

**IN THE INCOME TAX APPELLATE TRIBUNAL
"C" Bench, Mumbai**

**Before Shri R.S. Padvekar, Judicial Member
and Shri B. Ramakotiah, Accountant Member**

ITA No. 293/Mum/2009
(Assessment Year: 2001-02)

Phulchand Sons Investments P. Ltd. Cabin No. 4, C/o M.K. Realties P.Ltd. Bhagyodayas Bldg., 79, N.M. Road Fort, Mumbai 400023 PAN - AAACP 8901 G	Vs.	ACIT - 2(2) Aayakar Bhavan, M.K. Road Mumbai 400020
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Appellant

Respondent

Appellant by: Shri A.V. Sonde & Smt. Payal Gada
Respondent by: Shri Ajit Kumar Sinha

ORDER

Per B. Ramakotiah, A.M.

This appeal by the assessee is against the order of the CIT(A)- II, Mumbai dated 29.10.2008.

2. Assessee has raised the following grounds: -

“1. The Commissioner of Income-tax (Appeals)-II, Mumbai (hereinafter referred to as the CIT(A)) erred in upholding the action of the Assessing Officer in making addition of a sum of Rs.16,06,23,687/- on account of long-term capital gains by treating lending of shares as transfer of shares within the meaning of section 2(47) and thereby charging tax under section 45 of the Act.

The appellants contend that the share of Global Trust Bank (GTB) have been lent to a Corporate and not sold as alleged and assumed by the CIT(A) and that the appellants are the rightful owners of the shares lent. The appellants are entitled to receive back the said shares of GTB from the loanee of the shares, and consequently, there is no “transfer” of shares within the meaning of section 2(47) of the Act.

2. The CIT(A) erred in not adjudicating the following ground of appeal -
“The Assessing Officer erred in not allowing credit of a sum of Rs.2,50,000 being tax paid on regular assessment.

The appellants contend that this is a mistake apparent from record and a suitable direction may be given to the Assessing Officer in this behalf.”

3. *The CIT(A) erred in not adjudicating the following ground of appeal -
“The Assessing Officer erred in charging interest of Rs.88,93,733 under section 234B of the Act.*

The appellants contend that the Assessing Officer ought not to have charged interest under section 234B inasmuch as –

(a) no interest has been charged on framing of order under section 143(3) dated 16.08.2004 and hence, the provisions of section 234B(4) are not applicable,

(b) the Assessing Officer has not given an opportunity to the appellants before charging the said interest as required by the principles of natural justice.

(c) The Assessing Officer has not given a specific direction to charge interest under section 234B and hence, the charging of interest under this section is not tenable in law and requires to be quashed.

(d) the charging of interest is not in accordance with law.

4. *The CIT(A) erred in not adjudicating the following ground of appeal -
The Assessing Officer erred in charging interest of Rs.40,56,632 under section 220(2) of the Act.*

The appellants contend that the Assessing Officer ought not to have charged interest under section 220(2) inasmuch as –

(a) the Assessing Officer has not given an opportunity to the appellants before charging the said interest as required by the principles of nature justice,

(b) the charging of interest is not in accordance with law.”

3. Ground No. 1 pertains to the issue of bringing to tax the capital gains of ₹16,06,23,687/- by treating lending of shares as transfer of shares within the meaning of section 2(47) and thereby charging tax under section 45 of the Act. Briefly stated the assessee had filed return of income for A.Y. 2001-02 on 31.10.2001 declaring Nil income being dividend income exempt under section 10(33). The return was processed under section 143(3) vide order dated 28.07.2003. An amount of ₹3,11,070/- was disallowed under section 14A and incomes from business were determined at Nil. Consequent to the examination by the CIT of the transactions of loan of 20 lakhs shares of Global Trust Bank Ltd. to M/s. Classic Credit Ltd. on 28.11.2000, which was in fact examined by the A.O. under section 131 also, the CIT was of the opinion that the transaction resulted in sale of 20 lakhs shares and capital gain thereon was required to be computed for the year. Accordingly he

directed the A.O. to compute the capital gain. In addition to the above the CIT also has taken non-reconciliation of over draft taken and also directed the A.O. to examine the above. This order under section 263 dated 19.01.2004 was subject matter of appeal before the ITAT in ITA No. 1651/Mum/2004 wherein on the request of the counsel the directions to the A.O. were modified and the A.O. was directed to examine the matter de novo in accordance with the law by way of speaking order after giving due and fair opportunity of hearing to the assessee. Consequent to the above the A.O. examined the issue and held that the lending of shares is a colourable transaction and assessee has sold the shares to a third party and accordingly the sale value was taken at ₹20.76 crores and cost of ₹4.70 crores (wrongly shown as 4.07 crores in the order) computing capital gain at 16.06 crores. The matter was carried to the CIT(A), who has confirmed the addition so made. Assessee is aggrieved in ground No. 1

4. The learned counsel referred to the facts of the case and submitted the following: -

- a) The assessee purchased for the purpose of investment 20.50 lakhs shares of GTB in earlier years.
- b) The said shares have been shown as investment in Balance Sheet.
- c) On request of M/s. Classic Credit Ltd. (CCL) by their letter dated 24.11.2000 and 27.11.2000 the assessee lent and CCL borrowed 20 lakhs shares of GTB. M/s. CCL after borrowing, sold the shares in open market.
- d) The beneficial interest of the shares lent remains with the assessee and the right of ownership and title of the said shares vests with the assessee and hence the same is shown in the Balance Sheet as on 31.03.2001.
- e) All the beneficial interest, such as dividend, rights, bonus, etc. declared during the period of lending shall accrue to the assessee.

- f) Lending and borrowing of shares is widely prevalent practice in Stock Exchange and it cannot be considered to be a transfer within the meaning of section 2(47) of the Act.
- g) The lending was for a short period, however, due to unforeseen financial setbacks suffered by KP group the assessee could not recover the shares on due date.
- h) The assessee, as owner of the shares, and by virtue of Law of Contract and the Companies Act, 1956 have all the rights, which a beneficial owner of the shares had.
- i) Lending of shares is also recognized by Circular No. 751 dated 10.02.1997, which permits the shares to be lent to a borrower and when the borrower gives it back to the lender it is not a 'transfer' as defined in section 2(47) of the Act.
- j) The impugned transaction of lending of shares is a transaction at arms length as the share holders and directors of the lending company and borrowing company are not common.
- k) The shares have been sold by the assessee company in the previous year relevant to the A.Y. 2003-04 and the income of ₹13,78,140/- arising thereon has been offered for tax under the head 'Capital Gains' and in the balance sheet for the year ended 31.03.2003, the investment in shares in GTB has been reduced from ₹486.25 lakhs to ₹11.85 lakhs.

5. Referring to the paper book and facts placed before the authorities the learned counsel submitted that M/s. Classic Credit Ltd., a Ketan Parekh's company, has sold 15,00,000 shares on 20.11.2000 in the market for a consideration of ₹15,68,72,806/- at ₹104/105 and further 6,00,000 shares on 27.12.2000 at ₹84.60 for a consideration of ₹5,07,50,881/-. In view of delivery of shares as required by the said company on 24.11.2000, it requested for lending of the shares of 20,00,000 as that large number of shares were held by the assessee in the investment portfolio having purchased much earlier. Assessee as part of lending of shares after taking a deposit of ₹15,00,000/- allowed the shares to be lent and credited the same to the demat account of the broker directly which were also examined by the

A.O. and CIT(A). The learned counsel referred to the correspondence in the matter and submitted that M/s. Classic Credit Ltd. has sold the shares first in the market and for delivery of the shares they borrowed the bulk shares from assessee by letter dated 24.11.2000, i.e. after the sale of shares of 21,00,000 in the market and before the delivery it requested assessee for lending of shares for the purpose of delivery. Assessee in good faith allowed the lending and the shares were delivered in the market by CCL and for the purpose of delivery on the request of the said CCL credited directly to its broker. Then the learned counsel referred to the Balance Sheet as on 31.03.2001 and the return filed in this regard to submit that the assessee has treated the transactions only as lending of shares and the said value of the shares was shown in the Balance Sheet. The learned counsel further on an enquiry conducted by the A.O. both with reference to CCL and Triumph International Finance (I) Ltd. and after due examination has accepted the transaction as one of lending only. It is also further submitted that the assessee has ultimately sold the shares in A.Y. 2003-04 for a price of ₹6 crores as the market has fallen and offered capital gain of ₹13,78,140/-. He then referred to the bank statements at the time of sale to submit that out of the ₹6 crores the assessee has received only an amount of ₹3.15 crores by way of cheque on 2nd July 2002 and the balance amount is still outstanding and could not be recovered even as of now. The shares were sold to M/s. Ruby Merchandise Pvt. Ltd., M/s. Ruby Millenium Infotech & Communication Pvt. Ltd. and Metro Milenium Infotech & Communication Pvt. Ltd. at the behest of CCL and assessee got credit of the above amounts which were considered for capital gains in A.Y. 2003-04. As far as the facts are concerned, the learned counsel submitted that even the return offering the capital gains for A.Y. 2003-04 was filed much before the time the CIT(A) has initiated the proceedings under section 263 and by the time the assessment for A.Y. 2001-02 was completed under section 143(3) by the A.O., the sale was also effected and the return for that year was due. In view of these chronology of events it was the submission of the learned counsel that the transaction was genuine transaction of lending and no transfer of shares were involved in A.Y. 2001-02. It was also further submitted that the

transaction of sale occurred in the hands of CCL and for their delivery assessee's shares were placed with an understanding that the said shares would be returned. It was submitted that lending of the shares is a normal business practice in the stock market. This lending was undertaken with corporate benefits such as dividend accrue to the assessee. With reference to the observations of the CIT(A) that the transaction is a bogus transaction and the company CCL was brought in as a special purpose vehicle to undertake sale of shares, it was the submission that the CIT(A) has wrongly concluded as the sale in the stock exchange was undertaken on 20.11.2000 by the company CCL and since they did not have shares to deliver in exchange, requested the assessee vide letter dated 27.11.2000 for lending of the shares which the assessee has transferred to the broker directly as the delivery has to be undertaken on 28.11.2000 in the Stock Exchange. It was his submission that it was the company CCL which sold the shares and not the assessee. It was the submission that the assessee company is in no way connected with KP group. Assessee company is in the business for the last 30 years and have no connection at all with the KP group or KP group concerns except that they are all dealing with/in the stock market. As an arms length loan transaction, the CCL requested for delivery of shares to the extent of 20,00,000 which were available with the assessee (to the extent of 20.50 lakhs) Since the shares were to be returned in a short period assessee did not undertake any agreement or assurance but unfortunately the KP group was involved in the scam and subsequently after the Joint Parliamentary Committee the group concerns were prohibited by the SEBI in transacting in the market which resulted in assessee not getting back the shares. However, the shares were sold in the stock market again by the Classic Group in July 2002 for which only an amount of ₹3.15 crores was received and the balance amount was still due. It was his submission that the assessee has genuinely undertaken the lending of share transaction in 2000-01 but due to unforeseen circumstances the said Classic group could not return the shares immediately and subsequently sold it on 01.07.2002 and assessee has offered the capital gains in that year. Consequently the observations of the A.O. and the CIT(A) that the transactions are undertaken

by the assessee to a third party for postponement of capital gains were not correct. He relied on the sequence of events and facts to submit that the transactions were genuine.

6. The learned D.R., however, contested the submissions of the learned A.R. and submitted that the transaction was not undertaken before and these are not loan transactions as the stock lending was supposed to be observed in the letter and spirit of SEBI circular No.751 and the guidelines therein, which was not followed by the assessee. The shares were not lent through any approved intermediary and there was no agreement to prove that shares were lent. It is also the submission that the assessee has not shown any income or profit in the transaction and so the explanation that it was only a lending transaction and not a sale is not correct. He also pointed out that the shares were transferred to the demat account of the broker and not to the account of the CCL, which was supposed to have taken the shares. He relied on the findings of the A.O. and the CIT(A) to submit that the transactions of lending was not genuine and assessee has sold the shares whereby the A.O. was right in bringing to tax the capital gains.

7. Learned counsel in reply submitted that the stock lending scheme of the SEBI is for the protection of the borrowers and does not prevent any other parties undertaking lending scheme. It was the submission that the acquired benefits are with the assessee and that is why the assessee has followed up the matter with Classic Group and ultimately got sold them in A.Y. 2003-04 in the year of which the capital gains were offered, eventhough the full amount of consideration was not received. He relied on the principles established by the ITAT in the case of Reliance Communication Infrastructure Ltd. vs. CIT 34 SOT 241 with reference to the principles on regulations of SEBI and findings of the above said case to submit that the assessee also has correctly reflected lending transaction in the Balance Sheet and accounts of the assessee and the A.O. did in fact enquired and accepted the transaction in the order under section 143(3) originally.

8. At this stage the Bench has asked for the details of the sale by CCL and the corporate benefits (dividend) received by the assessee company for which clarifications were filed in writing as under: -

- “1. Photo copy of the ledger account of Triumph International Finance India Limited (TIFIL) in the books of account of Classic Credit Limited (CCL) (since in liquidation) for the year ended 31st March 2001 which includes the two bills of Triumph International Finance India Limited for sale of 21 lakhs shares of Global Trust Bank. This shows that Classic Credit Limited has considered the sale of 20 lacs shares of Global Trust Bank in their accounts which have been borrowed form our clients.
2. Corporate Benefits (Dividend) – Dividend history of Global Trust Bank for the years 2000 to 2002 is as tabled below -

For the financial year	Date of declaration of dividend	% of dividend declared	Remarks
1999-00	20.04.2000	22%	Duly reflected in annual accounts for the year ended 31/03/00 - Rs.24,10,000
2000-01	21.05.2001	15%	Entitled to receive from Classic Credit Limited the dividend declared by Global Trust Bank. However, Classic Credit Limited fell into financial crisis in March, 2001 and their bank accounts and other assets had been frozen by the DRT. Hence, our clients could not recover the dividend from Classic Credit Limited.
31.03.02	27.08.2002	5%	The said shares lent to Classic Credit Limited have been sold by our clients on 01.07.02. Thus, our clients would not be entitled to the dividend declared for the year 2002

9. We have considered the issue and examined the record. Keeping in view the rival contentions we are of the opinion that the assessee has lent the shares and not sold the shares during the year. As the sequence of events indicate sale was made by M/s. Classic Credit Ltd. through broker Triumph International Finance (I) Ltd. The sale details paced on record before the A.O. was regarding sale of 21,00,000 shares of Global Trust Bank by CCL, which was accounted for in the books of CCL. Whether it is business transaction or a capital gain transaction in the hands of CCL has

not been examined by the A.O., however, he has blindly followed the directions of the CIT(A) without application of mind even though the order u/s 263 was modified by the ITAT. As seen from para 8 of the assessment order the total consideration received as per Bill No. W/221/00-01/0001 dated 20.11.2000 was ₹15,68,72,806/-, vide the bill of Triumph International Finance (I) Ltd. for CCL in the stock exchange on 20.11.2000 (for the settlement period from 20.11.2000 to 20.11.00 of 15,00,000 shares in different blocks of that date) for a price of ₹104.50 to ₹105.05 per share in different lots. The next bill No. 5/58/00-01/0001 was dated 21.12.2000 for Classic Credit Ltd. for settlement period on that date again undertaken by Triumph International Finance (I) Ltd. for sale of 6,00,000 shares of ₹84.60 per share for a consideration of ₹5,07,50,881/-. As can be seen from the above two bills the total shares sold were 21,00,000 whereas the assessee has lent only 20,00,000 shares. While computing the capital gain the A.O. took the total value of 21 lakh shares but gave credit for 20,00,000 shares only that too at the cost price even though the assessee was eligible for indexation of shares as per the provisions of the Act. This indicates that the A.O. has mechanically treated the sale by the broker in the case of Classic Credit Ltd. as the total sale consideration of the assessee, even though the assessee does not own 1,00,000 shares at all which was also brought to tax. This shows that the transactions of Classic Credit Ltd. which was recorded in that company's books of account had been comply treated as transaction of the assessee without establishing that the said transaction was that of the assessee.

10. All these transactions were undertaken much before the securities scam has come out and the assessee was caught unaware vis-à-vis the Classic Credit Ltd. whose transactions were prohibited subsequently. Eventhough at the time of lending the assessee, in good faith, has not entered into any agreement and has not taken any commission or security other than ₹15,00,000/- received on account through the bank the transactions cannot be disbelieved, as it happened much before the securities scam came out. It is not the allegation that the assessee company is also part of the scam as the assessee company had no relationship either

by way of share holding or otherwise with the KP group except that it has undertaken the lending transaction as they were owning substantial shares of Global Trust Bank when they were required for delivery in the market by the Classic Credit Ltd. The letters received by the assessee before undertaking the lending transaction are as under: -

Dt. 24Th Nov 2000

“with reference to the above and subsequent to our telephonic talks we request you to kindly loan us 20,00,000 (20 Lakhs) shares of Global Trust Bank Ltd.

Kindly let us know of your intention of providing the shares on loan to us at your earliest.”

Dt.27 Nov 2000

“with reference to the above and subsequent to your confirming of providing the shares on loan to us, we request you to kindly transfer the 20 lakhs shares of Global Trust Bank Ltd. to DEMAT account, details of which are as follows:

Client ID : 10001348

Client Name : Triumph International Finance (I) Ltd.

DP ID : IN 300062

DP Name : Indsec Securities Finance Ltd.

Please do the needful and oblige.”

11. After reading the above letters which was received in due course and were placed on record in the assessment proceedings under section 143(3) originally, it does not indicate that it was the assessee who undertook the whole exercise by just giving shares as loan and transferring the shares to demat account as alleged by the CIT(A) in page 4 of the order. Since these are routine correspondence of requesting for loan of 20,00,000 shares and assessee accepted providing the shares on loan, nothing can be read more so as to treat the transaction as colourable transaction adopted by the assessee to avoid tax. The Revenue also did not brought on record how it helps the assessee in avoiding the capital gain tax when assessee could have received the whole consideration, more than what it ultimately received as submitted by the learned counsel that they are yet to receive more than 385 lakhs of consideration and received only ₹3.05 crores out of ₹4.40 crores

investment. They also offered the capital gains on the sale price in AY 2003-04 with out receiving full consideration.

12. The sequence of events do indicate that it was only a lending transaction and not sale of shares as alleged by revenue. In fact the A.O. has issued summons under section 131 on 10.01.2003 to the Principal Officer, CCL as part of the enquiry in the original assessment proceedings. The said CCL, vide letter dated 10.01.2003, has replied that they have obtained a loan of 20,00,000 shares of Global Trust Bank from the assessee on 28.11.2001 which have been directly transferred to the demat account of their broker, Triumph International Finance (I) Ltd. and the same have been subsequently been sold through them. They also enclosed bills evidencing sale of shares aggregating to 21,00,000. It was also confirmed that the aforesaid loan of shares has been utilised to give delivery of the said sale of shares. The Triumph International Finance (I) Ltd. also confirmed that they have received 20,00,000 shares of Global Trust Bank from the assessee on 28.11.2000 which have been sold through NEAT system of the National Stock Exchange and also categorically confirmed that the shares have not been sold in an off market. Further the company in the course of enquiry on 19.01.2004 has also explained to the CIT as under: -

- “a) the shares have been lent to CCL*
- (b) the right of ownership and the title of the said shares still vest with our abovementioned clients and hence, shown in their Balance Sheet of 31st March, 2001 that is, post lending of shares*
- (c) as the shares are “capital asset” within the meaning of 2(14) of the Act and thee is, on facts of the case, no “transfer” within the meaning of the provisions of 2(47) the charging provisions of section 45 would not get attracted and hence, there would be no capital gains eligible to tax*

During the course of discussions you commented that CCL has after borrowing, sold the shares and compared with borrowings of other kind where the borrower is prohibited to sell the articles / goods borrowed, to which we confirmed the sale by CCL and also mentioned that borrowing in share market has to be viewed in a different perspective inasmuch as what the borrower of shares would do after borrowing? He would obviously give delivery of the shares to overcome the inadvertent (or otherwise) excess sale positions in the market. The borrower would not keep the shares idle with him. This kind of borrowing is an age old phenomena in

the share market trade. As such it cannot be considered to be a transfer within the meaning of section 2(47) of the Act.”

In view of these confirmations/submissions on record it cannot be stated that the assessee has sold the shares by way of a ‘special purpose vehicle’ of CCL, which is an independent company transacting on its own.

13. The lending of shares is an accepting methodology in the stock market and recognising the practice SEBI also brought out Security Lending Scheme 1997 which inter alia brings out an approved intermediary, generally a bank, a borrower and lender and provided a scheme wherein the lender has to enter into an agreement through an intermediary and various procedures are prescribed. However, in the case of the assessee, assessee has not brought any approved intermediary in the picture and directly dealt with the borrower at its own risk. As rightly submitted by the learned counsel the scheme prescribes certain methodology to avoid risk in the market whereas the assessee has undertaken the risk by lending directly. However, this does not bar transactions between the two independent companies per se. The Board also, vide circular No. 751, has clarified on the basis of the scheme that the lending of shares does not involve transfer of assets. Vide para 3 and 4 of the circular No. 751 the following has been clarified: -

“3. The following taxation issue may arise in respect of transactions under the scheme of securities lending:

‘Whether the lending of shares under the securities lending scheme will amount to “transfer” under section 2(47) of the Income-tax Act in the hands of the lender?’

4. As far as the stock market is concerned, shares are fungible assets. “Fungible” has been defined in the Shorter Oxford English Dictionary on Historical Principles as “said of a thing which is the subject of an obligation when another thing of the same or another class may be delivered in lieu of it”. One share of a company is good replacement for another share of the same company. The market does not lay any emphasis on the distinctive numbers. It is only for the purpose of reckoning the holding period of any particular share or to distinguish between an original share and a bonus share, that the Income-tax Department relies on the distinctive numbers. The Board are advised that when the lender gets back equivalent number of shares of the company with different distinctive numbers, it is not a case of

exchange of assets. This is so because once the asset is fungible, when the lender receives back the same number of shares of the same company of the same face value and carrying the same rights, it is immaterial whether they have different distinctive numbers. He will be in a ready position to either sell the shares and realise their value or send them to the company for transfer to his name. The transaction of the lending shares of some distinctive numbers and receiving back shares of some other numbers is not “exchange” of assets within the meaning of “transfer” as defined in section 2(47) of the Income-tax Act. The meaning of the word “exchange” necessarily involves exchange of two different assets. The asset received back in the aforesaid type of transaction is no different from what was lent so long as it represents the same fraction of the ownership of the company. At no stage, the lender or borrower intended to “exchange” different assets, hence, transaction of lending of shares or any other security under the securities lending scheme would not result in “transfer” for the purpose of invoking the provisions relating to capital gains under the Income-tax Act.”

14. In assessee's case the facts indicate that the shares which are in investment portfolio of the assessee have been lent to the said CCL on their request and the assessee as per companies auditor's report vide item No. 24 the transactions has been reported as such in the books of account by the auditor in his note to the accounts. Consequent to the blocking of transactions of CCL subsequently the assessee could not get back the shares as such but sold them through the said company to another third party and offered the capital gains in A.Y. 2004-05 which the A.O. has accepted. In view of the above, we are of the opinion that the assessee did undertake a loan transaction and not sale of shares during the year under consideration. The Revenue was unable to bring any evidence on record to establish that the assessee has engaged in sale transaction and not a loan transaction. The basis for the Assessing Officer's order is only some of the observations made by the CIT in the order under section 263 and has not been made on any independent enquiries. As seen from the details placed on record, the said CCL sold the shares in the market, borrowed shares from the assessee company, delivered them when it was due and subsequently when the said company was held in the securities scam and operations were barred, assessee has no other option than to sell those shares which are lent by them earlier to a third party, sale of which was recorded and the capital gains was offered. In view of these facts, there is no basis for Revenue's

contention that assessee has sold shares in this year. Accordingly assessee's grounds are allowed.

15. In the result, appeal is allowed.

Order pronounced in the open court on 21st January 2011.

Sd/-
(R.S. Padvekar)
Judicial Member

Sd/-
(B. Ramakotiah)
Accountant Member

Mumbai, Dated: 21st January 2011

Copy to:

1. *The Appellant*
2. *The Respondent*
3. *The CIT(A) – II, Mumbai*
4. *The CIT– II, Mumbai City*
5. *The DR, “C” Bench, ITAT, Mumbai*

By Order

//True Copy//

Assistant Registrar
ITAT, Mumbai Benches, Mumbai

n.p.