

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

**RESERVED ON: 21.03.2014
PRONOUNCED ON: 16.04.2014**

ITAs 1102/2011 & 1103/2011

+ ITA 1102/2011

COMMISSIONER OF INCOME TAX-IV APPELLANT

Through : Mr. N.P. Sahni, Advocate.

Versus

M/S DEVASAN INVESTMENT PVT. LTD.

.....RESPONDENTS

**Through : Mr. Ajay Vohra with Ms. Kavita
Jha and Mr. Vaibhav Kulkarni, Advocates.**

+ ITA 1103/2011

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CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE R.V. EASWAR

MR. JUSTICE S.RAVINDRA BHAT

1. In these appeals, the Revenue contends that the Income Tax Appellate Tribunal (“ITAT”) erred in concluding that the amounts originally brought to tax as business income of the assessee were short and long term capital gains as claimed in the returns filed. The following common question of law arises in both appeals:

Did the ITAT fall into error in endorsing the decision of the CIT (A) that the sum of ₹ 35,75, 908/- short term capital gain (for 2006-07) claimed by the assessee and ₹ 1,43,43,154/- (for 2007-08) was not business income

2. The Assessing Officer (“AO”) assessed the short term capital gains on sale of shares at ₹ 35,75, 908/- (for 2006-07) claimed by the assessee and ₹ 1,43,43,154/- (for 2007-08) as business income. On the other hand he accepted the gain on of Mutual Funds as short term capital gain/long term capital gains. In the proceedings before AO, in respect of 2006-07 the assessee’s contentions were rejected, on the basis that that the assessee was doing frequent transactions for sale and purchase of shares; that on six occasions, the assessee had purchased shares of MIs, Monnet Ispat Ltd and on nine occasions, the assessee had made sales of this scrip, which meant that the sale-purchase was spread over the whole year; similarly, the assessee had purchased of shares of ING Vysya Bank Ltd. on four occasions and had transacted sales on two occasions. Thus, these activities, along with other facts of the case showed that its motive was to earn profit from sale and purchase of

shares and not to earn dividends. The AO agreed with the assessee that the gain on Mutual Funds was gain on investment as units could not be purchased-sold in the open market. The gains from the purchase-sale of units of Mutual Funds were accepted by the assessee as income from capital gains, over long term or short term. By the CIT(A)'s order, the AO was directed to treat the income of Rs. 35,75,908/- as short term capital gain instead of business income, as done by the AO.

3. For 2007-08, it had been contended that the funds invested in MFs were investments, and not stock in trade, and that they were not tradable in the stock exchange but had to be redeemed. Thus, the profits were not business profits. The sum of ₹ 12,70,710/- was LTCG and ₹34,56,000/- was STCG. It was also contended that the assessee had invested in only 9 scrips during the year and a total purchase/sale of ₹ 3 crore was made. Reliance was placed on the fact that in the preceding year, 2005-06, similar treatment was accepted. The net owned funds of the assessee were ₹ 7.32 crore. It was contended that in Schedule III to the audited accounts, the company had disclosed the investment: of ₹4.58 crores, ₹ 2.5 crores were kept in investment, in terms of the company's Board resolutions. The AO, however, directed that the amounts be treated as business income in the assessee's hands. The latter, therefore, appealed to the Commissioner (Appeals). That appeal succeeded.

4. Since the revenue lost both appeals for AY 2006-7 and 2007-08 before the Appellate Commissioner, feeling aggrieved it appealed to the ITAT, which dismissed its appeals for both years. It has, therefore, preferred the present appeals.

5. The revenue contends that the assessee failed to keep separate accounts for investments and normal trading activities. Relying on the decisions, especially in *Commissioner of Income Tax v. Associated Industrial Development Company*, 82 ITR 586 (SC), it was contended that the volume, frequency and quantum test as well as whether the assessee maintains separate investment accounts is a strong indicator to examine whether the profit is capital gain or income from business. It was contended that the assessee is engaged in the business of a share broker. Its investments in the impugned transactions were clearly part of its trading activities, not only because there were no separate accounts, but also because frequent sale and purchase of shares of few companies had been resorted to. The decision in *Commissioner of Income Tax v. P. Manomani*, 245 ITR 48 (Mad) and *Commissioner of Income Tax v. Malabar Investment Co.*, 320 ITR 486 (Kar) were relied on. Relying on the reasoning of the AO, it was argued that the pattern of share acquisition and share clearly showed that the assessee's intention was to trade or conduct business and not to hold the scrips for investment. Had the intention been genuinely to invest in such shares, the assessee

would have taken the trouble of keeping a separate investment account.

6. It was argued that the AO's finding of fact that there were 40 transactions of sale and purchase of shares and the duration of holding were as short as 10 days clearly proved that the assessee's intention was to engage itself as trader in the normal line of business activity, and not invest these sums. The assessee was transferring shares from stock-in-trade account to investment account according to its sweet will. During the year 2004-05 relevant to Assessing Year 2005-06, the assessee transferred stock-in-trade amounting to Rs. 1,77,540 140 to investment account. This indicated the intention of assessee, that they were only classifying these shares as investment only to avoid tax incidence. It was also contended that the decision in *Raja Bahadur Visheshwar Singh v. CIT*, (1961) 41 ITR 685 [\(SC\)](#) would apply to the facts of this case, to establish that in fact the use of funds without a clear demarcation, and free transfer from stock in trade account revealed that the assessee's intention was to trade in the shares. Relying on *Commissioner of Income Tax v. NSS Investments Ltd*, 2007 (277) ITR 149 (Mad) it was contended that the objects of the assessee company were to trade in shares. Since it held the shares which were sold, in question, as stock in trade, it was but legitimate that profit out of such sale should be treated as business income and not as capital gains.

7. It was contended on behalf of the assessee, that whilst there is no quarrel with the proposition that whether a particular transaction has resulted in business income or sale of capital asset is a question of intention, the fact remains that each transaction has to be analysed by the authority and no generalized conclusion based on stereotypes can be reached. It was argued that the mere circumstance that the amounts used were not specifically sourced from investment account did not absolve the Revenue from the task of unravelling the nature of the transaction. It was submitted that if the Revenue were correct, then investment and share dealing companies would be placed at a disadvantage and discriminated against. There cannot be a rule – at least there is no statutory basis for holding- that such companies cannot or do not invest. Like business and trading concerns which engage themselves in other business activities, share brokers and dealers too can, and do, invest.

8. It was submitted that primacy to no single factor or aspect can be given, and an overall effect of the various indicia have to be taken into consideration by the court. Whilst in a given case, the volume frequency, and duration of holding test could be crucial, in another it might well be that the line of business of a concern is not to indulge in share trading activity; in yet another, the fact that share trading is indulged in with borrowed (as opposed to own) funds, could be the dispositive consideration. It was submitted that, therefore, the straightjacket approach adopted by the AO – basing himself on the sole fact that demarcation of funds was not made in

the assessment year, cannot be upheld. Learned counsel here emphasized that the overemphasis on the holding of share only for 10 days was unjustified because that was in respect of one transaction, which the Commissioner in the appellate order had analysed in detail and concluded that the shares had been subdivided into separate lots of lesser value; they were acquired the previous year and sold later during the assessment year in question.

9. The main reasoning of the ITAT can be found in the following extract of its impugned order, which earlier recorded the contentions of the parties, analyzed the nature of the transactions, and took note of the case law cited:

26. We are unable to see as to how this decision runs counter to the case of the assessee. First of all, the substantial nature of transactions has been laid bare by the assessee before the Department right from the word “go”, as deliberated upon in the preceding paragraphs. The holding of shares was by way of investment. The activity was in accordance with the main objective of the assessee company. It was duly authorized by the Memorandum and Articles of Association of the assessee company. The shares were purchased out of the assessee's own funds and not borrowed funds. The decision of investment of the assessee's shareholder's funds in share/units and Mutual Funds was taken by the management of the assessee company from time to time with the objective of capital appreciation in the long term and in case the target price was achieved in the short run, the shares were to be sold in the market. It was depending on the funds available, that the management of the assessee company decided which shares were to be acquired. The investment was shown as such in the balance sheet

of the assessee company, under Schedule III of the audited accounts. The AO had also misconstrued the volume of share transactions. Undisputedly, the assessee dealt in only nine scripts during the entire year. This included 17 transactions of share purchases and 22 transactions of share sales, aggregating to 40 transactions in ten days, which, by no stretch of imagination, can be said to be a high frequency of transactions. Therefore, “Fidelity North Star Fund & Other In re” (supra), also does not act in any manner detrimental to the case of the assessee.”

Analysis & Findings

10. The above discussion brings to the fore the question what factors are to be given weight while examining whether a taxpayer is a dealer in shares or having regard to the nature of investment, it is to be construed that the income bears the character of sale of a capital asset so as to attract capital gains tax – either STCG or LTCG. In [Commissioner of Income Tax, U.P. v. Madan Gopal Radhey Lal](#), [1969] 73 ITR 652 (SC) the Supreme Court dealt with the issue, and discussed the question:

"A trader may acquire a commodity in which he is dealing for his own purposes, and hold it apart from the stock-in-trade of his business. There is no presumption that every acquisition by a dealer in a particular commodity is acquisition for the purpose of his business; in each case the question is one of intention to be gathered from the evidence of conduct and dealings by the acquirer with the commodity."

In *Associated Industrial Development* (supra) the Supreme Court observed as follows:

“...it was open to the assessee to contend that even on the assumption that it had become a dealer and was no longer an investor in shares the particular holdings which had been cleared and the sales of which had resulted in the profit in question had always been treated by it as an investment. It can hardly be disputed that there was no bar to a dealer investing in shares. But then the matter does not rest purely on the technical question of onus which undoubtedly is initially on the revenue to prove that a particular item of receipt is taxable. Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge, of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence from its records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment.”

In [Vijaya Bank Ltd. v. Additional Commissioner of Income-tax, Bangalore, AIR 1991 SC 239](#) the Supreme Court dealt with a situation where the assessee-bank, had received amounts on securities purchased from another bank company as well as in the open market. The two amounts were brought to tax by the AO overruling the assessee's claim that they were deductible. The High Court, on a reference, observed that the amount spent by the assessee for the purchase of securities were in the nature of capital outlay and they could not be set off as expenditure against income

accruing on the securities. In that context, the Supreme Court held as follows: -

"In the instant case, the assessee purchased securities. It is contended that the price paid for the securities was determined with reference to their actual value as well as the interest which had accrued on them till the date of purchase. But the fact is, whatever was the consideration which prompted the assessee to purchase the securities, the price paid for them was in the nature of a capital outlay, and no part of it can be set off as expenditure against income accruing on those securities. Subsequently when these securities yielded income by way of interest, such income was attracted by Section 18.

Claim for deduction can be sustained only when the assessee is in a position to show that any reasonable expenditure had been incurred for the purpose of realising the interest on securities. The amounts claimed by the assessee for deduction are not shown to have been expended for the purpose of realising the interest, and are therefore not allowable as deductible expenditure."

11. *P.M. Mohammed Meerakhan v. Commissioner of Income-tax, Kerala*, 73 ITR 735 (SC) another ruling of the Supreme Court reiterated that it was not possible to evolve any single legal test or formula which could be applied in determining whether a transaction was an adventure in the nature of trade or not. The answer to the question must necessarily depend in each case on the total impression and effect of all the relevant factors and circumstances proved therein and which determine the character of

the transaction. Likewise, in *Raja Bahadur Kamakhya Narain Singh* (supra) the question of adventure in the nature of trade was again considered by the Supreme Court and which reiterated that since the expression “*adventure in the nature of trade*” implied the existence of certain element in the transactions which in law would invest these with the character of trade or business and the question on that account became a mixed question of law and fact, the court could review the Tribunal’s findings if it had misdirected itself in law. It was fairly clear that where a person in selling his investment realised an enhanced price, the excess over his purchase price was not profit assessable to tax as income, but it would be so, if what was done was not a mere realisation of the investment but an act done for making profit. The distinction between the two types of transactions is not always easy to make. Whether the transaction is of one kind or the other depends on the question whether the excess is an enhancement of the value by realising a security or a gain in an operation of profit-making. The assessee might invest his capital in shares with the intention to resell these if in future their sale brings in a higher price. Such an investment, though motivated by a possibility of enhanced value, did not necessarily render the investment a transaction in the nature of trade.

12. [The Madras High Court in *N.S.S. Investments \(P\) Ltd.*](#) (supra) had to deal with the question whether on the facts and in the circumstances of the case, the ITAT erred in holding that the profit on sale of shares was to be treated as capital gains instead of

business income. The Court referred to paragraph 15 of the ITAT order and then stated as follows: -

"The finding of fact recorded in para 15 of the order of the Tribunal is that the shares in question were never treated by the assessee as stock-in-trade and they were held for earning dividend only. A company can hold some shares as stock-in-trade for the purpose of doing business of buying and sale of such shares, while at the same time it can also hold some other shares as its capital for the purpose of earning dividend income. Here the shares in question were held as the assessee's capital and not as stock-in-trade. Hence, there would be capital gain and not business income. Hence, we answer the question referred in the affirmative i.e., in favour of the assessee and against the Department."

13. In *Commissioner of Income Tax v. Gulmohar Finance Ltd.*, [2008] 170 Taxman 483 (Delhi), this Court observed as follows:

"It was noted by the Tribunal that in earlier assessment years, the assessee had shown the shares held in BT Tech Net Ltd. as investment right from the date of purchase and this was shown as such in the balance sheet of the assessee, which was filed along with the return of income. No objection was taken to this position in the earlier years. However, the Commissioner has now decided that it was not an investment without there being any change in facts and therefore, the Tribunal held that there was no occasion for the Commissioner to take a contrary view than what was disclosed and accepted on earlier occasions. Even on merits, the Tribunal came to the conclusion that the shares held by the assessee in BT Tech Net Ltd were an investment and therefore, any profit earned on the sale thereof is

required to be treated as capital gains. Whether the shares were held by the assessee as an investment or stock-in-trade is a matter of fact and we do not find any perversity in the view taken by the Tribunal that the shares were held as an investment."

14. The Circular issued by the Central Board of Direct Taxes (CBDT) on 15th June, 2007 notes several rulings, notably *Associated Industrial, Commissioner of Income-tax, Bombay and Commissioner of Income Tax v. H. Holck Larsen*, [1986] 160 ITR 67 (SC), and goes on to deal with what should be the test to see if shares are held as stock-in-trade or as investments. The following guidelines were given:

"10. CBDT also wishes to emphasise that it is possible for a taxpayer to have two portfolios, i.e., an investment portfolio comprising of securities which are to be treated as capital assets and a trading portfolio comprising of stock-in-trade which are to be treated as trading assets. Where an assessee has two portfolios, the assessee may have income under both heads, i.e., capital gains as well as business income."

11. Assessing Officers are advised that the above principles should guide them in determining whether, in a given case, the shares are held by the assessee as investment (and therefore giving rise to capital gains) or as stock-in-trade (and therefore giving rise to business profits). The Assessing Officers are further advised that no single principle would be decisive and the total effect of all the principles should be considered to determine whether, in a given case, the shares are held by the assessee as investment or stock-in-trade."

15. In 2007-08 the assessee company in its P&L Account, for year ending 31.03.2007, showed profit on sale of investment of ₹ 1,57,29400/-. In its return of income, the assessee has shown long term capital gain of ₹ 1,47,2151/- which was claimed as exempt under Section 10 (38) of the Income Tax Act. The assessee claimed short term capital gain of ₹ 1,43,43,154/- on which tax was been paid under Section 111A of the Income Tax Act, 1961. The AO had raised a query why income from STCG/L TCG should not be treated as business income. The assessee claimed that funds invested in Mutual Funds and Equity Shares on which capital gains have been received were investments and could not be treated as Stock in Trade. The units were not tradable on the stock exchange and had to be redeemed by such Fund houses; thus profits thereon could not possibly be treated as business income. Similarly, investments were made in shares. During the whole year the company dealt with in only 11 scrips. The total sale consideration during the year was ₹ 5.56 crore only and there were no frequent transactions. Therefore capital gain on shares of ₹ 1.43 crores was not business profit. The assessee company is had net owned funds of Rs. 9.41 crores as on 31-03-2007 as per details hereunder:-

<u>Share Capital</u>	<u>Reserves and Surplus</u>
46.25 lakhs	895.09 lakhs

<u>TOTAL:</u>	<u>941.34 lacs</u>

16. As on 31-03-2007 the assessee company had made investments of Rs. 4.61 crores in terms of the following details:

<u>Investment in .Shares</u>	<u>Investment in Mutual Funds</u>
<u>259.53 lacs</u>	<u>201.00 lacs</u>
<u>TOTAL:</u>	<u>460.53 lacs</u>

The assessee invested its shareholders' funds in shares/units of mutual funds in terms of the decision of its management from time to time. These were made in mutual fund units and shares. Whilst the investments were not demarcated and sourced through separate accounts, equally the fact remains that the objects of the company permitted such transactions. What is more, there were only 11 sale and purchase of scrips – these did not indicate any great volume or frequency of share/purchase transactions. Keeping in mind the ruling in *Associated Industrial* (supra) as well as other decisions that undue emphasis cannot be given on one indicating factor alone, the findings of fact arrived at by the Commissioner (Appeals) and confirmed by the ITAT, in the impugned order, in this Court's opinion, do not disclose any error so as to call for interference.

17. So far as AY 2006-07 is concerned, this Court notices that the AO had in his order accepted that the gains derived out of sale of mutual funds could not be said to constitute business income. However, he was considerably influenced by the profit in respect of sale of shares, to the extent of ₹ 35,75, 908/-, which, according

to him, on analysis of the facts, was business income. One of the primary reasons for his conclusion was the short duration- to the extent of the holding period of 10 days. The assessee counters the revenue's submissions here arguing that the shares had been purchased out of its own funds; the activity was duly authorized by its Memorandum of Articles of Association. As regards the volume of share transactions, the assessee points out that it had dealt in only nine scripts during the entire year, which included 17 share purchase transactions and 22 sale transactions during the year, totaling to 40 transactions in all during the entire year, i.e., one transaction in 10 days. This was not a very high frequency of transactions. The assessee also received dividend on the shares held by it; and its infrastructure was small, whereas the business activity required a much larger infrastructure.

18. The suspect transaction in question, i.e sale and purchase of Monnet Ispat shares, was gone into in some detail by the Commissioner (Appeals) after which it was concluded that the nature of the transaction was essentially as investment, notwithstanding that the purchase and sale took place in a short duration. The *rationale* for this appeared to be that the assessee kept a "target" price for the shares, before it. As long as such target was not achieved, the assessee had decided to hold the shares. In this particular instance, the target appeared to have been achieved within one or two months. The following chart is extracted from the order of the Commissioner (Appeals):

Name of the scrip	Date	Qty	Net	Date	Qty	Gross
Monnet Ispat Ltd.	03.01.06	10000	2,062,70 3	10.02.06	10000	238847 3
Monnet Ispat Ltd.	04.01.06	23500	4,937,38 9	13.02.06	4878	116872 8
Monnet Ispat Ltd.	05.01.06	15000	3,039,17 5	14.02.06	6981	166514 6
Monnet Ispat Ltd.	05.01.06	1500	311,053	14.02.06	2500	593990
Monnet Ispat Ltd.			-	17.02.06	10641	257309 5
Monnet Ispat Ltd.			-	17.02.06	5000	120360 5
Monnet Ispat Ltd.			-	28.02.06	10000	247730 1

Before this Court, the assessee pointed out that in all about 27,000 shares were all acquired in January 2006. Even though they were on different dates, the proximity of their acquisition was because one purchase order was given, but the delivery of shares was based

on their availability, which was on different dates. All these shares were sold after a month, and in some cases about 45 days.

This Court notices that for 2006-07 the total share consideration was Rs. 3.4 crores, as against Rs. 4.58 for the previous year. Furthermore, the assessee had its own funds to the tune of Rs. 7.31 crores, in the form of shareholder's funds. Further, dividend income to the extent of Rs. 1.12 crore was also earned. The Commissioner found that during the year, there was no transfer from stock in trade to investment account and that the transfers had been accepted during the year 2005-06. Keeping all these aspects in mind, it was held that the income derived from sale of shares was, for 2006-07, not business income but capital gains.

19. As in the case of AY 2007-08, the Appellate Commissioner's evaluation of facts was based on an overall consideration of *all* the circumstances. As emphasized in *H. Holck Larsen* and *P. Mohammed Mirakhan* (supra) by the Supreme Court, no single factor or criteria ought to be given undue weight, ordinarily. Having regard to the entire facts, the court is satisfied that on a fair application of the various tests, viz the volume, frequency and duration of holding test; the source of funds (own or borrowed); the objects – of the enterprise- test; the nature of the assessee's business; the previous history of such transactions, etc the conclusions of the Commissioner, endorsed by the ITAT after its independent analysis of the circumstances, does not disclose any error of law warranting interference by this Court.

20. For the foregoing reasons, the question of law framed is

answered in favour of the assessee and against the revenue. The appeals are consequently dismissed without any order as to costs.

**S. RAVINDRA BHAT
(JUDGE)**

**R.V. EASWAR
(JUDGE)**

APRIL 16, 2014

