

IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH: KOLKATA
[Before Shri P. K. Bansal, AM & Shri Mahavir Singh, JM]

I.T.A No.783/Kol/2009
Assessment Year: 2005-06

Income-tax Officer, Wd-12(1), Kolkata Vs. M/s. Nupur Carpets Pvt. Ltd.
(PAN: AABCN0170A)
(Appellant) (Respondent)

&

C.O. No.41/Kol/2009
In I.T.A No.783/Kol/2009
Assessment Year: 2005-06

M/s. Nupur Carpets Pvt. Ltd. Vs. Income-tax Officer, Wd-12(1), Kol.
(Cross Objector) (Respondent)

Date of hearing: 10.06.2015
Date of pronouncement: 01.07.2015

For the Revenue: Shri Sanjay, Addl. CIT, Sr. DR
For the Assessee/Cross Objector: Shri S. Jhahharia, FCA

ORDER

Per Shri Mahavir Singh, JM:

These, appeal by revenue and Cross Objection by assessee, are arising out of order of CIT(A)-XII, Kolkata in Appeal No. 501/XII/12(4)/07-08 dated 27.02.2009. Assessment was framed by ITO, Ward-12(4), Kolkata u/s. 143(3) of the Income-tax Act, 1961 (hereinafter referred to as the Act) for Assessment Year 2005-06 vide his order dated 31.12.2007.

2. At the outset, it is seen that this appeal by Revenue is barred by 20 days and has filed condonation petition in which it was stated that there was no delay in the following reason vide letter dated No. ITO/Wd-12(1)/Nupur Carpets/ Appeal /Kol /2012-13 date 19.06.13 :

“In the above case the order dated 20.02.2009 of the Commissioner of Income Tax (Appeals)-XII, Kolkata was communicated on 20.03.2009 vide F No. CIT(A)-XII/Kol/Batch/08-09/347-551 dt. 20.03.2009. It appears owing to typographical error in Form No. S6 dated of communication was stated as 20.02.2009. The actual date of communication of the order of CIT(A)-XII-Kolkata is 20.03.2012.”

Ld. counsel for the assessee has not objected to the above as there is no delay, the appeal is within time.

3. First issue in this appeal of Revenue is against the order of CIT(A) in treating the income from sale of shares as Long Term Capital Gains (LTCG for short) as against the order of Assessing Officer in which the sale of shares were treated as "business income". For this, Revenue has raised following ground No.1:-

"(1) On the facts and under the circumstances of the case, Ld. CIT(A) has erred in not taking the entire income arising out the sale of share/unit as income from business while the main business of the assessee during the year was only purchase and sale of shares."

4. Briefly stated facts are that the assessee-company is deriving the income from business as well as from investments. The assessee is engaged in the business of carpets, garments, shares and stocks etc., The assessee has disclosed its income from sale of shares as LTCG and STCG as the case may be. The AO during the course of assessment proceedings noticed that assessee-company has LTCG and STCG from numerous sale and purchase transactions of units of mutual funds/shares through own investment/off market sale and through Kotak PMS. The AO required the assessee to explain as to why the profit on sale of shares be not treated as "business income" instead of LTCG/STCG. The assessee explained vide letter dated 28-12-2007 and the relevant portion of the letter submitted before AO reads as under:-

"3)a) This is to submit that by Resolution dated 28.02.2004 a certified copy of which is enclosed herewith, all shares, units of mutual funds other instruments as held by Kotak Securities Ltd., under their Portfolio Management were transferred to investment account and since then all such shares, units of mutual funds and other instruments as held by Kotak Securities Ltd., under their Portfolio Management on 01.04.04 are being held by company as investment, shares and securities and any sale thereof after 01.04.04 was only as investment of share and securities and on investment account only.

b) As will further appear from the aforesaid resolution on and from 01.04.04 all shares and securities purchased by Kotak Securities Ltd on behalf of the company under the Portfolio Management Scheme are being held as investments, shares and securities and all the purchases and sales since then are only purchases and sales of investment of shares and securities held as investments."

According to AO, assessee is carrying on the activities of shares transactions in a systematic manner and according to him, the same is in the nature of business. Accordingly, he assessed the income arising out of sale and purchase of shares and mutual funds as "business income" at Rs.2,78,47,070/-. Aggrieved, assessee

preferred appeal before CIT(A), who after considering the submission of assessee treated the profit arising out of sale of shares as LTCG but issue of conversion of investment in stock-in-trade as business income by observing as under:-

“4.4 Decision

In the light of the discussion held both on facts and law, I am of the opinion that the original intention of the appellant was to treat shares as investment and not stock in trade as evident from the entries made in the books of accounts and balance sheet. The volume of transactions, frequency of transactions, period of holding etc., would not alter the nature of transaction from investment to trading when the initial intention of the appellant was to hold the shares under investment and accordingly recorded in the books. As such the assets (shares) categorized under the head 'investment' are to be treated as capital assets and the profit on sale of such assets are taxable under the head 'capital gains'. As observed by the Hon'ble ITAT Kolkata Bench in the assessee of Reliance Trading Enterprises Ltd. (supra) the shares were purchased with an intention of earning dividend in addition to the prospect of making profit on sale of such investment shares at an opportune moment without making any hurry for sale ignoring dividend. Respectfully following the ratio laid down by the ITAT, Kolkata Bench in the case of Reliance Trading Enterprises Ltd., and the ratios laid down in the cases discussed, I hold the profit on sale of shares/units as capital gains as against business income assessed by the AO. However in the preceding para (point 11 of para 4.4), I have discussed the issue of conversion of 'investment into stock-in-trade and back again into investment'. The profit attributable to such trading activity need to be separated from the regular investment account to arrive at the net surplus under the head capital gains. As directed earlier the profit attributable to the trading activity (conversion of stock-in-trade into investment) is to be taxed under business income. Accordingly I direct the AO to give effect taking into consideration both investment account and trading account separately. The profit attributable to trading activity (conversion of stock-in-trade into investment) shall be taxed under the head 'business income'. The net surplus resulted out of 'investment account' shall be taxed under the head 'capital gains'. In the result the appellant's ground on this issue (Ground No. b) is partly allowed.”

Against the decision of CIT(A), Revenue came in appeal against the treatment of profit arising out of sale as CG and assessee came in Cross Objection against treatment of conversion and investment into stock-in-trade as business income.

5. We have heard rival contentions and gone through the facts and circumstances of the case. We find from the facts of the case that the AO treated net surplus as business income instead of capital gains on the ground that the assessee carried out business of share trading as evident from large volume of transactions and systematic, organized, repeated and regular activity in shares with a clear intention to earn huge profits. But the facts suggests that the assessee-company was holding shares as investment all along and that the initial intention

was evident by way the entries made in books and valuation of shares at cost and that the volume of transactions was low and that substantial dividend income earned reflecting the intention. Thus, according to assessee the net surplus was not a business income but on account of capital gain. To decide whether a transaction is in the nature of investment or trading the crucial test that laid down by various courts is that the intention of the assessee at the time of purchase of shares. The AO on the other hand, was on the conduct of the business of the assessee which according to him carried out in a systematic and organized manner involving large volumes of transactions in shares. As seen from the principles laid down by various courts, the main test prescribed is the initial intention of the assessee to decide whether an activity amounts to trading activity or investment activity. As seen from the above facts, the assessee is justified in its argument that its original initial intention is to hold the shares as investments and not as stock-in-trade. The intention of the assessee as is evident from the circumstances at the time of purchase of shares/units, is a relevant factor and often a conclusive factor in determining whether a transaction is in the nature of trade or in the nature of investment. The assessee had been keeping its holdings in certain companies from a few months to a few years, which clearly indicates that the motive and intention of the assessee is to earn returns in the form of capital gain apart from dividend income.

6. As regards the AO's observation that the assessee carried out numerous transactions with larger volumes, the assessee submitted that the volume of transactions carried out in terms of total holding is not large. It is further submitted that out of 113 scrips including mutual funds only 8 scrips were sold. According to assessee most of surplus (capital gain) was on account of sale/redemption of investment held for a long period. It is submitted that out of total net capital gain of Rs.2,78,47,070/- the major capital gain amounting to Rs.2,43,14,169/- pertains to sale of shares of J.J. Exports which were held from AY 1992-93 onwards. The relevant details have been produced during the course of appellate proceedings before CIT(A) and even before us now. As regards AO's observation that purchases were effected out of borrowed funds, the assessee argued that the sources for acquisition of shares are from share capital, reserves and surplus funds.

In this regard, Ld. counsel for the assessee filed summary of accounts from AYs 1993-94 to 2005-06. During the course of appellate proceedings, it is noticed that the assessee-company during the AY 204-05, converted investment portfolio of Rs.50,01,126/- carried out through Kotak PMS into stock-in-trade as on 01-04-2003 and accordingly made entries in the books and continued purchases and sales under that head i.e. trading account. The resultant closing stock of Rs.2.22 crores remaining as on 31.03.2004 under trading account carried forward to next AY 2005-06 and again brought back under investment head by converting the entire closing stock lying under trading account in the previous AY 2004-05. Thus, the stock-in-trade converted into investment got merged with regular opening stock of Rs 3.34 crores lying under investment account as on 01.04.2004. On a specific query, the Ld. counsel for the assessee mentioned that out of total gain derived on sale of investment, assessee gained only Rs.29,03,004/- on sale of portfolio investment held by Kotak (out of stock in trade converted to investment as on 01.04.2004) and balance gain was only on investments. Thus it is clear that out of total gain derived by the assessee of Rs.2,7847,069/-, the gain corresponding to conversion of stock-in-trade into investment amounts to Rs.29,03,004/-. In view of the above facts assessee argued that on the issue of capital gain versus business income the assessee mainly argument on the point of intention of the assessee and the corresponding entries and treatment given in the books of accounts. It was argued that the assessee has been an investor and not a trader as seen from the intention of the assessee. It was further argued that the treatment given in the books under the head investment clearly shows that the assessee's intention to deal in shares as investment. Going by the same arguments/logic and applying the same principles as laid down by the courts, the above conversion of investment into stock-in-trade in AY 2004-05 and continuing the trading under that head and again converting the closing stock under that head into investment in the AY 2005-06 under consideration amounts to a clear change of intention depending on the circumstances. We have gone through ledger accounts of the assessee for the year under consideration and noticed separate ledger accounts in respect of conversion of stock-in-trade into investment. By converting the stock-in-trade into investment, it does not alter the character, nature and intention of that particular

transaction especially in the context of capital gain versus business income. By bringing in stock-in-trade under the head investment the assessee could reduce the tax incidence considerably. The activity of trading in shares carried out separately in the AY 2004-05 and again brought forward to be continued in the next AY i.e. 2005-06 under the head investment is to be considered as trading activity only. Subsequent conversion and treatment given in the books of accounts do not alter the character of commercial transaction. Accordingly, the profit that has been attributable to this trading activity corresponding to conversion of stock-in-trade into investment is to be treated as business income and accordingly to be taxed. In view of the above findings of CIT(A) that the income from investment is to be taken as capital gains and conversion of stock-in-trade to investment is to be taken as trading income, which is based on facts of the case and need no disturbance. Accordingly, we confirm the findings of CIT(A).

7. Next issue in Revenue's appeal in ITA No.783/Kol/2009 is as regards to the order of CIT(A) deleting the disallowance on travelling and conveyance charges amounting to Rs.1,20,028/-. For this, Revenue has raised following ground No.2:-

“(2) On the facts and in the circumstances of the case, Ld. CIT(A) erred in deleting the disallowance of Rs.1,20,028/- on account of ‘Travelling and Conveyance’ though purchase and sale of carpet, the main business of the assessee, gone down to Nil during this A.Y.”

8. We have heard rival contentions and gone through the facts and circumstances of the case. We find that AO has made disallowance of travelling & conveyance allowance by estimating at 10% of the expenditure. It is seen that assessee has incurred total expenditure on travelling & conveyance at Rs.12,00,280/- as the assessee's sale of carpet has gone to nil. According to AO, there is no relevance in allowing the whole of the expenditure. Accordingly, he disallowed 10% of the expenditure. Aggrieved, assessee preferred appeal before CIT(A), who allowed the claim of the assessee. Now, Revenue came in second appeal before us.

9. We have heard rival contentions and gone through the facts and

circumstances of the case. We find that assessee mainly contended that the expenditure in question has been incurred to exploit the possibilities of reviving the export of carpet business. According to the assessee the business expenditure incurred on attending the World Business Congress Organized by International Chamber of Commerce by the Chairman and Managing Director would not be treated as anything else but for the purpose of business and in connection with the business and hence the entire expenditure is allowable expenditure u/s. 37 of the Act. It is further argued that the expenditure was incurred due to commercial expediency and incurred wholly and exclusively for the purpose of business. In support of the arguments, the assessee cited plethora of cases which are in favour of the assessee.

10. As seen from the assessment order except questioning the rationality of the expenditure in the absence of carpet business, the AO has not brought on record any material evidence to dispute the reasonability and purpose of the expenditure incurred. As argued by the assessee, the AO has not disproved expenditure incurred nor proved such expenditure was personal in nature or capital in nature. The books of accounts are audited and auditors have not pointed out any discrepancies in the nature of personal expenses or capital expenditure debited to profit and loss account. During the course of hearing, the Ld. counsel for the assessee clarified that the expenditure incurred on travelling and conveyance was mainly on account of foreign tour to interact with business people and to explore the prospects of export in carpets and garments which is otherwise the main line of business activity of the assessee. Accordingly, we confirm the order of CIT(A).

11. The issue in assessee's CO is as regards to disallowance of expenses relating to total income (in relation to exempt income) by invoking the provision of Section 14A and new Rule 8D (2)(iii) of the IT Rules, 1962. For this, assessee has raised following ground No. 2 and 3:-

"2. For that in view of the facts and circumstances of the case Ld. CIT(A) was wholly wrong and unjustified in not deleting the arbitrary, adhoc and estimated disallowance of expense of Rs.6,37,182/- u/s. 14A of the I.T. Act @ 10% of the exempt dividend income of Rs.63,71,824/- made in the assessment merely on

presumption without pointing out any specific item of expenditure actually incurred for earning such income. Action of the Ld. CIT(A) in not deleting the said disallowance, inspite of his holding that such estimated disallowance was not in accordance with law, was wholly unreasonable, uncalled for and bad in law.

3. For that in view of the facts and circumstances of the case Ld. CIT(A) was wholly wrong and unjustified in directing the AO to apply Rule 8D(2)(iii) of the IT Rules and compute the disallowance u/s. 14A @ 0.5% of the average of the opening and closing value of investment and thereby enhancing the income without issuing any prior notice of enhancement u/s. 251(2) of the Act without considering the fact that the assessment proceeding was completed before the date of insertion of Rule 8D w.e.f. 24.03.2008. Action of the Ld. CIT(A) was wholly unreasonable, uncalled for and bad in law.”

12. Brief facts are that the AO estimated the disallowance of expenses at Rs.6,37,182/- out of total dividend income of Rs.63,71,821/- @ 10%. Aggrieved, assessee preferred appeal before CIT(A), who also confirmed the action of AO by applying provision of Sec. 14A of the Act and Rule 8D(2)(iii) of the IT Rules.

13. We have heard rival contentions and gone through the facts and circumstances of the case. We find that this issue is now covered by the decision of co-ordinate Bench of ITAT & Bench Kolkata in ITA No. 954/Kol/2010 dated 29.04.2011 restricted the disallowance to 1% of dividend income. Relevant portion of his order reads as under:-

“16. The Hon'ble ITAT ‘C’ Bench, Kolkata in the case of assessee for assessment year 2006-07 in ITA No. 954/Kol/2010 dated 29.4.2011 has held as follows:

-In view of facts of this case and the principle laid down by Hon'ble Bombay High Court in the case of Godrej Boyce Mfg. Co. Ltd. (supra), that Rule 8D is applicable for and from assessment year 2008-09 and prior to that the Assessing Officer can make estimate in the given facts and circumstances. Hence, we restrict the disallowance to 1% of dividend income and direct the Assessing Officer to calculate the expenditure on that basis. This ground of assessee's appeal is partly allowed.

17. Following the decision of the Hon'ble ITAT in the case of the assessee for assessment year 2006-07, the disallowance is restricted to 1% of dividend income. Hence, the disallowance is restricted to Rs.7,566/- only against the disallowance of Rs.15,16,710/-. This ground of appeal is partly allowed.”

Since CIT(A) confirmed the disallowance at 10% made by the AO but we are consistently taking a view that prior to AY 2008-09, disallowance @1% will meet the end of justice, by following the decision of co-ordinate Bench -CØ Kolkata cited (supra). This ground of assessee's CO is partly allowed.

14. In the result, the appeal of revenue is dismissed and Cross Objection of the assessee is partly allowed.

15. Order is pronounced in the open court on 01.07.2015

Sd/-
(P. K. Bansal)
Accountant Member

Sd/-
(Mahavir Singh)
Judicial Member

Dated : 1st July, 2015

*Dkp-P.S.

Copy of the order forwarded to:

1. APPELLANT - ITO, Ward-12(1), Kolkata, 3, Govt. Place (W), Kol-1
2. Respondent ó M/s. Nupur Carpets Pvt. Ltd. 23C, Ashutosh Chandra Avenue, KCI Plaza, Kolkata-700 019
3. The CIT(A), Kolkata
4. CIT Kolkata
5. DR, Kolkata Benches, Kolkata

/True Copy,

By order,

Asstt. Registrar.