

IN THE HIGH COURT OF JUDICATURE AT CALCUTTA

SPECIAL JURISDICTION (INCOME TAX)

ORIGINAL SIDE

RESERVED ON: 23.09.2022

DELIVERED ON:30.09.2022

CORAM:

THE HON'BLE MR. JUSTICE T.S. SIVAGNANAM

AND

THE HON'BLE MR. JUSTICE SUPRATIM BHATTACHARYA

ITA/48/2009

M/S. GYAN TRADERS LIMITED

VERSUS

COMMISSIONER OF INCOME TAX, KOLKATA-II

Appearance:-

Mr. J.P. Khaitan, Sr. Adv.

Mr. Agnibesh Sengupta, Adv.

Mr. Saptarshi Kar, Adv.

.....For the Appellant.

Mr. Om Narayan Rai, Adv.

.....For the Respondent.

JUDGMENT

(Judgment of the Court was delivered by T.S.SIVAGNANAM, J.)

1. This appeal filed by the assessee under Section 260A of the Income Tax Act, 1961 (the Act) is directed against the order dated September 30, 2008 passed by the Income Tax Appellate Tribunal "A" Bench, Kolkata (tribunal) in ITA No. 1006/Kol/2008 for the assessment year 2005-2006. The appeal was admitted on April 29, 2009 on the following substantial question of law:-

(1) Whether the Income Tax Appellate Tribunal substantially erred in law in holding that the gain of Rs. 29,28,799/- made by the appellant on sale and purchase of shares was normal business profit and not short term capital gain as claimed by the appellant?

2. The appellant assessee is a public limited company in the business of granting loans and advances and also dealing in shares and units of mutual funds. The assessee invests in shares with a view to hold them and earn income by way of dividend and receive bonus shares. The investments in shares are out of the own funds of the assessee. The shares which are held as investments are valued at cost and those held as stock-in-trade are valued at cost or market value. Owing to vagaries in the stock market the assessee varies its investment after a relatively short period of holding in order to avoid losing its capital or because of the sudden rise in the share prices making it imprudent to hold on to the shares in the expectation that long term holding may result in better appreciation.
3. During the previous year, relevant to the assessment year under consideration (A.Y. 2005-2006), the assessee earned income from its

business of granting loans and also earned income in the purchase and sale of units of mutual funds. The trading transactions in shares resulted in a loss. During the previous year, the assessee received dividend and bonus shares in respect of some of the shares held as investments from the earlier years and also on those acquired during the previous year. The assessee filed the return of income disclosing an income of Rs. 69,38,870/- and tax payable thereon of Rs. 7,37,467/-. The assessing officer while completing the assessment under Section 143(3) of the Act by order dated December 31, 2007 accepted the long term capital gains which arose in respect of shares held as investments from the earlier years, he also accepted the short term capital gains to the extent the same related to shares held as investments from the earlier years. However, short term capital gains amounting to Rs. 29,28,799/- arising from the shares purchased as investments during the previous year ended March 31, 2005 was treated as business income. The assessing officer held that such shares were acquired by the assessee with the intention of earning quick profit and the transactions relating thereto were adventure in the nature of trade. Accordingly, the short term capital gains of Rs. 29,28,799/- was subjected to tax as business income at the rate of 35%.

4. Aggrieved by the order of assessment dated December 31, 2007, the assessee preferred appeal before the Commissioner of Income Tax Appeals – VI, Kolkata CIT(A). The said appeal was allowed by the order dated March 20, 2008. The revenue preferred appeal before the tribunal which was allowed by the impugned order.

5. Mr. J.P. Khaitan, learned senior advocate submitted that the tribunal failed to take into consideration the relevant facts, more particularly that the shares held by the assessee as investments were valued at cost whereas the shares held as stock-in-trade were valued at cost or market value whichever was lower. Further, the tribunal ought to have considered that the assessee earned substantial dividend income and the shares held as investment were invariably purchased by the assessee out of its own funds and never out of borrowings. The tribunal ought to have noted that the economic scenario has undergone a substantial change and the investment in shares is a recognized mode of investment as opposed to the earlier times where the recognized investment options were landed properties, precious metals and jewellery. Further during the recent times the Government itself had promoted the primary and secondary markets in respect of shares as an investment option and had encouraged and granted tax incentives for such investment. Further even the holding period of 3 years for long term capital assets was reduced to one year in respect of shares and mutual funds by inserting clause 37 in Section 10 of the Act by Finance No. 2 Act, 2004 with effect from 01.04.2005. Further the tribunal failed to consider that the short term capital gains from shares held as investment could not be assessed as business income merely because the period of holding of the shares in such cases was somewhat short as compared to other investments. Thus, it is submitted that whether the shares were acquired by way of investment or as an adventure in the nature of trade could not be decided only with reference to the period of holding of such shares. Reliance was placed on Circular No. 4 of 2007 dated 15.06.2007 issued by the Central Board of Direct Taxes

(CBDT) wherein it was clarified that the question whether shares were capital assets or stock-in-trade could not be decided only with reference to the period of holding and the total effect of several factors had to be considered for the purpose of deciding the question. Further the learned tribunal failed to note that the assessee had maintained separate and distinct accounts in respect of shares acquired as investment and those purchased for the purpose of trading and that it was not open to the assessing officer to treat some of the shares held on investment accounts as stock-in-trade and treat the gains arising therefrom as business income. The learned tribunal ought to have seen that the CIT(A) had given cogent and substantial reasons for assessment of the income of Rs. 29,28,799/- as short term capital gains and the learned tribunal was not justified in reversing such order that to in a vague manner. In support of his contention, learned senior advocate placed reliance on the decision in the case of **Commissioner of Income Tax-VII Versus Avinash Jain** ¹, **Commissioner of Income Tax Versus Merlin Holding Private Limited** ², **Commissioner of Income Tax-2 Versus IHP Finvest Limited** ³ and **Jet Age Securities Private Limited Versus Commissioner of Income Tax, Kolkata- III in ITA No. 79 of 2010 dated 15.09.2022**.

6. Mr. Om Narayan Rai, learned senior standing counsel while seeking to sustain the order passed by the learned tribunal submitted that most of the shares were purchased and sold in the financial year relevant to the assessment year under consideration. This aspect has been very clearly

¹ (2013) 214 Taxman 260 (Del)

² (2015) 375 ITR 118 (Cal)

³ (2016) 236 Taxman 64 (Bom)

brought out by the assessing officer in the assessment order dated December 31, 2007 by mentioning the relevant details in a tabular form and after noting the facts, the assessing officer has rightly held that the transactions were intended for the purpose of business and it is incorrect to state that the shares were purchased for the purpose of investment. Further it is submitted that the shares were not acquired from the primary market for long term holding rather acquired from the secondary market with a view to sell and earn quick profits and therefore the transactions are adventure in the nature of trade. Further it is submitted that the learned tribunal as well as the assessing officer took note of the various decisions of the Hon'ble Supreme Court including the decision in the case of **Venkataswami Naidu Company Versus Commissioner of Income Tax** ⁴ and rightly held that the shares purchased and sold which were mentioned in Table No. 1 of the assessment order are for the purpose of business and all the transactions are adventure in the nature of trade. The learned standing counsel placed reliance on the decision in **Commissioner of Income Tax, Bombay Versus H. Holck Larsen** ⁵ in which various decisions of the Hon'ble Supreme Court including the decision in **P.M. Mohammad Meerakhan Versus Commissioner of Income Tax, Kerala, Ernakulam** ⁶ have been referred. Reliance was also placed on the decision in the case of **P.V.S. Raju and P. Rajyalakshmi Versus Additional Commissioner of Income Tax** ⁷.

7. We have elaborately heard learned counsel for the parties.

⁴ (1959) 35 ITR 594 (SC)

⁵ (1986) 3 SCC 364

⁶ (1969) 2 SCC 25

⁷ (2012) 340 ITR 75 AP

8. The CBDT by Circular No. 4 of 2007 dated 15.06.2007 laid down the tests for distinguishing shares held as stock-in-trade and shares held as investment. The CBDT took note of the decision of the Hon'ble Supreme Court in **Commissioner of Income Tax, (Central), Calcutta Versus Associated Industrial Development Company Private Limited** ⁸, and the decision in **H. Holck Larsen** and the decision of the Authority for Advance Ruling (AAR), 288 ITR 641-AAR wherein 3 principles have been carved out and dealt with by the AAR. After taking note of the aforementioned decisions, the CBDT emphasized that it is possible for the 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. Further it was pointed out that where an assessee has two portfolios, the assessee may have income under both heads i.e. capital gains as well as business income. In the light of the above, the assessing officer were advised to bear in mind the principles which should guide them in determining whether in a given case the shares are held by the assessee as investment and giving rise to capital gains or as stock-in-trade giving rise to business profits. The assessing officers were 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. In the said circular, the CBDT took note of the decision of the AAR and culled out 3 principles which were answered in the following terms:-

⁸ (1971) 82 ITR 586 (SC)

The Authority for Advance Rulings (AAR) (288 ITR 641), referring to the decisions of the Supreme Court in several cases, has culled out the following principles:-

- (i) “Where a company purchase 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 transactions;*
- (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”.*

Dealing with the above three principles, the AAR has observed in the case of Fidelity group as under:

“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 realizing capital gains on investments and accounts of remittance to India for investment in India and realizing capital gains on investment from such remittances. The third principle suggests that ordinarily purchases and sales of shares with the motive of realizing 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.”

9. As pointed out above, the second principle is a guide for determining the nature of transactions whether there were substantial transactions, the magnitude, maintenance of books of accounts and ascertaining the ratio between purchases and sales. With regard to the third principle, it was pointed out that where the object of investment in shares of the companies is to derive income by way of dividend etc. the transactions of purchases and sale of shares would yield capital gains and not business profits. The above circular was taken note of in **Avinash Jain** and it was held that the intent and purport of the circular is to demonstrate that a tax payer could have two portfolios, namely an investment portfolio and a trading portfolio, the assessee could own shares for the purpose of investment and/or for the purposes of trading. In the former case whenever the shares are sold and

gains are made the gains would be capital gains and not profits of any business venture and in the latter case any gains would amount to profit in business. In **Merlin Holding Private Limited**, the question was whether frequency of the transactions could be sole determinative factor to ascertain the intention of the assessee as to whether the same was an investment or stock-in-trade. The said question was answered by pointing out that frequency alone cannot show that the intention was not to make an investment, as the legislature has not made any distinction on the basis of frequency of transaction. The benefit of short term capital gain can be availed of for any period of retention up to 12 months. Although a ceiling has been provided but there is no indication as regards the floor, which can be as little as one day. Further it was pointed out that the investor has to adduce and prove to show that some transactions were intended to be business transactions and some transactions were intended to be by way of investment, some transactions by way of speculation and the revenue cannot find fault merely because there were thousands of transactions in a year or that the majority of the income was from shares dealing etc. In **IHP Finvest Limited** the court held that where the assessee maintained two separate accounts in respect of its dealings in mutual funds and shares i.e. one in respect of its trading and others in respect of its investment and when there were no allegation of shifting of scrips from trading to investment or vice-versa, the assessee's claim of capital gains on sale of shares held as investment was to be allowed.

10. In **Jet Age Securities Private Limited**, identical issue arose and this the court after taking note of the decision in **Merlin Holding Private**

Limited, Principal Commissioner of Income Tax, Central – 1, Kolkata Versus Purvanchal Leasing Limited ⁹ and the decision in **Associated Development Company Private Limited**, held that the issue regarding the holding of shares is by way of investment or forming part of stock-in-trade is a matter within the knowledge of the assessee and if he produces proof to show that he had maintained the distinction between the shares which are held as stock-in-trade and which are by way of investment, then the intention of the assessee is a main criteria to be judged. The substantial question of law which arose in the said case was whether the assessee therein was a dealer in shares in the accounting periods relevant to the assessment years 1959-1960 and 1960-1961. The Hon'ble Supreme Court noted various decisions including the decision in **P.M. Mohammad Meerakhan** by referring to the decision in **Ramnarain Sons (Pr.) Limited Versus Commissioner of Income Tax** ¹⁰ wherein the Hon'ble Supreme Court observed that in considering whether transactions was or was not an adventure in the nature of trade, the problem must be approached in the light of the intention of the assessee having regard to the legal requirements which was associated with a concept of trade or business. It was further held that the question whether the assessee's transactions amounted to dealing in shares and properties or investment was a mixed question of law and fact and the legal effect of the facts formed by the tribunal on which the assessee could be treated as a dealer or as investor was a question of law. In

⁹ (2022) 287 Taxman 20 (Cal)

¹⁰ (1961) 41 ITR 534 (SC)

Janaki Ram Bahadur Ram Versus Commissioner of Income Tax ¹¹ the Hon'ble Supreme Court observed that the profit motive in entering the transaction was not decisive, for accretion to capital did not become taxable income merely because the asset was acquired in the expectation that it might be sold at a profit. Further it was observed that if a transaction was related to the business which was normally carried on by the assessee, do not directly partake, an intention to launch upon the adventure in the nature of trade might readily to be inferred. In **P.M. Mohammad Meerakhan**, it was reiterated that it is not possible to evolve a 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 relevant factors and circumstances accrued therein which determined the character of the transaction. In **Raja Bahadur Kamakhya Narain Singh Versus Commissioner of Income Tax**¹² the Hon'ble Supreme Court held that where a person while selling his investment realized 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 realization of the investment but an act done for making profit. It was pointed out that the distinction between the two types of transactions is not always easy to make. Whether the transaction is of one kind or other depends on the question whether the excess is an enhancement of the value by realizing the security or a gain in an operation of profit making. Further it was pointed

¹¹ (1965) 57 ITR 21 (SC)

¹² (1970) 77 ITR 253 (SC)

out that the assessee might invest his capital in shares with the intention to resell these if in future there sale bring 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.

11. After noting the above decisions, it was held that the totality of all the facts will have to be borne in mind and the correct legal principles have to be applied. If all the relevant factors have been taken into consideration and there has been no misapplication of the principles of law then the conclusion arrived at by the tribunal cannot be interfered with because the inference is a question of law.

12. The legal principle that is deduceable from the above decisions are that in considering whether a transaction was or was not an adventure in the nature of trade, the problem must be approached in the light of the intention of the assessee having regard to the legal requirements which were associated with the concept of trade or business. That it is not possible to evolve a single legal test or formula which could be applied in determining whether a transaction was an adventure in the nature of trade or not and the answer to the question would depend in each case on the relevant factors and circumstances proved therein which will determine the character of the transaction. Further the distinction between the two types of transactions is not always easy to make.

13. Bearing the above legal principles in mind, we proceed to examine the facts of the case. It is not in dispute that the assessee maintains two accounts, one for its investment portfolio and the other for stock-in-trade. From the computation of income as done by the assessing officer in his

order dated December 31, 2007, it is seen that the income from investment earned by the assessee during the relevant assessment year was Rs. 6,61,40,926/-. Out of the said investment income, the assessing officer treated the short term capital gains of Rs. 29,28,799/- as business income. Considering the total investment income to that of the short term capital gains which was treated as business income, it is only about 4.4 % of the total investment income. The question would be whether this could have been treated as business income. The assessing officer picked up 25 transactions and listed the same in a tabulated format giving the names of the shares, the number of shares, the date of purchase, the date of sale, the number of shares sold, the period of holding and the profit earned. In the said table, 25 shares have been listed of which we find the substantial amount is in respect of shares held by the assessee in Bank of India and Reliance Industries Limited. It is not in dispute that shares were held by the assessee in 13 other companies which the assessing officer accepts to be an investment. The assessing officer was largely guided by the period of holding and held that the frequency of purchase and sales was very high and therefore held the same to be trading in shares and the profits earned to be business income. In the aforementioned decisions, it has been held that the frequency in the transaction is not the sole determinative factor. The tribunal while examining the correctness of the order passed by the CIT(A) grossly erred in not taking note of the entire facts which were placed by the assessee. The facts, in our view was rightly appreciated by the CIT(A) holding that the assessee sold some of its investment and earned long term capital gains and also short term capital gains; the fund deployed in

investment of shares was own funds and object of investment was capital appreciation. On going through the details which were segregated by the assessing officer, the CIT(A) held that there was no huge quantities of shares purchased nor there is any repetition of transactions in the same script. Further, the CIT(A) noted that the assessee invested in shares of blue chip companies and no frequent transactions in each scripts took place. Further if in a year, the assessee invested in the scripts of 25 companies it cannot be called frequent trading. Furthermore, the CIT(A) noted that the assessee invested own surplus funds and shares were duly showed as investment in its D-Mat Account and the assessee had also invested in earlier years and received long term investment income which were treated as long term capital gains / short term capital gains. Thus, on appreciation of the entire materials placed, the CIT(A) came to the conclusion that the main object of the assessee was investment in shares and financing and net surplus received on investment could not be business of the assessee. The learned tribunal while reversing the findings of the CIT(A) did not consider all facts and relevant materials. The learned tribunal referred to the decision in **Venkataswami Naidu and Company** and agreed with the assessing officer stating that the assessee retained the scripts only for a few days and therefore the intention of the assessee was to earn quick profit. The learned tribunal failed to take note of the fact that the assessee had maintained two separate accounts and the assessee deployed its own surplus funds and the shares were duly showed as investment in their D-Mat account. As held by the Hon'ble Supreme Court that it is not possible to evolve a single legal test or formula which could be applied in determining whether a transaction was

an adventure in the nature of trade or not, it was necessary for the learned tribunal to examine all the relevant materials and facts which were placed by the assessee. As pointed out earlier, the short term capital gains which was treated as business income was only about 4.4% of the total investment income of Rs. 6,61,40,926/- and out of the said income substantial income has been treated as either short term profit or long term profit, in other words about Rs. 6.30 crores has been accepted by the assessing officer to be an investment income. Therefore, in our view the learned tribunal had committed an error in reversing the order passed by the CIT(A) which had granted relief in favour of the assessee taking note of the entire material which was on record.

14. The learned senior counsel appearing for the appellant assessee had elaborately referred to the balance sheet as at 31.03.2005 and pointed out the various facts and figures. During the course of scrutiny assessment, the assessee was called upon to explain as to why the 25 transactions should not be treated as business transactions and to such query, the assessee had explained that they had dealt with the shares in two different capacities which was an accepted fact before the assessing officer. Further it was explained that whether shares were acquired by the assessee from the secondary market or from the primary market was immaterial. The assessee acquired the shares with the intention of holding the same as investment and as soon as they found that the shares have appreciated in value, they realized such appreciation by selling such investment. Further the assessee explained that their intention to hold the shares was clearly spelt out by debiting cost of such purchase to the investment account. Further the

assessee pointed out that Schedule 11 attached to the profit and loss account and the balance sheet of the relevant years clearly shows the details of profit on sales of investment shares and the assessing officer had failed to take note of the aspect that the Act provides different rate of tax for the capital gains earned by the assessee on the sale of shares held as long term capital asset and short term capital assets. This important factual explanation offered by the assessee was not considered and dealt with by the learned tribunal while reversing the order passed by the CIT(A).

15. Mr. Rai, referred to the decision in **P.V.S. Raju** and on going through the said decision we find that the same would lend support to the case of the assessee. In any event in the said case, the assessing officer, the CIT(A) and the tribunal concurrently held against the assessee on facts and the court having found the orders to have been passed after considering all the factors and to be a reasoned order declined to entertain the appeal. In the said decision, several decisions of the Hon'ble Supreme Court having been referred, to some of which we shall take note. In **CIT Versus Vazir Sultan and Sons**¹³, it was held that one of the relevant tests in determining whether or not the shares/security are capital asset or whether it is in the nature of fixed assets or constituted as stock-in-trade of the assessee's business, fixed Asset is what the owner turns to provide keeping the asset in his own possession, stock-in-trade is what he makes profit by parting with it and letting it change master. After noting several other decisions it was held in determining the question whether after acquiring the shares, the assessee dealt with it as an investor or carried on business with it treating it as stock-

¹³ (1959) 36 ITR 175 (SC)

in-trade or as a trading asset what is relevant is that, if the case falls within the former category receipts by way of sale of such shares will be capital receipts but if it falls within the latter the receipts will be trading receipts and profits therefrom is business income and in deciding this question the object with which such operation are carried on assumes importance. In ***Union of India Versus Azadi Bachao Andolan***, ¹⁴, it was pointed out that to decide as to whether the sale of shares amounted to capital gains or business income would require examination of facts. Further it was held that the 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 value motivated the investment. Further a transaction is not necessarily in the nature of trade because the purchase was made with the intention of resale. Further it was pointed out where the purchase of any article or of any capital investment, for instance shares is made without the intention to resell it at a profit, the resale under such changed circumstances would only be realization of capital and would not stamp the transaction with a business character. If the above legal principles are applied to the facts of the case on hand, the only irresistible conclusion is to approve the view of the CIT(A) who had considered all the relevant materials and details which were placed by the assessee. The learned tribunal had failed to note that the assessee had maintained a separate account for investment, which fact was very material to consider the nature of transactions effected by the assessee during the relevant period.

¹⁴ (2003) 263 ITR 706 (SC)

16. Thus, for the above reasons, we are of the considered view that the learned tribunal erred in reversing the order passed by the CIT(A).
17. In the result, the appeal filed by the assessee is allowed and the substantial questions of law are answered in favour of the assessee.

(T.S. SIVAGNANAM, J.)

I Agree.

(SUPRATIM BHATTACHARYA, J.)



(P.A.- SACHIN)