(5368)

In the High Court of Judicature at Madras

Dated: 08.10.2012

Coram

The Honourable Mrs.JUSTICE CHITRA VENKATARAMAN

and

The Honourable Mr.JUSTICE K.RAVICHANDRABAABU

Tax Case (Appeal) No.2397 of 2006

Commissioner of Income Tax

Chennai.

.... Appellant

Vs.

Shri.Allu Arvind Babu

98/88 Kamdar Nagar

Mahalingapuram,

Chennai 600 034.

.... Respondent

APPEAL under Section 260 A of the Income Tax Act against the order dated 28.02.2006 in I.T.A.No.104/Mds/2005 on the file of the Income Tax Appellate Tribunal, Madras 'A' Bench for the assessment year 2001-02.

For Appellant : Mr.M.Swaminathan

Standing Counsel for Income Tax

For Respondent : Mr.C.V.Rajan

J U D G M E N T

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

The Revenue is on appeal as against the order of the Income Tax Appellate Tribunal relating to the assessment year 2001-02. This Court, at the time of admission, admitted this Tax Case on the following substantial question of law:

"Whether in the facts and circumstances of the case, the Tribunal was right in holding that the assessee, who is not in the business of buying and selling of stocks and shares is entitled to claim loss arising on redemption of units as business loss?"

2. The assessee is engaged in various business, such as, film production, film distribution, exploitation, export of films, real estate development, dealing in properties etc. It is seen from the facts narrated herein that on 08.03.2001, the assessee purchased Blue Chip Fund Units for Rs.7.00 crores from M/s.Kothari Pioneer Mutual Fund and sold the same for a sum of Rs.5,62,276,853/- to the same party on 12.3.2001. The source of investment in the shares came from the assessee's contribution of Rs.52.50 lakhs and the balance was arranged by M/s.Kotak Mahindra Finance Limited, Bombay. The units allotted to the assessee was given as a security for the above loan. Dividend of a sum of Rs.1,09,60,334/- was reinvested towards purchase of further units on 12.3.2001. On the very same day, all the units were transferred to M/s.Kothari Pioneer Limited by redemption for a total consideration of Rs.5,62,27,853/-. In this process, the assessee incurred a loss of Rs.1,30,57,575/-. After taking into account the interest element and the discount component, the assessee claimed this loss as a business loss to be set off against other business income.

3. Questioning the transaction as a colourable one, the assessee was asked to explain as to why the loss should not be treated as a capital loss. The assessee replied that as per the Mutual Fund Regulations, both sale of

units as well as redemption of units would take place only with the company dealing in mutual funds. Considering the various nature of business conducted by the assessee, the transaction in mutual funds being one such business, the loss have to be treated as a business loss.

4. The Assessing Officer viewed that the assesseee had not indulged in the line of buying and selling shares in the previous year and only for five days during the previous year under consideration, the assessee had entered into financial transactions with M/s.Kotak Finance Ltd. and with M/s.Kothari Pioneer Mutual Fund, which resulted in a loss as stated above. The Assessing Officer pointed out to the investment that the assessee had made investments in M/s.Kothari Pioneer-Infotech Fund; Kothari Pioneer Blue Chip Fund; Kothari Pioneer- Balanced Fund and Kothari Pioneer Internet Fund, totalling to a sum of nearly Rs.60.00 crores and odd that when these investments were treated as investments by the assessee, the solitary investment made in Kothari Pioneer Mutual Fund, could not be treated as adventure in the nature of trade. Thus holding, the Assessing Officer viewed that there was no business activity involved and what the assessee had done was to make an investment in mutual fund first, realise the dividend, which is tax free and then sell the units immediately thereafter.

5. Referring to case law, the Assessing Officer ultimately came to the conclusion that the motive of the assessee for the activity not being one to earn profit and it being to adopt a machinery to set off its income from other trade activities, the conduct was nothing short of colourable nature, hence, the claim of the assessee was rejected. Aggrieved by this, the assessee went on appeal before the Commissioner of Income Tax (Appeals).

6. After considering the facts, the Commissioner of Income Tax (Appeals) pointed out to the decision reported in (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. CIT) and came to the conclusion that the

intention of the assessee for carrying the transaction was not of a business interest nor of an investment; but, the sole purpose was to avoid and reduce his tax liability. The assessee had followed the same modus operandi in the subsequent year resulting in a capital loss and the assessee had also claimed deduction under Section 80 M of the Income Tax Act on the dividend income. Pointing out to these aspects, the Commissioner of Income Tax (Appeals) followed the decision reported in (1985) 154 ITR 148 (Mc Dowell & Co. Ltd. V. CIT) holding that it was a colourable device adopted by the assessee. The Commissioner of Income Tax (Appeals) viewed that the transaction of purchasing the units, taking loan from Kotak Mahindra Finance Ltd., reinvestment of the dividend and redemption and ultimately the sale of the units was a structured pre-planned, pre-mediated transaction. Thus, the loss suffered by the assessee had a direct nexus to the earning of the dividend. Pointing out that Kotak Mahindra Finance Ltd., had entered into these kinds of transactions with number of assessees, the Commissioner of Income Tax (Appeals) rejected the claim of the assessee. Aggrieved by this, the assessee went on appeal before the Income Tax Appellate Tribunal.

7. The Tribunal, without adverting to the facts, simply followed the decision of the Special Bench of the Mumbai Tribunal rendered in the case of Wallfort Shares & Stock Brokers Ltd. V. ITO reported in 96 ITD 1 and set aside the assessment. Thus the assessee's appeal was allowed. Aggrieved by this, the Revenue has come before this Court.

8. Learned Standing Counsel appearing for the Revenue referred to the assessment order to submit that the Tribunal had not rendered any finding as to the nature of the transaction, but merely applied the decision of the Mumbai Tribunal, which was subsequently considered by the Apex Court in the decision reported in 326 ITR 1 (Commissioner of Income-Tax V. Walfort Share and Stock Brokers P. Ltd.). The decision of the Supreme Court agreeing with the assessee has to be viewed on the strength of the facts stated therein. In the circumstances, going by the fact herein that the assessee had held shares just for six days and then sold it immediately for

a loss, would only show that the transaction is a colourable transaction. Hence, the order of the Tribunal has to be set aside.

9. Learned counsel appearing for the assessee referred to the decision of the Apex Court reported in 326 ITR 1 (Commissioner of Income-Tax V. Walfort Share and Stock Brokers P. Ltd.), wherein the Apex Court considered the effect of Section 94(7) as well as Section 14 A of the Income Tax Act and ultimately upheld Tribunal's order in favour of the assessee. Leaving that aside, learned counsel referred to the decisions reported in (1965) 58 ITR 328 (Griffiths (Inspector of Taxes V. J.P.Harrison (Watford) Ltd.), (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. Commissioner of Income-Tax), (1978) 113 ITR 483 (Commissioner of Income-Tax, West Bengal-II, Calcutta V. Central Kurkhend Coal Co. Ltd.) and (2001) 251 ITR 487 (Commissioner of Income-tax V. Malabar Building Products Ltd.) to contend that the Commissioner of Income Tax (Appeals) and the Income Tax Officer committed a serious error in overlooking the assessee's status as carrying on business in multi-various fields. He pointed out that there are absolutely no material to hold that the transaction was a colourable one. The entire reasoning of the Department rested on the sole fact that the assessee had incurred the loss on the sale of the shares cannot lead one to a conclusion that the loss incurred was only for the purpose of setting of the same as against the income earned from other fields of activity.

10. Learned Counsel further pointed out that if the assessee intended to make investments, he would have retained it as investments. However, when the assessee carried on business in multi-various fields and that it had held the shares just for six days itself would be an indication of a fact that it was a business income available for adjustments in the event of a loss suffered as against other income. Hence, no exception could be taken to the course of conduct adopted by the assessee. Thus, placing reliance on the decision, in particular, the decision reported in (1965) 58 ITR 328 (Griffiths (Inspector of Taxes V. J.P.Harrison (Watford) Ltd.), learned counsel submitted that the fact that the assessee had been carrying on business is a strong point to show that the investment in shares were

nothing other than for the purpose of business only and not an investment simpliciter.

11. Heard learned counsel appearing for the assessee and the learned Government Advocate appearing for the Revenue and perused the materials placed before this Court.

12. In the decision reported in (1965) 58 ITR 328 (Griffiths (Inspector of Taxes V. J.P.Harrison (Watford) Ltd.) the facts were that the assessee company sustained loss while carrying on its business; it sold the shares at a loss, which was sought to be set off as against other income. The Privy Council pointed out that the question as to whether the assessee was carrying on trade or not, could not be ascertained merely by the difference between the purchase price of the article and the selling price of the article. It was pointed out in the case of Johnson v. Jewitt ((1961) 40 A.T.C.314 C.A.) that irrespective of the fiscal result or the ulterior fiscal object of the transaction, so long as the transaction was not a sham one, the same could not be rejected as one in the course of the business. The Privy Council pointed out that one must only look at the usual characteristics of the trade; even an isolated transaction might be trade; although the object of a trader was to make a trading profit, in view of the law declared in the case of Edwards V. Bairsiow ((1956) A.C.14), it was pointed out "an individual or a company can conduct business in a most extravagant way, they can conduct it with the certainty of making a loss. But the Revenue is not concerned with the particular method of trading: they are only concerned with the results of the business. If there are profits or gains and the business is a trade then income tax is payable. If there are losses relief is available under Section 34l." It further pointed out "no doubt if it is established that a transaction is entered into with the evident intention of making a profit, that may be a strong indication that the company was trading. But the corollary by no means follows that the absence of an intention to make a profit or the intention to make a loss negatives trading. The test is an objective one. The question to be asked is not quo animo

was the transaction entered into but what in fact was done by the company." Thus the Court concluded that neither the fact that the company intended to make a loss nor the fact that the company intended to make a fiscal advantage out of the transaction, negatives trading.

13. In the decision reported in (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. Commissioner of Income-Tax), the Apex Court pointed out that the question as to whether the transaction was an adventure in the nature of trade is a mixed question of law and fact, it held that when Section 2(4) of the 1922 Act referred to an adventure in the nature of trade, it clearly suggested that the transaction in question cannot properly be regarded as trade or business. It was allied to transactions that constituted trade or business, but may not be trade or business itself. In other words, it is characterized by some of the essential features that make up trade or business but not only by all of them. Thus, even an isolated transaction can satisfy the description of an adventure in the nature of trade, provided, at least some of the essential features of trade are present in the isolated or single transaction. The Supreme Court pointed out that ultimately, it is the intention with which the person deals in the particular transaction, would be the decisive factor. The Supreme Court held that relevant facts and circumstances actually determines the character of the transaction. Thus, in deciding the character of the transaction, several factors are relevant, such as, "whether the purchaser was a trader and the purchase of the commodity and its resale were allied to his usual trade or business or incidental to it; the nature and quantity of the commodity purchased and resold; any act subsequent to the purchase to improve the quality of the commodity purchased and thereby make it more readily resaleable; any act prior to the purchase showing a design or purpose; the incidents associated with the purchase and resale; the similarity of the transaction to operations usually associated with trade or business; the repetition of the transaction; the element of pride of possession." It further observed that in case where the purchase has been made solely and exclusively with the intention to resell at a profit and the purchaser has no intention of holding the property for himself or otherwise enjoying or using it, the presence of such an intention is a relevant factor and unless it is offset by the presence of other factors, it would raise a strong presumption that the transaction is

an adventure in the nature of trade. It also cautioned that despite the said initiation and intention at the time of investment, there may be circumstances, which may result in an inference that the transaction was not an adventure in the nature of trade. The presumption drawn based on an intention is always a rebuttable one.

14. The above decision of the Apex Court was referred to subsequently in a decision of the Calcutta High Court reported in (1978) 113 ITR 483 (Commissioner of Income-Tax, West Bengal-II, Calcutta V. Central Kurkhend Coal Co. Ltd.) and (2001) 251 ITR 487 (Commissioner of Income-tax V. Malabar Building Products Ltd.). As far as the decision reported in (1978) 113 ITR 483 (Commissioner of Income-Tax, West Bengal-II, Calcutta V. Central Kurkhend Coal Co. Ltd.) is concerned, it related to a case of a company, which purchased shares-cum-dividend from another company belonging to the same group. The assessee earned high dividends. The purchase was effected in January, 1962 and the sale was effected in March, 1962, thereby the assessee incurred loss. On the question as to whether the loss was allowable as revenue loss, the Calcutta High Court referred to the decision reported in (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. Commissioner of Income-Tax) as well as to (1970) 77 ITR 253 (Raja Bahadur Kamakhya Narain Singh V. Commissioner of Income-tax) and held that the distinction between the two types of transactions is not always easy to make. If the transaction is in the ordinary line of assessee's business, there would hardly be any difficulty in concluding that it is a trading transaction, but where it is not, the facts must be properly assessed to discover whether it was in the nature of trade. In so holding, the Calcutta High Court also referred to the decision reported in (1951) 20 ITR 176 Radha Debi Jalan V. Commissioner of Income-tax), which is a case of an individual purchasing shares and then selling it. In answering the question, the Calcutta High Court considered the effect of an isolated transaction and to what extent such transaction could be held to be in the nature of business or trade. The Calcutta High Court held that when the person concerned in an isolated transaction from which he makes a profit is a man carrying on business in certain other lines, the task of deciding whether the transaction is or is not a trade, is comparatively an easier one than in the case of a person, who is not a

trader at all. Ultimately, the Calcutta High Court held that it is question of intention which has to be seen in the matter of considering the nature of trade.

15. In the decision reported in (2001) 251 ITR 487 (Commissioner of Income-tax Vs. Malabar Building Products Ltd.), the Kerala High Court also considered a similar question, but, however, after applying the decision reported in (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. CIT), the Kerala High Court rejected the Revenue's contention.

16. A reading of the decisions of the Privy Council, Supreme Court as well as the Calcutta High Court, point out that normally where a transaction is undertaken by a person who is a businessman, the question as to whether investment in shares is an income from the line of business could be taken as adventure in the nature of trade and it should not pose a problem, since such transactions would be either incidental or ancillary to the business, although the transactions undertaken may not have a direct bearing to the business already undertaken by the assessee. Yet, if the transactions have the characteristics of an adventure in the nature of trade, then, even it be an isolated transaction, inference cannot be otherwise against the assessee to hold that the transaction is not in the nature of trade. Thus, one cannot positively draw an inference from an isolated transaction that it could not be an adventure in the nature of trade. Secondly, as pointed out in the decision of the Privy Council, referred to supra, the assessment as regards the nature of transaction cannot rest on the results of the business. Even though the Revenue is concerned about the results of the business, yet, the manner and conduct of the business cannot certainly be the litmus test to decide on the nature of activity as to whether the purchase of shares is an investment or in the nature of a trade.

17. Going by the decision of the Apex Court that ultimately the intention and the circumstances alone have to have a bearing on the question as to whether the transaction is only of investment or in the

nature of trade, since the question as to whether the income earned as an income from investment or an income arising from a nature of adventure in the nature of trade has to rest on a finding of fact, particularly with reference to the intention of the party herein and the surrounding circumstances, in the absence of any such finding of the Tribunal, we feel, the proper course herein is to set aside the order of the Tribunal and remit the matter back for de novo consideration to find out whether the investments in mutual funds were in the course of the business or as adventure in the nature of trade or an investment simpliciter, to arrive at a finding as to whether the loss, in fact, could be treated as a business loss or not.

18. It may be pointed out herein that in the instruction issued by the CBDT in F.No.178/32/2033 ITA-1 dated 23.2.2004, the disallowance of the claim on the ground that the transactions were for tax avoidance or evasion, could be considered only after the in-depth investigation and proper recording and marshalling of all relevant facts, so as to establish the motive of tax avoidance.

19. The said instruction was extracted in the Tribunal's decision reported in (2005) 96 ITD 1 (Wallfort Shares & Stock Brokers Ltd. V. Income Tax Officer, Ward 4(2)(1)). The decision of the Tribunal was a subject matter of consideration by the High Court, Mumbai and ultimately taken to the Apex Court, which resulted in favour of the assessee vide decision reported in 326 ITR 1 (Commissioner of Income-Tax V. Walfort Share and Stock Brokers P. Ltd.)

20. In the light of the law declared in the decisions reported in 326 ITR 1 (Commissioner of Income-Tax V. Walfort Share and Stock Brokers P. Ltd.), (1965) 58 ITR 328 (Griffiths (Inspector of Taxes V. J.P.Harrison (Watford) Ltd.), (1959) 35 ITR 594 (G.Venkataswami Naidu & Co. V. Commissioner of

Income-Tax), (1978) 113 ITR 483 (Commissioner of Income-Tax, West Bengal-II, Calcutta V. Central Kurkhend Coal Co. Ltd.) and (2001) 251 ITR 487 (Commissioner of Income-tax V. Malabar Building Products Ltd.), we have no hesitation in setting aside the order of the Tribunal, thereby remanding the matter back to the Tribunal for proper enquiry into the facts of the case to arrive at a conclusion as to whether the assessee would be entitled to claim business loss to be set off against other business income. The Tax Case is disposed of accordingly. No costs.