*   THE HIGH COURT OF DELHI AT NEW DELHI

Judgment Reserved on: 8th September, 2010

%   Judgment Pronounced on: 18th October, 2010

\+ **ITA No.306/2010**

COMMISSIONER OF INCOME TAX ..... Appellant

Through: Ms. Sonia Mathur, Adv.

versus

PNB FINANCE & INDUSTRIES LTD. ..... Respondent

Through: Ms. Kavita Jha and Ms. Akanksha Aggarwal, Advs.

CORAM:
HON'BLE THE CHIEF JUSTICE
HON'BLE MR. JUSTICE MANMOHAN

1. Whether reporters of the local papers be allowed to see the judgment? Yes
2. To be referred to the Reporter or not? Yes
3. Whether the judgment should be reported in the Digest? Yes

DIPAK MISRA, CJ

In this appeal preferred under Section 260A of the Income Tax Act, 1961 (for brevity 'the Act'), the revenue, calling in question the legal substantiality of the order dated 17th December, 2008 in ITA No.3640/Del/2007 pertaining to the assessment year 2003-04 passed by the Income Tax Appellate Tribunal, Delhi Bench 'F' (for short `the tribunal'), has sought to raise the following substantial questions of law:-

(a) Whether on the facts of the present case, the ITAT was justified in law in holding that the income earned by the assessee from sale of shares and securities was liable to be assessed as income from business as against long term capital gain declared by the assessee?

(b) Whether if answer to the above question is in favour of Revenue, whether the Tribunal was justified in deleting the addition of Rs.2,65,77,430/- made by the Assessing Officer by disallowing set off of income against long term capital loss of earlier year?

(c) Whether in the context of facts of the present case, the Tribunal has correctly interpreted the principle of law laid down by the Hon'ble Apex Court in the judgments relied upon?

(d) Whether the order passed by the ITAT is vitiated by perversity on account of non-application of mind to the specific observations made by the Assessing Authority?

2. The basic facts which are requisite to be stated for adjudication of this appeal are that the assessee-respondent is a company engaged in the business of sale and purchase of shares. It filed its return declaring an income of Rs.60,05,375/- in which it included short term capital gain at Rs.38,476/- and long term capital gain at NIL after set-off of long term capital loss of previous years amounting to Rs.2,08,24,174/-. The return was processed under Section 143(1) of the Act. Thereafter, the case was selected for scrutiny and a notice under Section 143(2) of the Act was issued. In the course of assessment proceedings, the assessing officer observed that in computation of the income filed, the assessee had shown long term capital gain at Rs.2,08,24,174/-which had been set off against the long term capital loss of the assessment year 1995-96 amounting to Rs.2,02,45,035/- and of the assessment year 1996-97 at Rs.5,79,139/-. On a query being raised by the assessing officer as to why sale of investment be not treated as business or trading receipts as the assessee is an investment company having main

business of purchase and sale of shares, it was submitted by the assessee that it was registered as an investment and finance company having its main activity of investing its funds in long term securities like shares, debt and equity mutual funds, etc for generating dividend, interest and profit and loss on sale of investments and all the investments of the company are of long term nature and had not been held as stock-in-trade since the financial year 1999-2000 in which year all the investments held as stock-in-trade were transferred to the investment portfolio. It was contended on behalf of the assessee that the said practice of taking all its securities under the investment head had since then been followed and the revenue had never raised any query on that score. The assessing officer perused the clarification given by the assessee, referred to the Memorandum of Association and the decisions rendered in ***CIT V. Sutlej Cotton Mills Supply Agency Ltd**, **(1975) 100 ITR 706 (SC)**, **Raja Bahadur Visheshwar Singh v. CIT**, **(1961) 41 ITR 685 (SC)**, **Dalhousie Investment Trust Co. Ltd. v. CIT**, **(1968) 68 ITR 486 (SC)**, **Fidelity Advisor Series VIII**, **271 ITR 1*** and came to hold as follows:-

> "In view of the above the income from the transactions of sale and purchase of shares was business income of the assessee company and were in fact purchased not for investment purposes but for the purpose of sale at a profit are liable to be taxed under the head business income and not under the head capital gain as declared by the assessee company."

On the basis of aforesaid reasoning, the assessing officer assessed the tax at Rs.3,25,82,805/- and initiated penalty proceedings under Section 271(1)(c)and directed charge of interest under Section 234B/234D accordingly.

3. Being dissatisfied with the aforesaid order, the assessee preferred an appeal before the CIT(A). It was contended before the first appellate authority that the assessee company was incorporated on 19th May, 1894 under the Companies Act and the 'Objects Clause' of the Memorandum of Association has a large number of objects and not one of these objects could be said to be the principal object of the company. It was put forth that the company was not trading in shares in the year under consideration but, in fact, the company discontinued purchase and sale of shares in the said instruments many years ago and after 31st March, 1996, there had been no purchase of shares as stock-in-trade of the company. The company invested in the Times Bank Ltd., as a long term investment, a sum of Rs.100.35 lakhs in the year 1996 and Rs.201.15 lakhs in the year 1997 and, therefore, the said investment in the Times Bank Ltd are long term investments as per the resolution of the Board. On 5th May, 2000, the Times Bank Ltd got merged with HDFC Bank and in lieu of 30 lakhs equality shares of Times Bank Ltd held by the company, it received 5,21,739 converted equity shares of HDFC bank after the merger. The company adopted a policy of liquidating its equity investments and buying debt mutual funds and the said action of the company would clearly reflect that the company is not a trader in equity shares and it is doing no business of buying and selling of shares. It was set forth that after 1st April, 1997, no purchase of any equity shares had taken place except the management shares of the group companies. The shares were purchased on 27th January, 1996 and had been held for a period of

more than 7 years and, therefore, it is to be treated as long term capital gain under Section 2(42A) of the Act.

4. It is worth noting that various facts that were highlighted before the first appellate authority to establish that the investment was long term capital asset are : that the company had purchased Times Bank shares which were later converted into HDFC shares on amalgamation as long term investment vide resolution passed by the company; that the assessee-company from the year of purchase, i.e., the financial year 1995-96 –assessment year 1996-97 had classified the investment under the head 'investments-long term' and the classification as per the audited balance sheet and books of accounts would go a long way to show that it is a long term investment; that the company in the year under consideration had sold 89,996 shares and had a balance of 4,31,743 shares as balance shares and the company continued to hold the said shares as on date and earned dividends on the same; that the company had earned handsome dividends from the investment in HDFC Bank and the same have been declared and assessed by the assessing officer even during the year under consideration; that the company had not borrowed any amount and the investments were made in the year 1996 and hence, it is not a business where large amounts of monies are borrowed for investment in stock-in-trade and sale thereof; that as per the balance sheet, no purchase of equity shares had taken place in the year under consideration and all holdings remain the same except for the sale of 89,996 shares; that there has been no activity of purchase and sale of shares for the purpose of profit whatsoever and whenever shares have been purchased in group companies,

the same was for the purpose of long term investment and hence, the entire profit is capital gain on sale of long term investment and that in the year under consideration, the ratio of long term investment in shares to debentures, bonds, mutual funds and similar other debt instruments is 27.27%, i.e., the majority of the investment is in instruments other than equity instruments and the same would show that the assessee is not a dealer in shares; that the accounts of the company had not been rejected in the assessment year and there is no material to show that the assessee at any point of time indulged in trading of these shares and stocks in the year under consideration; that the order passed by the assessing officer is vulnerable inasmuch as he, at one place, opined that the Memorandum of Association is not the sale indicator while, on the other hand, relied on the same for the purpose of adjudication; that the Memorandum of Association has not been appositely appreciated which has made the order of the assessing officer indefensible; that incorporation of clause relating to investment in shares in the Memorandum of Association does not clothe the company with the characteristics of dealer in shares unless other circumstances like activities of the company are proved; that whether the assessee had invested in a long term investment or was dealing with shares would always depend upon facts; that on similar transactions of sale and long term investment in previous years, the assessing officer had himself accepted the same to be in the nature of long term assets giving rise to long term loss or profit; and, therefore, acceptance of the classification year after year is a strong factor in favour of the assessee though the doctrine of res judicata may not strictly apply.

5. The first appellate authority, on consideration of the submissions raised by the assessee, came to hold that the assessee company was not engaged in the trading of shares in the year under consideration as the said activity was discontinued several years ago as is evident from the fact that after 31st March, 1996, the assessee had not engaged in the purchase of shares; that the said submission gets supported from the fact that the assessee-company invested in the Times Bank Ltd (now HDFC Bank) a sum of Rs.100.35 lakhs as a long term investment in the year 1996 and further sum of Rs.201.15 lakhs in the year 1997; that there is no dispute that the assessee is not a trader in equity shares and no business of buying and selling of shares had been carried on after 1st April, 1997; that apart from the shares of HDFC Bank, all others are debt mutual funds which have been sold by the assessee during the year; that the assessee is not a dealer in the debt mutual funds and, therefore, the same is to be treated as short term capital gain to be assessed under the head 'Capital Gains' as far as the said aspect is concerned; that as regard the sale of shares of HDFC Bank, the said shares were purchased on 27th January, 1996 and had been held for a period of more than 7 years before being sold during the year under consideration and the Board resolution clearly shows that the shares when purchased were treated as the company's investment and they have been classified under the head 'Investment-Long Term' in the audited balance sheets from the year of purchase upto the year under consideration and, therefore, the sale of shares

of HDFC Bank during the year cannot be treated as business activity of trading in shares, since such a decision should be based on the consideration of facts as a whole and not merely one clause which finds mention in the Memorandum of Association; that the entire gamut of facts reveal that the assessee company did not engage in any purchase and sale of shares and, therefore, the very intention of investment in these shares was for long term investment purposes.

6. Being of the aforesaid view, the CIT(A) came to hold that the profit arising on the sale of shares has to be treated as long term capital gains and, accordingly, the addition of Rs.2,65,77,430/- was deleted and the assessing officer was directed to recompute the total income of the assessee company by treating the profit on sale of shares as long term capital gains.

7. Being grieved by the aforesaid order, the revenue preferred an appeal before the tribunal. There were two appeals being ITA No.3640/Del/2007 and ITA 2872. The ITA 3640 dealt with the assessment year 2003-04 where the question arose whether the first appellate authority had acted appropriately in deleting the addition of Rs.2,65,77,430/- made by the assessing officer on account of treatment of capital gains on sale of shares as profits and gains of business. The tribunal, after referring to the submissions of the parties, came to hold as follows:-

> "We find that the Assessing Officer in the present case has assessed the income in question as income from business on the basis of the object clause of Memorandum of Association of the assessee company as per which the assessee can deal in shares. The Assessing Officer has placed reliance on various judgments but as per para No.3 and 3.2 of his order, Ld CIT(A) has noted that all these judgments are distinguishable. Ld DR of the

> revenue could not point out any defect in this finding of Ld CIT(A). In para No.3 and 3.1, a clear finding is given by Ld CIT(A) that the shares in question were sold by the assessee in the present year being shares of HDFC Bank were purchased by the assessee on 27.1.1996 and have been held for a period of more than seven years before being sold during the year under consideration. In para No.3.3 of his order, it is also noted by Ld CIT(A) that the assessee has no business of buying and selling of shares after 1.4.1997. It is also noted by Ld CIT(A) in para No.3.3 of his order that apart from the shares of HDFC Bank, all others are debt mutual funds which have been sold by the assessee during the year and on the basis of these facts, a clear finding is given by Ld CIT(A) that the assessee is not a dealer in the debt mutual fund and therefore income arising on sale of these investments are to be assessed as short term capital gain and income arising on sale of shares of HDFC bank is assessable under the head long term capital gains. While deciding this issue, Ld CIT(A) has followed the judgment of Hon'ble Apex Court rendered in the case of Madan Gopal Radhey Lal (supra) and in the case of Schedule Investment Co. Ltd. (supra). Considering all these facts of the present case, we find no reason to interfere in the order of Ld CIT(A) because neither the Assessing Officer nor the Ld DR of the revenue, could bring anything on record to show that the assessee was engaged in the business of purchase and sale of shares on regular basis and hence merely because as per the object clause of the Memorandum of Association, the assessee can deal in shares, it cannot be held that any transaction by the assessee for purchase of shares or for sale of shares, purchased in earlier years is a business transaction."

8. We have heard Ms. Sonia Mathur, learned counsel for the appellant, and Ms. Kavita Jha and Ms.Akaknsha Aggarwal, learned counsel for the respondent.

9. The question that emerges for consideration is whether in the obtaining factual matrix, it should be construed that the assessee was a dealer in shares or regard being had to the nature of investment, it is to be construed that the said security constitutes an investment for the purpose of gaining the status of long term capital gain. In this context, we may refer to

a passage from the decision in ***Commissioner of Income Tax, U.P v. Madan Gopal Radhey Lal, [1969] 73 ITR 652 (SC)*** :

> "A trader may acquire a commodity in which he is dealing for his own purposes, and hold it apart from the stock-in-trade of his business. There is no presumption that every acquisition by a dealer in a particular commodity is acquisition for the purpose of his business; <u>in each case the question is one of intention to be gathered from the evidence of conduct and dealings by the acquirer with the commodity</u>."
>
> [Emphasis supplied]

10. In this regard, it is profitable to refer to the decision in ***Vijaya Bank Ltd. v. Additional Commissioner of Income-tax, Bangalore, AIR 1991 SC 239*** wherein the Apex Court was dealing with the fact situation where the assessee, a banking company, had received certain amounts on securities purchased from another banking company as well as in the open market. The two amounts were brought to tax by the assessing officer despite the assertion of the assessee that the same were deductible. The order of the assessing officer was confirmed by the first appellate authority but the tribunal held that the interest earned from the securities was deductible under Sections 19, 20 and 37 of the Act. The High Court, on a reference, observed that the amount expended by the assessee for the purchase of securities were in the nature of capital outlay and they could not be set off as expenditure against income accruing on the securities. In that context, their Lordships have held thus: -

> "In the instant case, the assessee purchased securities. It is contended that the price paid for the securities was determined with reference to their actual value as well as the interest which had accrued on them till the date of purchase. <u>But the fact is, whatever was the consideration which prompted the assessee to</u>

> purchase the securities, the price paid for them was in the nature of a capital outlay, and no part of it can be set off as expenditure against income accruing on those securities. Subsequently when these securities yielded income by way of interest, such income was attracted by Section 18.
>
> Claim for deduction can be sustained only when the assessee is in a position to show that any reasonable expenditure had been incurred for the purpose of realising the interest on securities. The amounts claimed by the assessee for deduction are not shown to have been expended for the purpose of realising the interest, and are therefore not allowable as deductible expenditure."
>
> [Emphasis added]

11. In ***Commissioner of Income Tax v. N.S.S. Investments (P) Ltd., [2005] 277 ITR 149 (Madras)***, the question that was referred to was whether on the facts and in the circumstances of the case, the appellate tribunal is right in law in holding that the profit on sale of shares is to be treated as capital gains instead of business income. The Bench referred to paragraph 15 of the order of the tribunal and expressed the view as follows: -

> "The finding of fact recorded in para 15 of the order of the Tribunal is that the shares in question were never treated by the assessee as stock-in-trade and they were held for earning dividend only. A company can hold some shares as stock-in-trade for the purpose of doing business of buying and sale of such shares, while at the same time it can also hold some other shares as its capital for the purpose of earning dividend income. Here the shares in question were held as the assessee's capital and not as stock-in-trade. Hence, there would be capital gain and not business income. Hence, we answer the question referred in the affirmative i.e., in favour of the assessee and against the Department."

12. In ***Commissioner of Income Tax v. Gulmohar Finance Ltd., [2008] 170 Taxman 483 (Delhi)***, this Court was dealing with the issue whether the shares held as an investment of the assessee and profit earned by the

assessee on the sale of the shares should be treated as capital gains or as a business income. In that context, the Bench has held thus: -

> "It was noted by the Tribunal that in earlier assessment years, the assessee had shown the shares held in BT Tech Net Ltd. as investment right from the date of purchase and this was shown as such in the balance sheet of the assessee, which was filed along with the return of income. No objection was taken to this position in the earlier years. However, the Commissioner has now decided that it was not an investment without there being any change in facts and therefore, the Tribunal held that there was no occasion for the Commissioner to take a contrary view than what was disclosed and accepted on earlier occasions.
>
> Even on merits, the Tribunal came to the conclusion that the shares held by the assessee in BT Tech Net Ltd were an investment and therefore, any profit earned on the sale thereof is required to be treated as capital gains. Whether the shares were held by the assessee as an investment or stock-in-trade is a matter of fact and we do not find any perversity in the view taken by the Tribunal that the shares were held as an investment."

13. At this juncture, we may refer with profit to the Circular issued by the Central Board of Direct Taxes (CBDT) on 15th June, 2007. In the said circular, the CBDT dealt with the shares held as stock-in-trade and investments and what should be the test for such a distinction. The Board referred to the decisions in ***Commissioner of Income-tax (Central, Calcutta v. Associated Industrial Development Co. (P) Ltd., [1971] 82 ITR 586 (SC)*** and ***Commissioner of Income-tax, Bombay v. H. Holck Larsen, [1986] 160 ITR 67 (SC)***, the ***Authority for Advance Rulings (AAR) (288 ITR 641)*** and after reproducing certain passages therefrom, gave the following guidelines:

> "10. CBDT also wishes to emphasise that it is possible for a 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. Where an assessee has two portfolios, the assessee

may have income under both heads, i.e., capital gains as well as business income.

11. 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."

14. The present factual scenario is to be tested on the anvil of the above principles. In the case at hand, the assessee had purchased the shares on 27th January, 1996 and the same were held for a span of 7 years and were sold during the year under consideration. The assessee had not involved himself in the business of buying and selling shares after 1st April, 1997. The assessee had not engaged himself as a dealer in debt mutual funds. Nothing has been brought on record to show that the assessee was engaged in the selling of shares. The object incorporated in the Memorandum of Association only refers to the fact that the assessee can deal with shares but, there was no regular activity on that score. The nature of activity, intention and conduct has significance. They play a pivotal role in the entire gamut of transaction. As per the circular issued by the CBDT, a tax payer can have two portfolios, that is, 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. The assessee is entitled to have income from both heads, namely, capital gains as well as business income. On a proper scanning of the facts that have been brought

on record, there can be no iota of doubt that the shares that was made by the assessee as an investment gave rise to capital gains. Therefore, the concept of business income does not arise and hence, we are inclined to think that the findings recorded by the first appellate authority as well as by the tribunal stand on terra firma.

15. In view of our preceding analysis, we do not perceive any merit in this appeal and, accordingly, the same stands dismissed without any order as to costs.

CHIEF JUSTICE

MANMOHAN, J.

OCTOBER 18, 2010
vk/kapil