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IN THE HIGH COURT OF DELHI AT NEW DELHI

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Date of Decision : 27th April, 2012.

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CIT

..... Appellant

Through Mr. Kamal Sawhney, sr. standing
counsel with Mr. Amit Shrivastava, Adv.

versus

VINAY MITTAL

..... Respondent

Through Mr. Ajay Vohra, Ms. Kavita Jha and
Mr. Somnath Shukla, Advs.

CORAM:

HON'BLE MR. JUSTICE SANJIV KHANNA

HON'BLE MR. JUSTICE R.V. EASWAR

SANJIV KHANNA,J: (ORAL)

We have heard counsel for the parties. We frame the following
substantial question of law :

“Whether the Income Tax Appellate Tribunal was right in
holding that the gains from sale and purchase of various
securities should be treated as long term capital gains or
short term capital gains and not business income?”

2. The respondent Vinay Mittal is an individual and for the
assessment year 2007-08 had filed his return of income on 31.10.2007

declaring total income of ₹6,00,62,080/-. Long term capital gains of ₹2,59,52,165/- which was claimed as exempt and this included short term capital gains of ₹5,53,32,591/- from sale and purchase of various securities.

3. The Assessing Officer held that the two amounts should be treated as business income and not income from capital gains and an addition of ₹8,12,84,756/- was made. The said addition was deleted by the first appellate authority and the Tribunal by the impugned order has affirmed the said deletion.

4. The appellant before us has filed a chart giving the details of the sale purchase transactions which are subject matter of the assessment year 2007-08. The chart reads as under :

Short Term Capital Gains

Sl. No.	Name of Company	No. of Shares	Purchase Price	Date of Purchase	Date of Sale	Months	Selling Price	Gains/Loss
1.	Amtek Auto	15000	4590887	02/09/2005	09/05/2005	8	5350247	759360
2.	Unitek	267500	29633058	28/04/2006	24/11/2006	7	81648641	52015583
3.	Zee Entertainment	24000	8363126			2.5	5761635	2601491
4.	WWTL	12000				4	1342946	1342946
5.	Zee News Ltd.	10850				11	402557	402557

6.	D.S.Kulkari	15000	2281543	06/09/2005	19/05/2006	8.5	4852211	2570668
7.	Ansal Property	47500	43271579	01/12/2006	09/02/2007	2.4	44114547	842968
	Total							55332591

Long Term Capital Gains

Sl. No.	Name of Company	No. of Shares	Purchase Price	Date of Purchase	Date of Sale	Years	Selling Price	Gains/Loss
1.	Kesoram Inds	9000	233100	2002-03	18/05/2006	4	2330053	2096953
2.	Neyveli Lignite	32100	1243923	13/11/2003	18/05/2006	2.5	2587356	1343433
3.	Welspun India	5405	425048	07/09/2003	18/05/2006	2.6	593543	168495
4.	Shaw Wallace	258619	5444612	21/01/2005	19/05/2006	1.5	5745539	300927
5.	Lumax Industries	53178	1409217	2002-03	22/05/2006	4	70594473	5650256
6.	Arvind Mills	30000	1637609	23/10/2003	09/05/2006	2.5	2878042	1240433
7.	Rico Auato	48920	2965417	09/07/2005	14/09/2006	1.2	3566727	601310
8.	Lumax Auto	26489	529780	2002-03	09/10/2006	4	1533396	1003616
9.	Mahindra Gesco	12590	2677277	10/08/2005	22/06/2006 (sic.)	1.1	10285855	7608578
10.	J.P. Associates	15000	416250	2002-03	09/09/2006	4.5	6354414	5938164

	Total							25952165
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5. During the course of hearing Id. counsel for the Revenue has stated that as far as long term capital gains is concerned the findings recorded by the CIT(Appeals) and the Tribunal are correct and Revenue cannot really contest the same. He however, submits that as far as short term capital gains is concerned, the Revenue is right as the assessee had earned substantial amount of ₹5,53,32,591/- and he has also drawn our attention to the findings recorded by the Assessing Officer, which are as under :

- a) The sole and exclusive purpose/motive of the assessee is to earn profit from sale and purchase of securities and not to earn dividend/interest income, as is evident from the fact that the assessee has earned profit of Rs.8,12,84,756/- and dividend of only Rs.36,63,100/- from its activity of sale and purchase of securities.
- b) The assessee is mainly dealing in shares in which always there is an element of risk or uncertainty is involved, which is a basic prerequisite to consider an activity to be in the nature of trade/adventure in the nature of trade.
- c) The holding period of most of the securities is usually very short.
- d) The Ratio of sales to purchases is 1.77 (18,64,07,182/10,51,22,426), again pointing that the

assessee is engaged in the business of sale and purchase of securities.

- e) The assessee is indulging in the sale and purchase of securities frequently and regularly during the F.Y. 2006-07.
- f) The scale of the activity of sale and purchase of securities by the assessee is substantial.”

6. Whether a person dealing with shares has made an investment or has treated them as stock-in-trade, has been the subject matter of considerable debate. It is a matter of intention of the assessee, which has to be gathered from his conduct and surrounding circumstances. Various parameter/criteria have been elucidated and explained. A pragmatic and common sense approach has to be adopted, when we determine and decide the question always keeping in mind commercial considerations.

7. The Assessing Officer in this regard referred to the circular issued by the Central Board of Direct Taxes through Instruction No.4/2007 dated 15.6.2007, which reads as under :

“Distinction between shares held as stock-in-trade and shares held as investment—Tests for such a distinction.

1. The Income-tax Act, 1961 makes a distinction between a “capital asset” and a “trading asset”.

2. Capital asset is defined in section 2(14) of the Act. Long-term capital assets and gains are dealt with under section 2(29A) and section 2(29B). Short-term capital assets and gains are dealt with under section 2(42A) and section 2(42B).

3. Trading asset is dealt with under section 28 of the Act.

4. The Central Board of Direct Taxes (CBDT) through Instruction No. 1827 dated August 31, 1989, had brought to the notice of the Assessing Officers that there is a distinction between shares held as investment (capital asset) and shares held as stock-in-trade (trading asset). In the light of a number of judicial decisions pronounced after the issue of the above instructions, it is proposed to update the above instructions for the information of the assesseees as well as for guidance of the Assessing Officers.

5. In the case of CIT (Central), Calcutta v. Associated Industrial Development Co. (P) Ltd. [1971] 82 ITR 586, the Supreme Court observed that :

“Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the shares and it should, in normal circumstances, be in a position to produce evidence from his records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment.”

6. In the case of CIT, Bombay v. H. Holck Larsen [1986] 160 ITR 67, the Supreme Court observed :

“The High Court, in our opinion, made a mistake in observing whether transactions of sale and purchase of shares were trading transactions or whether these were in the nature of investment was a question of law. This was a mixed question of law and fact.”

7. The principles laid down by the Supreme Court in the above two cases afford adequate guidance to the Assessing Officers.

8. 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 purchases 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 transaction ;

(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”.

9. 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 and 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”.

10. CBDT also wishes to emphasise that it is possible for a tax payer 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. Where an assessee has two portfolios, the assessee may have income under both heads, i.e., capital gains as well as business income.

11. The Assessing Officers are advised that the above principles should guide them in determining whether, in a given case, the shares are held by the assessee as investment (and therefore giving rise to capital gains) or as stock-in-trade (and therefore giving rise to business profits). The Assessing Officers are 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.

12. These instructions shall supplement the earlier Instruction No. 1827 dated August 31, 1989-Circular No.4/2007, dated 15-6-2007.”

8. In *Commissioner of Income Tax Vs. Rewashanker A. Kothari* (2006) 283 ITR 338, the Gujarat High Court, after considering its earlier decision in the case of *Pari Mangaldas Girdhardas Vs. CIT* (1977) 6 CTR 647 (Guj.), has formulated the following tests to determine whether the assessee can be said to be carrying on business of sale and purchase of various securities or holding them as an investment. The tests are as under:

“(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 applied 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, frequency, 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.”

9. In the present case, the assessee is an employee and is in service of a company. He has salaried income. The assessee had also made purchases and had sold securities. He is maintaining two separate portfolios i.e. investment portfolio and trading portfolio. The Assessing Officer has admitted the said position in the assessment order. It is pointed out that the shares in question which are subject matter of short term capital gains form part of the investment portfolio and were not part of the trading portfolio. We are not concerned with the trading portfolio in the present case as profits and gains from the trading portfolio have to be treated as business income/loss. As far as seven shares/transactions subject matter of short term capital gains are concerned it is noticeable that in four cases, the shares were held for a period of more than 7 months, 8 months, 8.5 months and 11 months. In three cases shares were held for 2.4 months, 2.5 months and 4 months. Quantum or total number shares is substantial but the transactions in question are only seven in number and the period of

holding as mentioned above cannot be treated as insignificant and small. Quantum or total number may not be determinative but in a given case keeping in view period of holding may indicate intention to make investment. The Tribunal applying the aforesaid tests in the present case has accepted the position of the assessee that these shares which are subject matter of short term capital gains were rightly held by the assessee and treated by the assessee an investment portfolio and not a trading portfolio. We also notice that the Tribunal has mentioned that the assessee has received substantial dividend income of more than ₹19 lakhs and ₹27 lakhs in the assessment year 2005-06 and 2006-07. The Assessing Officer as noticed above was influenced to a large extent of the fact that the assessee had earned huge profits during the year in question from the sale of the said shares. This can happen even in case of investment portfolio because when investment is liquidated to earn gains and change their portfolio. Element of uncertainty and risk is always there when a person deals in securities but this factor cannot be determinative factor whether the assessee is trading in shares or is an investor. Some investors do take risk. The Assessing Officer has recorded that during the financial year 2006-07, the assessee had indulged in frequent and regular trade in securities. The Assessing Officer did not refer to and specifically dealt with the transactions in question though the chart and the figures noted above

in this order were available and on record at the time of original assessment. He has not mentioned whether the assessee had indulged in frequent transactions in the previous period or subsequently. Merely because the assessee had sold the said shares in the relevant year and made substantial gains and could not show basically the objective for acquiring the shares was not as an investor but as a trade. The ratio of sales and purchase may be relevant in a particular case but when an assessee liquidates any investment, the said ratio will always be in favour of sales.

10. The Tribunal in the facts of the present case has examined and correctly applied test/criteria, which has to be applied. We may note that in the earlier assessment years, transactions in the investment portfolio by the assessee were accepted by the Assessing Officer.

11. In view of the aforesaid position we answer the question of law mentioned above in negative i.e. in favour of the assessee and against the Revenue. No costs.

SANJIV KHANNA, J.

R.V.EASWAR, J.

APRIL 27, 2012

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