$~
* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

22-23.
\+ **ITA 947/2011**

CIT ..... Appellant
Through: Mr. Rohit Madan, Senior Standing counsel.

versus

MORGAN SECURITIES & CREDITS PVT LTD ..... Respondent
Through: Mr. Simran Mehta, Advocate.

<u>And</u>

ITA 539/2014

COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: Mr. Rohit Madan, Senior Standing counsel.

versus

MORGAN SECURITIES & CREDITS PVT LTD ..... Respondent
Through: Mr. Simran Mehta, Advocate.

CORAM:
HON'BLE DR. JUSTICE S.MURALIDHAR
HON'BLE MR. JUSTICE VIBHU BAKHRU

<u>O R D E R</u>

% 23.09.2015

1. ITA No. 947 of 2011 is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act') against the order dated 8th December 2010 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.

3254/Del/2009 for the Assessment Year ('AY') 2005-06.

2. ITA No.539 of 2014 is an appeal directed against the order dated 31st January 2014 passed by the ITAT in ITA No.5791/Del/2010 for AY 2006-07.

3. As far ITA No. 947 of 2011 is concerned by an order dated 25th September 2013, the following question of law was framed:

> "Whether the transaction in question was rightly held by the Tribunal in the nature of investment and not in the nature of trade?"

4. In ITA No.539 of 2014, notice was issued limited to the question concerning the treatment of capital loss as business loss.

5. The brief background to the appeals is that the Assessee is a private limited company engaged in the business of trading and finance. For the AY 2005-06, the Assessee filed its return of income on 31st October 2005 declaring a total income of Rs.3,75,88,170 which comprised of business loss of Rs.(-)1,08,73,143, net short term capital gain of Rs.4,84,61,310 and long term capital gain of Rs.51,92,406. The case was picked up for scrutiny by the Assessing Officer ('AO') and a notice was issued to the Assessee under

Section 143 (2) of the Act. The AO noticed from Clause 11 of the tax audit report (TAR) in Form 3CD that there has been a change in the method of accounting affecting the profitability of the company. The inventory of shares valued at Rs. 9,83,45,399 had been treated as investment in the current year. Although the TAR stated that Annexure-3 thereto contained a note on the effect to the profitability of the Assessee, the AO found no such annexure. What was furnished by the Assessee before the AO was a copy of Schedule 4A forming part of the balance sheet and profit and loss (P&L) account as on 31st March 2005. This, according to the Assessee, was the same as Annexure-3 to the TAR. The AO found that the basis of the valuation of the opening stock and closing stock of shares shown as investment was not clear. The Assessee had changed the treatment of the shares by treating them as investment instead of stock in trade. The AO concluded that when examined in the light of the CBDT circular dated 15th June 2007 and the decided cases, it was apparent that there was no justification for the change in the method of accounting during the current year by treating the stock of shares as investment instead of stock in trade. According to the AO, the only motive for this undue change in this year (AY 2005-06) appeared to be lowering the tax incidence and taking undue benefit of the exemption from tax on long term capital gains under Section 10(38) of the Act and concessional rate of tax @ 10% on short term capital gains under Section 111A which had been brought into the Act with effect from 1st April 2005. Treating the entire shares held by the Assessee as stock in trade, the AO treated the resultant profit from the sale of shares in the sum of Rs.10,22,58,060 as business profit in the hands of the Assessee and directed it to be brought to tax as such.

6. During the pendency of the appeal filed by the Assessee before the Commissioner of Income Tax (Appeals) [CIT(A)], in response to the queries raised, the Chartered Accountant ('CA') of the Assessee wrote a letter dated 24th February 2009, enclosing therewith the said Annexure-3 which was referred to in the TAR for AY 2005-06. The CA in the said letter stated that "shares valued at Rs.9,83,45,399 shown as stock in trade in the Asst. Year 2004-05 have been regrouped under the head investment in the accounts for the Asst. Year 2005-06." Enclosed with the said letter, was a sheet titled Annexure-III, with the opening sentence stating "The figures of the previous year as on 31-03-2004 has been regrouped in the following manner". Set out thereunder was a table with two columns for entries in the P&L account and the balance sheet (as regards reserve and surplus, investment and inventory)

with the 'old' and 'revised' figures. In particular, under the balance sheet column the old 'inventory' was shown as Rs.6,88,64,982 and the revised one as Rs.16,99,384. The old 'investment' was shown as Rs.6,94,72,661, and the revised as Rs.16,78,18,099. As far as the P&L account was concerned, the old 'purchase of shares' was shown as 9,83,45,872 and 'nil' in the revised column. The old 'closing stock of shares' was Rs. 6,88,64,982 and the revised figure was shown as Rs. 16,99,384.

7. The CIT (A) sought a report from the AO on the above letter and enclosures. The AO in his report pointed out that the Assessee had consistently shown these shares as stock in trade. Contrary to the Assessee's claim, it had never shown them as investment prior to AY 2005-06 as evidenced by the auditor's report. Importantly, it was pointed out that the Assessee had shown the value of opening stock as on 1st April 2004 at Rs. 16,99,384/-which should have been taken at Rs. 6,88,64,982/-. It had transferred the balance stock of shares from the stock in trade and treated it as investment in the AY 2005-06. This is also evident from the Balance Sheet and P & L account of AYs 04-05 and 05-06. The Audit report of AY 04-05 filed along with the return had shown different figures under the heads 'closing stock', 'purchase of shares', 'profit before taxation' and 'balance

carried over to Balance sheet' as shown in the P & L account of AY 05-06 under the head "as at 31.3.04." This indicated that the figures in the Audit Report filed along with the return for AY 04-05 had not been shown in the previous year's column and was changed by the auditor for which a note in Annexure 3 was given which was deliberately not furnished along with the Audit report for AY 05-06. The AO then set out the changed figures under the different heads in a tabular form. The AO concluded that the Assessee had treated the shares as stock in trade and not as investment and no diminution could be done in the case of investment but only in the case of stock in trade.

8. The CIT(A) in the order dated 1st May 2009, however, came to the conclusion that the transactions under consideration were on investment account and not stock in trade and directed the AO to amend the computation of total income accordingly.

9. In the appeal filed by the Revenue, the ITAT by the impugned order dated 8th December 2010, observed that the AO had accepted the stand of the Assessee that shares were held as investment for AY 2004-05 as well.

According to the ITAT, the AO could not have taken a different view for AY 2005-06 particularly since there was no material on record to justify it.

10. During the course of hearing of these appeals on 15th September 2015 the Court called for the record of the AO as well as CIT (A) for the purpose of examining what was in fact stated by the Assessee in the P& L account as well as the balance sheet for the for the financial years ending 31st March, 2004 and 31st March, 2005.

11. Today, Mr.Rohit Madan learned Senior Standing counsel for the Revenue, has produced the record of the AO for AY 2005-06 but not the record of the CIT (A). The record of the AO for AY 2005-06 reveals an important fact concerning the regrouping of the investment by the Assessee for the year ending 31st March 2004. It is seen that the audited balance sheet of the Assessee for the year ending 31st March 2005 which was signed by its Directors and by its CA on 5th July 2005 contains two columns giving the figures as on 31st March 2004 and 31st March 2005. It is seen that in this balance sheet the figures given for the 'inventory' as on 31st March 2004 have sought to be shown as per 'regrouping' as indicated in Annexure-3 to the TAR, a copy of which was enclosed by the CA in its letter dated 24th

February 2009 addressed to the Additional Commissioner of Income Tax, which has been referred to earlier. It is obvious that the 'regrouping' of the figures of the inventory of shares for the year ending 31st March 2004 took place subsequent to the finalization of the balance sheet for the financial year ending 31st March 2004. What is not on record, however, is a copy of the signed audited balance sheet of the Assessee for the year ending 31st March 2004 which alone would indicate whether the figures shown in the balance sheet for the year ending 31st March 2005 under the column concerning the position as on 31st March 2004 is the same as the original signed audited balance sheet for the year ending 31st March 2004 or has been changed.

12. It is, therefore, not clear whether after the signing of the audited balance sheet as on 31st March 2004 by Directors and CA any resolution was passed by the Board of Directors of the Assessee deciding to treat as investment the shares shown therein as stock in trade. This is an important aspect which does not appear to have merited attention by the CIT (A) or even the ITAT.

13. The Court would like to observe at this stage that it is inconceivable that after an audited balance sheet of a company for a financial year is signed by

its Directors and statutory Auditors, and submitted to the statutory authorities, including the Registrar of Companies (RoC) and the income tax authorities, the figures in such balance sheet for the closing stock of shares can simply be altered subsequently by adopting the device of 'regrouping' by the Assessee, even by a Board resolution. That is a process unknown to the law. Even from the point of view of principles governing statutory accounts, such change cannot be simply given effect to in the balance sheet and P&L account for a subsequent year. For instance, such a change, as was sought to be made by the Assessee in the instant case, to the value of the closing stock of shares by treating it as investment instead of stock-in-trade, would affect (and perforce necessitate changes) in the balance sheet and P&L accounts for at least two financial years. It is doubtful if this can at all be done particularly if the statutory authorities including the RoC and the income tax authorities have already been provided with (and perhaps acted upon or accepted) such signed audited accounts for a particular financial year.

14. The authorities concerned, and in particular the income tax authorities, ought to strictly scrutinise such claims as to 'regrouping' of figures appearing in the audited and signed accounts by an Assessee subsequent to such

signing. In other words, the decision regarding such change in the figures, like for e.g., the 'regrouping' of shares in the present case, if at all permissible, has to be preceded by a legally acceptable procedure adopted by the Assessee, and in any event prior to the finalization and signing of the audited balance sheet for a particular financial year.

15. Considering that above aspects having not been examined by the ITAT, the Court sets aside the impugned order dated 8th December 2010 of the ITAT in ITA No. 3254/Del/2009 on the above issue and remands the said appeal to the ITAT for a fresh consideration keeping in view the above aspects. The ITAT is urged to call for the complete details of the records both from the AO as well as the CIT (A) and any further relevant particulars to arrive at a correct decision.

16. As regards ITA No. 539 of 2014 for AY 2006-07, the answer to the issue regarding the treatment of 'capital loss' as 'business loss' will depend on the outcome of the decision of the ITAT in ITA 3254/Del/2009 for AY 2005-06. Consequently, the impugned order dated 31st January 2014 of the ITAT in ITA No. 5791/Del/2010 for AY 2006-07 is also set aside and the said

appeal is remanded to the ITAT for a fresh decision on the above issue in accordance with law.

17. The appeals are disposed of in the above terms.

S.MURALIDHAR, J

VIBHU BAKHRU, J

SEPTEMBER 23, 2015/mg