

**IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A", HYDERABAD**

**BEFORE SMT. P. MADHAVI DEVI, JUDICIAL MEMBER
AND
SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER**

ITA No.	Asst. Year	Appellant	Respondent
832/Hyd/16	2009-10	M/s. G2 Corporate Services LLP, (Formerly M/s. G2 Corporate Services Ltd) SECUNDERABAD [PAN: AABCD2471J]	Dy. Commissioner of Income Tax, Circle-2(3), HYDERABAD
833/Hyd/16	2011-12		

For Assessee : Shri K.A. Sai Prasad, AR
For Revenue : Shri M. Sitaram, DR

Date of Hearing : 21-05-2018
Date of Pronouncement : 08-06-2018

ORDER

PER B. RAMAKOTAIAH, A.M. :

These two appeals are by assessee against the order of the Commissioner of Income Tax (Appeals)-2, Hyderabad. In the AY. 2009-10, there was an issue in treating the capital gains as 'business income', whereas in both the assessment years, the common issue is with reference to disallowance u/s. 14A of the Income Tax Act [Act]. Since the issues are common, these appeals are heard together and decided by this common order.

Issue of treating capital gains as business income:

2. This issue arises in AY. 2009-10. Assessee has declared Short Term Capital Gain of Rs. 1,89,980/- on sale of shares and Long Term Capital Gain of Rs. 10,54,32,172/- on sale of un-listed shares in the company, Indu Tekzone Private Limited. AO was of the opinion that assessee's transactions are to be considered as 'business' and after discussion on the issue, he has treated the capital gains declared by assessee as 'business income'. Ld.CIT(A) after extracting assessee's contentions both factual and legal, however in the brief order, has upheld the action of AO. The submissions and the order is as under:

"5.2. On the other hand, the AR contends as under:

"1. During AY 2009-10 the appellant has declared short term capital gains of Rs 1,89,980 from sale of listed equity shares and long term capital gains of Rs 10,67,54,573 from sale of shares of M/s Indu Tech Zone Pvt Ltd, an unlisted company. These gains were treated as business income by the Assessing Officer. The appellant has consistently, been treating all the investments as capital assets being long term investments, as they were acquired with an intention to be held for longer terms. The investments are reflected in the Balance Sheet as long term investments only. (as referred from pages given below for each Asst. Year). They are not being reflected as part of its stock in trade. The investments were valued at cost only and the surplus/(loss) on transfer of the investments are consistently being shown under the head 'Capital Gains' which was accepted by the department, except for the year under appeal. The particulars of capital gains offered and the assessment status is presented in the table below for perusal by your Honours:

SL. No	Asst. Year	Paper book Page No.	Source of Capital gains/ (loss)	Assessment Status
1	2006-07	13 & 14	Sale of shares of Matrix Labs Ltd- Long Term Capital Gains	Assessment u/s. 143(1)(a)
2	2007-08	29 & 30	Sale of shares of Matrix Labs Ltd- Long Term Capital Gains	Assessment u/s. 143(1)(a)
3	2008-09	50	Sale of shares of Indu Tec Zone Pvt Ltd – Short term capital gains	Assessment u/s. 143(1)(a)
4	2010-11	102	Sale of shares of Silicon Builder Pvt Ltd and Green Infrastructure Pvt Ltd – Long Term Capital Gain	Assessment u/s. 143(3), assessed as capital gains only (pages 179 to 184)
5	2012-13	158	Sale of shares of Quality Care India Ltd – Long Term Capital Gains	Assessment u/s. 143(3), assessed as capital gains only (pages 185 to 191)

(for Asst. Year 2009-10 page 73 of the paper book)

(for Asst. Year 2011-12 page 132 of the paper book)

2. The Assessing Officer relied on the ruling of the Hon'ble Supreme Court in the case of *Investment Ltd. vs Commissioner of Income Tax 77 ITR 533*. (Copy placed at pages 175 to 178 of the paper book.) He relied on the observation of the Hon'ble court "that the description of shares and securities in the balance sheet as 'investment' is not decisive". It is respectfully submitted that the AO has not brought out fully the facts of that case relied upon which are as follows-

(a) In that case the Appellant claimed certain losses from securities as business losses which was rejected by the Assessing Officer on the following grounds:

i) the assessee was reflecting the securities under the head investments

ii) the securities are valued at market value although the market value was less

iii) there is no frequency of transactions

b) The assessee lost all the appeals till the High Court. On appeal, the Supreme Court held that the assessee's claim of business loss can be allowed on the following basis:

a) that revenue accepted assessee's claim as business loss from securities in immediately preceding and succeeding years

b) Tax payer can value his stock at cost or market value.

c) A method of accounting adopted by the trader consistently and regularly cannot be discarded by the departmental authorities on the view that he should have adopted a different method of keeping account of or valuation

d) The method of accounting regularly employed may be discarded only if in the opinion of the taxing authorities income of the trade cannot be properly deduced therefrom.

e) Valuation of stock at cost is one of the recognised methods. No inference may therefore arise from the employment by the company of the method of valuing stock at cost, that the stock valued was not stock-in-trade.

f) The description of stock in the balance-sheet as "investments" is not decisive.

(c) In the case before the Supreme Court, the assessee claimed the losses from the sale of securities as business losses while such securities were reflected as investments in its balance sheet. It is based on such facts that the Supreme Court held that the description of shares and securities in the balance sheet as investment is not decisive.

3. In contrast, the appellant has consistently been reflecting the shares as investments and consequently the surplus/loss on sale thereof were being reflected as capital gains. In fact the Supreme Court was quite categorical in declaring that method regularly employed by the assessee cannot be discarded. It is further submitted that the assessing officer arrived at the same figure of income in either of the computations, implying that there is no difficulty in calculating the income as per method employed by the assessee (as stated at pointed above). Hence there is no reason to discard the consistent approach of the appellant. The AO has not applied the law as decided by the Supreme Court as mentioned at (a) to (f) above.

4. The Appellant brings to your kind attention the following rulings of the Hon'ble Supreme Court supporting the appellant's stand that the Assessing Officer erred in treating Appellant's investments as business assets:

(a) The Hon'ble Supreme Court in the case of CIT v. Associated Industrial Development Co. (P.) Ltd. [19717 82 ITR 586 has observed as under:

"Whether a particular holding of shares is by way of investment or forms part of the stock-in-trade is a matter which is within the knowledge of the assessee who holds the

shares and it should, in normal circumstances, be in a position to produce evidence from its records as to whether it has maintained any distinction between those shares which are its stock-in-trade and those which are held by way of investment. "

(b) The Hon'ble Supreme Court in the case of Dalhousie Investment Trust Co. Ltd. v. CIT [1967J 66 ITR 473 (SC) has observed as under:

"Mere fact that an investment company periodically varies its investment does not necessarily mean that the profits resulting from such variation are taxable under the Income-tax Act. Variation of its investments must amount to dealing in investments before such profits can be taxed as income under the Income Tax Act. "

(c) In Commissioner of Income Tax, U. P v. Madan Gopal Radhey Lal, [1969J 73 ITR 652 (SC) the Supreme Court dealt with the issue, and discussed the question:

"A trader may acquire a commodity in which he is dealing for his own purposes, and hold it apart from the stock-in-trade of his business. There is no presumption that every acquisition by a dealer in a particular commodity is acquisition for the purpose of his business; in each case the question is one of intention to be gathered from the evidence of conduct and dealings by the acquirer with the commodity. "

5. The Assessing Officer relied upon the circular 4/2007 dt 15.06.2007 of CBDT (copy placed at pages 173 & 174) and quoted the following therefrom:

8. The Authority for Advance Rulings (AAR) (288 ITR 641), referring to the decisions of the Supreme Court in several cases, has culled out the following principles:

"(i) Where a company purchases and sells shares, it must be shown that they were held as stock-in-trade and that existence of the power to purchase and sell shares in the memorandum of association is not decisive of the nature of transaction;

(ii) the substantial nature of transactions, the manner of maintaining books of account, the magnitude of purchases and sales and the ratio between purchases and sales and the holding would furnish a good guide to determine the nature of transactions;

iii) ordinarily the purchase and sale of shares with the motive of earning a profit, would result in the transaction being in the nature of trade/adventure in the nature of trade; but where the object of the investment in shares of a company is to derive income by way of

dividend, etc., then the profits accruing by change in such investment (by sale of shares) will yield capital gain and not revenue receipt".

and concluded that "In fact, having regard to the frequency of transactions of large number of shares of those companies made by the assessee during the previous year and as seen from discussion made already, it has to be held that those transactions of sale of shares made by the assessee were principally in the nature of business transactions. "

While doing so, he overlooked certain other important points given in the circular itself which are as follows:

11. Assessing officers are advised that the above principles should guide them in determining whether, in a given case, the shares are held by the assessee as investment (and therefore giving rise to capital gains) or as stock-in-trade (and therefore giving rise to business profits). The Assessing Officers are further advised that no single principle would be decisive and the total effect of all the principles should be considered to determine whether, in a given case, the shares are held by the assessee as investment or stock-in-trade. (emphasis supplied)

61. It is submitted that the Assessing Officer has mainly commented on the frequency of transactions carried out by the appellant with respect to shares of listed entities. He did not apply various other parameters laid out by the Supreme Court and the CBDT. His remarks that the statement of account of the appellant in M/s Zen Securities for the Asst Year 2009-10 is 10 pages in length were made while looking at investments in shares of listed companies only. (Copy of Zen Statement placed at pages 163 to 172). He did not go in detail about the pattern of the appellant's investments in unlisted companies which have a lion's share. The equity shares transferred are of a private limited company. These were acquired on 25.03.2007 and were transferred on 12.08.2008 after being held for nearly 17 months. (Copies of allotment letter & sale acknowledgement placed at pages 192 to 197 of the paper book). Equity shares of a private limited company are not freely transferable and transfers are subject to the restrictions as per clause 9 of the Articles of the Association of the company. In light of the restrictions these shares were transferred to M/s Indu Projects Ltd the main promoter of the company. (Copy of Articles placed at pages 198 to 212 of the paper book). For all these reasons the equity shares of a private limited company cannot be treated as business assets.

62. It is submitted that in assessments u/s 143(3) for AYs 2010-11 and 2012-13, the surplus on sale of shares of unlisted entities were assessed as capital gains accepting the Appellant's claim that the shares transferred were capital assets and not business assets.

63. The AO's observations may at most be true in respect of the transactions carried out in relation to the shares of listed companies through M/s Zen Securities. The transactions carried out in relation to the investments in unlisted companies are very few and more over they are illiquid and exit from such investments were only to strategic investors which occur after thorough due diligence after various rounds of negotiations and varied legal documents. Such transactions cannot be so frequent to be treated as business transactions. Further the AO failed to observe that the Assessee is a company endowed with a rich corpus and all the investments are out of own funds.

64. It is prayed that the Hon'ble Commissioner of Income Tax be pleased to consider the above facts and submissions and direct the Assessing Officer to accept the assessee's contention that the investments in shares are capital assets. "

5.3. I have considered the above and I find that the action of the AO is justified in treating the capital gains of Rs.10,69,44,553 as "income from business", as the assessee, in fact, is engaged in trading in shares only. The AO has made out a case to this effect that it is the assessee's business and hence, treated the gain of Rs.10,69,44,553 as "income from business". In view of this, I am also in agreement with the view taken by the AO. As a result, the grounds raised by the assessee are dismissed".

2.1. It was the contention of Ld. Counsel that Ld.CIT(A) has not examined the issues both on facts and on law. Assessee has consistently showing the investments and not as 'stock in trade' and the gains were offered as such and was accepted by the department even in the scrutiny assessments earlier. Further Ld. Counsel relied on the Board Circular F.No. 225/12/2016/ITA.II, dt. 02-05-2016, wherein Board has given the following circular for the benefit of settling the disputes on this issue.

"Regarding characterization of income from transactions in listed shares and securities, Central Board of direct Taxes (CBDT) had issued a clarificatory Circular no. 6/2016 dated 29th February, 2016, wherein with a view to reduce litigation and maintain consistency in approach in assessments, it was instructed that income arising from transfer of listed shares and securities, which

are held for more than twelve months would be taxed under the head 'Capital Gain' unless the tax-payer itself treat these as its stock-in-trade and transfer thereof as its business income. It was further stated that in other situations, the issue was to be decided on the basis of existing Circulars issued by the CBDT on this subject.

2. Similarly, for determining the tax-treatment of income arising from transfer of unlisted shares for which no formal market exists for trading, a need has been felt to have a consistent view in assessments pertaining to such income. It has, accordingly, been decided that the income arising from transfer of unlisted shares would be considered under the head 'Capital Gain', irrespective of period of holding with a view to avoid disputes/litigation and to maintain uniform approach.

3. It is, however, clarified that the above would not be necessarily applied in the situations where:

- i. the genuineness of transactions in unlisted shares itself is questionable; or*
- ii. the transfer of unlisted shares is related to an issue pertaining to lifting of corporate veil; or*
- iii. the transfer of unlisted shares is made along with the control and management of underlying business and the Assessing Officer would take appropriate view in such situations".*

2.2. It was the contention that assessee's transactions are not covered by para 3 and therefore, since assessee is consistently showing the purchase of shares as investment and the capital gain earned is mostly from un-listed shares, the same is required to be assessed under the head 'capital gains'.

2.3. After considering the rival contentions and documents on record, we agree with the contentions of assessee. The income is to be assessed under the head 'capital

gains' only. Assessee has given detailed explanation and submissions both on facts and on law and also on the consistent treatment by the department in earlier years that the income is to be assessed under the head 'capital gains' only. Without countering any of the submissions, Ld.CIT(A) concurred with AO. Now that the Board circular has settled the issue, we are of the opinion that the income arising from transfer of un-listed shares should be considered under the head 'capital gains' only. Even for the Short Term Capital Gain on the sale of listed shares the parameters do indicate that assessee is only investing and not trading. Therefore, the capital gains offered by assessee should be assessed as such under the head 'capital gains' only. Grounds on this issue are allowed.

Disallowance u/s. 14A:

3. This issue arises in both the assessment years i.e., AY. 2009-10 as well as in AY. 2011-12. In AY. 2009-10, AO disallowed an amount of Rs. 1,87,52,042/- invoking Rule 8D(2)(iii) as percentage of average value of investments. Ld.CIT(A) accepting that dividends on foreign entities are taxable and are not exempt u/s. 10(34) of the Act, the investment to the extent of Rs. 253.50 Crores was directed to be excluded while determining the disallowance under rule 8D(2)(iii). However, in the later order in AY. 2011-12 he has confirmed the disallowance made by the AO as such, wherein

the disallowance was made to an extent of 2,01,57,833/- u/s. 14A by the AO.

3.1. Pointing out the inconsistency in the order of Ld.CIT(A), it was the submission that assessee has invested own funds in group concerns and expenditure itself is not that much so as to be disallowed u/s. 14A. There was no finding by AO that assessee has spent any amount. Alternatively Ld. Counsel submitted that the disallowance can be restricted only to the extent of dividend earned and relied on the Co-ordinate Bench decision in the case of Mylan Laboratories Ltd., in ITA Nos. 362/Hyd/2017 and 452/Hyd/2017, dt. 09-05-2018.

3.2. Ld.DR, however, relied on the orders of Ld.CIT(A).

3.3. We have considered the issue. As seen from the orders of the AO, the only disallowance is under Rule 8D(2)(iii). But there is no finding that assessee could have spent any amount. There is also inconsistency in the order of Ld.CIT(A). In AY 2009-10 he had rightly excluded investments made in foreign entities as the dividend earned thereon is not exempt u/s. 10(34) of the Act. He should have followed the same principle in AY. 2011-12 also. Be that as it may, it is established principle that the disallowance u/s. 14A should not exceed the income earned and claimed as exemption. This principle is discussed elaborately in the case of Mylan Laboratories Ltd., (supra) as under:

“5.5. Coming to the disallowance of ½% of average value of investment, some proportionate expenditure can be disallowed but in no case, it should exceed the amount earned claiming exemption. The Hon'ble High Court of Punjab & Haryana in the case of Pr. Commissioner of Income Tax Vs. Empire Package Pvt. Ltd., (supra), answered the question raised by Revenue in negative, wherein the Revenue has raised ‘whether in the facts and circumstances of the case, the Hon'ble Tribunal is justified in law to hold the disallowance made u/s. 14A r.w. Rule 8D cannot exceed the exempt income in the absence of any such restriction being there in the relevant section or rule’. Similar opinion was also expressed by the Hon'ble Delhi High Court in the case of Joint Investments Pvt. Ltd., Vs. CIT (supra), wherein the Hon'ble Delhi High Court has clearly held that the proportionate or portion of the tax exempt income surely cannot swallow the entire amount as happened in this case. The Co-ordinate Bench in the case of M/s. Kamadhenu Sukrit Pvt. Ltd., Vs. ITO (supra) relied on another decision in the case of Sahara India Financial Corpn. Ltd., Vs. DCIT [41 taxmann.com 251] (Delhi-Trib) and has held as under:

“8.1. As can be seen from the nature of expenditure, there is no indication even that the above expenditure is expended for earning dividend income. AO without giving any satisfactory reason, just invoked Rule 8D(iii) and disallowed the amount.

9. The Co-ordinate Bench in the case of Sahara India Financial Corpn. Ltd., Vs. DCIT (supra) has held in para 81 as under:

“We have heard the rival contentions and perused the material available on record. It has not been disputed that the administration, expenses and books of account of investment division are separately carried out and maintained by the assessee. No infirmity has been found by the department in this behalf. One of the main issue is on whom lies the onus to establish nexus of available funds with free and taxable income. Similarly courts have held that a finding in objective terms about assessee working being unsatisfactory is to be recorded by AO in the order. Chandigarh Bench of the Tribunal in the case of Punjab State Co-op. & Marketing Fed. Ltd. (supra) has held that in any case the disallowance u/s 14A cannot exceed tax free income of the assessee. If mechanical method of rule 8D is applied, it leads to manifestly absurd results in as much as for tax free income of Rs.68,37,583/- disallowance of Rs.2,16,51,917 (enhanced by CIT(A) at Rs. 2,19,47,772) is made u/s 14A which is way too much than the exempt income. As the interpretation of provisions of sec. 14A r/w rule 8D is leading to unanticipated absurdities which cannot be the intention of legislature. Under these circumstances help of external aids of construction for interpretation of statute is called for. Looking at the varying interpretation offered by various courts and benches of tribunal in relation to sec. 14A, it is quite arduous to precisely decide the issue. In given facts and circumstances without going into all the issues, in our view it is appropriate to take guidance from Chandigarh bench judgment in the case of Punjab State Co-opt Marketing Fed. Ltd. (supra) holding that the disallowance of expenditure in any case cannot exceed the

income earned. In our view this judgment takes a holistic view that disallowance in terms of sec. 14A can be maximum to the extent of exempt income, there is no dispute that in this case which is at Rs. 68,37,583/-. This judgment implies that reasonable expenditure less than the exempt income can be disallowed. In our considered opinion, in the interest of justice, it will be reasonable to estimate and disallow, 50% of exempt) income (Rs.68,37,583/-) as relatable to exempt income u/s 14A r/w rule 8D. We do not go into various plea taken by both sides offering diverse views based on judicial citations. This ground of the assessee is partly allowed”.

10. *Respectfully following the above principles, as the disallowance made by AO has resulted in absurd situation of disallowing genuine other business expenditure, on which assessee earned more than Rs. 19 Lakhs income (as against Rs. 8,100/- of dividend), I am satisfied that the disallowance u/s. 14A should be restricted to the income earned of Rs. 8,100/-. AO is directed accordingly”.*

5.6. *Respectfully following the principles laid down in various judgments of the Hon'ble High Courts and the decisions of the Co-ordinate Benches, we are of the opinion that the disallowance under Rule 8D cannot exceed the dividend income earned and claimed as exempt. Therefore, the disallowance worked out under Rule 8D(iii) being administrative expenditure is restricted to the amount of dividend earned. AO is directed to modify accordingly. Ground is partly allowed”.*

3.4. *Respectfully following the same, we direct the AO to restrict the disallowance to dividend earned. As seen from the assessment order, the dividend earned in AY. 2009-10 was Rs. 18,61,730/- and dividend earned in AY. 2011-12 was Rs. 18,37,539/-. The respective disallowances are restricted to the above amounts. These grounds are allowed partly.*

4. *In the result, both the appeals of assessee are partly allowed.*

Order pronounced in the open court on 8th June, 2018

Sd/-
(P. MADHAVI DEVI)
JUDICIAL MEMBER

Hyderabad, Dated 8th June, 2018

TNMM

Sd/-
(B. RAMAKOTAIAH)
ACCOUNTANT MEMBER

Copy to :

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2. The Dy. Commissioner of Income Tax, Circle-2(3), Hyderabad.

3. CIT(Appeals)-2, Hyderabad.

4. Pr.CIT-2, Hyderabad.

5. D.R. ITAT, Hyderabad.

6. Guard File.