

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

Judgment Reserved on August 06, 2014
Judgment Delivered on September 09, 2014

+ **ITA 1032/2011**

CIT

..... Appellant

Through: Mr.Ruchir Bhatia, Advocate

versus

CENTRAL NEWS AGENCY PVT LTD

..... Respondent

Through: None

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE V.KAMESWAR RAO

V.KAMESWAR RAO, J.

1. The appeal pertaining to the assessment year 2005-06, raises the following substantial question of law:

“Whether the transaction in question were rightly held by the Tribunal to be in the nature of investment and not in the nature of trade?”

(We have partly modified the substantial question of law as framed on 25th September, 2013, to correct the typographical error).

2. The brief facts of the matter as taken from the Assessment Order are that the respondent assessee, at the relevant time, was engaged in the business of retail trade in periodicals and books including subscription

agents for Indian and Foreign Periodicals. The respondent assessee a company filed its original return on December 01, 2006 declaring income of Rs.93,87,127/-. Notice under Section 143(2) was issued and served upon the respondent assessee on June 13, 2008 and taken up for scrutinizing assessment.

3. The Assessing officer vide its order dated November 11, 2008 held that income of Rs. 30,81,610/- from sale of units of mutual funds, shown by the respondent assessee as short term capital gain should be treated as business income and accordingly taxed at the rate of 35%. We note that the Assessing Officer relied upon certain judicial pronouncements as well as a CBDT circular and summarized the facts as emerged from the record as under:-

“Principles Derived from CBDT Circular and Various Judicial Pronouncements:-

With regard to purchase/sale of shares/securities, how the treatment has been given in the books of accounts by the assessee.

Magnitude of purchase and sales and frequency of transactions and ratio of sales to purchases as shown on account of investment.

Whether dividend has been earned and on which securities before selling.

During the year under consideration, the assessee has sold shares/securities and earned:-

Rs/-

Short Term Capital Gains:- 30,81,610/-

In the instant case, if the above principles are applied to following scenario emerges:-

With regard to entry in its books of a/c's the same has been reflected as investment.

Further, no dividend has been received by the assessee company on shares on which short term capital gain has been received.

As far as period of holding is considered it varies from as short as 20 days to 6 months. But in majority of cases the period of holding is less than 3 months.

Thus, looking at the overall facts and circumstances of the case and in particular the facts that:-

The assessee company is engaged in the business of trading and investment of shares and securities.

Bought units of mutual funds during the previous year and sold in the same P.Y.

No dividend has been received on any of the units of mutual funds sold on which assessee company earned Short Term Capital Gain.

No dividend was received by the assessee company on these units of mutual funds still it preferred to sell the units of mutual funds holding them for a period as less as 3 months.

It is also pertinent to mention here that the assessee has shown any income under the head 'Business income' on account of sale of units of mutual funds.

The department has accepted the stand of the assessee in earlier years does not mean it has to be accepted in

this year as well. It is as well laid down law that the principle of stopple does not apply to income tax proceedings. Further it is pertinent to mention that during the F.Y. 04-05, w.e.f. from 01.10.04, LTCG has been exempted from tax and STCG is to be taxed at 10% (provided the transaction are through recognized stock exchange and STT has been paid on the same). Thus there is major development during the year with regard to the taxability of sale of shares and given the CBDT Circular dated 15.06.07 (4/2007), **it is very crucial to ascertain from facts & circumstances of the case that the income on units of mutual funds sold bear the nature of capital gains or business income. This is to be ascertained by looking at the intention of the assessee for holding the units of mutual funds for long time for earning dividend income or selling then within a short period for short term appreciation. In this case it is clear that the assessee has indulged in trading by selling the units of mutual funds in a short term appreciation.**

How the treatment has been given by the assessee to the units of mutual funds held in its books, is just one of the indicators. There are other important indicators which need to be looked into.

It is not necessary that the units of mutual funds need to sold on daily/weekly basis to categorise the activity as trading. It is the composite picture, period of holding, dividend received or not, etc. which needs to be looked into. Further the assessee's contention is not correct when it says that it has invested for dividend as hardly any dividend has been earned on units of mutual funds sold for STCG.

Considering the aforesaid facts and circumstances and in light of Board circular no. 4/2007 dated 15.06.2007, it is clear that the claim of the assessee for sale of units of mutual funds shown as investment and accordingly being treated as short term capital gain does not hold ground in view of the aforesaid discussion. Hence, the

income shown by the assessee company as capital gain of Rs 30,81,610/- is hereby treated as business income and is accordingly taxed at the normal rate i.e.35%.”

4. Aggrieved the respondent assessee approached Commissioner of Income Tax (Appeals) [CIT (Appeals) for short] in appeal wherein by an order dated January 20, 2010, it was held that the transactions-in-question for the purpose of trading and hence, the contention that the units were held for investment purpose, was not acceptable. Therefore, the Assessing officer was justified in treating the income from sale of shares as ‘Business Income’. In short, the adverse findings recorded by the Assessing Officer were affirmed and upheld.

5. Aggrieved the Respondent assessee filed an appeal with the Income Tax Appellate Tribunal (ITAT for short) being ITA No. 1166/De/2010 wherein vide its order dated February 22, 2011, it has been held that the profits on sale of Units of Mutual Funds would be assessable under the head ‘capital gains’ and not as business income. Thus, the issue stands decided in favour of respondent assessee and the findings of the Assessing Officer, affirmed by the CIT (Appeals) set aside and overturned. The relevant portion of the order is reproduced hereunder:

“5. We have heard both the parties and have gone through the material available on record. There is no dispute that in Assessment Year 2005-06 the sale of units/securities was accepted under the head ‘capital gain’. The respondent assessee in the balance sheet has treated the

shares and units as investments and have been valued at cost. We have also gone through the note on accounts attached to the balance sheet. The inventory have been valued at lower of cost or net releasable value. Further, the respondent assessee is not an investment company. We have also gone through the Memorandum and Articles of Association. As per Memorandum and Articles of Association the main objects of the company do not include activities relating to purchase and sale of shares. Under clause (6) of ancillary objects the respondent assessee is permitted to invest and deal with money of the company not immediately required in such a manner as may from time to time be determined. From these facts it is evident that respondent assessee had invested in shares/units of mutual fund as investment and had not held them as 'stock in trade'. Therefore, profit arising on sale of investments will be liable to tax under the head 'capital gains' and not under the head 'business or profession'. The issue is covered by the decision of Hon'ble High Court of Delhi in the case of Ess Jay Enterprises P. Ltd. (supra) wherein Hon'ble High Court of Delhi has held that the treatment given to a transaction in the books of accounts is of importance. The respondent assessee had shown shareholding as an investment and not 'stock in trade' of business. There was nothing on record to show that shares/units of mutual funds were converted into stock in trade. Under these circumstances, profits earned under the head investment was treated under the head capital gain. Respectfully following the decision of Hon'ble High Court of Delhi it is held that profits on sale of units of mutual funds will be assessable under the head 'capital gains' and not as business income. We, therefore, decide this issue in favour of the respondent assessee."

6. Aggrieved by the said order passed by the ITAT, the revenue filed the present appeal.

7. Having heard the counsel for the revenue and considered the record, we note that the issue whether the respondent-assessee had held the mutual funds as investment or sold them for earning profits to be taxed as business income is a complex and vexed one. The circular as referred to by the Assessing Officer and CIT (Appeals) was issued pursuant to a judgment of the Gujarat High Court in the case of in ***Commissioner of Income Tax Vs. Rewashanker A. Kothari, (2006) 283 ITR 338***, wherein the Gujarat High Court after considering its earlier decision in the case of ***Pari Mangaldas Girdhardas Vs. CIT, (1977) 6 CTR (Guj.)***, has formulated the following tests:-

“(a) The first test is whether the initial acquisition of the subject matter of transaction was with the intention of dealing in the item, or with a view to finding an investment. If the transaction, since the inception, appears to be impressed with the character of a commercial transaction entered into with a view to earn profit, it would furnish a valuable guideline.

(b) The second test that is often applies is as to why and how and for what purpose the sale was effected subsequently.

(c) The third test, which is frequently applied, is as to how the assessee dealt with the subject matter of transaction during the time the asset was with the assessee. Has it been treated as stock-in-trade, or has it been shown in the books of account and balance sheet as an investment. This inquiry, though relevant, is not conclusive.

(d) The fourth test is as to how the assessee himself has returned the income from such activities and how the Department has dealt with the same in the course of

preceding and succeeding assessments. This factor, though not conclusive, can afford good and cogent evidence to judge the nature of transaction and would be a relevant circumstance to be considered in absence of any satisfactory explanation.

(e) The fifth test, normally applied in cases of partnership firms and companies, is whether the deed of partnership or the memorandum of association, as the case may be, authorises such an activity.

(f) The last but not the least, rather the most important test, is as to the volume, frequently, continuity and regularity of transactions of purchase and sale of the goods concerned. In a case where there is repetition and continuity, coupled with the magnitude of the transaction, bearing reasonable proportion to the strength of holding, then an inference can readily be drawn that the activity is in the nature of business.”

8. It has to be seen on application of tests as laid down in the case of **Rewashanker A.Kothari** case (supra), whether the assessee held the mutual funds as investment or by selling them had earned profits as business income. We find that the ITAT had noted that the assessee in the balance-sheet had treated the mutual funds as investments and never classified its investment in securities as stock-in-trade. The assessee company was not an investment company. The objective of the assessee company do not include activities relating to purchase or sales of shares rather, under clause 6 of ancillary objects, permitted to investment and deal with the money not immediately required in such a manner as may from time to time be

determined. Valuation was made as per the norms of capital asset and not as a trading asset.

9. Regrettably the ITAT has not taken into consideration the facts as noted by the Assessing Officer and also CIT (Appeals). The facts recorded and highlighted by the authorities, do not find mention or noticed. The ITAT was required to determine the cumulative effect of all the facts as noted by it and the authorities below, including whether any dividend had been received on the units; the frequency of 26 transactions and volume of the said transactions. Why and for what reason, purchase/sale was made, source of the funds and whether sale of old units and purchase were simultaneous or after a gap. Entries in the books of account, would normally reflect treatment given by the assessee. Articles and Memorandum were written at the time of incorporation. We are concerned with the actual intention and manner in which transaction of sale and purchase. Intention has reference to practical and empirical side of the de facto and functional aspects. We deem it appropriate to remand the matter back, calling upon the ITAT to determine the issue afresh after first elucidating and pronouncing on facts and then by applying the parameters laid down by the Gujarat High Court in **Rewashanker A.Kothari** case (supra) as well as circular issued by CBDT dated 15.06.2007.

10. We, accordingly, allow the appeal and set aside the order of the ITAT, but with an order of remand for fresh adjudication. We clarify that we have neither affirmed nor negated the facts noted by the Assessing Officer, CIT (Appeals) and ITAT nor finally observed and adjudicated the legal effect and consequence of the said facts.

11. No costs.

(V.KAMESWAR RAO)
JUDGE

(SANJIV KHANNA)
JUDGE

SEPTEMBER 09, 2014
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