

IN THE INCOME TAX APPELLATE TRIBUNAL

"E" BENCH, MUMBAI

BEFORE SHRI S.V. MEHROTRA, ACCOUNTANT MEMBER. AND

SMT ASHA VIJAY RAGHAVAN, JUDICIAL MEMBER

ITA No.799/Mum./2009

(Assessment Year : 2005-06)

Date of Hearing: 30.8.2010

Dy. Commissioner of Income Tax-4(2)
Aayakar Bhavan, M.K. Road
Mumbai 400 020

..... Appellant

v/s

M/s. SMK Shares & Stock Broking
Pvt. Ltd. ,244, P.J. Tower, Dalal
Street, Fort, Mumbai 400 001
PAN – AABCS4531Q

..... Respondent

Revenue by : Shri Virendra Oza
Assessee by : Shri Satish Mody

ORDER

PER S.V. MEHROTRA, A.M.

This appeal by the Revenue, is directed against the impugned order dated 18th November 2008, passed by the Learned CIT(A)-IV, Mumbai, for assessment year 2005-06, on the following grounds:-

"1. On the facts and in the circumstances of the case, the learned CIT(A) erred in treating income from share trading as investment income.

2. On the facts and in the circumstances of the case, the learned CIT(A) erred ignoring the facts that due to high frequency of transactions, the profits from such transaction should be treated as business income.

3. On the facts and in the circumstances of the case, the learned CIT(A) erred not appreciating the fact that the assessee has in subsequent years declared income from similar transactions as business income."

2. Brief facts of the case are that, the assessee company, a member of Bombay Stock Exchange, in the relevant assessment year, filed return of income declaring total income at Rs.58,92,409/- which was duly accompanied with tax audit report under section 44AB of the Income Tax Act, 1961 (for short "*the Act*"). The Assessing Officer noticed that the assessee had disclosed short term capital gains during the year at ₹ 42,34,000 and long term capital gains at ₹ 60,95,000. He noted that the assessee had purchased shares in small lots and entered into more than 300 transactions during the year. Thus, the assessee had consistently purchased and sold the shares during the year. Considering the volume and frequency of sale and purchase, the Assessing Officer concluded that the assessee had no intention to hold the shares. He further observed that the assessee is a broking firm and, therefore, the share transactions relate to the business of the assessee. He further pointed out that in subsequent assessment year, the assessee had treated income from similar transactions as business income. He, thus, concluded that income returned as short term capital gains was actually business income, observing as under:-

"7.3 In CIT v/s Sulej Cotton Mills Supply Agency Ltd. (1975) 100 ITR 706 (SC), the respondent-assessee subscribed for 3,49,000 shares of a new issue of Gwalior Rayon and paid the application and call money. Subsequently, it sold 1,58,200 shares with a profit. The Income-tax Appellate Tribunal found that the transaction constituted business being an adventure in the nature of trade and that the profit was liable to income-tax. On reference to High Court of Madhya Pradesh held that the transaction was not an adventure in the nature of trade. On appeal to the Hon'ble Supreme Court, the decision of the High Court was reversed holding that the Tribunal had considered the evidence on record and applied the correct test of law, and there was no scope for interference with the finding of the Tribunal.

The court while deciding the case also observed "If a transaction is in the assessee's ordinary line of business there can be no difficulty in holding that it is in the nature of trade. But the difficulty arises where the transaction is outside the assessee's line of business and then, it must depend upon the facts and circumstances of each case whether the transaction is in the nature of trade". Also "the view of the Tribunal was, it was with borrowed funds that the assessee purchased the shares. It is no doubt true that there was no evidence to show that the money was specifically borrowed for the purpose of buying shares. But there was evidence before the Tribunal for its finding that the liabilities of the assessee exceeded its assets. The finding, therefore, that the

shares were purchased with borrowed funds on which the assessee was paying interest, was a finding supported by evidence. The reasoning of the Tribunal that it is most improbable that the assessee would be investing borrowed money on which interest would have to be paid in shares which yielded no dividend was correct. We cannot say that this was not a relevant circumstances of the Tribunal to take into consideration for coming to the conclusion that the transaction was an adventure in the nature of business."

3. Before the learned CIT(A), the assessee submitted that the composition of its long term capital gains and short term capital gains was as under:-

a)	Short term capital gains (without STT)	2,82,973	
b)	Short term capital gains (with STT)	39,51,295	42,34,268
c)	Long term capital gains (without STT)	15,48,988	
d)	Long term capital gains (with STT)	45,46,233	60,95,221

Short term capital gains (without STT)		
Regular Transactions	251410.13	
In short duration / auction sale	102296.88	353707.01
Short term capital gains (with STT)	3851063.97	
Regular Transactions	3851063.97	
In short duration / auction sale	100231.21	3951295.18
Less: Service Tax / Transaction / Other charges		70733.80
	Total:-	4234268.39

4. It was pointed out that short term capital gains of ₹ 10,13,678 were out of the opening investments and ₹ 28,37,386 were out of the purchases during the year. The assessee further pointed out that the main object of the

company is to carry on the business of shares and stock brokers which reads as under:-

"To carry on the business as share and stock brokers, underwriters sub-underwriters, agents and brokers for taking hold, dealing in, converting stock, shares and securities of all kinds, brokers for units Unit Trust of India, brokers for debentures, bonds, Government securities, National Savings Certificates, small saving scheme and generally for securities of all kinds and a carry on the above business in India or abroad."

5. The assessee further submitted that surplus funds had been utilized for making investment in the shares which is evident from the following analysis of balance sheet.

Share Capital	250.00	250.00
Reserves and Surplus	399.49	277.53
Secured Loan	2.97	Nil
Investment	319.08	282.82

6. The assessee pointed out that no borrowed funds were utilized for making investments in shares and securities. The intention of the assessee was to acquire and hold the shares and securities as an investment. The shares were held for a reasonable period of time before selling the same. Further, it was pointed out that the shares held as investment had been valued at cost and the profit on sale of such shares had been shown as profit on sale of investment. The assessee had relied on various decisions noted at Pages-5 to 7 of the order passed by the CIT(A). The assessee had submitted the details of sale and purchase of shares from which it was noticed that majority of shares had been held by the assessee for more than 300, 200 and 100 days and only in a very small number of cases, shares were sold within ten days. Further, CBDT Circular dated 15th June 2007 was pointed out before the CIT(A), wherein it was clarified by the CBDT that it was possible for a tax payer 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 asset. Where the assessee has two portfolios, the assessee may have income under both the heads i.e., capital gains as well as business income.

7. Learned Departmental Representative referred to Page-8 of assessment order, wherein AO's findings have been summed up. He further referred to Page-24 of the paper book wherein the computation of income is contained which shows profit on sale of investment was ₹ 1,03,29,489 as against which the dividend income was ₹ 3,29,999 only. Thus, he submitted that it is evident that assessee's intention was not to earn dividend but to trade in shares. He submitted that magnitude and frequency of the transactions and the ratio of sales to purchase and total holdings clearly demonstrate that the assessee's intention was to trade in shares. Learned Departmental Representative pointed out that in such circumstances, the twin criteria for deciding such issue is to consider the frequency of transactions and to find out the intention of the assessee as to whether to earn profits or to earn dividend. He pointed out that the CIT(A) has gone only by one reasoning without considering the entirety of facts. He pointed out that one of the bench marks for deciding true intention of the assessee is to find out whether the assessee had intention to earn dividend by holding the shares as investment or to earn profit by trading in the same. He referred to the assessment order for assessment year 2001-02 contained at Pages-1 to 4 and pointed out that long term capital gains were 7,67,976 whereas short term capital gain was only Rs.20,584 which was very small as compared to dividend which was only ₹ 4,90,957 being 50% of the total capital gains. This suggests that the assessee had intention to earn dividend. He referred to the computation of income for assessment year 2002-03 contained at Page-5 of the paper book and pointed out that the assessee had incurred loss on sale of investment of ₹ 1,12,290 as against which it had earned dividend of ₹ 2,95,776, which suggests dividend earning motive of the assessee. He further referred to the computation of income for assessment year 2003-04 contained at Page-10 of the paper book and pointed out that in this year, the assessee had shown profit on sale of

investment of ₹ 11,57,076 which was consistent with the assessee's motive of holding shares as investment. The same was the position for assessment year 2004-05 as per the computation of income contained at Page-15 of the paper book. With reference to the above computation, learned Departmental Representative submitted that the conclusions drawn in earlier years could not be a yard stick for the current year's transactions carried on by the assessee. It is primarily the motive of the assessee which is to be examined. He relied on the decisions of Mumbai Bench of the Tribunal in ITA No.3608/Mum./2007 in the case of Jayshree Pradip Shah, vide order dated 24th February 2010 and in ITA no.2586/Mum./ 2009, in the case of Smt. Sadhna Nabera Vs ACIT, vide order dated 26th March 2010, in support of his contentions.

8. Per-contra, learned Counsel referred to Page-8 of the assessment order to demonstrate that the Assessing Officer had questioned the assessee's transactions only in regard to which the assessee had returned its income as short term capital gains of ₹ 42,34,000. He pointed out that long term capital gains of ₹ 60,95,000 havenot been disputed by the Assessing Officer. He further referred to Para-2.4 of the CIT(A)'s order wherein the CIT(A) had noted that majority of shares were held by the assessee for more than 300, 200 and 100 days and in a very small number of cases, the shares were sold within ten days.

9. Learned Counsel further referred to the assessment order for assessment year 2001-02 contained at Pages-1 to 4 and pointed out that the Assessing Officer, under section 143(3), had accepted the assessee's claim regarding long term capital gains and short term capital gains with respect to shares sold by it. He referred to Page-7 of the paper book, wherein balance sheet as on 31st Mqarch 2002, is contained to demonstrate that investments as on 31st March 2001 and 31st March 2002 continued to remain almost same. He pointed out that the assessee had not borrowed any funds for making investment in shares and it was assessee's own surplus funds which had been kept invested in shares. Further, Ld. Counsel pointed out that assessee had no intention to avoid tax which is evident from the fact

that though the market value of quoted investment as on 31st March 2002 was ₹ 1,30,96,743, the assessee had shown the investment at ₹ 2,04,50,680=54. He submitted that the assessee did not claim the difference on account of fall in value of shares as loss.

10. Learned Counsel further pointed out that in the immediately preceding year viz. 2004-05, the assessee's profit on sale of investment of ₹ 58,00,769 was duly accepted by the Department and, therefore, since no new facts have in this year, there is no reason to deviate from assessee's stand of treating part of its shares under the investment portfolio and balance as part of trading portfolio. He submitted that there is no bar on brokers being investors also. Learned Counsel further submitted that the dividend earned cannot be compared with the profit on sale of investment. Counsel further submitted that the short term capital gains to the extent of ₹ 10,00,000 were out of opening investment and, therefore, investment to this extent was already accepted in earlier year. Counsel relied on the decision of Mumbai Bench of the Tribunal in the case of Gopal Purohit v/s JCIT, (2009) 122 TTJ 87 (Mum.), wherein it was, inter-alia, held that there being no change in the modus operandi of the assessee, benefit conferred by the legislative agencies in the form of introduction of securities transactions tax and consequently allowing concessional rate of tax @ 10% on short term capital gains could not be denied. He also relied on the following decisions, wherein similar view has been taken as in the case of Gopal Purohit (supra):-

- i) *Decision of Mumbai Bench of the Tribunal in ITA No. 3676/Mum./2008 in the case of Shri Ramesh G. Bhuta, ITA No.3677/Mum./2008 in the case of Shri Prabodh G. Bhuta, and ITA No.3678/Mum./2008 in the case of Dilip G. Bhuta, vide consolidated order dated 19th May 2009;*
- ii) *Decision of Mumbai Bench of the Tribunal in ITA No. 6544/Mum./2008 in the case of Shri Bharat Kunverji Kania, vide order dated 15th May 2009;*
- iii) *Decision of Mumbai Bench of the Tribunal in ITA No. 3861, 3862 & 3863/Mum./2001 in the case of Shri*

Motilal Oswal, vide consolidated order dated 28th August 2006; and

- iv) *Decision of Mumbai Bench of the Tribunal in ITA No. 2801/Mum./2000, ITA No.2802/Mum./2000 and ITA No. 5488/Mum./2001, in the case of J.M. Shares and Stock Brokers Ltd., vide consolidated order dated 30th November 2007.*

11. Learned Counsel submitted that insofar as Smt. Sadhna Nabera (supra) case is concerned, the same is distinguishable on facts because that was a case concerning transactions between shares of group companies. Further, the assessee had borrowed funds for making investment in shares and in earlier years, there was nil income from capital gains or very small long term capital gains. These features clearly distinguish the case of the assessee from that of Smt. Sadhana Nabera (supra). As regards the decision in the case of Jayshree Pradip Shah (supra), Ld. counsel submitted that in the said case, the assessee had shown non delivery based transactions under the head "*Business Income*", whereas, all the transactions wherein delivery of shares had been taken were returned under the head "*Short Term Capital Gains*". The Tribunal, taking note of frequency of transactions, had concluded that the assessee was carrying on trading activity only. However, in the present case, the assessee had returned under the head "*Short Term Capital Gains*", not only in respect of shares acquired during the year but also in respect of opening investment carried forward from earlier year. Thus, learned Counsel submitted that both the cases relied on by the learned Departmental Representative are distinguishable on facts.

12. We have heard the rival submissions, perused the orders of the lower authorities and the materials available on record. There is no dispute on facts particularly with regard to income returned as "*Short Term Capital Gains*" to the extent of ₹ 10,00,000 being out of opening investment. By now, the issue that a person can be both "*Investor*" as well as "*Trader*" in shares is no more res integra. In this regard Draft Instruction No.2005, under the subject "*Distinction between shares held a stock-in-trade and shares held in investment - tests for -*", reads as under:-

"The Central Board of direct Taxes in its instruction no.1827 dated 31.8.1989 had laid down certain tests to distinguish between shares held as stock-in-trade and shares held as investment. The following supplementary instructions in this regard will provide further guidelines for determining whether a person is a trader in stocks or an investor in stocks.

- i. Whether the purchase and sale of securities was allied to his usual trade or Business was incidental to it or was an occasional independent activity;*
- ii. Whether the purchase is made solely with the intention to resale at a profit or for long term appreciation and / or for earning dividends and interest;*
- iii. Whether scale of activity is substantial;*
- iv. Whether transactions were entered into continuously and regularly during the assessment year;*
- v. Whether purchases are made out of own funds or borrowings;*
- vi. Typical holding period for securities brought and sold;*
- vii. Ratio of sales to purchases and holding;*
- viii. The time devoted to the activity and the extent to which it is the means of livelihood;*
- ix. The characterization of securities in the books of account and in balance sheet as stock in trade or investments;*
- x. Whether the securities purchased or sold are listed or unlisted;*
- xi. Whether investment is in sister / related concerns or independent companies;*
- xii. Whether transaction is by promoters of the company;*
- xiii. Total number of stocks dealt in; and*
- xiv. Whether money has been paid or received or whether these are only book entries."*

13. CBDT, vide Circular No.4/2007 dated 15th June 2007, has observed that whether a particular holding of shares is by way of investment or form part of the stock in trade is a matter which is within the knowledge of the assessee who holds his shares and he should, in normal circumstances, be in a position to produce evidence from his records as to whether he is maintaining any stock-in-trade or holding the shares by way of investment. In the present case, it is not disputed that the assessee had maintained this distinction in its records. It is true that volume of transaction is an important indicator of the intention of the assessee whether to deal in shares as trading asset or to hold the shares as investor but certainly not the sole criterion. In our considered opinion, the Assessing Officer's conclusion that since sale and purchase had been determined by the volatility in the market, the same is against the basic feature of investor, is not based on sound rational reasoning. A prudent investor always keeps a watch on the market trends

and, therefore, is not barred under law from liquidating his investments in shares. The law itself has recognised this fact by taxing these transactions under the head "*Short Term Capital Gains*". If the Assessing Officer's reasoning is accepted, then it would be against the legislative intent itself. It is always a vexed question to find out as to whether the assessee was holding the shares as stock in trade or under an investment portfolio particularly because one has to infer the intention of the assessee which is primarily within his own knowledge. The conduct of the assessee assumes significance in this regard. It has been laid down in various judicial pronouncements that there is no acid test to decide this issue. In the present case, we find that the Assessing Officer while passing assessment order under section 143(3) for assessment years 2001-02 and 2004-05, did not dispute the assessee's claim regarding profit on sale of investment. One more important aspect is that the assessee had not borrowed any fund for investment in shares and this fact cannot be lost sight off while deciding the true intention of the assessee.

14. Learned Departmental Representative pointed out that in assessment year 2001-02, the dividend was ₹ 4,90,957 as against profit on sale of investment of ₹ 7,67,976 and, therefore, there was no reason to dispute the assessee's claim. However, in assessment year 2004-05, we find that the dividend was only ₹ 3,06,219 as against the profit on sale of investment of ₹ 58,00,769. Thus, this objection of the learned Departmental Representative does not hold good. It is true that principles of *res judicata* do not strictly apply to income tax proceedings but at the same time it is a well settled law that the principles of consistency should not be ignored. The uniformity in treatment and consistency under the same facts and circumstances is one of the fundamentals of the judicial principles which cannot be brushed aside without proper reason. When approximately ₹ 10,00,000 was out of the earlier investment then if the *modus operandi* of the assessee remained the same in regard to other shares purchased during the year, then the assessee's claim could not be negated only on the basis of frequency of the transaction. This is a case for assessment year 2005-06 and possibly major consideration which weighed the Assessing Officer's conclusion was on

account of the introduction of securities transactions tax by Finance Act, 2004, consequent to which the short term capital gains were taxed at a concessional rate of tax i.e., 10%. Further, since there was no change in the modus operandi of the assessee from earlier year, there was no reason to deviate from earlier year's conclusions. The assessee has maintained separate investment portfolio and all the sales out of this portfolio are identifiable to purchases made in the said portfolio. Assessee's claim regarding long term capital gain has not been disturbed by the Assessing Officer and, thus, Assessing Officer himself has accepted that the assessee was investor in shares also. All these factors outweigh the test of frequency of transaction being undertaken by the assessee in deciding the true intention of assessee . We, therefore, confirm the order of the learned CIT(A).

15. In the result, Revenue's appeal stands dismissed.

Order pronounced in the open Court on 24/11/2010

Sd.

Sd/-

ASHA VIJAY RAGHAVAN
JUDICIAL MEMBER

Sd.

Sd/-

S.V. MEHROTRA
ACCOUNTANT MEMBER

MUMBAI, DATED: 24th Nov. 2010

Copy to:

- (1) *The Assessee*
- (2) *The Respondent*
- (3) *The CIT(A), Mumbai, concerned*
- (4) *The CIT, Mumbai City concerned*
- (5) *The DR, "A" Bench, ITAT, Mumbai*

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BY ORDER

ASSISTANT REGISTRAR
ITAT, MUMBAI BENCHES, MUMBAI

Pradeep J. Chowdhury
Sr. Private Secretary