

IN THE INCOME TAX APPELLATE TRIBUNAL

HYDERABAD BENCH 'A', HYDERABAD

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER

AND SHRI SAKTIJIT DEY, JUDICIAL MEMBER

ITA No.163/Hyd/2011 : Assessment year 2007-08

Asst. Commissioner of Income-
tax Circle 10(1), Hyderabad V/s. Shri Anil Kumar Jain,
Secunderabad

(PAN - AALPJ 7273 K)

(Appellant)

(Respondent)

ITA No.164/Hyd/2011 : Assessment year 2007-08

Asst. Commissioner of Income-
tax Circle 10(1), Hyderabad V/s. Shri Rupender Kumar Jain,
Secunderabad

(PAN - AALPJ 7016 Q)

(Appellant)

(Respondent)

Appellant by : Smt. Nivedita Biswas

Department by : Shri A.V.Raghuram

Date of Hearing	23.8.2012
Date of Pronouncement	28.9.2012

ORDER

Per Chandra Poojari, Accountant Member:

These two appeals filed by the Revenue are directed against similar but separate orders of the CIT(A)-VI, Hyderabad dated 29.10.2010 for the assessment year 2007-08. Since only a common issue is involved, these appeals are being disposed off with this common order for the sake of convenience.

2. The only issue involved in these appeals is with regard to the direction of the CIT(A) to treat the income on sale of shares as capital gains.
3. The facts involved in both these case are similar. Hence, we may note in detail the facts relating to Shri Anil Kumar Jain, and based on the same, proceed to dispose off these appeals, in common.
4. Assessee Shri Anil Kumar Jain, an individual, filed return of income on 20.2.2008 admitting an income of Rs.1,35,83,637, consisting of share of profit from partnership firm, salary income, short term capital gains and income from other sources like interest, dividend, etc. The assessing officer while completing the assessment, treated the income of the assessee arising out of sale of shares as business income, rejecting the assessee's claim for taxing the same as short term capital gains. Against this finding of the assessing officer, assessee went in appeal before the CIT(A), who gave a finding that the income arising out of sale of shares has to be considered as income from short term capital gains, and thus allowed the appeal of the assessee.
5. Aggrieved by the above findings of the CIT(A), which are similar even in the order of the first appellate authority impugned in the appeal concerning Shri Rupender Jain as well, Revenue preferred the present appeals before us.
6. Learned Departmental Representative submitted that the assesseees' have been carrying on the business in shares continuously in a systematic manner and there is high volume of business. Some shares on regular basis. Being so, it has to be considered as business activity of the assessee. The treatment given by the assesseees in their books of account

cannot be considered as conclusive for determining the real intention of the assessee has to be seen to find out whether it is business activity or investment activity. He also that the assessee has consistently engaged themselves in the business of buying and selling of shares and therefore, it cannot be said that the assessee has only made investments in shares and have not carried any business. He relied on the decision of the Tribunal in the case of M/s. Spectra Shares and Scrips Hyderabad in ITA No748/Hyd/2011 for the assessment year 2006-07 dated 5th August, 2011 (62 DTR 41 = 142 TTJ 483(Hyd)), wherein it has been held as under-

“Assessee company, having carried on the activity of buying and selling of shares in a systematic and regular manner with high frequency and volumes, repetitive purchases and sales of the same scrips throughout the year, it has to be held that it was engaged in trading in shares to earn profits and not buying shares for the purpose of investments and, therefore, income earned by the assessee falls under the head ‘profit and gains of business or profession’ and not ‘capital gains’.”

7. On the other hand, the learned Authorised Representative for the assessee, reiterating the contentions urged before the lower authorities, strongly supported the order of the CIT(A). He submitted that the assessing officer was not justified in treating the short term capital gains derived by the assessee on sale of shares as business profits. He submitted that frequency in transactions and high volume does not alter the nature of income from short term capital gains into income from business. In this behalf, reliance is placed on the decision of the Mumbai Bench of the Tribunal in the case of Janak Rangwala (11 SOT 627). He further submitted that there is no intra-day trading in shares, as the sales were made from out of the earlier purchases only. In support of this contention, he invited our attention to the tabulation furnished before the CIT(A), which has been extracted by the CIT(A) on pages 12 and 13 of the impugned order. He submitted that the assessing

officer misunderstood the meaning of day trading, as the assessee never purchased the shares on a particular day and sold the same on the same day. Learned Authorised Representative disputing the findings of the assessing officer further submitted that after the demat procedure has set in, the question of the assessee's taking over physical delivery of shares does not arise, as the shares stand automatically credited into the demat account of the assessee, the moment they are purchased. It was pointed out that the assessing officer took demat account as base for recording the purchase and sale transactions which is not correct, as instead, he should have taken the contract note which gives the details of actual purchase and sale. It was stated by the assessee that the chart was prepared by the assessing officer from the demat account only which shows that the assessee did not indulge in day trading where the delivery of the purchases is credited and sale is debited. He further submitted that the investment in shares at the end of the year is valued at purchase price only and not at cost or market value as it is in the case of stock in trade. The assessee recorded in the balance sheet on the asset side the purchase of shares as investment and never held the shares as stock in trade. It was further submitted that in respect of shares, the maximum period of holding is 12 months from the date of purchase for the purpose of short term capital gains. There is no minimum period for holding shares specified in the Act. He further submitted that the assessing officer has committed many arithmetic mistakes, while preparing the chart from the Demat account. He also distinguished the decision of the Apex Court in the case of Juggilal Kamalpath V/s. CIT(75 ITR 186) relied upon by the assessing officer in the impugned assessment order. With these submissions, the learned Authorised Representative for the assessee strongly supported the orders of the CIT(A) and submitted that the same may be confirmed. Further, the learned Authorised Representative relied on the order and judgment of the Gujarat High Court dated 27.6.2012, in the case of

CIT V/s. Vaibhav J. Shah (HUF) (Tax Appeal No.77 of 2010 with Tax Appeal No.78 of 2010), duly filing a copy thereof before us, wherein the Hon'ble Gujarat High Court has held as follows-

"9. In view of the aforesaid decisions of the Apex Court as well as this Court, it is clear that where number of transactions of sale and purchase of shares takes place, the most important test is the volume, frequency, continuity and regularity of transactions of purchase and sale of shares. However, where there is repetition and continuity, coupled with magnitude of the transactions, bearing reasonable proportion to the strength of holding, then an inference can be drawn that activity is in the nature of business. Learned counsel for the revenue from the records could not demonstrate that there were large number of transactions which had frequency, volume, continuity and regularity and fell within the tests laid down by the division Bench of this Court.

10. For the aforesaid reasons, we are of the considered opinion that the income earned by the assessee from trading in the shares under the head long term capital gains/short term capital gain was correctly shown."

He also placed reliance on the judgement of Bombay High Court in the case of CIT vs. Gopal Purohit (336 ITR 287) (228 CTR 582) (Bom). Further, the Learned counsel for the assessee has also placed reliance on the circular of the CBDT No.4/2007 dated 15.6.2007, which reads as follows-

"INCOME TAX CIRCULAR NO. 4/2007, DATED 15-6-2007

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 assesseees as well as for guidance of the assessing officers.

5. In the case of Commissioner of Income Tax (Central), Calcutta Vs Associated Industrial Development Company (P) Ltd (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 its 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 Commissioner of Income Tax, Bombay Vs H. Holck Larsen (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 accounts, 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. 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.

(F.No.149/287/2005-TPL)”

8. We heard both the parties and perused materials on record. The contention of the assessee is that it always treated the shares as investment, and there is no business activity whatsoever carried on by the assessee with reference to shares.

10. Now the question before us is not whether the assessee have carried on the investment activity or business activity. On the other hand, the question is when the assessee classified the shares in

the books as investments, whether really they are 'investment' or 'stock in trade'. One of the relevant tests for determining whether it is in the nature of fixed asset or constitutes stock in trade of the assessee's business. Fixed asset is what the owner turns to profit keeping the asset in his own possession, stock in trade is what he makes profit of by parting with it and letting it change masters. If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital. If, on the other hand, it is made not for running the business of working it with a view to produce profits it is relatable to stock in trade. In determining the question whether after acquiring the shares, the assessee dealt with it as an investor or carried on business with it treating it as its stock-in trade or as a trading asset, what is relevant is that, if the case falls within the former category, receipts by way of sale of such shares will be capital receipts but if it falls within the latter the receipts will be trading receipts and profits therefrom business income. The intention with which such operation is carried on is relevant. If a owner of an investment realizes it and obtained a greater price for it than the price at which he originally acquired, if the enhanced value obtained from the realisation or conversion of securities may be profit from business. The distinction whether the investment transaction is a mere realization of the investment or an act done for making profit depends on the question whether excess was an enhancement of the value for realising the shares by a gain in an operation of making profit. If the transaction is in the ordinarily lien of the assessee's business, there would hardly be any difficulty in concluding it to be a trading transaction, but where it is not, the fact must be properly assessed to determine whether it is in the nature of trade. The surplus realized on the sale of share would

be capital, if the assessee an ordinary investor realising his holding, but it would be revenue if he deals with them as a trader. If the assessee is an ordinary investor, the income arising out of sale of shares is capital gain. On the other hand, if he trades in shares in regular manner, it is income from business. If an individual invests in shares for the purposes of earning dividend, he is not carrying on a business. If the assessee is holding shares as investment and sold it due to change of circumstances and earns profits, that profit is nothing but capital gain. Whether a purchase is made with an intention of resale and gain to earn profit, such income has to be treated as income from business.

11. While deciding whether the sale of shares is income from business or income from capital gain, one has to go by the following criteria, as held by the jurisdictional High Court in the case of P.V.S.Raju & Anr. V/s. Addl. Commissioner of Income-tax (340 ITR 75)-AP.-

- (a) The frequency of buying and selling of shares by the appellants were high;
- (b) The period of holding was less;
- (c) The quantum of turnover was on account of frequency of transactions, and not because of huge investment;
- (d) The intention of the assessee to make quick profits on a huge turnover;
- (e) No. of scrips shares held for fewer days;

(f) Whether engaged in dealing in the same scrips frequently;

(g) Intention of the assessee in buying shares is not to derive income by way of dividend on such shares, but to earn profits on the sale of the shares;

(h) Whether the assessees had indulged in multiple transactions of large quantities with high periodicity. These periodic transactions selecting the time of entry and exit in each scrip, called for regular direction and management which would indicate that it was in the nature of trade;

(i) Repeated transactions, coupled with the subsequent conduct of the assessee to re-enter the same scrip or some other scrip, in order to take advantage of market fluctuations lent the flavour of trade to such transactions;

(j) The assessees were purchasing and selling the same scrips repeatedly, and were switching from one scrip to another;

(k) Mere classification of these share transactions as investment in the assessee's books of accounts was not conclusive;

(l) The intention of the assessees at the time of purchase was only to sell the shares immediately after purchase;

(m) Frequency of purchase and sale of shares showed that the assessee never intended to keep these shares as investment; and

(o) It is only for the purpose of claiming benefit of lower rate of tax, under Section 111A of the Act, that they had claimed certain

shares to be investment, though these transactions were only in the nature of trade.

12. In the light of the above parameters and the decision of the jurisdictional High Court, on perusal of the statements incorporated by the assessing officer in the assessment order we find that the assessee has made several transactions of purchase of shares during the relevant year under consideration, and if there high volume, frequency and regularity of the activity carried on by the assessee in a systematic manner, it would partake the character of business activities carried on by the assessee in shares, and it cannot be said that the assessee has merely made investments in shares. In our opinion the findings of the CIT(A) cannot be sustained in the eyes of law, as he has not considered relevant facts to decide the issue. Accordingly, we reverse the order of the CIT(A) and restore the order of the Assessing Officer.

13. In the result, both the appeals of the Revenue are allowed.

Order pronounced in the court on 28.9.2012

Sd/-

(Asha Vijayaraghavan)
Judicial Member

Sd/-

(Chandra Poojari)
Accountant Member

Dt/- 28th September, 2012

Copy forwarded to:

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2. Shri Rupender Kumar Jain, 31, Paigah Colony, S.P. Colony, Secudnerabad.

3. Asst. Commissioner of Income-tax, Circled 10(1), Hyderabad.
4. Commissioner of Income-tax(Appeals) VI, Hyderabad
5. Commissioner of Income-tax V Hyderabad
6. Departmental Representative, ITAT, Hyderabad.

B.V.S.