

G.M. Breweries Ltd.^* Vs. Dy. Cit, Central Circle 17

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Mar-22-2006

Reported in : (2006)9SOT133(Mum.)

Appellant : G.M. Breweries Ltd.^*

Respondent : Dy. Cit, Central Circle 17

Judgement :

This appeal filed by the assessee is directed against the order of Commissioner (Appeals) XV dated 6-12-1999 at Mumbai for the assessment year 1996-97. The proceedings arise out of assessment made under section 143(3) of the Income Tax Act, 1961.

We have heard both the parties, perused the records and other applicable legal position.

Ground Nos. 1 to 10 deal with the issue of treatment of loss on sale of shares as speculation loss and denial of setting-off of the same against the capital gain earned by the assessee on other assets during the year under consideration.

Briefly stated, facts of the case are that the assessee is a company engaged in the manufacture of liquor. In the return of income, the assessee showed capital gain on sale of assets at Rs. 2,71,489 which was arrived at after netting off against loss on sale of investment at Rs. 80,95,183. The assessing officer noted that the assessee had incurred loss in multiple share transactions wherein the shares were

held for a very brief period. The assessing officer was of the opinion that the assessee was engaged in the sale and purchase of shares and showed the share purchase in the earlier years under the head investment only with the purpose of to avoid the application of Explanation to section 73 of the Act. The assessing officer relying on various decisions, was of the opinion that section 73 would be invoked only when the conditions specified therein are satisfied as there were purchase and sale of shares of companies during the year under consideration were of the nature of regular business. The assessing officer was further of the opinion that the nomenclature adopted for that transactions was not important rather it was sum and substance of the transactions which had to be considered. The assessing officer finally held that Explanation to section 73 was applicable to such transactions on the given set of facts and accordingly loss in trading in shares amounting to Rs. 53,83,538 pertaining to shares purchased and sold during the year under consideration was speculation loss and not available for set off against short-term capital gains on sale of shares. Accordingly, assessing officer computed short-term capital gain is at Rs. 65,93,355. Aggrieved, the assessee preferred an appeal before the learned Commissioner (Appeals), who after carefully considering the Submissions made by the assessee and the findings of the assessing officer based on various judicial precedents, upheld the action of assessing officer and recorded his findings as under : "I have carefully considered the facts of the case and the submissions of the appellant. Under the Explanation to section 73 wherein any part of the business of a company, other than those companies as specified therein consists in the purchase and sale of shares of other companies, such company shall for the purpose of section 73 be deemed to be carrying on a speculation business to the extent to which the business consists of purchase and sale of such shares. Question to be examined is whether the purchase and sale of shares by the appellant company. No hard and fast rule can be laid down for giving such a finding and inference in this regard has to be given from the overall facts and circumstances of the case. Though the appellant has tried to argue that it has always treated that the shares as part of its investment but it is not a conclusive test. Nor the appellant can get any benefit from the fact that in the earlier years profit on sale of shares was assessed as short-term capital gain. From the details of short-term capital gain/loss on the

shares and other assets given in the earlier order, it may be seen that right from assessment year 1994-95 it is carrying on purchase and sale of shares. In this year also, the appellant has sold shares in as many as 34 companies. The appellant has sought to justify the sale of shares after holding the same for less than a year by arguing that it wanted to reduce losses as the share prices were going down. This explanation would have carried some weight if the appellant had sold only shares which were held for a long time and whose prices were going down because of general fall in the shares prices. On the other hand, in this year the appellant has sold the same after holding them for a short duration. This is definitely indulging in speculative business. I do not accept the contention of the appellant that no part of its business consists of purchase and sale.

It is clear from the facts that no investor in shares will indulge in purchase and sale of shares over a period of five years. The appellant has failed to substantiate that it was acquiring shares only by way of investment.

In support of its contention the appellant has inter alia relied upon the order of ITAT, Delhi in the case of M/s. VIP Growth Fund Ltd. v. Assistant Commissioner, 95 Taxman 313. In that case there was only a solitary transaction in regard to sale of shares. On the other hand, as mentioned earlier, the appellant has sold shares in as many as 34 companies in this year. On the facts of the case of the appellant, the observations made by the ITAT in the case of Laxmi Feeds & Exports (P) Ltd. which has been relied upon by the assessing officer are squarely applicable. In this case it was inter alia observed that plurality of transaction and plurality of companies is a pre-condition for attracting the provisions of Explanation to section 75. In the case of the appellant also, there is plurality of transaction and companies and the conduct of the appellant over preceding two years and subsequent two years makes it clear that sale and purchase of shares was part of the business of the appellant company though appellant company has specifically not admitted the same and tried to camouflage it as purchase and sale of investments. Accordingly, Explanation to section 73 is attracted in the case of the appellant.

For the detailed reasons given in this order, the action of the assessing officer in holding that loss of Rs. 53,83,538 is speculation loss in view of the provisions of Explanation 73 is upheld." Aggrieved by the decision of the learned Commissioner (Appeals), the assessee is in appeal before us.

The learned counsel appearing on behalf of the assessee elaborated the factual matrix of the case and contended that the assessee invested surplus funds in shares and once the prices started falling in respect of particular scrip, as a prudent businessmen, the assessee sold the same to avoid further losses. It was also contended that the assessee was holding such shares as investment and in the earlier year where the assessment was completed, the loss/profit on sale of such shares was assessed under the head Capital gains, therefore, the revenue could not take different approach in the year under consideration. In support of his above contentions, he referred to relevant pages of the paper book.

He also relied on the decision of Honble Bombay High Court in the case of CIT v. Amritlal & Co. Ltd. (1995) 212 ITR 540 (Bom), to contend that over all view of the functioning of the company was material for the purpose of determining whether the company was engaged in sale and purchase of shares and not the income of the year under consideration and pointed out that the companys main business was to manufacture wine/liquor spirits and IMFL and alcohol based products, therefore, company could not be said to be involved in the dealing of shares merely on the basis of investment by the company of surplus funds in purchase of shares. The learned counsel appearing on behalf of the assessee further placed reliance on the decision of the Tribunal in the case of M. Manifold (P) Ltd. v. ITO (IT Appeal No. 1190 (Mum) of 2003 dated 2-12-2003) to contend that when the shares were purchased as investment and profits on sale of the shares in earlier years were taxed as capital gains then in a subsequent year, profits on sale of shares could not be treated as speculation profit. The learned counsel further placed reliance on the un-reported decision of the Honble jurisdictional High Court in the case of CIT v. Ceramics & Electrical India (P) Ltd. (IT Appeal No. 335 of 1991 (Bom) dated 18-1-1982) wherein the Honble court in similar circumstances agreeing with the findings of the Tribunal that the assessee-company was not a dealer in shares, rejected the Reference Application filed by the revenue against

the aforesaid decision of the Tribunal.

The learned Departmental Representative, on the other hand, contended that the nature of business as such was not material for the application of Explanation to section 73 of the Income Tax Act, 1961 in a sense if the impugned transactions met the requirement of that section and the assessee was not falling under the exceptions made therein, then, the transactions of sale and purchase of shares and resultant gain/loss thereon would attract the provisions of Explanation to section 73 of the Act. The learned Departmental Representative also contended that during the year under consideration, the assessee sold two properties whereon a profit of Approx. Rs. 83,66,672 was earned which was liable to be taxed on capital gain. The assessee had set off a loss of Rs. 80,95,183 against the same as short-term capital loss incurred on share transactions. The assessing officer after analyzing the transactions of sales and purchase, disallowed the set off of loss incurred only on the transactions of shares purchased and sold during the year under consideration and in respect of loss suffered on the shares purchased in earlier years, the same was treated as short-term capital loss, therefore, assessing officer was quite reasonable in his approach. The learned Departmental Representative. also contended that looking to the number of transactions and companies involved, the volume thereof, it could be safely concluded that the assessee was engaged in the business of sale and purchase of shares that though the same might not be the main business of the assessee. In this regard, he referred to clause 6 of the Memorandum of Association of the assessee-company which authorized the company to deal in shares and stock of other companies. Regarding assessee's contention that the investment in shares were shown as investments in the books of account, the learned Departmental Representative relying on the decision of the Honble Apex Court in the case of *Sutlej Cotton Mills Ltd. v. CIT* (1979) 116 ITR 1 (SC) contended that the manner in which entries were recorded in the books of account could not be a sole factor to decide the nature of transactions and it was the sum and substance of the transactions which was required to be considered to arrive at a proper conclusion.

The learned Departmental Representative further pointed out that the holding period in respect of shares purchased during the year was less than 8 months

while an investment is usually made for the purpose of reaping returns by way of dividends and capital appreciation and stressed on the fact that most of the shares which were purchased and sold during the year the assessee suffered a loss, therefore, an obvious inference could be drawn that such transactions were entered into with a view to mitigate the tax liability on capital gain on other assets earned by the assessee during the year under consideration. With regard to the assessee's contention that the department could not change its stand regarding trading of shares for the year under consideration which were treated as investment by the department in the preceding year, the learned Departmental Representative contended that the principle of *res judicata* did not apply to income tax proceedings and every year was a separate year, therefore, the assessing officer was not prohibited from taking a different view in the year under consideration. The learned Departmental Representative, further referred to the decision of the Special Bench of the Tribunal in the case of *Concord Commercial* to contend that to arrive at the composition of income, loss under the head Business was to be considered and in the present case loss from business was much more than the loss arising under the heads Capital gains and income from other sources, therefore, the case of the assessee squarely fell within the ambit of Explanation to section 73 of the Act and consequently loss arising out of dealing in shares as computed by the assessing officer of Rs. 53,83,538 was in the nature of speculation loss which could not be set off against the capital gain arising on sale of other properties. It was also pointed out that the borrowed funds had been utilized to purchase shares and it was held that if the borrowed funds were utilized for purchase of shares, the same would constitute as business activity and not investment activity. With regard to reliance placed by the authorised representative on the decision of Honble Bombay High Court in the case of *Ceramics & Electrical India (P) Ltd.* (supra), the learned Departmental Representative contended that the Tribunal in that case has held that the impact for transactions for the year in question was not much as to warrant a finding that the assessee-company dealt in shares, therefore, the Explanation to section 73 was held not to be applicable. Similarly, in other decisions of ITAT in the case of *M.Manifold (P) Ltd.* (supra), it was held that the assessee did not carry purchases and sale of shares of other companies. It only held shares of its subsidiary company which were sold. The

facts of both the cases were different from this case and therefore, these judgments quoted were completely out of context as far as this case was concerned.

In the rejoinder, the learned counsel contended that the Memorandum of Association gave only legal competence to the company to purchase the shares and such power cannot be constituted so as to mean that the company was indulging in purchases and sales of shares as business activity. It was further pointed out that the assessing officer had himself treated such transactions in the nature of investment and, therefore, he could not approbate and reprobate on the same issue. It was also contended that if the assessee, to be classified as an investor, was required to hold the shares for longer periods in spite of expected losses, then it would not be a justified or valid proposition. He also contended that the decision of Honble Calcutta High Court in *Eastern Aviation & Industries Ltd. v. CIT* (1994) 208 ITR 1023 (Cal), relied on by the revenue was not applicable to the facts of the case.

We have considered the submissions made by both the sides, orders of authorities below, material on record and applicable legal provisions.

Admittedly, the assessee is a company engaged in the manufacture of liquor and other alcohol based products and during the year under consideration the turnover of the company is approx. Rs. 80 crores. In the financial statements, the assessee company has classified the holding of the shares under the head Investments on the asset side. It is also an admitted fact that the company has invested funds in the sale and purchase of shares for last so many years. From the perusal of the Balance Sheet as on 31-3-1995, it is noted that investments made by the assessee-company are to the tune of Rs. 1.65 crores comprising of quoted shares, units, mutual, funds, debentures, un-quoted shares, Government securities and bonds etc. as compared to investment of Rs. 3.04 crores as on 31-3-1996, thus there has been a substantial reduction in the holdings of quoted shares. It is also observed from the assessment order that in addition to aforesaid holdings, the assessee-company also purchased and sold shares of 34 companies in the year under consideration. It is also a settled principle that entries in the

books of account per se cannot be binding as regards to the determination of correct nature of transactions. It is also a settled principle that res judicata is not applicable to the income-tax proceedings, therefore, revenue is not barred from taking different stand as compared to earlier year when the circumstances warrant such different stand or in the situations where stand taken in earlier year is not correct in law. It is also a settled principle that certain transactions can be treated as trade transactions or investment in different years or even in the same year, some share transactions can be treated as investment and some share transactions can be treated as purchase/sale in the course of carrying on business. The learned Commissioner (Appeals) has summarized the composition of total income for the periods beginning from assessment year 1994-95 till 1998-99 in his order which shows that the assessee has shown income from business, short-term capital gain/loss on other assets and short-term capital gain/loss on shares. Thus, assessee has entered in share transactions in a regular manner over the years. It is also apparent from the perusal of the Memorandum of Association that the assessee company's main business is manufacturing of liquors. It is further noted that sub-clause 6 of Part B of clause III of M.O.A. permits the company to hold and deal in shares, stock and securities of any company as incidental or ancillary to the attainment of the main object of the company. Similarly, sub-clauses 13, 15 & 16 of Part B of clause III of Memorandum of Association also enable the company to deal in shares in different situations. Sub-clause 32 of Part-13, of clause III of Memorandum of Association reads as under : "To invest any money of the company not for the time being required for any of the purposes of the company such investments (other than shares or stock in the company) (Emphasis supplied) as may be thought proper and to avoid sell or otherwise deal with such investments." From the perusal of the aforesaid clause, it is amply clear that the company cannot invest surplus funds in shares or in stock of a company.

Further sub-clause 36 of Part-C (Other Objects) of clause III of the Memorandum of Association reads as under : "To carry on the business of investment and to buy, sell, underwrite, deal, invest in and acquire and hold shares, stocks, debentures, debenture stock, bonds, obligations and securities issued or guaranteed by any company constituted or carrying on business in India or

elsewhere and debentures, debenture-stock, bonds, obligations and securities, issued or guaranteed by any Government, State, dominions, sovereign, ruler, Commissioners, public body or authority, supreme, municipal, local or otherwise, firm or persons, whether in India or elsewhere and to deal with and turn to account the same provided always, that no investment imposing unlimited liability on the company shall be made." From the combined reading of the aforesaid clauses, it is absolutely clear that although the company's main business is of manufacturing but subsidiary or other business is of dealing in purchase and sale of, shares, even though such holdings have been classified as investments in the books of account. We are of the view that there is some merit in the contention of assessee that MOA/AOA provide only legal competence to the company, however, when the company is not legally competent to invest surplus funds in shares/stock of other company as investment by virtue of sub-clause 32 of Part B clause III of MOA and sub-clause 36 of Part-C of clause III of MOA permits the carrying of business of investment, therefore, only conclusion which can be drawn is that the company is carrying on business of dealing in purchase and sale of shares, which attracts the Explanation to section 73 as the same is "part of business carried on by the company".

In the case of M. Manifold (P) Ltd. (supra) the relevant findings of the Tribunal are cited below : "The assessee does not carry on the business of purchase and sale of shares of other companies. It held shares of its subsidiary company, which were sold. The object clause contained in the Articles of Association of the assessee permits it to invest in shares of other companies rather than to deal in shares of other companies. The shares which were acquired by the assessee were reflected in its accounts as investments and not as stock-in-trade. It has been rightly pointed out that were it the other way around, the assessee would have been entitled to claim and would have claimed the valuation loss in the earlier years by valuing the stock at cost or market value, as was suited to it. This was not done. The assessee, therefore, was clearly not dealing in shares of other companies. As such, the Explanation to section 3 was wrongly applied. The assessee did not indulge in any manipulation in share dealing in order to avoid tax payment. An Investment company does not deal in shares as stock-in-trade. It does not go against the assessee that interest expenditure was claimed as a deduction. It was

not found that borrowed funds were utilized to acquire shares. As rightly pointed out, the definition of "investment company" as contained in the erstwhile section 109(11) stands now incorporated in the Explanation to section 73." It is seen from the above that in the aforesaid case it was a categorical finding that the assessee was not dealing in purchase and sale of shares and the object clause permitted the assessee to invest in shares or other company rather than to deal in shares of other companies whereas in the present case the assessee-company is entitled to deal in the shares of other companies and not to make investments in the shares of other companies. Therefore, the aforesaid decision does not help the cause of the assessee. Similarly, in the case of *Ceramics & Electrical India (P) Ltd.* (supra) the Honble High Court rejected the Reference Application filed by the revenue because there was categorical finding by the Tribunal that the magnitude of transactions in the relevant year was not much so as to treat the assessee as a dealer in shares, whereas in the present case assessee has entered into regular sale/purchases of shares and the loss arising as a result of transactions of sale and purchase of shares of the year only has been taken as a speculation loss. From the composition of income of the year under consideration, it is clear that loss from the business is much more than the capital gain or income from other sources. In the case of *Eastern Aviation & Industries Ltd.* (supra) it was held that the words "income" or "profits and gain" should be understood as including loss also, because in one sense "profits and gain" represent "a positive income" whereas losses represent "negative income". In other words, "loss" is a negative profit. Both positive and negative profits are of revenue character. Both must enter into computation, where it becomes material in the taxable income of the assessee. It was further held that since business loss exceed income computed under the head "Income from other sources" therefore, Explanation to section 73 was clearly applicable and the loss suffered by the assessee-company in its share trading transactions inclusive of interest paid on borrowed money attributable to that business was rightly treated by the Tribunal as loss on speculation business. As held by the Honble High Court income includes losses and, based upon the test of composition of income, the assessee does not fall into the exception as provided in Explanation to section 73 of the Act. It is further noted that during the period starting from assessment year 1994-95 to assessment year 1998-99 in

majority of years the income from business is more than other incomes, therefore, even on this criteria, the assessee-company comes within the ambit of Explanation to section 73 of the Act. The assessee is also not covered within other exception clause of a company engaged in the business of granting loans and advances or business of banking. The Special Bench of the Tribunal in the case of Concord Commercial has held that the two kinds of exceptions provided in Explanation to section 73 are based on two independent tests laid down in the Explanation itself. The test to be applied on the first category of companies is the character of its gross income. It was further held that if the gross total income of the company was mainly made up of income under the head "Profit and gains of business/profession", it was caught by the mischief to Explanation to section 73. It is important to note that in the aforesaid decision of the Tribunal, it was held that the transactions of purchase and sale of shares would be held as a speculation business only if the company was hit by the Explanation to section 73. In present case, it has been established that the Explanation to section 73 is applicable to the share transactions and accordingly the resultant loss would be treated as speculation loss. In this view of the matter, we are of the considered opinion that the orders of the revenue Authorities are in accordance with law and accordingly, we uphold the same.

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