

# Tax tribunal clears air over capital gains and biz income

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A MUMBAI bench of Income Tax Appellate Tribunal (ITAT) has laid out the parameters to decide whether profit from sale of shares is capital gain or business income.

Since there is no tax on long term capital gains, determining the character of income is a sensitive issue for tax authorities as well as tax payers. According to an ITAT order issued on April 30, the frequency of transactions in shares, the ratio between purchase, disposal and holding of shares, separate board resolutions for carrying out investments and money borrowed for purchase of shares are key factors for making the distinction.

ITAT, while deciding an appeal in the case of Management Structure & Systems, delineated those parameters. A primary indicator is frequency of purchase and disposal of securities. If the transaction in shares is substantial, it is an indication to trade, and therefore, the income from it can be identified as business income. Another criterion is the ratio between purchase, sales and holding of shares. High transactions and low holdings indicate trade, and therefore, business income while low transactions and high holding indicate investments, hence capital gains.

Besides, if the purchase and sale is for profit making, it indicates trading, and therefore, cannot be characterised as business income. If purchase and sale are for retention and appreciation in valuation, it indicates investment, hence, should be treated as capital gains.

Another test is authorisation in Memorandum of Association or Articles of Association. Where board resolutions are passed for carrying out investment, the intention of the taxpayer is to treat it as investment.

The ITAT observed that the intention of the taxpayer is reflected in his conduct and the way he treats the transactions. In this case, the taxpayer has received substantial dividend from his investments. Therefore, the tribunal, taking into account the totality of the transactions, held that the profit should be assessed as capital gains.

“The conduct of the taxpayer is critical in deciding whether an activity of buying and selling is investment income or business income. This decision reiterates that characterisation of the income is based on the economics of the activity,” said Vispi T Patel of Vispi T Patel & Associates.