

IN THE INCOME TAX APPELLATE TRIBUNAL
[DELHI BENCH "F" DELHI]

BEFORE SHRI RAJPAL YADAV, JM AND SHRI K. D. RANJAN, AM

I. T. Appeal No. 1368 (Del) of 2010

Assessment year : 2006-07.

M/s. Radials International,

Asstt. Commissioner of Income-tax,

80 / 1, Block – II, W H S Kirti Nagar,

Vs. Circle : 27 (1),

NEW DELHI.

NEW DELHI.

PAN / GIR No. AAA FR 0154 J.

(Appellant)

(Respondent)

Assessee by : Shri Rakesh Nanda, C. A.;

Department by : Shri B. Kishore, Sr. D. R.;

O R D E R.

PER K. D. RANJAN, AM :

This appeal by the assessee for assessment year 2006-07 arises out of order of the ld. CIT (Appeals)-XXIV, New Delhi.

2. The grounds of appeal raised by the assessee are as follows :-

“ 1. The order passed by the ld. CIT (Appeals), New Delhi under section 250(6) dismissing the appeal against the assessment order passed under section 143(3) of the Income-tax Act, 1961 by the ld. ACIT assessing the total income for assessment year 2006-07 at Rs.3,37,26,993/- and raising the demand of Rs.16,36,716/- is bad in law and needs to be quashed;

2. That ld. CIT (Appeals), New Delhi has erred in facts and law in holding transactions relating to sale / purchase of equity shares under Portfolio Management Scheme as an adventure in the nature of trade and not as a sale of investments;

3. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding the Long Term and Short Term gains / losses on sale of equity shares under Portfolio Management Scheme as business income and not under the head Capital Gains;

4. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding the charging of tax on the gains / losses on sale of equity shares under Portfolio Management Scheme as business income and not under the head Capital Gains;

5. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding that the exemption under section 10(38) on long term capital gains on sale of Equity shares under Portfolio Management Scheme is not allowable;

6. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding that tax at concessional rate of 10 per cent under section 111-A on short term capital gain on sale of Equity shares under Portfolio Management Scheme is not applicable;

7. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding the initiation of penalty under section 271(1)(c) and alleged furnishing of inaccurate particulars of income and thereby concealing income;

8. That *ld. CIT (Appeals), New Delhi* has erred in facts and law in holding the charging of interest under section 234-B of Rs.3,45,345/- and 234-D of Rs.13,200/- . “

3. The first issue for consideration relates to confirming the stand of the assessing officer that the transactions involving sale and purchase of shares under Portfolio Management Scheme [PMS] are adventure in the nature of trade and not a sale of investments. The facts of the case stated in brief are that the assessee had shown short term capital gain of Rs.35,02,080/- and short term capital gain of Rs.22,17,955.06 on sale of shares. During the course of assessment proceedings it was noticed by the AO that the assessee had made numerous purchase and sale of shares during the relevant previous year. On a query raised by the assessing officer it was submitted by the assessee that the assessee was engaged in the business of providing technical, marketing and maintenance services for earth-movers tyres and trading in tyres. The substantial part of its income was generated out of above business of the assessee. The assessee had invested the surplus funds generated out of profits of its above business in mutual funds and shares either directly or through Portfolio Management Scheme of Kotak and Reliance etc. and such investments have been clearly shown under the head investments on the assets side. The

surplus funds in the past were invested in the fixed deposits with the banks and the same have been partly invested in mutual funds. Therefore, the intention of the assessee was to earn dividend from such investments. The investments in mutual funds were held by the assessee as investments and not stock-in-trade.

4. This contention of the assessee was turned down by the assessing officer relying on CBDT Circular No. 4 dated 15/06/2007 and decision of Authority for Advance Ruling reported in 288 ITR 641. He noted that the assessee has purchased and sold shares with the motive of earning profit. The holding period of shares during the relevant previous year ranged from two days to a few months at the most. It was evident that the object of the investment in these shares was not to derive income by way of dividend, but to earn profit through sale as in almost all the transactions the share bought were sold in short period of time. The assessing officer thereafter examined the nature of Portfolio Management Scheme and duties of portfolio manager. He noted that portfolio manager proceeds systematically to manage on an Ongoing basis the collection of securities in his custody in tune with market variations to optimize in the return of process. He carries out regular follow-up trading operations, selling securities on hand and / or buying new items of security based on the sentiments and movement of the stock market. In fact he makes sizeable profits through these supplementary follow-up operations. He chooses to buy securities when the market is bearish and sells or off-loads those securities when market is bullish. This enables him to secure considerable trading profits which results in the value addition to his holdings. The Id. assessing officer in view of these facts came to the conclusion that the transactions were not of investment but an adventure in the nature of trade. The shares were purchased with the sole intention of selling them and not to holding them as investment. The assessing officer, therefore, treated the profits arising on purchase and sale of shares under PMS as business income. The assessing officer also held that it was not possible for an investor to have two portfolios i.e. trading as well as investment. Once the nature of income has been determined as income from trading, then there was no rational justification for treating income from shares held for more than 365 days as long term capital gains. The assessing officer, therefore, did not allow the benefit of long term capital gains in respect of shares or units of mutual funds held for more than one year.

5. On appeal before the Id. CIT (Appeals) it was submitted that the transaction of purchase and sale of equity shares under PMS were delivery based meaning thereby the delivery was taken on purchase and similarly delivery was given on sale of shares and the same were duly reflected in the statement of DEMAT account with National Securities Depository Ltd. It was submitted that since the assessee had taken and given delivery of shares, the same could not be treated as trading activities. The Id. CIT (Appeals) noted that the assessee in the relevant year was a debt free entity except car loan. The assessee was carrying on business of providing technical, marketing and maintenance services for earth movers, earth mover tyres and trading in tyres since 1987. The assessee had purchased and sold shares of various companies in hundreds of transactions during the assessment year under consideration. The brokers M/s. Kotak Securities Ltd., Reliance Capital and Fortis had charged fee in lieu of transactions carried on behalf of the assessee. The assessee had also paid share transaction tax on trading of shares. The assessee had not claimed fee paid to brokers and share transaction tax etc. as business expenditure as it appears that the same have been debited in the assessee's account by the broker / service provider. The result thereof has been shown as sale consideration. All transactions of purchases and sale of shares were undertaken by the assessee through professional portfolio managers under PMS. The investment in equity shares was started in assessment year 2005-06, which was accepted under scrutiny and assessment year 2006-07 was the second year of trading. The investment in mutual fund had been considered as capital investment and income derived there-from has been assessed as capital gain during the previous years as well as during relevant year. Only the nature of income derived from sale / purchase of equity shares has been disputed by the assessing officer.

6. As regards the claim of the assessee that income derived from share trading has been assessed as capital gains in the preceding year, Id CIT(A) had held that merely because the tax authorities had assessed it as capital gain in preceding year would not in any way operate as res-judicata to preclude from holding the same as business income in subsequent year. He placed reliance on the decision of Hon'ble Supreme Court in the case of *New Jahangir Vakil Mills Vs. CIT 49 ITR 138 (SC)*; *Raja Bahadur Vishwaria Singh Vs. CIT 41 ITR 685 (SDC)*; and *Dalhausi*

Investment Trust Co. Ltd. Vs. CIT 68 ITR 486. He also observed that the transactions dealing in shares is a mixed question of law & facts and the legal effect of fact on which the assessee could be treated as a dealer or as investor is a question of law. He placed reliance on several decisions in support of the contention. The Id. CIT (Appeals) further observed that when what is done is not merely a realization or a change of investment, but an act done in what is truly the carrying on of a business, the amount recovered as appreciation will be assessable as business profit as held in the case of Rajabhadur Vishweshara Singh (supra). In such a situation what is to be found out for such determination is whether at the time of purchasing a particular lot the assessee had an intention to sell it subsequently at profit or only to make an investment. The presence of commercial motive is a primary legal requisite. This commercial motive is established by the fact that the assessee's focus has not been on earning the dividend on the investments; rather reaping the profits out of volatility of the market. Purchase and sale as a business deal is another requisite. An intention to make profit normally inspires trade and commerce. Similarly, habitual dealing is ordinarily indicative of trade and commerce. Also the magnitude and frequency and the ratio of sales to purchase and total holding is evidenced from which the authorities can come to the conclusion as to the true nature of assessee's activities in such situation. The Id. CIT (Appeals) examined the facts of the assessee's case in the light of decision of Hon'ble Supreme Court and observed that from the details of purchase and sale of shares enumerated in annexure to assessment order and details submitted before him, the assessee at the time of purchasing the shares had an intention to sell them subsequently at a profit. This commercial motive is established by the fact that the assessee sold bought and sold shares after holding them for a small period. Therefore, the initial investment was utilized for purchase and sale of shares in such a way which resulted in profit derived from business and profession. Such an intention was clearly discernible from the facts of the case.

7. Regarding the contention of the assessee that actual delivery was given at the time of purchase and sale and, therefore, the transactions were in the nature of investments. In this regard the Id. CIT (Appeals) observed that the assessee acquired shares and sold. They were not held as property which yielded to its owner an income or personal enjoyment merely by virtue of its ownership as the fee paid to the broker was more than the return on the property excluding

return on account of trading of the property. Therefore, the shares were acquired with the object of a deal. A large number of shares were sold in short period. All these facts clearly showed that the assessee was engaged in dealing in shares. As regards the frequency of number of similar transactions, the Id. CIT (Appeals) observed that the assessee has entered into numerous and frequent transactions on regular basis to carry out his trading venture in shares. The Id. CIT (Appeals) therefore, came to the conclusion that the assessee was carrying on dealing in shares in a systematic and organized manner. Therefore, the conclusion of the assessing officer that income from sale of shares claimed as investment was to be assessed under the head 'Income from business or profession'.

8. Before us the Id. AR of the assessee submitted that the assessee is engaged in the business of providing technical, marketing and maintenance services for earth-movers and also deals in trading of tires. Substantial part of income is generated out of the above business of the assessee. The assessee had invested surplus funds in units or mutual fund and in shares through Portfolio Management Scheme [PMS]. The assessee is not dealing in shares as business income. The investments in the year under considerations were made as in the last year. The transactions of purchase and sale of equity shares under PMS were delivery based. The delivery of scrips was taken on purchase of shares. Similarly delivery of scrips was given on sale of shares and are duly reflected in the statement of DEMAT account with National Securities Depository Ltd. The assessee has treated delivery based transactions as investment and, therefore, profits on sale of shares will be in the nature of capital gains / short term capital gains depending upon the period of holding of such shares. The Id. AR of the assessee placed reliance on the decision of Hon'ble Bombay High Court in the case of Gopal Purohit Vs. JCIT [2010] 188 Taxman 140 (Bom). The Id. AR of the assessee further submitted that merely because of volume of transactions is high will not decide the nature of transactions. The assessee had invested in shares in surplus fund and, therefore, the profit arising on sale of shares will be in the nature of capital gains. On the other hand, the Id. Sr. DR submitted that the shares purchased through PMS, no discretion is left with the assessee. It is the PMS Manager, who decides as to when the shares are to be sold. The PMS is structured in such a way so that maximum earning is made. Shares are not held as investment, but stock-in-trade. The portfolio manager is agent of the assessee. Therefore, the

shares held by the assessee are stock-in-trade and the profit arising on sale of shares would be in the nature of business income and not as short term / long term capital gains.

9. We have heard both the parties and gone through the material available on record. The assessee apart from investment in mutual funds deposited money with three different Portfolio Management Schemes. Under PMS as per SEBI the term 'Portfolio' means a collection of securities owned by an investor. It represents the total holding of the securities belonging to any person. 'Portfolio Manager' means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client [whether as a discretionary Portfolio Manager or otherwise] the management or administration of a portfolio securities or the funds of the client as the case may be. From the definition of 'Portfolio Manager' it is clear that portfolio manager acts like an agent who buys and sells shares on behalf of the Individual. The portfolio manager devotes sufficient time in reshuffling the shares on hand in line with changing dynamics of the market. It prevents holding of dormant or stocks of depreciating value. The PMS provides the skill and expertise to steer through the complex volatile and dynamic conditions of the market. A portfolio manager proceeds systematically to manage on an on-going basis the collection of securities in his custody in tune with market variations to optimize his returns in the process. He carries out regular follow-up trading operations, selling securities on hand and or buying new items of securities based on the sentiments and movement of stock market. He chooses to buy securities when market is bullish and sells those securities when it turns bullish. This enables him to secure considerable profits as a result of value addition to his holding.

10. Under PMS a person deposits the money under the contract for a period normally not less one year. After depositing the money the investment in securities is left to the choice of the portfolio manager. The assessee has no control either on selecting the securities or the period of holding. The portfolio manager normally gives the account quarterly on the basis of which the investor comes to know about the profit earned and the securities in which the transactions were done by the portfolio manager on behalf of the assessee. The shares purchased and sold are

credited and debited to the DEMAT account of the party, which remains in the control of portfolio manager. It is the portfolio manager who can only deal with the DEMAT account of a particular person. At the time of depositing the amount the assessee will definitely make entry in his books of account as investment in PMS. But he is not aware of the transactions in the shares being entered into by the portfolio manager on his behalf as his agent. The portfolio manager charges his fee for the services rendered and other expenses incurred on the same lines as is done in a case where the agent charges from the his principal. Since the assessee comes to know about the purchase and sale of shares under PMS after the expiry of a period of three months, the accounting treatment in the books of the assessee in respect of shares purchased/sold by the portfolio manager under PMS cannot be entered in the books of the assessee. It is at the end of the year the shares available in the DEMAT account can be entered. Therefore, at the time of deposit of amount, the intention of the assessee was to maximize the profit. The purchase and sale of shares under PMS was not in the control of the assessee at all. Therefore, it cannot be said that the assessee had invested money under PMS with intention to hold shares as investment. The portfolio manager has carried out trading in shares on behalf of his clients to maximize the profits. Therefore, it cannot be said that shares were held by the assessee as investment.

11. We may also like to mention that there is difference in investment in mutual fund and PMS. In case of mutual fund the investor is allotted units for the amount invested by him in the mutual fund. The mutual fund manager purchases and sells shares frequently and makes profit/loss. The profit/loss so earned/incurred, increases/decreases the net asset value of the units. The units are also tradable depending upon the lock in period and terms of the fund. However, in the case of PMS the amount is invested under the scheme. No units or instruments are issued, which can be traded. The portfolio manager undertakes trading in shares to maximize the profits on behalf of the investor. Therefore, the investment in PMS cannot be equated with that of investment in units of mutual fund.

12. Further, in case of an assessee, who purchases shares from the market and sells frequently after getting them routed through the DEMAT account. Such transactions will be in the nature of trading activity and the resultant profit will be assessed as business profits. Merely because the shares are credited to DEMAT account at the time of purchase and debited at the time of sale would not make the transactions in the nature of investment. What is important is the intention at the time of purchase, frequency of transactions and volume of the transactions even if he has employed his own funds.

13. The assessee had made investment under PMS. The profit has not arisen directly from the deposits made, but from the securities purchased from such deposits, which were traded by the portfolio manager on behalf of the assessee. The quantity of share traded is huge as is evident from the list appended with the assessment order. The shares have been traded frequently with a motive to maximize profit and not with a view to hold them as investment. The volume of the transaction is very high. All these facts indicate that the portfolio manager had in fact done trading on behalf of the assessee. There is no difference between similar transactions carried out by an individual in shares and the transactions carried out by portfolio manager. Such transactions can be compared with trading in commodities or real estate. If an assessee gives money to a property dealer with the instructions to purchase, get possession and sale at a reasonable profit keeping in view the market conditions. The property dealer acting as an agent enters into series of transactions of purchase and sale earns profit in some of the transactions and incurs loss in some of them. The property dealer after charging his commission and expenses will handover the amount together profit to the principal. Can the profit earned or loss incurred on such transactions be treated as capital gain or loss. The answer is no. Therefore, in our considered opinion, the profits arising on purchase and sale of shares are in the nature of business and not as investment. Merely because the purchase and sale of shares had occurred through DEMAT account on delivery based; it would not change the nature of the transaction. Since the portfolio manager in the capacity of an agent has traded in shares on behalf of the assessee, the profits arising therefrom will be in the nature of business profits. Further simply because the assessee has treated the deposits made under PMS as investments and balance shares lying in DEMAT account as on the last day of the accounting year under the head 'investment'

would not change the character of trading done by the portfolio manager on behalf of the assessee. The shares purchased and sold during the year have not been recorded in the books of accounts as investment nor it is feasible to record as the details were not available with the assessee and the assessee has no control or say as to when and the type of shares or the period of holding of the shares. Therefore, in our considered opinion, the transactions are in the nature of business. The decision relied upon by the assessee in the case of Gopal Purohit (supra) is not applicable to the facts of the assessee's case.

14. It is also a settled law that the principle of res-judicata is not applicable to income tax proceedings. Hence, the assessing officer was not debarred in taking a different view if the earlier view was not in accordance with law. It is also a settled law that the mistake committed earlier should not be perpetuated. Hon'ble Supreme Court in the case of Distributor (Baroda) p. Ltd v Union of India 155 ITR 120 (SC) has held mistake committed earlier should be rectified. It should not be perpetuated. Hon'ble Supreme Court summarized their views at page 124 in following words:-

".....To perpetuate an error is no heroism. To rectify it is the compulsion of the judicial conscience. In this, we derive comfort and strength from the wise and inspiring words of justice Bronson in Pierce v. Delameter (A.M.Y. at page 18): " a judge ought to be wise enough to know that he is fallible and, therefore, ever ready to learn: great and honest enough to discard all mere pride of opinion and follow truth wherever it may lead : and courageous enough to acknowledge his errors ".

In view of decision of Hon'ble Supreme Court we dismiss the contention of the assessee that in assessment year 2005-06 the similar transactions were treated as capital gains on the ground that the view taken earlier was not in accordance with the law. Profit arising from a trading transaction cannot be treated as capital gain. Accordingly in view of the above discussion, we do not find any infirmity in the order of the Id. CIT (Appeals) holding that the profit arising on sale/purchase through PMS as business income and is accordingly upheld.

15. The next issue for consideration relates to disallowing the exemption of section 10(38) on long term capital gains on sale of equity shares under portfolio management scheme. Since we have held that the shares were traded by the portfolio manager as an agent on behalf of the assessee and, therefore, the profits arising are in the nature of business profits. Therefore, provisions of section 10(38) of the Act will not apply in case of profits arising on trading activity though the shares were held by the assessee for more than a period of 12 months. Accordingly we do not find any infirmity in the order of the Id. CIT (Appeals) confirming the disallowance under section 10(38) of the Act.

16. The next issue for consideration relates to rejecting the concession rate of 10 per cent under section 111-A on short term capital gains on sale of equity shares under portfolio management scheme. Since we have held the profits on purchase and sale of shares as business income, provisions of section 111-A of the Act are not applicable. We, therefore, uphold the order of the Id. CIT (Appeals).

17. The last issue for consideration relates to charging of interest under section 234-B and 234-D of the Act. Charging of interest under sections 234-B and 234-D is mandatory and consequential to the additions made. We, therefore, direct the assessing officer to charge interest, if any, after giving effect to this order.

18. In the result, the appeal filed by the assessee is dismissed.

The order pronounced in the open court on : **16th December, 2011.**

Sd/-

[RAJPAL YADAV]
JUDICIAL MEMBER

Dated : **16th December, 2011.**

MEHTA

Sd/-

[K. D. RANJAN]
ACCOUNTANT MEMBER

“ Copy of the order forwarded to :-

1. Appellant.
2. Respondent.
3. CIT,
4. CIT (Appeals),
5. DR, ITAT, NEW DELHI.

True Copy. By Order.

Assistant Registrar, ITAT.”