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If Assessing Officer has ‘Reason to believe’ that income has escaped assessment, he can invoke the power to reopen assessments.

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Synopsis

The Kerala High Court in the case of Equity Intelligence India Pvt. Ltd. has held that the Assessing officer (AO) should have 'reason to believe' that income chargeable to tax has escaped assessment to invoke the power to re-open the assessment under section 147 of the Income tax Act, 1961 (the Act). The High Court has explained that the 'reason to believe' does not mean that AO must be satisfied about the existence of grounds for reopening the assessment or the AO should have formed an opinion about the nature of the reassessment order that shall be finally passed.

The High Court further held that income from sale of shares is business income and not capital gains since the taxpayer was engaged in trading of shares.

Facts

- The taxpayer company, Equity Intelligence India Pvt. Ltd, was engaged in providing portfolio management services and was registered under the Securities and Exchange Board of India (Portfolio Managers) Regulation 1993.
- The taxpayer filed its return of income for assessment years 2006-07 and 2008-09 treating the income arising from purchase and sale of shares as capital gains.
- In the assessment year 2006-07, return of income filed was processed under section 143(1) of the Act and assessment was completed.
- The assessment proceedings for assessment year 2008-09 and 2010-11 were respectively completed under section 143(3) of the Act, treating the income arising from the purchase and sale of shares as 'business income' as against capital gains per taxpayer's return of income.
- For the assessment year 2006-07 the AO reopened the assessment and passed order under section 147 holding that income arising from purchase and sale of shares, was business income.

- The taxpayer filed an appeal before of Commissioner of Income tax (Appeals) [CIT(A)] for the assessment years 2006-07. The CIT(A) upheld the AO's order.
- The taxpayer's appeal filed before the Tribunal was dismissed.
- The taxpayer filed an appeal before the High Court

Issues before the High Court

- Whether the Tribunal was right in confirming the reopening of assessment under section 147 of the Act?
- Whether Tribunal was right in confirming that the profit on sale of shares is to be assessed under the head 'Business income and not 'capital gains'?

Ruling of the High Court

- The High Court examined the term 'reason to believe' referred in section 147 of the Act.
- The High Court referred to the decisions[1] of Supreme Court and Delhi High Court Full Bench decision[2] and held that the power under section 147 of the Act can be invoked by the AO, if, based on the materials available before him, he has 'reason to believe' that any income chargeable to tax has escaped assessment in any assessment year, subject to the period of limitations prescribed under section 147 of the Act.
- The High Court held that the term 'reason to believe' does not mean that the AO must be satisfied that there exists grounds for reopening.
- The High Court held that the scope of enquiry that is permissible in an assessment proceedings under section 143(1) was very limited.
- The High Court observed that once assessment proceedings for the assessment year 2008-09 were completed assessing the profits from sale of shares as business income,

[1] ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd (SC), CIT v. Kelvinator of India Ltd. (2010) 187 Taxman 312 (SC),
[2] CIT v. Usha International Ltd. (2012) 348 ITR 485

the AO had sufficient material to believe that income chargeable to tax in the assessment year 2006-07 had escaped assessment.

- The High Court upheld the reopening under section 147 for the assessment year 2006-07
- The taxpayer contented that there was no consistency in the AO's approach as no action was taken by the AO for assessment years 2007-08 and 2009-10, since there was a loss per return of income. The High Court held that power under section 147 can be invoked only if any income chargeable to tax has escaped assessment. The High Court held that since there was a loss in the said assessment years, no income chargeable to tax had escaped assessment.
- The High Court relied on CBDT Circular no.4/2007 dated 15 June 2007, which enunciated principles for distinguishing between shares held as stock-in-trade and shares held as investment.
- The High Court observed the below facts in the case of the taxpayer for assessment year 2008-09 to determine if the profit on sale of shares was in the nature of 'business income' or 'capital gains:
  - The taxpayer has traded in shares of 45 companies
  - The average holding period of the majority of the shares ranged from 3 days to 91 days
  - The purchase and sale of shares were frequently carried out by taxpayer.
  - The taxpayer had all the infrastructure for buying and selling shares.
  - Dividend income was earned from very few scripts as compared to value of shares held by the taxpayer.
  - Involvement of the taxpayer in the trading of shares was not an occasional one but was carried out in a systematic and organized manner.
- The High Court held that whether trading in shares is not the main object of the taxpayer or that the shares were not shown as stock-in-trade in books of the accounts of the taxpayer is irrelevant to determine the taxability of shares.
- The High Court also relied on Supreme Court ruling[3] and upheld the Tribunal's decision of treating the profit on sale of shares as business income.

[3] CIT v. Sutlej Cotton Mills Supply Agency Ltd (1975) 100 ITR 706 (SC)

Comments

- The following principles are generally looked at for characterization of the gains / loss on purchase and sale of securities:-
  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 accounts, 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.
- There are conflicting judicial precedents[4] on what constitutes capital gains v business income.
- In the instant case, an inconsistent approach has been adopted of taxing profits as business profits while losses are taken as capital losses which otherwise cannot be set off against business income.

Source: Decision of the Kerala High Court dated 3 July 2015, in the case of Equity Intelligence India Pvt. Ltd. v. Assistant Commissioner of Income-tax, Circle -1(1), Kochi [ITA No. 267, 274, and 280 of 2014].

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[4] Decision of Mumbai Tribunal in the case of Sagar Constructions Vs. ACIT (ITA No.4646-4711/Mum/2011) for the assessment year 2008-09, CIT vs. Kapur Investments (P.) Ltd. (ITA No. 158-159/2014) Karnataka High Court, CIT v. Vinay Mittal (2012) 22 taxmann.com 151 (Delhi High Court), Radials International v. ACIT (2015) 55 taxmann.com 106 (Delhi), Radials International v. ACIT (2012) 18 taxmann.com 20 (Delhi)

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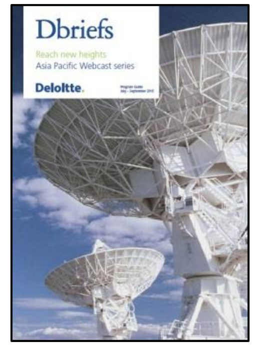

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