

Note on Taxation of Shares and Securities by CA. Kapil Goel can be contacted at cakapilgoel@gmail.com

1. Capital Gains on Shares and Securities – Tax Matrix

Nature of Security	Tax Rate
LTCG on STT paid listed securities	Sec 10(38) exemption
LTCG on Listed Securities – No STT – Buyback, Open	20% with Index. or 10% without Index.
LTCG on Unlisted Securities- STT Not Applicable	20% with indexation
STCG on STT Paid Listed Securities	Sec 111A – 10% (15% from AY 2009-10)
STCG on Listed Securities – No STT– Buyback, Open	Normal Taxation
STCG on Unlisted Securities	Normal Taxation

2. Capital Gains on Shares and Securities – Some Latest Developments

**Capital Asset versus Stock In Trade Snap Shot**

- Need for classification : Because of section 14 of the Income Tax Act, 1961 to apply appropriate head of taxation and corresponding provisions for deductions and allowance (refer table below) and because of section 2(14) of the Act (definition of capital asset – excludes stock in trade, as if a share holding is classified as capital asset – section 45 (chapter XIV-E) will apply & if a share holding is classified as stock in trade section 28 (chapter XIV-D will apply)

<b><i>If share transaction(s) classified under business head – implications</i></b>	<b><i>If share transaction(s) classified under capital head – implications</i></b>
<p><u>Closing stock valuation</u> on cost or market price which ever is lower <u>available</u> and consequential difference in purchase price and closing market price, if loss, allowable to be set off against other income (business head and other- if <u>non speculative</u>)</p>	<p>“<u>Closing stock valuation</u> on cost or market price which ever is lower” - <u>Not available</u>, that is loss if any will be available on transfer of shares stipulated u/s 2(47)</p>
<p><u>Business expenses</u> (u/s 28 to section 37) allowable including respective purchase cost</p>	<p>Only <u>cost of acquisition</u> as stipulated in <u>section 48 allowable</u> r/w section 55 of the Act</p>
<p><u>Unrestricted set off</u> available u/s 70/71 that is business loss (<u>non speculative</u>) from share transaction is allowable to be set off against other income (<u>excl salary head</u>).(for current year)</p> <p><u>No possibility for dead loss</u> as in case of capital assets – see opposite column</p>	<p><u>Restricted set off</u> – as per <u>section 70(2)</u> and <u>sec 70(3)</u> and <u>sec 71(3)</u> that is, short term capital loss can be set off against (<u>ANY</u>) capital gains only and long term capital loss can be set off against long term capital gains only (current year and subsequent year)</p> <p>Further, if loss arises out of listed shares held on long term basis on which STT is paid, since reciprocal gains exempt u/s 10(38) – consequential loss – <u>may be treated as dead loss</u> (refer Mad HC in 129 ITR 115)</p>
<p><u>Benefit of section 10(38) LTCG –STT Paid Securities</u> – Exempt and section 111A concessional STCG on STT paid securities and section 112 concessional LTCG on listed securities – NOT AVAILABLE</p>	<p><u>Benefit of section 10(38) LTCG –STT Paid Securities</u> – Exempt and section 111A concessional STCG on STT paid securities and section 112 concessional LTCG on listed securities – AVAILABLE</p>
<p><u>Explanation to section 73 applicable to companies</u> – loss from shares <u>business-</u> deemed to be speculative in nature – set off allowable only against speculative business income</p>	<p><u>Explanation to section 73 not applicable to capital assets</u> (refer Mum ITAT in 6 SOT 497, 6 SOT 458, Del ITAT in Bonanza Portfolio, Del ITAT TM in 101 ITD 129 etc)</p>

<p>Share transaction falling in cap of <u>“speculative transaction” u/s 43(5) or under expl to section 73</u> – consequential loss speculative – set off against speculative business income only</p> <p>Note: Non delivery share transactions (BEING speculative u/s 43(5)) is generally classified as business transaction r/w expl 2 to section 28.</p>	
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- Intention to acquire shares : whether intention to make trading or hold shares as investment (refer latest Mad HC in 305 ITR 434): host of factors to be considered (no single factor conclusive/decisive):
  - Basic legislative intent : from scheme of taxation u/s 10(38), section 112, section 111A, section 2(42A) (concept of short term capital asset (in case of shares – if held for not more than 12 months) with securities Transaction Tax in place – read with finance minister speech accompanying budget of 1987-1988 available at [www.indiabudget.nic.in](http://www.indiabudget.nic.in) - :
 

“At present shares have to be held for a period of 36 months before capital gains on their transfer qualify for the concessional treatment allowed for long term capital gains. It is proposed to reduce the holding period to 12 months. **This will provide greater flexibility to investors and also improve the mobility of capital invested in shares....**” Similar intention has been codified in budget speech of (for increased mobility):

    - i) Finance Bill for 1977-1978
    - ii) Finance Bill for 2003-2004
    - iii) Finance No. 2 Bill for 2004-2005”
  - Consistency : Treatment in preceding and succeeding years may be referred – refer DHC in Gulmohar Finance 170 Taxman 483 (in case assessee consistently shown shares purchase as investment in balance sheet – consequential gains – capital nature) similar ratio in DHC in Bhartesh Jain, Mum ITAT in Janak S Rangwalla 11 SOT 627 (mere fact that investment in large magnitude would not decide the nature of transaction spl.. where in past share income has been assessed as capital gain) , Citadell 11 SOT 273 and , P&HHC in 260 ITR 417, 115 TTJ 639 (when purchase of shares has been accepted as investment in past years- consequential gains in subsequent years – capital nature) 86 TTJ 395 (case of

- lady not engaged in trading of shares from market place, sold shares accepted as capital investment in earlier asst – held consequential gains – capital nature), etc Del ITAT in 25 SOT 414
  - Periodicity of Holding refer 155 Taxman 214 (long period of holding taken as a factor to held capital nature), also in 11 SOT 273
  - Specific Object/Purpose behind sale/purchase: Whether any particular/specific object in acquire/sale of shares (eg acquiring shares as promoter – consequential sale held in capital nature refer 100 TTJ 1132, DHC in Essjay given below , Mad HC in 305 ITR 434, 55 ITD 502, 59 ITD 643, 62 ITD 39 etc)
  - Treatment in books –refer 115 TTJ 639, DHC in Ess Jay, 2 SOT 371 , 87 TTJ 368, 4 SOT 239, 8 ITD 237 (caution : stand taken in ITR/ROI, ordinarily must match with treatment given in books)
  - Use of Borrowed/Own Funds – 117 Taxman 188 Mag, 11 SOT 273, , 4 SOT 239
  - Delivery based/ Non Delivery based transactions – Ratio 117 Taxman 188 Mag
  - Primary Market (IPO's) versus secondary (sensex) deals – Ratio 117 Taxman 188 Mag
  - Infrastructure Deployed – Systematic activity carried on ?
  - Magnitude and frequency of transaction – 88 TTJ 384 , SC in 212 CTR 347, SC in 82 ITR 812
  - Assessee's main activity in normal course vis a vis share transactions (like assessee is a salaried person, retired pensioner, practicing engineer/doctor/professional - is engaged in normal business of trading or profession etc)
  - Time devoted & Risk assumed
- Principles emerging from CBDT Circular No 4 of 2007 dt 15/6/2007 :
  - Onus on assessee to prove whether shares held as investment or stock in trade (also in SC in 82 ITR 586)
  - If intention to earn dividend – transaction capital in nature and if intention to earn profits – transaction trade in nature – *how far viable in present scenario where investor is hardly concerned with dividend, if applied strictly, all transactions may become of business nature?*
  - Multiple Portfolio envisaged (also refer recent Mad HC in N.S.S Investments 277 ITR 149, Chd ITAT in Vesta Investments 70 ITD 200 etc) An assessee can hold two portfolios also in Luck ITAT in Sarnath Infrastructure ITA NO 301/Luck/2006; Del ITAT in V.N. Aggarwal 25 SOT 414
  - Issues arising: treatment for investment through **portfolio management scheme (PMS)** investors and treatment for **day traders etc** – albeit two views possible – but author's view: a) intra day non delivery transactions – business income subject to section 43(5); b) intra day delivery based transactions – more

*closer to trader –c) F&O – business income subject to section 43(5),  
d) **PMS investor – capital gains (also refer Article at 146 Taxman 278 Mag) since basic intention is of investment and not trading***

- Endorsing views of AAR in 288 ITR 641 stating FII's to be taxed under Cap Gains
- Message to AO's: Totality of all factors to be considered

### **Latest Case laws on Capital Asset versus Stock In Trade:**

- DHC in Ess Jay Enterprises 165 Taxman 465 affirming Delhi ITAT in 9 SOT 695 – Ratio Where intention is to control the company further corroborated by treatment and assessment as 'investment' in books and balance sheet from beginning, share trading being not main object, retaining the shares in time of boom – held to be of Capital Nature
- Delhi ITAT in Ashwani Minda 163 Taxman 94 Mag– Where intention at all times to hold shares as investment- taken delivery of all shares and made full payments – Capital Asset (Burden on revenue to prove loss transactions are sham or non genuine)
- Mum ITAT in Janak . S. Rangwalla 11 SOT 627 – Mere Large magnitude of transactions not sufficient to hold assessee as trader spl. when in previous years same has been accepted an investor.....
- Raj ITAT in 117 Taxman 188 Mag– (“An assessee might invest his capital in shares with the intention to resell, such as investment though motivated by possibility of enhanced value would not necessarily mean a transaction in course of trade”, merely because shares are purchased at a time when share market is in boom and investment contemplated “re sale” with enhanced value do not turn “investor” into trader....)
- Kol ITAT in A.T.N International 4 SOT 239 : Extensively analyzing conspectus of case laws surrounding the issue

### 3. Bogus Capital Gains on Shares and Securities – Reopening and Taxation u/s 68 – Cash Credits - Some Latest Developments

- Furnish Maximum Documentary evidence in form of – Broker's contract note (sale/purchase), banking transaction proof (if any), distinctive no of shares/ share certificate ; share price quotation on dt of sale/purchase from newspaper; share transfer documents, confirmation from company in which share are transferred etc

- If above evidence furnished, no addition u/s 68 for bogus capital gains held by P&HHC in Anupam Kapoor 299 ITR 180; 264 ITR 579; ITAT in 9 DTR 564; 7 DTR 158; 6 DTR 141; 89 TTJ 1095; 54 ITD 508 and Latest Luck ITAT in 175 Taxman 60 (Mag) (Onus/ burden shifts on revenue to prove bogusness in capital gains by positive/tangible material on record) also see Del SB of ITAT in Manoj Aggarwal case 113 ITD 377
- Latest Mum ITAT in 119 TTJ 643: In case of transfer of shares at cost, between related parties, agreed price cannot be substituted by fair market value unless revenue proves some extra consideration has passed (also see 109 ITD 173 transfer between promoters)
- On reopening front : whether 148 notice can be issued on recpt of information from Investigation Wing in relation to bogus capital gains entry : If specific and direct information is there for an assessee and not on basis on general and vague information – refer DHC in 299 ITR 383; All HC in 268 ITR 400; Del ITAT in 6 DTR 141 ; 9 DTR 564