

Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes

New Delhi, the 15th day of June, 2007

Sub : Distinction between shares held as stock-in-trade and shares held as investment – tests for such a distinction.

The Income Tax Act, 1961 makes a distinction between a “capital asset” and a “trading asset”.

2. Capital asset is defined in Section 2(14) of the Act. Long-term capital assets and gains are dealt with under Section 2(29A) and Section 2(29B). Short-term capital assets and gains are dealt with under Section 2(42A) and Section 2(42B).

3. Trading asset is dealt with under Section 28 of the Act.

4. The Central Board of Direct Taxes (CBDT) through **Instruction No.1827 dated August 31, 1989** had brought to the notice of the assessing officers that there is a distinction between shares held as investment (capital asset) and shares held as stock-in-trade (trading asset). In the light of a number of judicial decisions pronounced after the issue of the above instructions, it is proposed to **update the above instructions** for the information of assessees as well as for guidance of the assessing officers.

5. In the case of *Commissioner of Income Tax (Central), Calcutta Vs Associated Industrial Development Company (P) Ltd (82 ITR 586)*, the Supreme Court observed that:

“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.”

6. In the case of *Commissioner of Income Tax, Bombay Vs H. Holck Larsen* (160 ITR 67), the Supreme Court observed :

“The High Court, in our opinion, made a mistake in observing whether transactions of sale and purchase of shares were trading transactions or whether these were in the nature of investment was a question of law. This was a mixed question of law and fact.”

7. The principles laid down by the Supreme Court in the above two cases afford adequate guidance to the assessing officers.

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 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”.

9. Dealing with the above three principles, the AAR has observed in the case of Fidelity group as under:-

"We shall revert to the aforementioned principles. The first principle requires us to ascertain whether the purchase of shares by a FII in exercise of the power in the memorandum of association/trust deed was as stock-in-trade as the mere existence of the power to purchase and sell shares will not by itself be decisive of the nature of transaction. We have to verify as to how the shares were valued/held in the books of account i.e. whether they were valued as stock-in-trade at the end of the financial year for the purpose of arriving at business income or held as investment in capital assets. The second principle furnishes a guide for determining the nature of transaction by verifying whether there are substantial transactions, their magnitude, etc., maintenance of books of account and finding the ratio between purchases and sales. It will not be out of place to mention that regulation 18 of the SEBI Regulations enjoins upon every FII to keep and maintain books of account containing true and fair accounts relating to remittance of initial corpus of buying and selling and realizing capital gains on investments and accounts of remittance to India for investment in India and realizing capital gains on investment from such remittances. The third principle suggests that ordinarily purchases and sales of shares with the motive of realizing profit would lead to inference of trade/adventure in the nature of trade; where the object of the investment in shares of companies is to derive income by way of dividends etc., the transactions of purchases and sales of shares would yield capital gains and not business profits."

10. CBDT also wishes to emphasise that it is possible for a tax payer to have two portfolios, i.e., an investment portfolio comprising of securities which are to be treated as capital assets and a trading portfolio comprising of stock-in-trade which are to be treated as trading assets. Where an assessee has two portfolios, the assessee may have income under both heads i.e., capital gains as well as business income.

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.**

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12. These instructions shall supplement the earlier Instruction no. 1827 dated August 31, 1989.

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(F.No.149/287/2005-TPL from Central Board of Direct Taxes)