

IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE MR. JUSTICE ANTONY DOMINIC
&
THE HONOURABLE MR. JUSTICE SHAJI P. CHALY

FRIDAY, THE 3RD DAY OF JULY 2015/12TH ASHADHA, 1937

ITA.No. 267 of 2014 ()

AGAINST THE ORDER IN ITA 240/COCH/2014 of I.T.A. TRIBUNAL, COCHIN BENCH
DATED 08-08-2014

APPELLANT(S)/APPELLANT:

EQUITY INTELLIGENCE INDIA PVT. LTD.
5TH FLOOR, AREEKAL MANSION, MANORAMA JUNCTION
PANAMPILLY NAGAR, COCHIN - 682 036.

BY ADVS. SRI. JOSEPH MARKOSE (SR.)
SRI. V. ABRAHAM MARKOS
SRI. BINU MATHEW
SRI. TOM THOMAS (KAKKUZHIYIL)
SRI. ABRAHAM JOSEPH MARKOS
SRI. ISAAC THOMAS
SRI. NOBY THOMAS CYRIAC

RESPONDENT(S)/RESPONDENT:

THE ASSISTANT COMMISSIONER OF INCOME TAX
CIRCLE -1 (1), ERNAKULAM, KOCHI - 682 018.

R-R BY ADV. SRI. P.K.R. MENON, SR. COUNSEL, GOI (TAXES)
R-R BY ADV. SRI. JOSE JOSEPH, SC, FOR INCOME TAX

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 26-06-2015
ALONG WITH ITA. 274/2014, ITA. 280/2014, THE COURT ON 03-07-2015, DELIVERED
THE FOLLOWING:

APPENDIX IN ITA.267/14

APPELLANTS' EXHIBITS:

ANNEXURE A: TRUE COPY OF THE ASSESSMENT ORDER DATED 23.12.2008 FOR AY 2006-07.

ANNEXURE B: TRUE COPY OF THE REASSESSMENT ORDER DATED 15.12.2011 ISSUED UNDER SECTION 147 OF THE ACT.

ANNEXURE C: TRUE COPY OF THE APPELLATE ORDER DATED 3.3.2014 PASSED BY THE COMMISSIONER OF INCOME TAX (APPEALS) -11, KOCHI.

ANNEXURE D: TRUE COPY OF THE APPEAL DATED 23.5.2014 PREFERRED BY THE APPELLANT BEFORE THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH.

ANNEXURE E: CERTIFIED COPY OF THE IMPUGNED COMMON ORDER DATED 8.8.2014 PASSED BY THE INCOME TAX APPELLATE TRIBUNAL, COCHIN BENCH.

/TRUE COPY/

PS TO JUDGE

C.R.

ANTONY DOMINIC & SHAJI P. CHALY, JJ.

I.T.A.Nos.267, 274 & 280 of 2014

Dated this the 3rd day of July, 2015

JUDGMENT

Antony Dominic, J.

1. These three appeals are filed by the assessee, who is aggrieved by the orders passed by the Income Tax Appellate Tribunal, Cochin Bench, upholding the assessment orders passed for the assessment years 2006-07, 2008-09 and 2010-11.
2. Assessee is a company engaged in portfolio management services having obtained necessary registration from the SEBI. The return of income for the assessment year 2008-09 was filed and assessment under section 143(3) of the Income Tax Act was completed, treating the transactions in purchase and sale of shares as 'business income' instead of capital gains as shown by the assessee company. In so far as the assessment year 2006-07 is concerned, return of income was processed under section 143(1) of the Act and assessment was completed. After completing the assessment for the assessment year 2008-09, the assessment for 2006-07 was reopened by the Assessing

Officer invoking his power under section 147 of the Act. Accordingly, assessment was completed under section 143(3), where also, the income of the assessee from the purchase and sale of shares, which was originally treated as short term capital gains and taxed at the lower rate, was assessed as business income. The assessment for the year 2010-11 was also completed under section 143(3) as in the case of the assessment year 2008-09. These orders were confirmed by the Commissioner of Income Tax (appeals) and the Tribunal, dismissing the appeals filed by the assessee. This is the background in which these appeals are filed.

3. The questions of law framed in ITA.267/14, which is common in these appeals, are the following:

"(1) Whether on the facts and circumstances of the case, the Appellate Tribunal is right in confirming the reopening of assessment under Section 147?

(2) Whether on the facts and circumstances of the case, the Appellate Tribunal is right in confirming that the profit on sale of shares is to

be assessed under the head "income business" and not under the head "capital gains"?

(3) Whether there was any material or documents on record to justify the finding of the Appellate Tribunal that the Appellant is engaged in trading activity and therefore profit on sale of shares should be assessed under the head "income from business"?

(4) Whether on the facts and circumstances of the case and in the light of the Department having accepted the assessment of similar income under the head "capital gains" for earlier Assessment Years and intervening Assessment Years, the assessment under the head "income from business" for this Assessment Year is justified?

(5) Whether the Appellate Tribunal is right in law in disregarding the decisions of various High Courts including the jurisdictional High Court which were relied on at the time of hearing, without a speaking order as to why they are not followed."

4. We heard the senior counsel for the appellant and the learned senior standing counsel appearing for the Revenue.

5. According to the learned senior counsel, the re-opening of the assessment for the year 2006-07, invoking the power under section 147 of the Act, is illegal. He also contended that the grounds contemplated for re-opening an assessment under section 147 are not existing in this case. According to him, the assessee has been in the business since the assessment year 2002-03 and that till 2006-07, the income derived by the assessee from the sale and purchase of shares was accepted by the Department as capital gains and that by treating such income for the aforesaid three assessment years as business income, the Department has shown that it did not have consistency in the matter of assessment and treatment of income. It was also his case that even after re-opening the assessments for the year 2006-07 and completing the assessments for the years 2008-09 and 2010-11, the Department has left out assessments for the years 2007-08 and 2009-2010. According to the counsel, such picking and choosing some of the years and leaving out the remaining years when the assessee had returned loss is impermissible.

6. These contentions were contradicted by the learned senior counsel appearing for the Revenue.

7. We have considered the submissions made. The first issue that is required to be considered is the scope of the power of the Assessing Officer under section 147 of the Act. Section 147 of the Act provides that if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153, assess or re-assess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned. Under the first proviso, a time limit of 4 years from the end of the relevant assessment year has been fixed for taking action under section 147, unless any income chargeable to tax has escaped assessment by reason of the failure on the part of the assessee to make a return under

section 139 or in response to a notice under section 142(1) or section 148 or to disclose fully and truly all material facts necessary for his assessment for that year. This provision, therefore, shows that the power thereunder can be invoked by an Assessing Officer if he has reason to believe that any income chargeable to tax has escaped assessment for any assessment year.

8. The expression 'reason to believe' incorporated in section 147 by Act 3 of 1989 with effect from 1.4.1989 came up for the consideration of courts on various occasions. In Assistant Commissioner of Income Tax v. Rajesh Jhaveri Stock Brokers P. Ltd [(2007)291 ITR 500], the Apex Court examined this expression and held thus:

"Section 147 authorises and permits the Assessing Officer to assess or reassess income chargeable to tax if he has reason to believe that income for any assessment year has escaped assessment. The word reason in the phrase reason to believe would mean cause or justification. If the Assessing Officer has cause or justification to know or suppose that income

had escaped assessment, it can be said to have reason to believe that an income had escaped assessment. The expression cannot be read to mean that the Assessing Officer should have finally ascertained the fact by legal evidence or conclusion. The function of the Assessing Officer is to administer the statute with solicitude for the public exchequer with an inbuilt idea of fairness to taxpayers. As observed by the Supreme Court in *Central Provinces Manganese Ore Co. Ltd. v. ITO* [1991 (191) ITR 662], for initiation of action under Section 147(a) (as the provision stood at the relevant time) fulfilment of the two requisite conditions in that regard is essential. At that stage, the final outcome of the proceeding is not relevant. In other words, at the initiation stage, what is required is reason to believe, but not the established fact of escapement of income. At the stage of issue of notice, the only question is whether there was relevant material on which a reasonable person could have formed a requisite belief. Whether the materials would conclusively prove the escapement is not the concern at that stage. This is so because the formation of belief by the Assessing Officer is within the realm of subjective satisfaction (see *ITO v. Selected Dalurband Coal Co. Pvt. Ltd.* [1996 (217) ITR 597 (SC)]; *Raymond Woollen Mills Ltd. v. ITO* [1999 (236) ITR 34 (SC)]).

The scope and effect of Section 147 as substituted with effect from April 1, 1989, as

also Sections 148 to 152 are substantially different from the provisions as they stood prior to such substitution. Under the old provisions of Section 147, separate clauses (a) and (b) laid down the circumstances under which income escaping assessment for the past assessment years could be assessed or reassessed. To confer jurisdiction under Section 147(a) two conditions were required to be satisfied firstly the Assessing Officer must have reason to believe that income profits or gains chargeable to income tax have escaped assessment, and secondly he must also have reason to believe that such escapement has occurred by reason of either (i) omission or failure on the part of the assessee to disclose fully or truly all material facts necessary for his assessment of that year. Both these conditions were conditions precedent to be satisfied before the Assessing Officer could have jurisdiction to issue notice under Section 148 read with Section 147(a). But under the substituted Section 147 existence of only the first condition suffices. In other words if the Assessing Officer for whatever reason has reason to believe that income has escaped assessment it confers jurisdiction to reopen the assessment. It is however to be noted that both the conditions must be fulfilled if the case falls within the ambit of the proviso to Section 147. The case at hand is covered by the main provision and not the proviso."

9. Commissioner of Income Tax v. Kelvinator of India Ltd. [(2010) 228 CTR 488] is another case where the Apex Court had again considered the scope of this provision and it was held that one needs to give a schematic interpretation to the words 'reason to believe', failing which, section 147 would give arbitrary powers to the Assessing Officer to re-open assessments on the basis of 'mere change of opinion' which may not be, per se, reason to re-open. Accordingly, the Apex Court held thus:

" However, one needs to give a schematic interpretation to the words "reason to believe" failing which, we are afraid, s.147 would give arbitrary powers to the AO to reopen assessments on the basis of "mere change of opinion", which cannot be per se reason to reopen. We must also keep in mind the conceptual difference between power to review and power to reassess. The AO has no power to review; he has the power to reassess. But reassessment has to be based on fulfillment of certain pre-condition and if the concept of "change of opinion" is removed, as contended on behalf of the Department, then, in the grab of reopening the assessment, review would take place. One must treat the concept of "change of opinion" as an inbuilt test to check abuse of power by the AO.

Hence, after 1st April, 1989, AO has power to reopen, provided there is "tangible material" to come to the conclusion that there is escapement of income from assessment. Reasons must have a live link with the formation of the belief. Our view gets support from the changes made to s.147 of the Act, as quoted hereinabove. Under the Direct Tax Laws (Amendment) Act, 1987, Parliament not only deleted the words "reason to believe" but also inserted the word "opinion" in s.147 of the Act. However, on receipt of representations from the companies against omission of the words "reason to believe", Parliament re-introduced the said expression and deleted the word "opinion" on the ground that it would vest arbitrary powers in the AO. "

10. The Full Bench of Delhi High Court had occasion to consider the above expression in its judgment in Commissioner of Income Tax v. Usha International Ltd. [(2012) 348 ITR 485] and after survey of all relevant precedents on the subject, the position was summarised thus:

"It is, therefore, clear from the aforesaid position that:

(1) Reassessment proceedings can be validly initiated in case return of income is processed under Section 143(1) and no scrutiny assessment

is undertaken. In such cases there is no change of opinion.

(2) Reassessment proceedings will be invalid in case the assessment order itself records that the issue was raised and is decided in favour of the assessee. Reassessment proceedings in the said cases will be hit by the principle of "change of opinion".

(3) Reassessment proceedings will be invalid in case an issue or query is raised and answered by the assessee in original assessment proceedings but thereafter the Assessing Officer does not make any addition in the assessment order. In such situations it should be accepted that the issue was examined but the Assessing Officer did not find any ground or reason to make addition or reject the stand of the assessee. He forms an opinion. The reassessment will be invalid because the Assessing Officer had formed an opinion in the original assessment, though he had not recorded his reasons.

In the second and third situation, the Revenue is not without remedy. In case the assessment order is erroneous and prejudicial to the interest of the Revenue, they are entitled to and can invoke power under Section 263 of the Act. This aspect and position has been highlighted in CIT v. DLF Power Ltd. I.T.A.No.973 of 2011 decided on November 29, 2011 - since reported in [2012] 345 ITR 446 (Delhi) and BLB Ltd. v. Asst. CIT Writ Petition (Civil)No.6884 of

2010 decided on December 1, 2011 - since reported in [2012] 343 ITR 129 (Delhi). In the last decision it has been observed (page 135):

"The Revenue had the option, but did not take recourse to section 263 of the Act, in spite of audit objection. Supervisory and revisionary power under Section 263 of the Act is available, if an order passed by the Assessing Officer is erroneous and prejudicial to the interest of the Revenue. An erroneous order contrary to law that has caused prejudiced can be correct, when jurisdiction under Section 263 is invoked."

Thus, where an Assessing Officer incorrectly or erroneously applies law or comes to a wrong conclusion and income chargeable to tax has escaped assessment, resort to section 263 of the Act is available and should be resorted to. But initiation of reassessment proceedings will be invalid on the ground of change of opinion."

11. From the principles laid down in the above judgments, it can be seen that the power under section 147 of the Act can be invoked by the Assessing Officer, if, on the materials available before him, he has reason to believe that any income chargeable to tax has escaped assessment in any

assessment year, provided such proceedings are not barred by the time limit prescribed in the first proviso to the said section. The requirement that the Assessing Officer must have 'reason to believe' cannot be taken to mean that the Assessing Officer must be satisfied that there exists grounds for reopening the assessment or the Assessing Officer should have formed an opinion about the nature of the final order that is likely to be passed after re-opening the assessment. The question is whether the Assessing Officer was justified in re-opening the assessment for the year 2006-07. For the assessment year 2006-07, assessment was initially completed under section 143(1) of the Act. The scope of enquiry that is permissible in an assessment proceedings under section 143(1) is very limited as is evident from the section itself, which reads thus:

"143. Assessment - (1) Where a return has been made under section 139, or in response to a notice under sub-section (1) of section 142, such return shall be processed in the following manner, namely:-

- (a) the total income or loss shall be computed after making the following adjustments, namely:-
 - (i) any arithmetical error in the return; or
 - (ii) an incorrect claim, if such incorrect claim is apparent from any information in the return;
- (b) the tax and interest, if any, shall be computed on the basis of the total income computed under clause (a);
- (c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of the tax and interest, if any, computed under clause (b) by any tax deducted at source, any tax collected at source, any advance tax paid, any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91, any rebate allowable under Part A of Chapter VIII, any tax paid on self-assessment and any amount paid otherwise by way of tax or interest;
- (d) an intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable by, or the amount of refund due to, the assessee under clause (c); and
- (e) the amount of refund due to the assessee in pursuance of the determination under clause (c) shall be granted to the assessee:

Provided that an intimation shall also be sent to the assessee in a case where the loss declared in the return by the assessee is adjusted but no tax or interest is payable by, or no refund is due to him;

provided further that no intimation under this sub-section shall be sent after the expiry of one year from the end of the financial year in which the return is made."

12.The scope of this provision was considered by the Apex Court in its judgment in Assistant Commissioner of Income Tax v. Rajesh Jhaveri Stock Brokers P. Ltd (supra), where it was held thus:

"It is to be noted that substantial changes have been made to Section 143(1) with effect from June 1, 1999. Up to March 31, 1989, after a return of income was filed the Assessing Officer could make an assessment under Section 143(1) without requiring the presence of the assessee or the production by him of any evidence in support of the return. Where the assessee objected to such an assessment or where the officer was of the opinion that the assessment was incorrect or incomplete or the officer did not complete the assessment under Section 143(1), but wanted to make an inquiry, a notice under Section 143(2) was required to be issued to the assessee

requiring him to produce evidence in support of his return. After considering the material and evidence produced and after making necessary inquiries, the officer had power to make assessment under Section 143(3). With effect from April 1, 1989, the provisions underwent substantial and material changes. A new scheme was introduced and in the new substituted Section 143(1) prior to the subsequent substitution with effect from June 1, 1999, in Clause (a), a provision was made that where a return was filed under section 139 or in response to a notice under section 142(1), and any tax or refund was found due on the basis of such return after adjustment of tax deducted at source, any advance tax or any amount paid otherwise by way of tax or interest, an intimation was to be sent without prejudice to the provisions of Section 143(2) to the assessee specifying the sum so payable and such intimation was deemed to be a notice of demand issued under Section 156. The first proviso to Section 143(1)(a) allowed the Department to make certain adjustments in the income or loss declared in the return. They were as follows :

(a) any arithmetical errors in the return, accounts and documents accompanying it were to be rectified;

(b) any loss carried forward, deduction, allowance or relief which on the basis of the information available in such return, accounts or

documents, was prima facie admissible, but which was not claimed in the return was to be allowed;

(c) any loss carried forward, relief claimed in the return which on the basis of the information as available in such returns accounts or documents were prima facie inadmissible was to be disallowed.

What were permissible under the first proviso to Section 143(1)(a) to be adjusted were, (i) only apparent arithmetical errors in the return, accounts or documents accompanying the return, (ii) loss carried forward, deduction allowance or relief, which was prima facie admissible on the basis of information available in the return but not claimed in the return and similarly (iii) those claims which were on the basis of the information available in the return, prima facie inadmissible, were to be rectified/allowed/disallowed. What was permissible was correction of errors apparent on the basis of the documents accompanying the return. The Assessing Officer had no authority to make adjustments or adjudicate upon any debatable issues. In other words, the Assessing Officer had no power to go behind the return, accounts or documents, either in allowing or in disallowing deductions, allowance or relief."

13. For the assessment year 2006-07, assessment under section 143(1) was completed by order dated 23.12.2008. It was thereafter the Assessing Officer

completed the assessment under section 143(3) for the year 2008-09 by his order dated 30.12.2010. In that order, the income earned by the assessee in the purchase and sale of shares as capital gains, was treated as business income and was taxed. It was thereafter that proceedings under section 147 were initiated with respect to the assessment year 2006-07 and assessment was completed under section 143(3) by order dated 15.12.2011. The question that is required to be considered is whether the reopening of assessment is based on the mere change of opinion of the Assessing Officer as contended by the counsel for the appellant.

14. In our view, the aforesaid contention cannot be accepted. Law mandates that the Assessing Officer should have reason to believe that income chargeable to tax has escaped assessment for any assessment year to invoke the power to re-open assessments under section 147. Admittedly, assessments for the year 2006-07 were completed treating the income in question as capital gains. Once the assessment for the year 2008-09 was completed and the income for

that year was assessed as business income, the Assessing Officer had sufficient materials to believe that income chargeable to tax as business income for the assessment year 2006-07 had escaped assessment. It was on that basis, proceedings under section 147 was initiated. The initiation of such proceedings under section 147, according to us, is fully within the four corners of section 147 of the Act.

15. It is true that returns treating the income as capital gains were accepted in the previous assessment years also. It is on that factual basis that contention was raised by the assessee that Department should maintain consistency in the matter of assessment. In support of this contention, counsel for the appellant relied on the judgment of the Bombay High Court in Commissioner of Income Tax v. Gopal Purohit [(2011) 336 ITR 287]. This again is an untenable argument for the reason that in the matter of assessment of income tax, the decision arrived at in the previous year cannot be regarded as binding in the assessment for the subsequent years. It has been so held by the Apex Court in Dwarakadas

Kesardeo Morarka v. Commissioner of Income Tax [(1962) XLIV ITR 529], the relevant paragraph of which is extracted herein:

" It cannot be said that because in the previous years the shares were held to be stock-in-trade, they must be similarly treated for the assessment year 1949-50. In the matter of assessment of income-tax, each year's assessment is complete and the decision arrived at in a previous year on materials before the taxing authorities cannot be regarded as binding in the assessment for the subsequent years. . . . "

Therefore, though consistency is desirable, the desirability of consistency cannot operate against the Revenue in completing assessments for subsequent years in accordance with law. This is all the more so since the assessments for the previous years were completed under section 143(1) of the Act. In so far as the judgment of the Bombay High Court in Gopal Purohit (supra) is concerned, though the court has highlighted the need for consistency, it has also taken note of the fact that in that case, the Revenue did not furnish any justification for adopting a

divergent approach for the assessment year in question.

16. It is true, as contended by the learned counsel, that assessments for the years 2007-08 and 2009-2010 were left out and according to the counsel, the Revenue has, therefore, adopted a pick and choose method, choosing the assessment years when the assessee had returned profit. Though this contention would appear to be attractive, a closer examination thereof would show that there is no substance in it. Admittedly, for the assessment years 2007-08 and 2009-2010, the assessee had returned loss. The assessment for such years were also completed under section 143(1). Re-opening of those assessments is permissible only under section 147 and power under that section could be invoked only if any income chargeable to tax has escaped assessment. Here, in the instant case, the assessee has returned loss and therefore, no income chargeable to tax has escaped assessment, permitting invocation of the power under this provision.

17. Similar is the case with the revisional power of the Commissioner under section 263, which also can be invoked only if any order passed is prejudicial to the interest of the Revenue. Such being the case, the assessee cannot be heard to complain that the Revenue has adopted a pick and choose method in the matter of assessment for the years in question.

18. The main question that arises for consideration is regarding the legality of assessment treating the income for the years in question as 'business income' instead of 'capital gains'.

19. Before we proceed to consider the relevant facts, it would be appropriate to examine the legal principles which govern the issue. Although both sides have cited before us various precedents on the subject, in our view, having regard to the principles laid down by the Apex Court in its judgment in Commissioner of Income Tax, Nagpur v. Sulej Cotton Mills Supply Agency Ltd. [(1975) 100 ITR 706], it is unnecessary to refer to all those judgments. In this judgment, after referring to various other

authorities, the Apex Court summarised the principles thus:

"In the absence of any evidence of trading activity in cases of purchase and resale of shares, it has been held that profit arising from the resale is an accretion to the capital. If a transaction is in the assessee's ordinary line of business there can be no difficulty in holding that it is in the nature of trade. But the difficulty arises where the transaction is outside the assessee's line of business and then, it must depend upon the facts and circumstances of each case whether the transaction is in the nature of trade.

It is not necessary to constitute trade that there should be a series of transactions, both of purchase and of sale. A single transaction of purchase and sale outside the assessee's line of business may constitute an adventure in the nature trade. Neither repetition nor continuity of similar transactions is necessary to constitute a transaction an adventure in the nature of trade. If there is repetition and continuity, the assessee would be carrying on a business and the question whether the activity is an adventure in the nature of trade can hardly arise. A transaction may be regarded as isolated although a similar transaction may have taken place a fairly long time before [see Commissioners of Inland Revenue v. Reinhold (1953) 34 TC 389].

The principles underlying the distinction between a capital sale and an adventure in the nature of trade were examined by this court in *G.Venkataswami Naidu & Co. v. Commissioner of Income-tax* [(1959) 35 ITR 594 (SC)], where this court said that the character of a transaction cannot be determined solely on the application of any abstract rule, principle or test but must depend upon all the facts and circumstances of the case. Ultimately, it is a matter of first impression with the court whether a particular transaction is in the nature of trade or not. It has been said that a single plunge may be enough provided it is shown to the satisfaction of the court that the plunge is made in the waters of the trade; but mere purchase/sale of shares-if that is all that is involved in the plunge-may fall short of anything in the nature of trade. Whether it is in the nature of trade will depend on the facts and circumstances.

Where the purchase of any article or of any capital investment, for instance, shares, is made without the intention to resell at a profit, a resale under changed circumstances would only be a realisation of capital and would not stamp the transaction with a business character (see *Commissioner of Income-tax v. P.K.N.Co.Ltd* (1966) 60 ITR 65 (SC)).

Where a purchase is made with the intention of resale, it depends upon the conduct of the

assessee and the circumstances of the case whether the venture is on capital account or in the nature of trade. A transaction is not necessarily in the nature of trade because the purchase was made with the intention of resale (see *Jenkinson v. Freedland* [(1961) 39 TC 636 (CA)], *Radha Debi Jalan v. Commissioner of Income-tax* [(1951) 20 ITR 176 (Cal)], *India Nut Co. Ltd. v. Commissioner of Income-tax* [(1960) 39 ITR 234 (Ker)], *Mrs. Sooniram Poddar v. Commissioner of Income-tax* [(1939) 7 ITR 470, 478-9 (Rang)(FB)], *Ajax Products Ltd. v. Commissioner of Income-tax* [(1961) 43 ITR 297, 310 (Mad)], *Gustad Irani v. Commissioner of Income-tax* [(1957) 31 ITR 92 (Bom)] and *Mrs. Alexander v. Commissioner of Income-tax* [(1952) 22 ITR 379, 402 (Mad)].

A capital investment and resale do not lose their capital nature merely because the resale was foreseen and contemplated when the investment was made and the possibility of enhanced values motivated the investment (see *Leeming v. Jones* [(1930) 15 TC 333 (HL)] and also the decisions of this court in *Saroj Kumar Mazundar v. Commissioner of Income-tax* [(1959) 37 ITR 242, 250-1(SC)] and *Janki Ram Bahadur Ram v. Commissioner of Income-tax* [(1965) 57 ITR 21 (SC)].

In *Commissioner of Inland Revenue v. Fraser* [(1942) 24 TC 498, 502] Lord Normand said:

"The individual who enters into a purchase of an article or commodity may have in view the resale of it at a profit, and yet it may be that that is not the only purpose for which he purchased the article or the commodity, nor the only purpose to which he might turn it if favourable opportunity for sale does not occur.... An amateur may purchase a picture with a view to its resale at a profit and yet he may recognise at the time or afterwards that the possession of the picture will give him aesthetic enjoyment if he is unable ultimately, or at his chosen time, to realise it at a profit....."

An accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value; if it does so rise, its realisation does not make it income. Lord Dunedin said in *Leeming v. Jones* at page 360:

"The fact that a man does not mean to hold an investment may be an item of evidence tending to show whether he is carrying on a trade or concern in the nature of trade in respect of his investments but per se it leads to no conclusion whatever."

This court laid down in *G.Venkataswami Naidu & Co. v. Commissioner of Income-tax* [(1959) 35 ITR 594, 610, 622(SC)] that the dominant or even sole intention to resell is a relevant factor and raises a strong presumption, but by itself is

not conclusive proof, of an adventure in the nature of trade.

The intention to resell would, in conjunction with the conduct of the assessee and other circumstances, point to the business character of the transaction."

20. We may, in this context, also refer to the judgment of the Apex Court in M/s. Rajputana Textiles (Agencies) Ltd. v. Commissioner of Income tax, Bombay City [42 ITR 743], where the contention that buying and selling in shares was not one of the objects of the company was rejected and the court held that this was only one of the circumstances in the totality of the circumstances which must be considered, though this by itself is not determinative of the question. Again, in its judgment in Sutlej Cotton Mills Ltd. v. Commissioner of Income Tax, West Bengal [(1979) 116 ITR 1], the Apex Court held that the way in which entries are made by the assessee in its books of accounts is not determinative of the question whether the assessee has earned any profit or suffered any loss. Therefore, even if it is accepted that the objects

clause in the Memorandum of Association of the assessee did not provide for trading in shares and that in the accounts it was shown as investments, that by itself would not be determinative of the issue involved in these appeals.

21. While the precedents that we have referred to above lead to the irresistible conclusion that it is the totality of the circumstances which is determinative of the question as to whether the profit earned by the assessee is an accretion to the capital or is a trading profit, it is also relevant that the Central Board of Direct Taxes issued circular No.4/2007 dated 15.6.2007 indicating the tests to draw a distinction between the shares held as stock-in-trade and shares held as investment. This circular being relevant is extracted below for reference:

C.B.D.T. Circulars
Circular No.4/2007, dated June 15, 2007

Sub: Distinction between shares held as stock-in-trade and shares held as investment-Tests for such a distinction.

The Income-tax Act, 1961 makes a distinction between a capital asset and a trading asset.

2. Capital asset is defined in section 2(14) of the Act. Long-term capital assets and gains are dealt with under section 2(29A) and section 2(29B). Short-term capital assets and gains are dealt with under section 2(42A) and section 2(42B).

3. Trading asset is dealt with under section 28 of the Act.

4. The Central Board of Direct Taxes (CBDT) through Instruction No.1827 dated August 31, 1989, had brought to the notice of the Assessing Officers that there is a distinction between shares held as investment (capital asset) and shares held as stock-in-trade (trading asset). In the light of a number of judicial decisions pronounced after the issue of the above instructions, it is proposed to update the above instructions for the information of the assesseees as well as for guidance of the Assessing Officers.

5. In the case of CIT v. Associated Industrial Development Company (P) Ltd. [1971] 82 ITR 586, the Supreme Court observed that (headnote):

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 he should, in normal circumstances, be in a position to produce evidence from his records as to whether he has maintained any distinction

between those shares which are his stock-in-trade and those which are held by way of investment.

6. In the case of *CIT v. H.Holck Larsen* [1986] 160 ITR 67, the Supreme Court observed (page 87):

The High Court, in our opinion, made a mistake in observing whether transactions of sale and purchase of shares were trading transactions or whether these were in the nature of investment was a question of law. This is a mixed question of law and fact.

7. The principles laid down by the Supreme Court in the above two cases afford adequate guidance to the Assessing Officers.

8. The Authority for Advance Rulings (AAR) [2007] 288 ITR 641, referring to the decisions of the Supreme Court in several cases, has culled out the following principles (page 651):

(i) Where a company purchases and sells shares, it must be shown that they were held as stock-in-trade and that existence of the power to purchase and sell shares in the memorandum of association is not decisive of the nature of transaction;

(ii) the substantial nature of transactions, the manner of maintaining books of account, the magnitude of purchases and sales and the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions;

(iii) ordinarily the purchase and sale of shares

with the motive of earning a profit, would result in the transaction being in the nature of trade/adventure in the nature of trade; but where the object of the investment in shares of a company is to derive income by way of dividend etc. then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt.

9. Dealing with the above three principles, the AAR has observed in the case of Fidelity group as under (page 661):

We shall revert to the aforementioned principles. The first principle requires us to ascertain whether the purchase of shares by a FII in exercise of the power in the memorandum of association/trust deed was as stock-in-trade as the mere existence of the power to purchase and sell shares will not by itself be decisive of the nature of transaction. We have to verify as to how the shares were valued/held in the books of account i.e., whether they were valued as stock-in-trade at the end of the financial year for the purpose of arriving at business income or held as investment in capital assets. The second principle furnishes a guide for determining the nature of transaction by verifying whether there are substantial transactions, their magnitude, etc. maintenance of books of account and finding the ratio between purchases and sales. It will not be out of place to mention that regulation 18 of the SEBI Regulations enjoins upon every FII to keep and maintain books of account containing

true and fair accounts relating to remittance of initial corpus of buying and selling and realizing capital gains on investments and accounts of remittance to India for investment in India and realising capital gains on investment from such remittances. The third principle suggests that ordinarily purchases and sales of shares with the motive or realising profit would lead to inference of trade/adventure in the nature of trade; where the object of the investment in shares of companies is to derive income by way of dividends etc., the transactions of purchases and sales of shares would yield capital gains and not business profits.

10. The Central Board of Direct Taxes also wishes to emphasis that it is possible for a tax payer 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. The 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.

12. These instructions shall supplement the earlier Instruction No.1827 dated August 31, 1989.

22. Bearing the above in mind, we may now proceed to consider the facts that are available before us to decide whether the authorities were right in treating the sale of shares as business income as against capital gains. The transactions during the assessment year 2008-09, as reflected in the order of the Tribunal, show that the assessee has traded in the shares of 45 companies. Among the 45 companies, the maximum weighted holding period is in respect of 219,641 shares held by the assessee in M/s.JK Investo Trade and the minimum weighted holding period is in respect of 30000 shares of KITEX Garments traded by it. If the average holding period of the 45 scrips held by the assessee is taken, in the case of 36 shares, it ranges from 91 days to 3 days. The Tribunal has also referred to the frequency of

purchases and sales which show that during the assessment years 2006-07, 2008-09 and 2010-11 the assessee company had purchased and sold shares in 62 companies, 53 companies and 78 companies respectively. It is also seen that the scrip wise purchase to sales also indicate that in the assessment year 2006-07, while the company purchased shares in 55 companies, it had sold shares in 57 companies. In the assessment year 2008-09, the company purchased 51 scrips and sold 45 scrips. Similarly, during the assessment year 2010-11, while it purchased scrips in 67 companies, it had sold scrips in 72 companies.

23. The authorities have also taken note of the fact that the assessee has all the infrastructure for buying and selling shares and that it has incurred establishment expenses and various establishment expenses have been charged to Profit and Loss Account which indicated an organised and systematic activity carried on by the assessee. It was also found that the income earned by the company in the form of dividend was only in respect of very few scrips which

gave a very low rate of return as compared to the value of shares held by it. Yet another finding that has been entered into is that the involvement of the assessee in the trading of shares was not an occasional one but was carried on by it in a systematic and organised manner. The authorities have also found that the short period of holding of shares reveal that the assessee had no intention to hold the shares for longer term as an investment. These findings of the authorities below are absolutely unassailable and therefore, the fact that trading in shares is not the main object of the assessee or that the shares were shown as stock-in-trade in the books of accounts of the assessee cannot be of any consequence.

24. It is true as contended by the learned counsel for the assessee that it is possible for an assessee to have more than one portfolio, viz., that a part of the shares could have been held by it as investment and the remaining part, as stock-in-trade. Such a distinction has been recognised by the Central Government in circular No.4/07 (supra). This

submission was made mainly with reference to the 219,641 shares of M/s.JK Investo Trade held by the assessee, which has the maximum weighted holding period. In so far as these shares are concerned, along with I.A.1518/15, the Revenue has produced before us the details of acquisition of these shares which show that the company acquired these shares over a period of time from 8.12.2005 to 1.12.2006 and sold these shares during the period from 4.4.2007 to 26.11.2007. This particular transaction has been discussed in the assessment order for the year 2008-09, where the Assessing Officer has found thus:

"16. In order to see whether the shares of JK Investo Trade Ltd. was held by the assessee as an investment or as a prudent step to earn more income, the price value chart of the above said share for the period 1.12.2005 to 30.11.2007 was called for. The papers presented by the assessee is annexed as Annexure B, C & D. The assessee started purchasing the share on 8.12.2005 and went on buying it continuously till 1.12.2006. It started selling it off in 4.4.2007 and sold off the entire shares by 26.11.2007. Now a look at the price value chart show that except for a rise for the period May, 2006 to August, 2006, the price

of the share was almost statue till June-July, 2007. It started shooting upon in August 2007 and assessee started selling it in Sept., 2007 and the entire shares were sold off in Nov. 2007. Thus, it can be seen that holding of this share is not with an investors mind, but with a real business man's mind to sell it off at the right time. This instance itself shows that the assessee was not a mere investor but a prudent business man making the right calculation to see when to buy and when to sell, which share. This is definitely an adventure in the nature of trade. It may also be seen that though the assessee had held this share for a long period, it was engaged in buying and selling all the time throughout the year."

25. The factual correctness of the findings of the Assessing Officer was not disputed at any stage of the proceedings. It was on the basis of the assessment for the year 2008-09 that the assessment for the year 2006-07 was re-opened and the same standard has been applied in respect of the assessment for 2010-11 also. These findings, the factual correctness of which has been concurrently confirmed by the first appellate authority and the Tribunal, when appreciated in the light of the

principles laid down by the Apex Court in Commissioner of Income Tax, Nagpur v. Sulej Cotton Mills Supply Agency Ltd. [(1975) 100 ITR 706], only leads to the conclusion that the assessee was engaged in trading in shares and was not holding the shares as stock-in-trade to contend that the accretions are only capital gains. In such circumstances, the questions of law raised will have to be answered in favour of the Revenue.

Appeals are dismissed.

Sd/-
ANTONY DOMINIC, Judge.

Sd/-
SHAJI P. CHALY, Judge.

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