

Dr. Rajesh M. Parikh Vs. Ito

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Mar-07-2006

Judge : G Veerabhadrappe, V.P., S Kapoor

Appellant : Dr. Rajesh M. Parikh

Respondent : ito

Judgement :

1. These cross appeals arising out of the order of the Commissioner (Appeals)-XI, Mumbai dated 4-8-2004 for assessment year 2001-02, were heard together and are being disposed of by this consolidated order for the sake of convenience.

1. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals)-XI, Mumbai has erred in deleting the addition of Rs. 2,18,24,002 made by the assessing officer by disallowing the loss claimed to be arising out of the transactions in units of Kothari Pioneer Prima Plus Mutual Fund.

2. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals)-XI, Mumbai has erred in holding that incentive received by the assessee on acquiring capital asset could not be deducted to arrive at the cost of acquisition of the capital asset.

3. On the facts and in the circumstances of the case and in law, the learned Commissioner (Appeals)-XI, Mumbai has erred in not accepting the contention of the assessing officer that the loss arising out of sale of the units is an expense

incurred for earning the tax-free dividend." "The learned Commissioner (Appeals) erred in confirming the action of the assessing officer in treating the incentive of Rs. 24,14,007 received by the appellant against the investment as income from other sources instead of reducing the same from the cost of investment as claimed by the appellant in his return of income." 3. The assessee is a Psychiatrist attached to Jaslok Hospital, Mumbai.

His main source of income is from profession. During the previous year relevant to the assessment year under appeal, on 19-1-2001, the assessee purchased 735551637 units of Unit-IV Kothari Pioneer Prima Plus for a sum of Rs. 12.6 crores. On bulk purchases of the units, the assessee had received incentive of Rs. 24,14,007 from M/s. SPA Capital Services Ltd. On 23-1-2001 the assessee redeemed the said units for a sum of Rs. 10,41,75,998 and suffered a loss of Rs. 2,18,24,002.

However, the assessee had set off the incentive received of Rs. 24,14,007 against the purchase price and arrived at the short-term capital loss at Rs. 1,94,09,995 which was claimed as a deduction.

Before the redemption, the assessee has also earned a dividend of Rs. 1,83,88,792 on the said units. Before the assessing officer the assessee submitted that: The assessee has been investing in the shares and securities. The units in question were acquired out of friendly advances. The loss incurred is in the ordinary course and not deliberated.

Where accrued income is determinate, then the income can be separated and the net amount should be attributed to the cost of the investment.

In the case of securities, dividend is determinate till- it is declared based on the profits of the company and it is not continuously accruing to the assets in form of securities over the period of holding it by the investors.

If in case of securities after a long period of holding, the view that the dividends declared during the period of holding is to be reduced from the cost of acquisition of the securities is adopted, it will lead to the result which was never intended by

the law makers.

Outlay on the purchase of an income-bearing asset is in the nature of capital outlay and no part of the capital so laid out for income-tax purposes be set off against income accruing from the assets in question. In other words, the consideration paid for the purpose of securities can only be considered as total cost of asset without setting off any other income accruing on those securities.

It is the expenditure incurred in relation to the earning of exempted dividend income which will be subject to disallowance. The losses incurred by no stretch of imagination can be considered as expenses.

An expenditure means something which an assessee pays out. Expenses are something which comes out of the pocket of the assessee for a particular purpose. Loss is something different and not something which one expends or disburses. Reliance was also placed on *Chenab Forest Co. v. CIT* and *Indian Molasses Co. Ltd. v. CIT*.

Units were purchased from authorized broker. Incentive received was inextricably linked with the purchase of the units and forms part of cost of acquisition. Any commission is paid or other expenses are incurred to acquire an asset, the same forms part of acquisition.

Similarly, if any discount by whatever name called is received while acquiring such assets, it has to be taken into account for working out the cost of acquisition.

The only test to be applied is whether such expenditure or discount is wholly and exclusively incurred in connection with the acquisition of the asset. In the present case the assessee had not provided any services nor had any business dealings, which might be responsible for the receipt of incentive.

4. The assessing officer did not accept the claim of the assessee. She has painstakingly discussed the issue at length, which are summarized as under: The assessee is neither a broker nor speculator nor regular trader in stock market.

The assessee did not have the requisite funds and the funds had been borrowed from five persons, who had no surplus funds for advancing the loans to the assessee.

Though the assessee had obtained loans exceeding Rs. 20,000 no disclosure was made in the tax audit report to that extent.

The transactions appear to be innocuous, however, each of the intermediary transactions, i.e., purchase and sale of units and receipt of dividend cannot be viewed in isolation.

The transactions undertaken by the assessee satisfied the classical test prescribed in the Ramsay Principle of Tax Litigation.

The transactions undertaken by the assessee were circular, self cancelling, serving no commercial purpose as they were destined to result in losses.

The transactions are nothing but a colourable device with intent to avoid tax. The assessing officer relied on the decision of the Supreme Court in the case of McDowell Co. Ltd. v. CTO and Lupton (Inspector of Taxes) v. FA & FB Ltd. (1970) 75 ITR 544 (CA). The calculation of dividend by Mutual Funds is an integral albeit hidden part of series of transactions designed for tax litigation inasmuch as, dividend received from Mutual Funds is exempt under Section 10(33) of the Act.

The open ended Mutual Funds can issue units as and when an investor wanted, unlike the shares of the company where the number of shares remains fixed. The units can be redeemed any time whenever the investor intends to disinvest. Therefore, there is sudden rush of investors when the date of declaration of dividend nears and in the absence of any limit on number of unit holders, the number of unit holders swells. The market forces do not operate leading to rise in the prices of the units as the number of units that can be issued is unlimited. What has been distributed by the Mutual Funds is not out of their profits and income but a sum distributed out of their capital reserves, which cannot take the shape of dividend simply because the Mutual Funds term the same as dividend.

The assessee was aware at the time of investment that NAV will fall and he was ready to suffer loss in order to gain tax advantage.

Merely because market regulatory bodies have not objected to the action of Mutual Funds would not make the transaction genuine.

The transactions entered into by the assessee is nothing but what is called "dividend stripping" transaction and not a trading or investment transaction.

By entering into transactions the assessee has created a loss sink and generated tax-free income in the form of dividend. The loss of Rs. 2,18,24,002 incurred by the assessee in the transaction is in fact an expenditure incurred to earn income exempted under Section 10(33) of the Act. In this connection, the assessing officer referred to the provisions of Section 14A of the Act.

The depreciation in the value of units after declaration of dividend is nothing but part of the cost incurred.

The introduction of the amended provisions of Section 94(7) is merely a reflection of the right of the Legislature to codify its disapproval of misuse of the provisions of law as they stood before the amendment.

In the alternative, the dividend received must be reduced from the cost of acquisition in order to commute the loss.

The loss arising on sale of the unit can only be calculated by setting off the dividend receipt from the cost of acquisition. In support, reliance was placed on the decision of Supreme Court in the case of Miss Dhun Dadabhoy Kapadia v. CIT . Even the genuineness of the transaction is not disputed, it does not preclude her from denying the benefit as she can go behind the transactions to ascertain the real nature.

Relying on Supreme Court decision in the case of Sunil Siddharthbhai v. CIT , the whole series of transaction has to be viewed as a composite one.

The assessee did not get any discount from the mutual funds at the time of purchase and there is no material to suggest that the incentive was the discount

offered by the broker.

There is nothing on record to indicate that units could not be purchased without availing incentive, therefore, the incentive cannot be considered to be inextricably linked with the purchase of the units.

5. On the basis of the above discussion the assessing officer came to the following conclusions: Once the whole set of transactions are examined as one composite whole, it becomes clear that there is no real capital loss incurred on purchase and sale of mutual fund units by the assessee. In view of the discussions in the above paras, the entire loss on purchase/sale of mutual fund units needs to be disallowed as the transactions were dividend stripping transactions and not trading or investment transactions which made any commercial sense except tax mitigation. Further what has been distributed by the mutual funds is not something out of their profits and income but a sum distributed out of their capital reserves. The nature of the sum distributed cannot take the shape of dividend in the hands of the investors merely because the mutual funds have termed the sums distributed as dividend. The payment of dividend was nothing but distribution of part of the purchase price by naming it as dividend. The net loss which has been incurred by the assessee is on account of transactions which are part of a scheme perpetrated to mitigate his tax liability and not as a business. This is not a case of a person making investments and incurring a loss on their sale. Hence, the entire loss needs to be ignored and can neither be allowed to be set off nor allowed to be carried forward." Without prejudice to the above, the assessing officer came to the following conclusions: (i) It has already been discussed in the preceding paras why the entire loss is being ignored and not allowed to be set off nor allowed to be carried forward. Thus the reduction of dividend receipts from the cost of acquisition before computing the loss is not operationally relevant. It may however be mentioned without prejudice to the discussions in the preceding paras that, even if for the sake of discussion, the loss is to be accepted as legitimately arising out of the transactions of purchase and sale of units then the dividend receipts of the assessee must be reduced from the cost of acquisition before computing the loss which may be considered as legitimate.

(ii) In view of the above discussions, the loss of Rs. 1,94,09,995 (recomputed at Rs. 2,18,24,002 by reducing the cost of purchase from the sale price of the units) being claimed as short-term capital loss by the assessee is assessed as the cost of earning the dividend income of Rs. 1,83,88,791. As the dividend income has been claimed exempt under Section 10(33) the associated expenses cannot be allowed and the amount of Rs. 2,18,24,002 is therefore disallowed.

As this amount was treated by the assessee as short-term capital loss and was not debited to the accounts, no separate addition to income is however made at this stage subject to the discussion in the paras above." In the computation part of the total income the assessing officer has, inter alia, disallowed the loss on redemption of units of Rs. 1,94,09,995 and added the incentive of Rs. 24,14,007 as income from other sources.

6. The Commissioner (Appeals) considered in detail all the issues dealt with by the assessing officer. He observed that the assessing officer has rightly termed the transaction as dividend stripping. However, such transactions are taken care of by amendment to Section 94(7) of the Act. According to him if the Legislature intended, the amendment to Section 94(7) could have been made operational with retrospective effect to cover the assessment year under consideration also. Relying on the Calcutta High Court decision in the case of CIT v. Berger Paints (India) Ltd. (No. 2) (2002) 254 ITR 503 (Cal), the Commissioner (Appeals) held that provisions of Section 94(7) could not be said to be applicable before 1-4-2002. According to him it is immaterial whether the dividend by mutual funds is declared out of the accumulated profits or capital, but in the hands of the recipient the nature of receipt would remain that of dividend. He observed that the stand of the assessing officer in working out the capital gains, dividend must be deducted from the cost of acquisition is not correct, inasmuch as that any yield from the capital asset cannot be deducted to arrive at the cost of acquisition of the capital asset. Further the loss incurred by the assessee is an expenditure is also unacceptable as the loss is not something which is an outgoing. According to him the earning of incentive has nothing to do with the cost of acquisition and cannot form part of cost of acquisition of the asset. Therefore, the incentive has to be taxed separately as income from other sources. In the end, he held that short-term capital loss arising

on the sale of the units deserves to be allowed and he worked out the same as under: Aggrieved, both the revenue and the assessee are in appeal before the Tribunal.

7. The main issue in the departmental appeal to be considered is whether the loss on redemption of the units is to be treated as a short-term capital loss and the same is to be allowed to be set off against the positive income of the assessee. The learned Departmental Representative heavily relied on the discussion in the assessment order. The learned Counsel for the assessee, on the other hand, submitted that the facts of the present case are similar to the ones dealt with and disposed of by the Tribunal in the case of Wallfort Shares & Stock Brokers Ltd. v. ITO (2005) 96 ITD 1 (Mum.) (SB). The learned Counsel therefore strongly pleaded that on merits the issue has to be decided in favour of the assessee in the light of the aforesaid order of the Special Bench. The learned departmental Representative also agreed that the facts of the present case are identical to the facts in the case of Wallfort Shares & Stock Brokers Ltd. (supra) and has also agreed that similar exercise made by the department has not been approved by the Special Bench of the Tribunal in the case mentioned above.

8. We have carefully considered the rival submissions and have gone through the record. We find that the identical exercise, on similar facts, of the department has been discussed by the Special Bench of the Tribunal and has come to the conclusion that: (i) Mere knowledge of the mutual fund that its units might be purchased and redeemed by dividend strippers would not clothe mutual fund as a party to tax avoidance; (ii) it was difficult to regard transactions under consideration to be other than trading transactions, even though transactions were entered into by assessee with motive of reaping of fiscal advantage which was there for all to see; (iii) there was no merit in the contention that in view of Section 14A dividend received by the assessee could be adjusted for arriving at net result of computation in relation to assessee's transactions of purchase and sale of mutual funds; (iv) that as assessee and mutual funds were not known to each other, they were met and transactions were entirely in ordinary course at arm's length its claim for set off of loss from these transactions against its other income chargeable to tax could not be disallowed on the ground that it was a colourable

device in the name of tax planning and avoidance; (v) that provisions of Section 94(7) having been brought into statute book with effect from 1-4-2002 could not be applied to assessment years 2000-01 and 2001-02 to disallow assessee's claim for loss; that provisions of Section 94(7) are geared towards quick-in-quick-out aspect and not against claim of loss against other income of tax payer and that, therefore, assessee was entitled to have loss arising from these transactions set off against its income from any other transactions or source.

In the light of the above decision of the Special Bench, we are of the opinion that the order of the Commissioner (Appeals) on this issue does not suffer from any infirmity and the same is accordingly confirmed.

9. The second ground in the departmental appeal relates to the treatment to be given to the incentive of Rs. 24,14,007. The assessee has treated the same as a reduction in the cost of acquisition of the units. Accordingly, he reduced the same from the initial purchase price of Rs. 12.6 crores and arrived at the short-term capital loss as under: The assessing officer admittedly accepted the purchase price shown by the assessee at Rs. 12,35,85,993, after reducing the incentive of Rs. 24,14,007 which was brought to tax under the head 'Income from other sources'. The Commissioner (Appeals) directed that the incentive is not to be reduced from the purchase price of Rs. 12.6 crores. He further held that the incentive is to be taxed as income from other sources, It is against this direction of the Commissioner (Appeals) that the assessee is in appeal before us.

10. We have heard the parties to the dispute and have gone through the record. The learned Counsel for the assessee strongly argued that the issue is directly covered in favour of the assessee by the decision of the Supreme Court in the case of CIT v. U.P. State Industrial Development Corpn. (1997) 225 ITR 703 (SC), a copy of which has been placed on our record. The assessee in the case before the Supreme Court was a State Government undertaking incorporated with the object of developing industries in the State of Uttar Pradesh. With that end in view, it financed industrial projects in the State in various manners.

One such way of financing was that the assessee was underwriting certain public issues by such companies. The assessee was entitled to get some commission as

well as brokerage. In the case where the shares were not subscribed by the public in toto, the assessee was obliged to subscribe for those shares at face value, but was also entitled for underwriting commission as well as brokerage as if the shares of the said company were subscribed by the public. The method adopted by the assessee was that where the shares were to be subscribed by the assessee itself instead of credit underwriting commission and brokerage to its profit and loss account it reduced the cost of the shares held by it. While making the assessment the Income Tax Officer added the entire amount received by the assessee by way of underwriting commission and brokerage as part of the taxable income. He did not accept the deduction of underwriting commission and brokerage from the cost of acquisition. On appeal, the first appellate authority held that underwriting commission as such was assessable in the assessee's income, but brokerage has to be adjusted from the cost of the shares subscribed. On further appeal, the Tribunal after referring through various books on accountancy held that the underwriting commission was part of the profit and loss account, which included not only the income from underwriting commission and brokerage, but was debited by the expenses and the cost of shares, which the underwriter was called upon to take and as such, the underwriting commission could not be taken into consideration leaving aside the other items of this account. The Tribunal held that the underwriting commission in respect of the shares held by the assessee would reduce the cost of the shares and would not separately be assessable as the assessee's income. The Allahabad High Court upheld this view as in U.P. State Industrial Development Corpn.

Ltd. v. CIT . The Hon'ble Supreme Court affirmed this view of the High Court in U.P. State Industrial Development Corpn. case (supra). Applying the same principle laid down by the Apex Court, we are of the view that the assessee's contention and working deserves to be accepted. The assessee in this case was a bulk purchaser of the units. The units were purchased through various brokers who shared their income while selling those units, by offering the same as incentive to the bulk buyers like the assessee. Just before the incentive was given the assessee was not even the owner of the units.

Therefore, the question of treating the incentive as his income on the purchase of the units is not proper from any principle of accounting, which had been elaborately explained by the Supreme Court in the above mentioned decision. It is, therefore, fair and reasonable that the incentive which the assessee has received on the purchase of these units should only go to reduce the cost of the units as was done by the assessee. It may be pointed out that even the assessing officer has treated it as part of cost of the purchases. It may further be mentioned that even the department is aggrieved by the direction of the Commissioner (Appeals) that the incentive received by the assessee in acquiring the capital asset could not be deducted to arrive at the cost of acquisition of the capital asset. To this extent, the revenue's contention is accepted. As held above, incentive being deducted from the cost of acquisition of these units, the same cannot be brought to tax as income from other sources. We, therefore, allow the assessee's appeal in this regard.

11. In the light of the decision in the first ground in the departmental appeal, the third ground of the revenue becomes infructuous.

12. In the result, the assessee's appeal is allowed while the departmental appeal is treated as partly allowed.

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