

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on : 21.03.2014
Pronounced on : 21.04.2014

+ **ITA 561/2012**
+ **ITA 566/2012, C.M. NO. 16325/2012**

COMMISSIONER OF INCOME TAX-IVAppellant
Through: Sh. N.P. Sahni, Sr. Standing
Counsel and Sh. Nitin Gulati, Advocate.

Versus

M/S. D&M COMPONENTS LTD.Respondents
Through: None.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.V. EASWAR

MR. JUSTICE S. RAVINDRA BHAT

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1. These two appeals by the Revenue question a common order of the Income Tax Appellate Tribunal ("ITAT") by which the assessee's appeal in respect of its claim for short term capital gain was allowed and the Revenue's appeal in respect of the claim for long term capital gain was dismissed. The question of law which arises for consideration is whether the amounts claimed as long term and short term capital gains by the assessee could have been treated as such by the ITAT in its impugned order.

2. During the year under consideration (AY 2006-07) the assessee was engaged in the business of dealing in the auto spare parts and investment in bonds, mutual funds and other securities. On scrutiny of

the accounts, the Assessing Officer felt that assessee has disclosed long term capital gains to the tune of ₹ 31,13,006.51/- and ₹ 26,82,115.35/- claimed as short term capital gain was not permissible. The assessee claimed that the amounts were not business income, but towards capital gains from sale of investments, as stated in its returns. The AO held that the income or profits gained were, in truth, business income, having regard to the normal business activities of the assessee and given the pattern of sale and purchase transactions, especially since no books were separately maintained for the purpose. The assessee's appeal was partly accepted to the extent that the Commissioner (Appeals) ("CIT(A)") held that the claim for long term capital gains was established. However, the contentions with respect to short term capital gains were rejected. Both the assessee and the Revenue appealed to the ITAT. The assessee's appeal was allowed by the ITAT, in its impugned order; the Revenue's appeal, however, was rejected.

3. The CIT (A), on being approached, accepted the assessee's plea with respect to long term capital gain, but upheld the decision of the AO, in regard to the claim for short term capital gain being really business income. The Commissioner (Appeals) held that:

"...On going through a sample of the total share transactions, which has been reproduced above, it is apparent that the appellant has also been frequently buying and selling a large variety of shares on which income has also been earned in most cases. Apart from the above sample transactions, the appellant has transacted in a large number of Shares involving substantial amount of money

and the overall circumstances indicate that these shares had not been purchased by the appellant with the intention of investment even though they had been shown as investment in the balance sheet. It is important to keep in mind that whenever any share is purchased with the intention of investment, it cannot be sold of within a very short span of time, since the share market is always fluctuating. Since in the present case, very frequent purchase and sale of shares have been done it indicates that the main intention of the appellant was to earn income out of these shares which have been claimed to be under the head of short term capital gains. The argument of the appellant that in the earlier years also such a contention has been accepted by the department is not sufficient to decide the issue in its favour, keeping in view the specific facts and circumstances and the nature of frequent share transactions of various companies, sample of which have been reproduced above. The most important aspect which needs to be highlighted is the nature and purpose for which the shares were purchased and subsequently sold. Since with regard to the shares claimed under short term capital gain, these indicate the intention of the appellant to trade in these shares, I am of the firm opinion that in the present circumstances, such transactions have rightly been held as income from business by the AO. Therefore, the claim of the appellant that these shares transactions were in the nature of investment does not appear to be convincing and to that extent this ground of the appellant is dismissed.

Accordingly, subject to the above observations, I am inclined to hold that while the claim of long term capital gains amounting to Rs 31,13,006/- by the appellant is valid, the claim regarding short term capital gain amounting to Rs. 26,82,115/- does not appear to be logical and convincing. As a result, this ground of the appellant is partly allowed and relief is allowed only to the extent of amount of long term capital gain of Rs 31,13,006/- while the amount of Rs. 26,82,115/- shown as short term capital gain

is held to be business income. As a result, this ground is partly allowed....”

4. The ITAT, in its impugned order, differed with the Appellate Commissioner’s conclusions and found that the assessee’s claim that it had derived short term capital gain of ₹26,82,115/- was justified. It was held that:

“9. Let us examine the facts of present case in the light of these tests. In the books of account, assessee has shown its purchases of shares as investment. The copies of the balance sheet ending as on 31.3.2005 as well as on 31.3.2006 are available. Assessee has not used borrowed funds for the purchase of shares. Assessing Officer has pointed out that assessee is not maintaining separate bank account and it has used the business funds. The assessee pointed out that share capital of more than Rs.304 crores is available with the assessee. The non-maintenance of separate bank account, would not be a very material fact. The next test is about the frequency of purchases and disposal of particular item. Yes, there are frequent transactions and this test goes against the assessee. The value of the shares at the close of the year has been taken at cost and not at market price cost whichever is lower. It indicates that the shares available with the assessee were not treated as stock in trade. The Memorandum of Association; investment in shares is one of the line of activity assessee has to take. Thus, on an examination of the facts on record in the light of these tests, we find one test i.e. frequency of the transactions all are in favour of the assessee. In the tests, it has been observed that explanation of an assessee based on number of facts supported by evidence and circumstances whenever required consideration, whether the explanation is sound or not must be determined not by considering the weight to be attached to each single facts in isolation but by assessing the cumulative effect of all

the facts in the setting as a whole. In assessment year 2005-06 the purchases of the shares by the assessee have been treated as investment. Some of the shares which were treated as investment is the opening balance of this year. The assessment order has been posted under Section 143(3) and it is available at pages 5 and 6 of the paper book. No doubt, Assessing Officer has not discussed this issue in that year but that does not obliterate the concept that books of account were before him and he must have considered all the aspects. The frequency of front is one factor which may goad to the adjudicating authority to construe the transaction as a business transaction but i.e. not be absolute criteria. This has been considered by the ITAT in a number of orders referred by us in the foregoing paragraphs. Thus taking into consideration all the facts and circumstances, we are of the view that the learned CIT(Appeals) has erred in treating part of the transactions as of investment and partly as a trading in the shares. We set aside the order of the learned CIT (Appeals) and direct the Assessing Officer to accept the claim of the assessee of long terms capital gain as well as short term capital gain...”

5. The Revenue argues that the impugned judgment is in error of law as it fails to give any weightage or importance to at least two tests particularly since the assessee in this case is also engaged in the investment business. It is emphasized that the failure of the assessee to maintain separate books of account in respect of its investments, and for regular business, placed a heavy burden upon it to establish that the claim made was indeed profit by way of capital gains, and not through business or trading. The failure to maintain separate books made it impossible to bifurcate the income generated between sale of shares and funds invested in business. The ITAT also overlooked the

fact that the assessee was utilizing the funds of business for purchase of investment, which casts doubt on its claim that the amounts were used for investment. Most importantly, it was submitted that the frequency and volume of purchase and sale of shares, particularly of some scrips showed that the intention of the assessee was to generate income through trade, rather than invest in them. This aspect, submitted the Revenue's counsel, was gone into in great detail by the CIT (Appeals) but was entirely overlooked by the ITAT.

6. The assessee urges that the ITAT's impugned order does not call for interference. It is submitted in this regard that whether it is the volume, frequency test, or the duration of holding of shares, or whether the intention to derive dividend, or the existence of separate investment accounts, or even use of own as opposed to borrowed funds, no single test can prevail, ordinarily in any case. It is the cumulative effect of application of these tests which is determinative of the assessee's intention. In this case, the decision of the CIT(A) at least in respect of the long term capital gains claim of the assessee was a concurrent finding at the stage of the ITAT, which cannot be said to be in error of law. So far as the short term capital gain goes, the assessee's contention is that the ITAT has not committed any error of law; its application of law has led to a plausible, and not an unreasonable view. So long as there is no perversity in such findings, this Court should not interfere with its order.

7. As far as the Revenue's appeal with respect to long term capital gains is concerned, this Court is inclined to affirm the findings of the CIT (A) and those contained in the impugned order. Here, the record

disclosed that the transactions were few in number – 10 sale/purchases. Moreover, the purchases were shown as investments in the balance sheets for several years before their sale and claim for long term capital gains. There is nothing on the record to show that these were purchased with borrowed funds. In these circumstances, the findings of the ITAT with respect to the amount claimed as long term capital gains are sound and do not call for interference.

8. The position with regard to short term capital gains, however, is different. The AO and CIT(A) held that separate books were not used. Amounts were freely transferred from the profits gained to business and *vice-versa*. However, perhaps the single-most telling circumstance is the kind of transactions which the CIT (A) noticed in paragraph 5 (c) of his order. A chart reflecting the volume, frequency, duration (of holding) criteria was prepared and reproduced in the Commissioner's order. That chart was only illustrative, and is extracted below:

<i>Name of the share</i>	<i>Purchase date</i>	<i>Sale date</i>
<i>Jindal Photo</i>	<i>07.04.2005</i>	<i>07.04.2005</i>
<i>Infotech Ltd.</i>	<i>22.04.2005</i>	<i>22.04.2005</i>
<i>Zee Tele</i>	<i>02.05.2005</i>	<i>16.05.2005</i>
<i>Zee Tele</i>	<i>02.05.2005</i>	<i>17.05.2005</i>
<i>Sam Ele Development</i>	<i>23.05.2005</i>	<i>23.05.2005</i>
<i>Mahabir Spinning Mills</i>	<i>25.05.2005</i>	<i>08.06.2005</i>
<i>Mahabir Spinning Mills</i>	<i>25.05.2005</i>	<i>09.06.2005</i>
<i>Mahabir Spinning Mills</i>	<i>26.05.2005</i>	<i>09.06.2005</i>
<i>Mahabir Spinning Mills</i>	<i>26.05.2005</i>	<i>10.06.2005</i>
<i>Mahabir Spinning Mills</i>	<i>26.05.2005</i>	<i>13.06.2005</i>

<i>Mahabir Spinning Mills</i>	27.05.2005	13.06.2005
<i>Krishan Engineering</i>	25.08.2005	30.08.2005
<i>Krishan Engineering</i>	26.08.2005`	30.08.2005
<i>Krishan Engineering</i>	26.08.2005	06.09.2005
<i>Krishan Engineering</i>	26.08.2005	09.09.2005
<i>Rajesh Exports</i>	24.08.2005	16.09.2005
<i>Rajesh Exports</i>	24.08.2005	19.09.2005
<i>Rajesh Exports</i>	25.08.2005	19.09.2005
<i>Rajesh Exports</i>	16.09.2005	19.09.2005
<i>P.B. Infra</i>	28.11.2005	28.11.2005
<i>P.B. Infra</i>	28.11.2005	02.12.2005

9. Apart from the above significant aspect, the AO and the CIT (A) observed that the assessee had been purchasing and selling a large number of shares of a few companies. It was also held that the transactions involved large or substantial sums of money. The CIT (A) pertinently made the following observations:

“...it is important to keep in mind that whenever any share is purchased with the intention of investment, it cannot be sold off within a very short span of time, since the share market is always fluctuating. Since in the present case, very frequent purchase and sale of shares have been done it indicates that the main intention of the appellant was to earn income out of these shares which have been claimed to be under the head of short term capital gains....”

10. In *Commissioner of Income Tax v Associated Industrial Development Company (P) Ltd.* 82 ITR 586 (SC) the Supreme Court held that:

“3...it was open to the assessee to contend that even on the assumption that it had become a dealer and was no longer an investor in shares the particular holdings which had been cleared and the sales of which had resulted in the profit in question had always been treated by it as an investment. It can hardly be disputed that there was no bar to a dealer investing in shares. But then the matter does not rest purely on the technical question of onus which undoubtedly is initially on the revenue to prove that a particular item of receipt is taxable. 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.”

P.M. Mohammed Meerakhan v. Commissioner of Income-tax, Kerala, 73 ITR 735 (SC) is another judgment of the Supreme Court holding that it was not possible to evolve any single legal test or formula which could be applied in determining whether a transaction was an adventure in the nature of trade or not. The answer to the question must necessarily depend in each case on the total impression and effect of all the relevant factors and circumstances proved therein and which determine the character of the transaction.

11. Having regard to the short duration of holding of the shares, and the lack of clarity in the account books, this Court holds that the overall effect would be to reveal that the sale and purchase of shares in respect of ₹26,82,115/- as short term capital gain cannot be sustained. Accordingly the order of the ITAT is set aside to the said

extent. The said amount shall be treated as business income and not capital gains. The question of law is accordingly answered in favour of the Revenue in ITA No. 561/2012. The said appeal is allowed. ITA 566/2012 filed by the Revenue, in respect of the long term capital gain, has to fail and is accordingly dismissed.

**S. RAVINDRA BHAT
(JUDGE)**

**R.V. EASWAR
(JUDGE)**

APRIL 21, 2014

