

sas

IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.3111 OF 2009

The Commissioner of Income Tax-4(3))
Aayakar Bhavan, M.K. Road, Churchgate,)
Mumbai - 40 020.) ..Appellant.

V/s.

M/s. Kotak Securities Limited,)
1st Floor, Bakthawar 229, Nariman)
Point, Mumbai - 400 021.) ..Respondent.

Mr. Vimal Gupta for appellant.

Mr. F.V. Irani with Atul K. Jasani for respondent.

Dr. K. Shivram with Mr. Ajay Singh, Mr. S.C. Tiwari with Ms. Natasha, Mr. Rajeev Wagley and Mr. Pankaj Toprani for Intervenors.

CORAM : J.P. DEVADHAR AND A.A.SAYED, JJ.

JUDGMENT RESERVED ON : 11TH AUGUST, 2011

JUDGMENT PRONOUNCED ON : 21ST OCTOBER, 2011

JUDGMENT (PER J.P. DEVEDHAR, J.)

1) Although six questions of law are raised by the revenue in this appeal, learned counsel for the revenue does not press the first five

questions as the said questions stand answered against the revenue by the decisions of the Apex Court in the case of *Techno Shares and Stocks Ltd. V/s. CIT* reported in [2010] 327 ITR 323 (S.C.) and *T.R.F. Ltd. V/s. CIT* reported in [2010] 323 ITR 397 (SC).

2) The appeal is admitted on the sixth question of law and taken up for hearing by consent of parties. The sixth question of law (reframed) reads thus:-

" Whether on the facts and in the circumstances of the case and in law, the Tribunal was justified in holding that the transaction charges paid by the assessee to the stock exchanges were not fees for technical services and, therefore, the provisions of Section 194J were not attracted and consequently the provisions of Section 40(a) (ia) of the Income Tax Act, 1961 were also not attracted ? "

3) Since several appeals are pending before this Court wherein similar question is raised, we have permitted counsel for the assesseees in those appeals to appear as 'intervenors'.

4) The assessment year involved herein is AY 2005-06.

5) The respondent-assessee is a company engaged in the business of share broking, depositories, mobilization of deposits and marketing of public issues.

6) Trading in securities are carried out through various Stock Exchanges such as National Stock Exchange of India (NSE), Bombay Stock Exchange (BSE), etc. which are recognized Stock Exchanges under the provisions of the Securities Contracts (Regulation) Act, 1956.

7) The stock exchanges are established for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities. The recognized stock exchanges are empowered inter alia to make bye laws for the regulation of, entering into, making, performance and termination of contracts including contracts between members or between a member and its constituent or between a member and a person who is not a member and the consequences of default or insolvency on the part of a seller or buyer or intermediary, the consequences of a breach or omission by a seller or buyer and the responsibility of members who are not parties to such contracts.

8) Trading in securities were traditionally carried out under the open outcry system where the member brokers used to assemble in a trading ring for doing transaction in securities. To facilitate smooth trading, the open outcry system has been replaced by the BSE by introducing the BSE On-line Trading (BOLT) system. Similarly, the NSE has introduced the National Exchange for Automated Trading (NEAT)

System. For the sake of convenience, we deal with the BOLT system devised by the BSE. The BOLT system was introduced by the BSE with effect from 14-3-1995. This totally automated screen based trading in securities, facilitates the member brokers to trade in securities from the Trader Work Stations installed in their offices instead of assembling in the trading ring.

9) The trading in securities at the Exchange is conducted in an anonymous environment and the identify of the counter-party is not revealed on the screen based BOLT system with a view to ensure that the transactions are carried out in a free and fair manner and there is no scope for malpractices. Thus, the buyers and sellers of securities do not know the names of each other and the same is revealed only after the deal is finally settled.

10) Settlement of the transactions in securities entered into by the members is done as per the procedure adopted by the stock exchange which is continuously updated from time to time. The trading and settlement activities of the member brokers are closely monitored through On-line Real Time System known as BSE on-line Surveillance system ('BOSS' for short). This system enables the Exchange to detect market abuses at a nascent stage, improve the risk management system and strengthen the self- regulatory mechanisms.

11) To regulate and control the contracts for sale and purchase of securities, the recognized stock exchanges have framed Bye-laws which are duly approved by the Securities & Exchange Board of India (SEBI). As per the bye laws framed by the BSE which are duly approved by SEBI, the BSE is entitled to charge its members various fees, such as, listing fees, admission fees, arbitration fees, transaction charges, etc.

12) Transaction charges are levied by the BSE on the members who enter into transactions in securities / derivatives through the BOLT system provided by the BSE. BOLT system is a screen based system where the trading operations are made interactive by connecting the various stock brokers to the stock exchange through VSAT and lease line connections provided by the exchange to its members, The BOLT system provides all the data that is necessary for an intending buyer and intending seller of the respective securities. When a best buy order is matched with the best sell order the transaction is concluded. Under the BOLT system, members can proactively enter orders in the system which is displayed in the system till the full quantity is matched by one or more of counter orders and result into a transaction. In respect of the transactions carried out through the BOLT system, the exchange collects transaction charges depending upon the value of the transactions.

13) In the assessment year in question, the assessee had paid to the BSE Rs.5,17,65,182/- towards transaction charges. The question is, whether the said payment of transaction charges constituted payment of 'fees for technical services' covered under Section 194J of the Income Tax Act, 1961 ('the Act' for short) so as to hold that the assessee was liable to deduct tax at source at the time of crediting the transaction charges to the account of the stock exchange.

14) The assessing officer was of the opinion that the transaction charges paid by the assessee were in the nature of 'fees for technical services' covered under Section 194J of the Act and, therefore, the assessee was liable to deduct tax at source at the time of making payment to the BSE. As the assessee had not deducted tax at source, the assessing officer held that in view of Section 40(a)(ia) of the Act, the entire expenditure of Rs.5,17,65,182/- incurred by the assessee by way of transaction charges was liable to be disallowed.

15) On appeal filed by the assessee, the CIT(A) upheld the decision of the assessing officer by holding that the stock exchange is not merely a mute spectator providing only physical infrastructure to the members but the stock exchange was a supervisor, overseer, manager controller, settlor and arbitrator over the security trading done through the stock exchange which necessarily had vital inputs and ingredients of

rendering managerial services and, therefore, the provisions of Section 194J was applicable to the facts of the present case.

16) On further appeal filed by the assessee, the ITAT by the impugned order held that the stock exchange does not render any managerial service or render any technical consultancy service and, therefore, transaction charges were not covered under Section 194J of the Act and consequently Section 40(a)(ia) of the Act was also not attracted. Accordingly, the Tribunal deleted the disallowance made by the assessing officer. Challenging the aforesaid order of the ITAT, the revenue has filed the present appeal.

17) According to the revenue, the transaction charges paid by the assessee to the stock exchange constitute fees for technical services under Section 194J read with Explanation 2 to clause (vii) of the Section 9(1) of the Act, because, the stock exchange through the BOLT system provides a trading platform which is highly sophisticated and constantly monitored and managed by the managerial staff of the stock exchange and hence the services rendered by the stock exchange are technical services covered under 194J of the Act and, therefore, it was obligatory on the part of the assessee to deduct tax at source at the time of making payment to the stock exchange. Since the assessee failed to deduct tax at source, the assessing officer was justified in invoking Section

40(a)(ia) of the Act. On the other hand, counsel for the assessee as also counsel for the intervenors strongly supported the order passed by the ITAT and submitted that the transaction charges were paid by the assessee for user of a system provided by the stock exchanges. It is contended that the BOLT system like the ATM system provided by the banks does neither envisage a contract for rendering technical services nor a contract for rendering managerial services, but merely a contract for user of the BOLT system. Therefore, in the absence of a contract for rendering the technical services, the fact that the BOLT system itself is a device set up by using high technology cannot be a ground to hold that the transaction charges are fees for technical services under Section 194J of the Act and hence Section 194J is not applicable to the facts of the present case and consequently, the provisions of Section 40(a)(ia) are also not applicable to the facts of the present case.

18) Before considering the rival submissions, it would be appropriate to refer the relevant provisions of the Act. Section 194J was inserted to the Act by the Finance Act, 1995 with effect from 1/7/1995. Material part of Section 194J as it stood at the time relevant to AY 2005-06 reads thus :-

" **194J.** (1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of

- (a) fees for professional services, or
- (b) fees for technical services,

shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to (five) per cent of such sum as income-tax on income compromised therein;

Provided that

Provided further that -----

Provided also

Explanation : For the purposes of this Section --

- (a) 'Professional services' means
- (b) 'fees for technical services' shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of Section 9;
- (c) -----

19) Explanation 2 to Section 9(1)(vii) reads thus :-

" For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include

consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries" ;

20) Thus, plain reading of Section 194J read with Explanation 2 to Section 9(1)(vii) of the Act clearly shows that the expression 'fees for technical services' includes rendering of any managerial services. The question is, by providing BOLT system of trading in securities, whether, the stock exchange renders managerial services to its members ?

21) The ITAT as also the counsel for the assesseees have strongly relied on the decision of the Madras High Court in the case of *Skycell Communications Ltd. V/s. DCIT* reported in 251 I.T.R. 53 (Mad) ['Skycell' for short] wherein it was held that the cellular mobile telephone service provider does not render technical service though high technology is involved in the cellular mobile phone and, therefore, Section 194J of the Act cannot be applied to the payments made by the subscriber to the cellular mobile telephone service provider.

22) In our opinion, the decision of the Madras High Court in the case of Skycell is distinguishable on facts. In that case, the subscriber who had subscribed to the network was required to pay for the air time used by the subscriber at the rate fixed by the service provider. The

question before the Madras High Court was, whether the amount paid by the subscriber for the air time used on the cellular mobile phone constituted fees for technical services ? In the facts of that case, the Madras High Court held that the contract between the subscriber and the service provider was to provide mobile communication network and the subscriber was neither concerned with the technology involved in the cellular mobile phone nor the subscriber was concerned with the services rendered by the managerial staff in keeping the cellular mobile phone activated. It was held that the contract between the customer and the service provider therein was not to receive any technical service or managerial service and the customer was only concerned with the facility of being able to communicate with others on payment of charges for the air time used. Thus, there was no linkage between the contract for providing a medium of communication through the cellular mobile telephone and the technical or managerial service rendered by the service provider in keeping the cellular mobile phone activated.

23) However, in the present case, there is direct linkage between the managerial services rendered and the transaction charges levied by the stock exchange. The BOLT system provided by the Bombay Stock Exchange is a complete platform containing the entire spectrum of trading in securities. The BOLT system not merely provides the live connection between prospective purchasers and

prospective sellers of the respective securities / derivatives together with the rates at which they are willing to buy or sell the securities, but also provides a mechanism for concluding the transaction between the two parties. The BOLT system withholds the identity of the two contracting parties, namely, the buyer and the seller of the respective securities / derivatives. Under the screen based BOLT system the entire trading system is managed and monitored right from the stage of providing the platform for the prospective buyers / sellers of the securities / derivatives till the date the deal struck between the two parties are finally settled in all respects. The very object of establishing the stock exchanges is to regulate the transactions in securities and to prevent undesirable speculation in the transactions. To achieve this goal, the stock exchange continuously upgrades its BOLT system so that the transactions carried on through that system inspire confidence in the general public and that the transactions are settled smoothly and expeditiously. Thus, the entire trading in securities is managed by the Bombay Stock Exchange through the BOLT system provided by the stock exchange.

24) Unlike in the case of cellular mobile phones where the user of the cellular telephone is at the discretion of the subscriber and the service provider is not regulating user of the cellular mobile phone by the subscriber, in the case of BOLT system, the user of the system is

restricted to the trading in securities and the same is completely regulated by the stock exchange. If during the course of trading, it is found that a member is indulging in malpractices the stock exchange is empowered to suspend the member broker apart from making him liable for various other consequences. Thus, the decision of the Madras High Court in the case of Skycell is totally distinguishable on facts and the ITAT was in error in applying the ratio laid down therein to the facts of the present case.

25) The argument that in the present case there was no contract for rendering technical / managerial service is without any merit, because, the very object of providing the BOLT system is to provide a complete platform for carrying on the trading in securities / derivatives. If a member of the stock exchange does not enter into any transaction under the BOLT system he is not required to pay the transaction charges. It is only if the member trades through the BOLT system the member is required to pay transaction charges depending upon the volume of trading because, once the trading through the BOLT system takes place the member is assured that the other contracting party is a genuine buyer or seller as the case may be and that the price offered by the opposite party would be in consonance with the norm laid down by the stock exchange and that the transaction would be settled efficiently and expeditiously. The fact that the stock exchange levies or collects

lesser transaction charges where the value of the transaction is higher, cannot be a ground to hold that no managerial services are rendered by the stock exchange, because, what should be the criteria for levying the transaction charges is left to the discretion of the stock exchange. The fact that the transaction charge is based on the value of the transaction and not the volume of transaction is not determinative of the fact as to whether managerial services are rendered or not. In other words, whatever be the measure for levying the transaction charges, the fact remains that the stock exchange regulates and manages the entire trading activities on the exchange till the transactions are finally settled.

26) Unless the stock exchange constantly monitors the transactions relating to the sale or purchase of the securities right from the stage when the two contracting parties interact through the BOLT system, it would be impossible to ensure safety of the market. When there is considerable variation in the price of the securities offered to be sold or purchased the in-built system alerts and remedial measures are taken immediately so that no panic situation arises in the stock market. With a view to regulate the trading in securities, the stock exchange provides risk management and surveillance to the stock brokers to ensure the safety of the market. The surveillance function involves price monitoring, exposure of the members, rumour verification on a daily basis and take remedial actions like reduction of filters, imposition

of special margin, transferring scrips on a trade to trade settlement basis, suspension of scrips / members, etc. These are some of the identified managerial services rendered by the stock exchange for which transaction charges are levied.

27) The fact that the BOLT system provided by the stock exchange has in-built automatic safeguards which automatically gives alert signal if the fluctuation in the prices of the securities exceed a particular limit prescribed by the stock exchange does not mean that the managerial services are not rendered, because, firstly, the in-built mechanism in the BOLT system itself is a part of the managerial service rendered by the stock exchange and secondly, even the in-built mechanism provided in the system is varied or altered by the stock exchange depending upon the circumstances encountered during the course of rendering managerial services.

28) The argument that the BOLT system is like a ATM system provided by the banks is also without any merit, because through the ATM system, no trading activity is carried on, whereas, through the BOLT system trading activity is carried on which is monitored / regulated / managed by the stock exchange. Therefore, in our opinion, the Tribunal was in error in holding that no technical or managerial services are rendered by the stock exchange by providing the BOLT

system of trading in securities.

29) In the result, we hold that when the stock exchanges are established under the Securities Contracts (Regulation) Act, 1956 with a view to prevent undesirable transactions in securities by regulating the business of dealing in shares, it is obvious that the stock exchanges have to manage the entire trading activity carried on by its members and accordingly managerial services are rendered by the stock exchanges. Therefore, in the facts of the present case, the transaction charges were paid by the assessee to the stock exchange for rendering the managerial services which constitutes fees for technical services under Section 194J read with Explanation 2 to Section 9(1)(vii) of the Act and hence the assessee was liable to deduct tax at source before crediting the transaction charges to the account of the stock exchange.

30) The question then to be considered is whether the assessing officer was justified in invoking Section 40(a)(ia) of the Act and disallowing the entire business expenses incurred on account of transaction charges on the ground that the assessee has failed to deduct tax at source under Section 194J of the Act ?

31) The object of introducing Section 40(a)(ia) as explained in the CBDT circular No.5 dated 15/7/2005 is to augment compliance of

TDS provisions in the case of residents and curb bogus payments. Moreover, though Section 194J was inserted with effect from 1/7/1995, till the assessment year in question that is AY 2005-06 both the revenue and the assessee proceeded on the footing that Section 194J was not applicable to the payment of transaction charges and accordingly, during the period from 1995 to 2005 neither the assessee has deducted tax at source while crediting the transaction charges to the account of the stock exchange nor the revenue has raised any objection or initiated any proceedings for not deducting the tax at source. In these circumstances, if both the parties for nearly a decade proceeded on the footing that Section 194J is not attracted, then in the assessment year in question, no fault can be found with the assessee in not deducting the tax at source under Section 194J of the Act and consequently, no action could be taken under Section 40 (a)(ia) of the Act. It is relevant to note that from AY 2006-07 the assessee has been deducting tax at source while crediting the transaction charges to the account of the stock exchange though not as fees for technical services but as royalty. It is further relevant to note that it is not the case of the revenue that on account of the failure on the part of the assessee to deduct tax at source, the revenue has suffered presumably because, the stock exchange has discharged its tax liability for the assessment year in question. In any event, in the facts of the present case, in view of the undisputed decade old practice, the assessee had bonafide reason to believe that the tax

was not deductible at source under Section 194J of the Act and, therefore, the assessing officer was not justified in invoking Section 40(a)(ia) of the Act and disallowing the business expenditure by way of transaction charges incurred by the assessee.

32) Accordingly, we hold that the transaction charges paid by the assessee to the stock exchange constitute 'fees for technical services' covered under Section 194J of the Act and, therefore, the assessee was liable to deduct tax at source while crediting the transaction charges to the account of the stock exchange. However, since both the revenue and the assessee were under the bonafide belief for nearly a decade that tax was not deductible at source on payment of transaction charges, no fault can be found with the assessee in not deducting the tax at source in the assessment year in question and consequently disallowance made by the assessing officer under Section 40(a)(ia) of the Act in respect of the transaction charges cannot be sustained. We make it clear that we have arrived at the above conclusion in the peculiar facts of the present case, where both the revenue and the assessee right from the insertion of Section 194J in the year 1995 till 2005 proceeded on the footing that the assessee is not liable to deduct tax a source and in fact immediately after the assessment year in question i.e. from AY 2006-07 the assessee has been deducting tax at source while crediting the transaction charges to

the account of the stock exchange.

33) The question raised in the appeal is answered accordingly and the appeal is disposed off in the above terms with no order as to costs.

(A.A.SAYED, J.)

(J.P. DEVADHAR, J.)