Surplus arising to distributor of books from dealing in shares was capital gain if shares were held as investments

Summary – The High Court of Delhi in a recent case of Om Prakash Arora, (the Assessee) held that where assessee treated shares as investment, used his own funds and share transactions did not relate to his main business, in spite of assessee receiving bonus share, income arising from sale of such shares were to be treated as 'capital gain', and not as business income.

Facts

- The assessee was carrying on the business of trading in books. He had also been deriving income from purchase and sale of shares. He was deriving such income from similar sources in the earlier year also.
- For relevant assessment year, the Assessing Officer treated a part of income from sale of shares as business income whereas the assessee claimed same as short-term capital gain.
- On appeal, the Commissioner appeal and the Tribunal reversed the decision of the Assessing Officer.

Held

- 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.
- 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.

- 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.*
- 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. 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 pre dominant 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, on 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.
- 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.