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

Date of decision: 09.02.2018

+ **ITA 146/2018 & CM APPL. 5059/2018**
ITA 149/2018
ITA 150/2018 & CM APPL. 5080/2018

PRINCIPAL COMMISSIONER OF INCOME TAX-7..... Appellant
Through Mr. Sanjay Kumar, Adv.

versus

PAVITRA COMMERCIAL LTD. Respondent
Through None.

CORAM:

HON'BLE MR. JUSTICE S. RAVINDRA BHAT

HON'BLE MR. JUSTICE A. K. CHAWLA

HON'BLE MR. JUSTICE S. RAVINDRA BHAT (ORAL)

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In these appeals, the questions of law urged for various years
are, as follows :

- 1) Whether the decision of the ITAT affirming the Appellate Commissioner's view with respect to the assessee's claim of capital gain – rather than business income as held by the Assessing Officer is justified?*
- 2) Whether the ITAT was justified in holding that under the mercantile system of accounting, interest income accrued on basis of the assessee's contention that recovery as well as interest (on such deposits) is doubtful?*

2. On the first question, this Court notices that the AO brought to tax substantial amount for the concerned Assessment Year rejecting the assessee's claim of capital gains. The assessee was engaged in the business of investment and securities and had at the relevant time maintained a distinct portfolio in respect of stock in trade and investment. For the particular year, the assessee acquired shares in certain companies that underwent amalgamation. Those companies, which had investment portfolio containing shares of the companies in which the assessee had holdings, were treated as stock in trade. The assessee shifted some of the shares to its investment account and later sold them during the Assessment Year. The AO rejected the assessee's claim and held the profits to be business income. In doing so, the AO relied upon the judgment of the Supreme Court in *Dalhousie Investment Trust Co. Ltd. v. CIT, Central Calcutta*, (1968) 68 ITR 486 (SC) and other rulings. The CIT(A) upon re-appraisal of the facts and consideration of the authorities, held as follows :

“4.3 I have carefully considered the facts of the case, order of the AO and submissions made by the ld. AR. The central point of dispute in this ground of appeal is regarding the head of income under which the profit earned on shares/mutual funds is taxable. The appellant has vehemently claimed that as per the regular consistently followed policy of the company, the appellant had certain share portfolio under the category of investments on which long term and short terms capital gains have been disclosed, whereas on the sale of shares held as stock in trade profit earned have been disclosed as business income. On the other hand the AO is of the view that the entire income earned by the appellant on sale of shares and mutual funds is taxable as business income. It is noted that

the finding of the AO is primarily based on the notes of audit, wherein it is stated that during the year the appellant company has acquired the amalgamating companies which were engaged in the trading of shares. The appellant is pleading that the observation of the ld. AO is misconceived as it is a matter of record that the companies which have been amalgamated the appellant company were also holding these shares as investment. It is further emphasized by the ld. AR that the AO has misinterpreted the general terminology of the notes of the accounts/audit wherein even the sale of investments are termed as trading in shares. After considering the rival submissions and various case laws quoted by the AO as well as relied upon by the ld. AR, I am of the considered view that in the facts and circumstances of the instant case the view taken by the AO does not appear correct, it is seen from the records of the appellant that the appellant company had distinct portfolio of shares and mutual funds under two categories i.e investments and stock in trade. The contention of the ld. AR, that it is not open for the AO to summarily reject the decisions of the Board of directors of the company as it is their prerogative to decide as to whether the company would earn income under the head capital gains or business income from sale of shares, also appears correct. In the instant case during the last few years too, the appellant company had followed the same practice of holding certain shares under the head investments and some shares as stock in trade. Therefore, under these circumstances the action of the AO treating the entire income as business income is not justified, hence addition made by him on this account is deleted.”

3. The ITAT’s findings are, as follows :

“12. From the above observations by Ld. CIT(A) observed that Ld. AO has based his opinion on the basis of Notes to audited account. Two distinct portfolio maintained by assessee in respect of shares held for the

purposes of trading and for investment has not been observed by him.

13.....The summary of reconciliation of shares has been reproduced hereunder:

“PAVITRA COMMERCIALS LTD
ASSESSMENT YEAR 2005-06
RECONCILIATION OF SHARES HELD AS STOCK IN TRADE

PARTICULARS	NO. OF SHARES	AMOUNT (In Rs.)
Opening Stock (Refer Annexure-I)	8,056,059.710	117,602,153.77
Add :		
Shares of Vindhyachal Holdings transferred on amalgamation	4,889,109.883	54,007,145.72
Total stock of shares after amalgamation	12,945,169.593	171,609,299.49
Purchase of Shares	85,926.000	2,393,674.01
Stock of Shares	13,031,095.593	174,002,973.50
Less:		
Shares held as stock converted into investment (of Pavitra Commercial Ltd.) transferred to Capital Reserve (Refer Annexure-2)	2,078,066.000	32,767,348.61
Transferred to Capital Reserve on Amalgamation	287,500.000	662,500.00
Sale of Shares (on cost) (Refer Annexure-3)	2,244,050.254	41,425,034.89

Closing stock of Shares held as Stock (Refer Annexure-4)	8,421,487.000	99,149,290.00
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14. There is absolutely no allegation by Ld. AO regarding these facts as observed by Ld. CIT(A). We are therefore, of considered opinion that Ld. AO proceeded to compute sale of shares as business income merely on the basis of notes provided to Audited Accounts. We have perused the account at page 19 of paper book. From these Notes, it is clear that nature of business in respect of amalgamating companies has been held to be purchase and sale of shares, debentures stocks, properties and other similar activities. Ld. CIT(A) on the basis of these factual observation deleted the addition. We, therefore, do not find any infirmity in findings of ld. CIT(A) .

On the basis of the above discussion, we dismiss this ground raised by revenue.”

4. The decision of Revenue as to whether the claim of the assessee with respect to the income reported by it and whether it constitutes business income, is dependent on the entirety of the circumstances. The decisions of the Court have emphasized five broad tests whether the income bears the character of business income or capital gain – firstly, whether the company or concern is authorized in its Memorandum of constituting documents to deal with shares; (2) whether the entity had shown the shares under the head “Investment”; (3) whether the assessee/entity utilized its own funds and had not borrowed funds for the purpose of acquiring shares; (4) whether the nature of infrastructure – whether it is small, represents investment activity rather than the trading activity that would require larger infrastcuture; and lastly, whether the behaviour of the assessee is such

as to disclose income/earning has objective i.e. “obtaining dividend” rather than trading.

5. This Court notes that all the tests and the relevant rulings were noticed by both the authorities below, who had applied their mind and held that the AO’s approach in singular fixing scrutiny to the shifting and regulations of some shares to treat as business income, was erroneous. In the opinion of the Court, these findings are not only factual but sound, as they are based upon appreciation of facts at two levels and application of the settled law. No error of law is apparent; no question of law arises.

6. As far as the question with respect to reporting of mercantile interest of doubtful debts is concerned, the question is covered by the decision of this Court in *Commissioner of Income Tax Vs. Vasisth Chay Vyapar Ltd.* (ITA 552/2005 and connected cases decided on 29.11.2010). The Court had applied “real income” principle to uphold the assessee’s contention. Those observations are squarely applicable in the present case.

7. The appeals are dismissed. All the pending applications also stand disposed off.

S. RAVINDRA BHAT, J

A. K. CHAWLA, J

FEBRUARY 09, 2018

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