recent ruling, Mumbai Tribunal has held that assignment of life interest in immovable property held in a trust cannot be equated with transfer of land/building and accordingly, Sec. 50C cannot be invoked.

The assessee was holding 20% undivided share along with his four brothers in an ancestral family trust property. Such right was held as life interest in the property. Out of this, he assigned 10% undivided life interest to his nephew for consideration.

The AO invoked Sec. 50C and recomputed capital gains using stamp duty value by relying on Bombay High Court's ruling[6] of Vidarbha Veneer Industries wherein the Court upheld applicability of Sec. 50C in respect of leasehold rights in a property.

The assessee contested that transfer of life interest in property cannot be equated with transfer of land/building or leasehold rights in a property.

Tribunal ruling

The Tribunal held that life interest in a property is a succession-oriented right wherein holder can only use or enjoy income from the property, with an obligation to preserve it for the remainder beneficiaries. Such right extinguishes on the holder's death and cannot be alienated beyond the lifetime of the holder. In case of a Trust, the legal title stays with the trustee, and the life interest holder has only a **beneficial interest, not beneficial ownership**.

Accordingly, life interest is a personal, temporary, and non-commercial right unlike leasehold rights which are commercially exploitable, and transferable and can operate as a near-equivalent to ownership (in case of long-term industrial/commercial leasehold rights) during the lease period.

The Tribunal relied on ratio of Karnataka High Court in V.S. Chandrashekhar[7] to bring out that wherever the legislature intended to expand the meaning of land to include rights or interests in land, it has said so specifically in various sections like Sec. 54D which expressly refers to *"land or building or any right in land or building"*. Absence of similar language in Sec. 50C indicates that the provision is intended to operate in respect of transfer of land or building only, and not every form of interest connected with immovable property. Accordingly, the invocation of Sec. 50C was held to be unsustainable.

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[5] Vanraj Ranchhoddas Merchant (through Legal heir Harshit Merchant) v. ITO [2026] ITA No. 5234/Mum/2025 (Mum Trib)

[6] Vidarbha Veneer Industries v. ITO [2025] 174 taxmann.com 223 (Bom HC)

[7] V.S Chandrashekhar v ACIT [2021] 432 ITR 330 (Kar HC)

Our Comments

The Tribunal has distinguished life interest right from leasehold rights and reaffirmed the restrictive scope of Sec. 50C with respect to rights and interests in immovable property.

This decision is in line with rulings rendered in context of tenancy rights wherein too it is held that tenancy rights are not land or building and hence Sec 50C is not applicable.

While this decision rules out applicability of Sec. 50C to life interest, it may still be necessary to evaluate an appropriate valuation approach for effecting a sale.

Interestingly, valuation of life interest had been specifically provided under the Wealth Tax provisions wherein net average annual income from the property is multiplied by a prescribed 'life factor' multiplier, to arrive at the property value.

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