

**IN THE HIGH COURT OF KARNATAKA AT BANGALORE**

DATED THIS THE 23RD DAY OF AUGUST 2012

PRESENT

**THE HON'BLE MR. JUSTICE K.SREEDHAR RAO**

AND

**THE HON'BLE MR. JUSTICE B.MANOHAR**

ITA No.1400/2006

BETWEEN :

1. THE COMMISSIONER OF INCOME TAX  
CENTRAL CIRCLE,  
C.R.BUILDINGS,  
QUEENS ROAD,  
BANGALORE
2. THE DEPUTY COMMISSIONER  
OF INCOME TAX  
CIRCLE-12(1)  
C.R.BUILDINGS,  
QUEENS ROAD,  
BANGALORE. ...APPELLANTS

(BY SRI.M.THIRUMALESH, ADV)

AND :

M/S.NADATUR HOLDINGS AND  
INVESTMENTS PVT LTD  
NG.406, II FLOOR  
8TH MAIN, 4TH BLOCK  
JAYANAGAR,  
BANGALORE. ...RESPONDENT

(BY SRI.K.S.RAMABHADHAN,ADV)

ITA FILED U/S.260A OF I.T.ACT, 1961 ARISING OUT OF ORDER DATED 17-03-2006 PASSED IN ITA NO. 871/BANG/2004 FOR THE ASSESSMENT YEAR 2000-01, PRAYING TO FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED THEREIN AND TO ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE ITAT, BANGALORE IN ITA NO.871/BANG/2004 DATED 17-03-2006 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER & CONFIRM THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, A CIRCLE-12(2), BANGALORE-1, IN THE INTEREST OF JUSTICE AND EQUITY.

THIS ITA HAVING BEEN HEARD AND RESERVED AND COMING ON FOR PRONOUNCEMENT OF JUDGEMENT THIS DAY, **B.MANOHAR J.**, MADE THE FOLLOWING:

#### JUDGMENT

Appeal by the Revenue under Section 260A of the Income Tax Act (in short 'the Act') being aggrieved by the order dated 17-03-2006 made in ITA No.871/Bang/2004 passed by the Income Tax Appellate Tribunal, Bangalore Bench-B dismissing the appeal and confirming the order dated 27-01-2004 made in ITA NO.143/C-12(1)/CIT(A)-III/2002-03 passed by the Commissioner of Income Tax (Appeals)-III, Bangalore (in short 'CIT (Appeals)) modifying the assessment order dated 24-02-2003 passed by the Assessing Authority for the assessment year 1999-2000.

2. The respondent-assessee is a company incorporated under the Companies Act, 1956. The returns of income for the assessment

year 1999-2000 was filed on 23-11-2000 showing the total income of Rs.6,41,54,692/- out of which, Rs.6,41,50,338/- as a long term capital gain and Rs.4,354/- towards business income. The return was accompanied by the audited balance sheet and profit and loss account. The case was processed u/s 143(1) of the Act. Subsequently, the case was selected for scrutiny, notice under Section 143(2) was issued. Pursuant to the notice, the authorised representative of the assessee appeared and produced some documents. It was contended that the assessee-company was incorporated on 16-02-2000 consisting of three share holders, Sri.N.S.Raghavan and his wife, Jamna Raghavan and their relative V.Sarangarajan, with a share capital of Rs.3,000/-. Each one of them is holding 100 shares of Rs.10/- each. Apart from the three shareholders, their family members, Sriram, Nadathur and Sri.Anand Nadathur are the Directors of the company. The main object of the company is disclosed in the Memorandum of Association and it is an investment company.

3. Two Directors of the Company, i.e. N.S.Raghavan and his wife Jamna Raghavan gifted 25000 shares of Infosys Technologies Limited, i.e. 12500 shares from each them who were originally holding the shares of M/s.Infosys System for a long time through a

separate Gift Deed dated 23-02-2000 which was accepted by V.Sarangarajan on behalf of the company. Out of that, 5000 shares were sold on 07-03-2000 and profits were earned. The balance 20000 shares were shown under the investment at the value of Rs.89,875 /-. By selling 5000 shares, the respondent-assessee earned the profit of Rs.6,41,54,690/-. Accordingly, the company has paid the tax on capital gain as applicable to the original donor as described under Section 49(1)(ii) of the Act.

4. The Assessing Authority doubted the transaction of gift stating that in a transaction of gift, the principal element is natural love and affection to the donee. The company is an artificial juridical person, which is identified by the owner's i.e., share holders who are themselves are the Directors of the Company, such love and affection to a artificial, juridical person is imaginary. Since the gift has been made by the Directors to the Company. In which they themselves are the shareholders, it amounts to gifting to oneself. Hence, the transaction held to be a not genuine transaction. Further held that immediately after the gift, the assessee has sold 5000 shares and earned income. Hence the main object of the company is to deal with the shares, stocks, etc., and the profit from the sale of shares should be assessed as business income. The Assessing

Officer by his order dated 24-2-2003 has assessed the same as income from profit and gain of business and issued demand notice for a sum of Rs.2,65,29,360/- including interest.

5. Being aggrieved by the order dated 24-2-2003 passed by the Assessing Officer the assessee preferred an appeal before the CIT (Appeals) interalia contending that the respondent-company is only an investment company and its intention is to buy, invest, acquire and hold the shares, stocks and debentures. For the purpose of purchase of shares, 5000 equity shares gifted by the Directors have been sold for Rs.6,41,50,690/-. It is only a long term capital gain, for which, income tax has been paid. The gift is in accordance with law and there is no bar for the Directors gifting their holdings in favour of the Company. The finding of the Assessing Authority that the gift is not genuine is totally contrary to law. Selling of shares was not the business of the respondent-company. The Appellate Authority after examining the matter in detail allowed the appeal in part, setting aside the order passed by the Assessing Authority and held that sale of 5000 shares has to be assessed under the head 'capital gain'.

6. The Revenue being aggrieved by the order passed by the CIT(Appeals) preferred an appeal before the Income Tax Appellate Tribunal. The Appellate Tribunal by its order dated 17-03-2006 dismissed the appeal confirming the order passed by the CIT (Appeals). The Revenue being aggrieved by the order passed by the authorities below preferred this appeal.

7. The appeal was admitted on 22-08-2007 to consider the following substantial questions of law:

- i) *Whether the Appellate Authorities were correct in holding that the profits earned by the assessee on the sale of 5000 shares of Rs.6,41,79,500/- should be assessed as 'income from capital gains' and not under the head 'income from business' when the assessee was carrying on the business in trading shares as is evident from the memorandum of association of the assessee-company.*
- ii) *Whether the Appellate Authorities committed an error in failing to take into consideration, that the assessee has sold 19500 shares during the subsequent assessment year which clearly demonstrates that the assessee was engaged in the business of trading shares."*

8. Sri.M.Thirumalesh, learned counsel appearing for the appellant contended that the order passed by the CIT (Appeals) is contrary to law. The main object of the Company is to deal with the shares and to buy, invest and acquire shares. Immediately after

incorporation of the Company, two Directors have gifted 25000 shares, out of which, 5000 shares have been sold and earned profit of Rs.6,41,79,500/- and balance 20000 shares have been shown as investment. In the returns filed by the assessee, the profit earned on sale of shares were disclosed as long term capital gain and the cost of acquisition of the shares is shown as **NIL**. The dominant intention of gift of equity shares of 25000 in favour of the assessee is to do business and to generate the funds. The gift made by the Directors of the company in which, they themselves are the shareholders amounts to making gift to oneself. Hence, the gift transaction was not a genuine one. Apart from that within a few days of gift, 5000 shares have been sold and realized Rs.6,41,79,500/-. Since the Company is involved in the shares business, the profit earned out of selling of 5000 shares has to be treated as stock-in-trade in the hands of the assessee. The profit arising from the sale of 5000 shares should be assessed as business income. In support of his case, he relied upon the judgment of Hon'ble Supreme Court in COMMISSIONER OF INCOME TAX, NAGPUR v/s SUTLEJ COTTON MILLS SUPPLY AGENCY LIMITED, reported in (1975)110 ITR 706 and relied upon the relevant paragraphs which reads as under:

*“It is not necessary to constitute trade that there should be a series of transaction, 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 transaction 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 a isolated although a similar transaction may have taken place a fairly long time before.”*

He contended that a single transaction constitute a trade. Hence, the amount realized from the sale of 5000 shares should be assessed as business income. The order passed by both the authorities below is contrary to law and sought for setting aside the same by allowing this appeal.

9. Sri.Sarangan, learned Senior Counsel appearing for the respondent contended that there is no infirmity or irregularity in the order passed by both the authorities below. The concurrent finding recorded by both the authorities below is purely a question of fact and the same is not liable to be interfered with by this Court. He further contended that as per the Memorandum of Association, the main object of the Company is to function as an investment company and to buy, invest, acquire and hold shares, stocks,

debentures and bonds. Two of the shareholders of the respondent-company gifted 25000 shares of M/s.Infosys Technologies Limited who are the founder Director of M/s.Infosys Technologies by two separate gift deeds and the same was accepted on behalf of the assessee-company. Out of that, 5000 shares were sold and the remaining 20000 shares have been invested in the Company. The profit earned by sale of shares was disclosed by the assessee as capital gain. The cost of acquisition of shares was treated as the cost at which the previous owner acquired the shares under Section 41(ii) of the Act. The respondent-company is not dealing with the shares business. The shares were treated as investment. He also relied upon some of the paragraphs in the judgment relied upon by the appellant and also in a judgment of the Hon'ble Supreme Court in DALHOUSIE INVESTMENT TRUST CO. LTD., v/s COMMISSIONER OF INCOME TAX (CENTRAL) CALCUTTA reported in (1967) 66 ITR 473 and contended that mere fact that an investment company periodically varies its investments does not necessarily mean that the profit resulting from such variation is taxable under the Income Tax Act and sought for dismissal of the appeal.

10. We have carefully considered the arguments addressed by the learned counsel for the parties.

11. It is not in dispute that the respondent-company was incorporated on 16-2-2000 with a share capital of Rs.3,000/- consisting of three shareholders. Two of the shareholders gifted 25000 shares of M/s. Infosys Technologies Limited as per the gift deed dated 23-2-2000. Out of 25000 shares, 5000 shares were sold on 7-3-2000 and realized a sum of Rs.6,41,79,500/-. The said amount has been assessed as business income by the Assessing Authority holding that the transaction of gift cannot be believed. The company being an artificial, juridical person cannot receive the gift. The gift made by the Directors of the Company, in which they themselves are the shareholders amounts to making gift to oneself. Hence, the gift transaction is not a genuine one.

12. The question that arose for consideration is whether the shares held by the company is a capital gain and the profit earned by the assessee on sale of 5000 shares should be assessed as an income from the capital gain or income from the business. To examine the said issue, the dominant intention of incorporation of the company has to be taken into consideration. As could be seen from the

Memorandum of Association, the main object of the company to be pursued by it on its incorporation is as under:

*(i) To function as an investment company and to buy, invest, acquire and hold shares, stocks, debenture, bonds, obligation and securities issued or guaranteed by companies constituted or carrying on business in India or elsewhere and debentures, bonds, obligations and securities issued or guaranteed by a Government, Public Body or Authority, Municipal, Local or otherwise Firm or person whether in India or elsewhere and to deal with and turn to account the same.*

To implement the objects of the company, two of the shareholders gifted 25000 shares of M/s.Infosys Technologies Limited. The said shares were shown as investment. Merely because the company has earned profits by selling some of the shares, that doesn't mean that the company is engaged in shares trading. There is no bar for gifting the equity shares to its company. As per the definition of gift, the gift means transfer by one person to another of existing moveable or immoveable property made voluntarily and without consideration and includes deemed transfer or conversion of any property. The company being a separate entity in law, the Shareholders of the company can gift their shares in favour of the company. We find nothing wrong in gifting the shares in favour of the company by its shareholders. Admittedly the company was incorporated on 16-2-

2000 and shares have been sold on 07-3-2000, the account was prepared for a limited period of one and half months for the assessment year 1999-2000. For the solitary sale of shares, it cannot be said that the assessee is doing the business in shares. The assessee-company is only an investment company to buy, invest, acquire and hold the shares, stocks and debentures. Hence, the solitary sale of shares cannot be said that the assessee is doing business in shares. The Hon'ble Supreme Court in a judgment in **Sutlej Cotton Mills'** case has held that " in the absence of any evidence of trading activity in cases of purchase and resale of shares, it has to be held that the 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 to hold that it is in the nature of trade. But, the difficulty arise 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". In the instant case, the assessee being an investment company has sold the shares with an intention to buy, invest, acquire and hold the shares.

13. The principles underlying the distinction between the capital gain and the business income were examined in G.VENKATASWAMY NAIDU AND COMPANY v/s COMMISSIONER OF INCOME TAX, reported in 35 ITR 594 (SC) wherein the Hon'ble Supreme Court has held

*“The character of transaction cannot be determined solely on application of any abstract Rule, principle of test 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 water of trade; but mere purchase/sale of a share – if that is all that is involved in a plunge – may fall short of anything in the nature of trade. Whether it is in the nature of trade will depend upon the facts and circumstances.*

*Where the purchase of any article or of any capital investment, for instance, share, is made with the intention to resale at profit, a resale under the changed circumstances would only be realization of capital and would not stamp the transaction with a business character.*

*Where a purchase is made with the intention of resale, it depends upon the conduct of assessee and circumstances of the case, whether the venture is a 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 to resale.*

*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 for the enhanced value motivated the investment.*

14. The Hon'ble Supreme Court has clearly held that an accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would raise value. The Hon'ble Supreme Court clearly held that the dominant or even sole intention to resale is a relevant factor and raises a strong presumption but by itself is not conclusive proof of an adventure in the nature of a trade. The issue raised in this appeal is covered by the Judgment of Supreme Court reported in Sulej Cotton Mills' case

15. In view of the judgment of the Hon'ble Supreme Court and facts and circumstances of the case, we hold that the solitary sale of shares by the assessee cannot be treated as trade or business in the shares. Insofar as second substantial question of law is concerned, if the respondent-company has alienated any shares gifted by its shareholders and dealing with the selling and purchasing of the shares, the authority can take action in accordance with law. The present issue is with regard to the assessment year 1999-2000 only and we are not dealing with the subsequent years. The appellant has not made out a case to interfere with the concurrent finding recorded

by the authorities below. Hence the substantial questions of law are held against the revenue. Accordingly, the appeal is dismissed.

Sd/-  
JUDGE

Sd/-  
JUDGE

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