

(2014) 04 DEL CK 0036

In the Delhi High Court

Case No : ITA 539/2012

CIT

APPELLANT

Vs

Om Prakash Arora

RESPONDENT

Date of Decision : 01-04-2014

Acts Referred:

Citation : (2014) 04 DEL CK 0036

Hon'ble Judges : S. Ravindra Bhat, J;R.V. Easwar, J

Bench : Division Bench

Advocate : Balbir Singh, Sr. Standing Counsel and Mr. Abhishek Singh Baghel, Advocate for the Appellant; Ajay Vohra, Ms. Kavita Jha and Mr. Vaibhav Kulkarni, Advocate for the Respondent

Judgement

S. Ravindra Bhat, J.—In this appeal, the revenue contends that the Tribunal (hereafter "ITAT") fell into error in holding that the amount originally brought to tax as business income of the assessee, was short term capital gains as claimed in the returns filed. The following question of law arises in the appeal:

Did the ITAT fall into error in endorsing the decision of the CIT (A) that the sum of Rs. 8,78,16,545/- represented short term capital gain (for 2007-08) as claimed by the assessee and that it was not business income?

2. The assessee in this case is an individual; in the income tax returns, he reported a net taxable income of Rs. 9,34,80,539/-. The returned income comprised of the income derived by him from his business of trading in books in the name and style of M/s. Variety Book Depot as also income derived by the assessee in his individual capacity from house property, income from other sources as well as short term capital gains. The assessee continued to derive income from similar sources as was done by him in the earlier years. Its assessment was completed by order u/s 143(3) of the Act on 31.11.09 at an assessed income of Rs. 8,51,72,074/- inter alia treating the income from short term capital gains amounting to Rs. 8,78, 16,545/- earned by the assessee as business income. The Assessing officer held that 10% of the amount of Rs. 8,

78,16,545/- earned by the assessee as short term capital gains is "being expenses relating to the business" and in this manner made an addition of Rs. 7,90,34,891/- as business income of the assessee on account of shares as against the amount of Rs. 8,78,16,545/- declared as income from short term capital gains.

3. The CIT (A) in the order made in the assessee's appeal, observed that during the assessment year, the assessee had in all 47 transactions of sale and purchase of shares; the bulk of the profit was derived from sale of shares to the extent of Rs. 7,31,57,694 issued by Unitech Ltd, for which bonus shares had been issued to the assessee. The CIT (A) noticed that during the previous years' assessment, the purchase of 5000 shares and sale of 2000 had been reported and accepted as investment, and short term capital gain. The company had sub-divided shares after the value had been revised and thereafter issued bonus shares. This had augmented the shareholding of the assessee from the initial 3000 to 1,95,000. On an appreciation of these facts and the other relevant materials, the CIT (A) concluded that the assessee did not engage in share trading and accepted the explanation that the amount was short term capital gains. The revenue's appeal to the ITAT was dismissed; that Tribunal affirmed the views and findings of the Appellate Commissioner.

4. It is argued by the revenue that having regard to the settled law, which mandates that all relevant criteria have to be taken note of while deciding if any amount claimed as capital gains, is in fact that or business income, the CIT (A) and ITAT fell into error in application of those tests to the facts of this case. It was argued that during the Assessment Year, the gross total income reported was Rs. 9,35,80.539/-, which consists of STCG of Rs. 8,78,16,545/-. It was argued that transactions in shares do not constitute peripheral activity but the main activity of the assessee. He is carrying on the business as proprietor of M/s. Variety Book Depot, the profit from which was only Rs. 39,34,648/- This amount was less than 20% of the STCG. The computation of total income for assessment year 2005-06, especially the computation showed gross total income of Rs. 2,17,26,901/- and this amount inter alia includes profit from M/s. Variety Book Depot of Rs. 3,42,146/- and STCG of Rs. 2,01,51,090/-. Thus, in that year also the substantial activity of the assessee was in respect of share transactions. A similar position existed in assessment year 2006-07, in which business profits from M/s. Variety Book Depot amounted to Rs. 40,33,907/- and STCG amounted to Rs. 2,32,33,691/-. Thus, the assessee has been systematically indulging in share transactions leading to substantial profits year after year. The revenue also urged that the amounts used for deriving the income, were obtained from the assessee's other business, which clearly reflected the intention to trade in shares.

5. Learned Counsel argued that the assessee used to conduct business as proprietor of M/s. Variety Book Depot. The turnover in that business was about Rs. 20.13 Crore in this year. The assessee has also been investing small amounts in shares. The shares were held as investments. The assessee earned profit of

about Rs. 8.00 Crore on sale of shares in this year. After allowing deduction of certain amount as expenditure, the AO has calculated profit on the transaction at Rs. 7,31,57,694/-. This amount has been taxed as business income. The bulk of profit is on sale of bonus shares of Unitech Ltd. The assessee had been holding 15000 shares in this company in respect of which 1,80,000 bonus shares were allotted in this year. All the shares were sold in this very year. The AO accepted that gain on original holding of 15000 shares amounted to LTCG. However, profit on sale of 1,80,000 bonus shares was been held as business income. The conduct of the assessee will show that shares had been held as investment. 4.1 it is further submitted that the assessee employed his own funds in acquisition of the shares, which will be seen from the balancesheet as on 31.03.2006. This is also clear from the balance sheet as on 31.03.2007. Both the balance-sheets show the shares as investments at Rs. 8,96,21,300/- and Rs. 8,64,36,906/- respectively.

6. It would be relevant at this stage to reproduce relevant extracts from the impugned order of the ITAT, which are as follows:

8. At this stage, we may examine the factors, which are in favour of the assessee:

(i) the assessee has been assessed all through, except in this year, in the capacity of investor in shares;

(ii) investment has been made from own funds;

(iii) the assessee does not have a set up to deal in shares;

(iv) the transactions in shares are not in the line of business of marketing and distribution of books and magazines, and

(v) the assessee has been described as an active investor in the market for over 30 years in his profile available on website of Quantum Securities (P) Ltd.

8.1 We may also note down the points which go against the case of the assessee:

(i) the assessee is intimately connected with Quantum Securities(P) Ltd., a company dealing in stocks and shares. He has undertaken all his transactions through this company for which a running account is maintained and the website of the company which describes him as a managerial personnel. This means that the assessee has easy access to the necessary infrastructure available with Quantum Securities (P) Ltd. for undertaking transactions in shares;

(ii) the books of Variety Book Depot show the debit balance of about Rs. 19.68 lakhs on his account, which indicates that business funds of this proprietary concern have been used for undertaking transactions in shares;

(iii) admittedly, the assessee has a long experience and knowledge of equity market operations; a fact exploited even by Quantum Securities (P) Ltd. in its website

(iv) the assessee has undertaken a large number of transactions of purchase and sale of shares, which show that the transactions are undertaken systematically with a view to earn profit; and

(v) even the bonus shares of Unitech Ltd. received in this year were sold in this very year showing that there was no intention to hold on them as investment for any length of time.

9. As mentioned earlier, the bulk of profit is on sale of 15000 equity shares and 1,80,000 bonus shares of Unitech Ltd. Therefore, it becomes necessary to examine the nature of these holdings. As mentioned earlier, the assessee had purchased 5000 shares out of 2000 shares were sold in the earlier year. The AO had accepted that the shares were held on investment account as the gain from sale of 2000 shares was taxed under the head "capital gains". Remaining 3000 shares were sub-divided in 15000 shares in this year. The inference would be that 3000 shares sub-divided into 15000 shares were also held on investment account. In respect of the sub-divided 15000 shares the assessee received 180000 bonus shares. Bonus shares can only be issued out of accumulated profit in the form of general reserve available with the issuing company. Issuance of such shares does not enhance the reserves as the reserves of the issuing company get reduced on issuance of bonus shares. Therefore, the nature of bonus shares has to be taken the same as original shares...

What tipped the scales in favour of the assessee was the ITAT's finding that in the previous year too, purchase of the Unitech shares had been accepted as investment and that bulk of the gain reported as short term capital gain, was on account of sale of Unitech shares, which had been increased due to issuance of bonus shares.

7. The factors which Courts and Tribunals have to take into consideration whilst deciding whether income gained during a particular period is business income through purchase and sale of shares or other tradable capital assets, or capital gains on account of sale of such assets, has been spelt out and reiterated in a number of decisions. These include Raja Bahadur Visheshwara Singh and Others Vs. Commissioner of Income Tax, Bihar and Orissa, ; Commissioner of Income Tax, Uttar Pradesh Vs. Madan Gopal Radhey Lal, ; Commissioner of Income Tax (Central), Calcutta Vs. Associated Industrial Development Co. (P.) Ltd., ; P.M. Mohammed Meerakhan Vs. Commissioner of Income Tax, Kerala, and Commissioner of Income Tax v. NSS Investments Ltd 2007 (277) ITR 149 (Mad). It was in the light of these decisions that the CBDT Circular No. 4/2007, was issued, indicating the principles applicable in this regard. These criteria are:

(1) Intention of the assessee at the time of purchase of the shares. This can be found out from the treatment given to the purchase in the assessee's books of account.

(2) Did the assessee borrow money to purchase the shares, and paid interest for it. Money is generally borrowed to purchase goods for the purposes of trade and

not for investing in an asset for retaining.

(3) Volume and frequency of the purchases and sale/disposals. If purchase and sales are frequent, or there are substantial transactions in an item, that can indicate trade. Habitual dealing in a particular item is indicative of intention of trade. Likewise, ratio between the purchases and sales and the holdings may show whether the assessee is trading or investing (high transactions and low holdings indicate trade whereas low transactions and high holdings indicate investment). Another related factor is the duration for which the shares are held.

(4) Was the purchase and sale made for realizing profit, or for retention and appreciation in its value. The former indicates the purchases being part of trade; and the latter is indicative of the purchases being an investment. Furthermore, it would be relevant to ask whether the intention behind the purchase was to enjoy dividend, or merely to earn profit on sale of shares. Importantly, a commercial motive is an essential ingredient of trade in this context.

(5) Whether the items in question were valued at cost. If so, it would indicate that they were investments. Where they were valued at cost or market value or net realizable value, whichever is less, it will indicate that items were treated as stock-in-trade.

(6) Finally, it would be relevant to consider how the assessee is authorized in its Memorandum / Articles.

8. It has also been held that if the business activity of the assessee is trading in shares, there can be a presumption that the amount claimed was derived through trade; the assessee in such cases has to establish that the amount was indeed invested and the proceeds of sale were of a capital asset. Furthermore, keeping a separate investment account would also be a relevant indicia.

9. As is evident from the previous factual analysis in this case, the assessee had purchased the Unitech shares in the previous year; it had been shown as investment and that treatment was accepted by the income tax authorities. He had sold 2000 shares during the previous year; the gains were treated as short term capital gains. What happened during this assessment year was that the left out shares were firstly sub-divided leading to five fold increase in the assessee's holding. Later, Unitech issued bonus shares which resulted in the assessee becoming owner of 1,95,000 shares. This court is in agreement - and therefore affirms the ITAT's findings in that regard, that such acquisition of shares cannot be considered as investment. Considering that in all there were a total of 47 share purchase and sale transactions and that the predominant or overwhelming gain was on account of sale of Unitech shares, the income derived cannot be called as business or share trading income; it is short term capital gain. There is nothing to show such frequency of trading, or volume of share transactions, or any other factor (use of borrowed funds, or the line of business of the assessee being share trading) pointing to the amount gained to be on account of share trading.

10. For the foregoing reasons, the question of law framed is answered in favour of the assessee and against the revenue. The appeal is consequently dismissed without any order as to costs.