IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH 'F', MUMBAI

Before Shri S.V. Mehrotra , Accountant Member and
Shri Vijay Pal Rao, Judicial Member

I.T.A.No. 6556/Mum/2009
Assessment Year : 2005-06

Shri Vinod K. Nevatia 165, Shree Sadan, Sion (East), Mumbai 400 022. PAN: AAEPN 8175 H	**Vs.**	The Asst. Commissioner of Income-tax, Aayakar Bhavan, R.No. 647, M.K. Road,Mumbai 400 020.
(Appellant)		(Respondent)

I.T.A.No. 181/Mum/2010
Assessment Year : 2005-06

The Asst. Commissioner of Income-tax, Aayakar Bhavan, R.No. 647, M.K. Road,Mumbai 400 020.	**Vs.**	Shri Vinod K. Nevatia 165, Shree Sadan, Sion (East), Mumbai 400 022. PAN: AAEPN 8175 H
(Appellant)		(Respondent)

Appellant by : Shri S.C.Tiwari

Respondent by : Shri P. Peerya

O R D E R

PER S.V. MEHROTRA, AM:

These cross appeals by the assessee and the revenue are directed against the impugned order dated 21.10.2009, passed by the learned Commissioner of Income-tax (Appeals)-VIII, Mumbai, for the assessment year 2005-06.

ITA No.181/Mum/2010 (Revenue's appeal)

2. The grounds taken by the revenue read as under:

1 (i) On the facts and in the circumstances of the case and in law, the learned CIT(A) erred in deleting the disallowance of VSAT, Leaseline and Transaction charges of Rs. 2,21,755/- u/s.40(a)(ia) without appreciating the facts that these were composite charges for professional and technical

services rendered by the stock exchange to its members and the assessee has failed to deduct TDs thereon.

(ii) On the facts and in the circumstances of the case and in law the the Ld.CIT(A) erred in ignoring the fact that these services are essential in nature as they can only be availed by members of Stock Exchange.

(iii) On the facts and in the circumstances of the case and in law the Ld.CIT(A) erred in ignoring the facts that use of technology and algorithmic based programs have converted an erstwhile physical market into a digitally operated market.

(iv) On the facts and in the circumstances of the case and in law, the Ld.CIT(A) erred in ignoring the fact that the services rendered by the brokers are not standard services that has been developed to cater to the needs of the broker community to facilitate trading.

(v) On the facts and in the circumstances of the case and in law the Ld.CIT(A) has overlooked the fact that the brokers have in subsequent years themselves started deducting the TDS on such payments and there is no reason to vive a different treatment in this year.

2. On the facts and in the circumstances of the case and in law the Ld.CIT(A) erred in treating Rs.47,23,828/- as Capital Gain as against business income treated by the A.O. since the assessee is trader and not investor without appreciating multiplicity of transactions.

3. The assessee, an individual, a Member of the National Stock Exchange and proprietor of M/s. Gaurav Trading Company, in the relevant assessment year was engaged in the business of share trading and securities. He filed his return of income declaring total income of Rs. 2,12,77,512/-. The A.O. determined the total income at Rs. 2,24,50,205/-, inter alia, making the following disallowances:

(a) Disallowance u/s.40(a)(ia) on account of VSAT charges

Paid to National Stock Exchange

(i) Leaseline charges .. Rs. 67,828

(ii) Transaction charges .. Rs. 57,927

(b) Disallowance u/s.14A Rs. 4,69,413

(c) Treating Income by way of capital gains as business income Rs.47,23,828

The AO noticed that these charges are payable to Stock Exchange on account of services provided by it with regard to the transactions in securities through the Exchange. He observed that as per the provisions of section 40(a)(ia) no deduction is to be allowed unless tax has been deducted at source from the payments made for technical services as per the provisions contained under Chapter-XVII-B of the Act. He examined the nature of services rendered by the Stock Exchange and concluded that they were in the nature of technical services rendered by the Stock Exchange and therefore, tax was deductible under section 194 of the Act. He, therefore, disallowed the assessee's claim of Rs.2,21,755/-. The learned CIT(A) deleted the addition by following the decision of the I.T.A.T Mumbai in ITA No.1955/Mum/2008 for the assessment year 2005-06 in the case of Kotak Securities Pvt. Ltd., vide order dated 26th August, 2008, wherein it has been held that Stock Exchange does not provide managerial services and the fees paid by a member to the Stock Exchange is not for any technical services and therefore, no TDS was deductible from the assessee.

4. Having heard both the parties, we find no reason to interfere with the order of the CIT(A) in view of the decision of the I.T.A.T in the case of Kotak Securities Ltd. v. Addl.CIT(2009) 318 ITR (AT) 2268(Mum) wherein it has been held that "transaction fees paid to the stock exchange could not be said to be a fees paid in consideration of stock exchange rendering any technical services to the assessee. The provisions of section 9(1)(vii) Explanation 2, were, therefore, not attracted. Therefore, there was no obligation on the part of the assessee to

deduct tax at source. Consequently, the provisions of section 40(a)(ia) were also not attracted and therefore the disallowance made was deleted". In view of the above decision of the Tribunal, we decide this issue in favour of the assessee and against the revenue.

5. The second ground is that the learned CIT(A) erred in treating Rs.47,23,828/- as capital gains as against business income treated by the AO as the assessee is a trader. Brief facts apropos the issue are that the assessee in the relevant assessment year carried on the business as share broker of National Stock Exchange and carried on the business in the name and style of M/s. Gaurav Trading Co. The A.O. noticed that assessee had returned short term capital gains of Rs. 47,23,8928/-. He noted that the assessee had purchased shares during the year amounting to Rs. 4.21 crore. He noted that in the immediately preceding year the assessee had purchased shares of Rs.3.49 crores and sold shares worth 1.81 crores. Thus, he concluded that the purchase to sale ratio during the year was considerably higher than the ratio during the immediately preceding year. He further noted that during the year assessee had borrowed funds. He examined in detail various case laws laying down principles to decide whether an individual is trader or investor in shares and examined the facts qua these principles. He noted that the assessee's contention was that the funds were borrowed for conducting the business on National Stock Exchange. However, since the funds were common and could not be segregated as no evidence had been adduced with regard to the fact that the interest free funds were used to fund investments in shares, he concluded that borrowed funds were utilized for making investment in shares. He noted that the total loan taken during the year was to the extent of Rs.21,73,31,027/. He, therefore, concluded that the recordings made in the books of account were camouflaging devices to hide the real intent. He pointed out that

the assessee had not been able to show his intent to hold on the scrips. He summed his finding in para 7.4 at page 13 as under:

(i) The assessee is a broker and a trader as per the audit report. The transactions in shares have been done in the ordinary course of assessee's business. The decision of Hon'ble Supreme court in the case of CT v. Sutlej Cotton Mills (100 ITR 706) is squarely applicable to the facts of the case wherein the court has held – "If the transaction is in the ordinary course of assessee's business there can be little difficulty in holding that it is in the nature of trade".

(ii) Secondly it is a well settled principle of law that even a single transaction can be in the nature of trad. In our case the assessee has undertaken numerous transactions. In view of the multiplicity of transactions the assessee is treated as a trader. Reliance is placed on the decision of Hon'ble apex court in the case of Associated Industrial Development Co.(P) Ltd. (82 ITR 586)

(iii) Further the benchmarks of distinction between a trader and a investor as put forth by the royal commission in its report are clearly applicable on the assessee:

(A) The assessee deals in commodities or shares which are a subject matter of trading and are very exceptionally a subject matter of investment especially in case where trading in shares is the predominant source of income.

(B) As laid down by Royal Commission, usually profits on such a property are realized in short period of time. This is true in the case of assessee as already discussed above.

(C) Further there is no discernible reason of purchase and sale. That is the assessee acquired share to have substantial stakes in the company or sold them because he was in dire need of money. No such reason exists. The sale and purchase has been determined by the volatility at the markets, which is against the basic feature of an investor who is recognized by the discipline he displays in the market and is not easily swayed by the movements of the market.

(D) Finally the frequency and continuity in the nature of similar transactions is definitely indicative of his intent i.e. to trade.

(iv) Further during the assessment proceedings in the A.Y. 2004-05 the income from short term capital gain was treated as business income and the assessee has not preferred an appeal against the decision.

He, accordingly, treated the sum of Rs. 47,23,828/- as business income of the assessee.

6. Before the learned CIT(A) the conclusion of A.O. was assailed firstly on the ground that in most of the scrips held in the field of the investment activity,

the period of holding by the assessee had been several months and years and not few days only as concluded by the A.O. It was pointed out that investment transactions of the assessee where shares of a particular company were sold within a few days from purchase were very few and far between. Secondly, it was pointed out that the assessee had been maintaining separate demat accounts of investment shares and only the shares where the intention is an investment are taken into investment demat account. Thus, there is clear demarcation of investments. Thirdly the assessee had offered long term capital gains on sale of shares aggregating to Rs.2,37,29,464/- which has been accepted by the A.O. Fourthly, from the perusal of analysis of period of holding of scrips yielding short term capital gains, it would be clear that the assessee had dealt only in 14 scrips. Out of the total STCG of Rs. 4,723,827 short term capital gains amounting to Rs.3,582,813/- had arisen from the transactions where the holding period was more than six months. Lastly, no part of the assessee's interest bearing borrowings was utilized for acquisition of shares on investment account. The learned CIT(A) allowed the assessee's appeal taking note of the fact that assessee had maintained separate portfolio of scrips as stock in trade or investments by maintaining separate demat account for both. He also took into consideration the fact that share trading pertaining to stock in trade has been declared by the assessee as business income and the A.O. had accepted the assessee's claim with respect to long term capital gain of Rs. 2,37,29,463/-.

7. The learned Departmental Representative referred to the assessment order and pointed out that h has discussed in detail the guiding principles laid down in various laws for deciding whether the assessee has been doing business of trading in share or was holding the same as investment. He pointed out that assessee had not furnished any evidence before the A.O. to establish that the borrowings made by it were only for business purposes and no borrowed funds

were utilized for making the alleged investments in shares. He pointed out that in various case laws it has been laid down that multiplicity of transaction is an important factor for deciding whether the assessee was carrying on business or not. In this regard he referred to the decision of the Supreme Court in the case of Raja Bahadur Visheshwar Sing v. CIT (41 ITR 685)(SC), wherein it has been held that magnitude and frequency of transactions and the ratio of sales to purchases is an important factor for deciding whether the assessee was dealer in shares and security or not. Learned DR relied on various case laws referred to by the AO in para 7.1 of his order.

8. Learned counsel for the assessee submitted that the A.O. has relied only on two factors viz. frequency of transaction and borrowing made by the assessee. He pointed out that the assessee is primarily carrying on three activities which are as under:

(1) Regular brokerage business;
(2) Trading in shares and
(3) Investor in shares.

He pointed out that for all these three activities assessee has maintained separate books of account. Further he submitted that the A.O. has not pointed out even a single instance regarding borrowed funds being used for investing in shares. He further pointed out that AO has not considered the position of opening stock and closing stock.

9. The learned counsel for the assessee referred to CBDT's Circular No. 4/2007 dated 15.6.2007 wherein it has been, inter alia, observed as under:

> *"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 assessee 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 name 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."

"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."

With reference to above circular the learned counsel pointed out that the assessee has maintained separate demat account for its trading transactions vis-à-vis investment made in shares. He further submitted that the A.O. has accepted long term capital gain which was more than Rs. 2 crores. He submitted that whereas a trader looks at margin of profit, the investor looks in realizing its investment in order to ensure that it does not looses its capital. He pointed out that in the case of trading transaction turnover is more and that is not so in the case of investment. He pointed out that in the present case, bulk of shares were sold after six months, number of scrips were only 14 in which assessee had made investments and, therefore, the learned CIT(A) rightly accepted the assessee's contention. He submitted that the decision of the I.T.A.T in the case of Gopal Purohit v. JCIT, ITA No.4854/Mum/2008, for the assessment year 2005-06 (122 TTJ (Mum) 87dated 10.2.2009 has been confirmed by the Hon'ble Bombay High Court wherein also the assessee's claim of short term capital gains was accepted by Tribunal.

10. We have considered the rival submissions and have perused the records of the case. Before we consider the merits of the case, we may first deal with the reliance placed by the Ld. Counsel on the decision in the case of Gopal Purohit v. JCIT (surpa). In this case the facts as fund by the Tribunal were that assessee was engaged in the activity of sale and purchase of shares for quite long time. It was also noted that non-delivery based transaction had been treated by the assessee as business activity and delivery based transaction had been treated as an investment activity and accordingly, the assessee had claimed himself both dealer as well as investor and had offered income for taxation accordingly. However, in the present case, the facts are entirely different, inasmuch as, even in respect of shares where delivery had been taken, the assessee had returned the income both under the head business income as well as capital gains. Therefore, the case of Gopal Purohit (supra) is clearly distinguishable on facts.

11. Now coming to the facts of the case, it is not disputed that the assessee had maintained separate books of account as well as separate demant accounts in respect of its trading activity and for making investment in shares. The Hon'ble Supreme Court in the case of raja Bahadur visheshwar Singh v. CIT (41 ITR 685), inter alia, observed that the manner in which the books had been maintained is an important piece of evidence for arriving at proper conclusion in such circumstances. It all depends on facts and circumstances of each case whether the assessee's conduct was directed towards realizing its investment or change in investment or the act was done which truly could be branded as carrying on the business. No single fact can be said to be decisive factor under such circumstances. No acid test has been laid down in any of the judgments referred to by the A.O. In all cases only certain principles have been laid down having regard to the peculiar facts obtaining in the said cases. Primarily, it is the intention with which an assessee starts its activity which is the most important factor which

has to be considered keeping in view the adjoining circumstances. If the assessee purchases the shares from its own funds, with a view to keep the funds in equity shares to earn considerable return on account of enhancement in the value of share over a period then merely because the assessee liquidates its investment within six months or eight months would not lead to the conclusion that the assessee had no intension to keep the funds as invested in equity shares but was actually intended to trade in shares. Mere intention to liquidate the investment at higher value does not imply that the intention was only to trade in security. However, it cannot be held that in all circumstances if assessee has used its own funds for share activity then it would only lead to inference of investment being the sole intention. In such circumstances, frequency of transactions will have to be considered to arrive at proper conclusion regarding the true intention of the assessee. However, if the assessee, on the other hand, borrows funds for making investment in shares then definitely it is a very important indicator of its intention to trade in shares. In the present case, we find that the A.O. merely proceeded on the assumption that borrowed funds had been utilized for buying shares on the ground that funds were common and could not be segregated. Before the CIT(A) it was categorically pointed out that no part of the assessee's interest bearing funds were utilized for acquisition of shares on investment account. This plea has been accepted by the CIT(A) and the Department has not brought on record anything to controvert the same. Further, in the CBDT Circular No. 4/2007 dated 15.6.2007, the CBDT has emphasized 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. Further, the A.O. has accepted the assessee's claim of LTCG to the extent of Rs. 2 crore which implies that he has accepted the assessee's claim regarding holding investment portfolio. In view of

the above discussion we do not find any reason to interfere with the order of the CIT(A). Accordingly, we confirm the order of the CIT(A).

ITA No. 6556/Mum/2009-(Assessee's appeal)

12. The only effective ground of appeal raised by the assessee is in respect of direction of the AO to recompute the disallowance u/s.14A in accordance with Rule 8D of the I.T.Rules. Brief facts apropos this issue are that the assessee during the year under consideration had received a dividend of Rs.35,53,986/- and Rs.2,29,77,048/- from long term capital gains. The Assessing Officer observed that no deduction was allowable in respect of expenditure incurred by the assessee in relation to the income which did not form part of total income under the Act. After considering the assessee's submissions and case laws on the issue, he treated 10% of the total expenses as being incurred by the assessee towards earning of dividend income and made the disallowance accordingly.

13. Before the learned CIT(A), the assessee had taken the ground that the assessee had not incurred any expenditure to earn the dividend income and therefore, the disallowance to the extent of Rs.4,69,413/- was not warranted as the same was attributable to its brokerage business income only. The learned CIT(A) following the decision of the I.T.A.T. Special Bench in the case of Daga Capital Management Pvt. Ltd. (117 ITD 169), restored the matter to the A.O. for computing the disallowance in accordance with Rule 8D.

14. Having heard both the parties, we find that the Hon'ble Bombay High Court in the case of Godrej and Boyce Mfg. Co. Ltd. v. DCIT (34 DTR 1)(Bom.) has reversed the findings of the Special Bench of the Tribunal in holding that Rule 8D is retrospective. Therefore, Rule 8D was not applicable for the assessment year 2005-06 and, therefore, the directions of the CIT(A) are not sustainable. The assessee's plea that it had not incurred any expenditure for earning the dividend income has not been considered by the learned CIT(A) and, therefore, as agreed

by both the parties, we restore this issue to the file of the A.O. for deciding the same denovo after considering the assessee's submissions.

15. In the result, the revenue's appeal is dismissed while the appeal filed by the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on this 3rd day of December, 2010

Sd.	Sd.
(Vijay Pal Rao)	(S.V. Mehrotra)
Judicial Member	Accountant Member

Mumbai dated the 3rd December, 2010.

Copy to:

1. The Assessee
2. The Revenue
3. The CIT-IV, Mumbai
4. The CIT(A)-VIII, Mumbai
5. The DR 'F' Bench, Mumbai

/True copy/

By order

Asst. Registrar, ITAT, Mumbai