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Income from investments under discretionary portfolio management scheme taxable as capital gains and not as business income

In brief

In a recent ruling in the case of Salil Shah Family Pvt. Trust[1] (the 'appellant'), the Mumbai bench of Income-tax Appellate Tribunal (Tribunal) held that income from investments under discretionary portfolio management scheme (PMS) is to be treated as income from capital gains and not a profits and gains from business or profession (business income).

Facts

- The appellant is a private family trust, who has appointed four portfolio managers (PMs) for investing its corpus fund, received from settlor of the trust, into various securities namely, equity shares, mutual funds, etc.

- The appellant offered to tax income from long-term capital gains (LTCG) of INR 0.89 million, short-term capital gains (STCG) of INR 59.73 million and Income from other sources in its tax return of income for the assessment year (AY) 2008-09.

[1] Salil Shah Family Pvt. trust *v.* ACIT [TS-40-ITAT-2013 (Mum)]

Issue

- Whether the income from sale and purchase of shares under discretionary portfolio management scheme should be treated as income from 'capital gains' or 'business income'?

Appellant's contentions

- The appellant is only an investor and is not engaged in any business activity of trading in shares. It had appointed PMs with the sole objective of making investment and to preserve the capital and achieve growth in the capital corpus of the trust. Further, the PMs were not allowed to indulge in any speculation activities on behalf of the appellant.
- The funds were used purely for investment activities only.
- The shares whose characterisation is accepted as 'capital asset' in earlier AY, if sold in the year under consideration, the resultant gain can be taxed only under the head capital gains.
- The average holding period of shares is 178 days.
- As per CBDT Circular No. 4, dated June 15, 2007, as well as Instruction No. 1827, dated August 31, 1989, the appellant can have two types of portfolio, one as investment and the other as stock-in-trade.
- Investment made through PMs cannot always result into business income.

Revenue's contentions

- Due to enormous volume, periodicity, frequency and multiplicity of transactions of purchase and sale in shares and securities, it cannot be said that the shares/securities have been held as assets.
- The shares are sold at a loss which a prudent investor normally would never do and the appellant devoted full time for carrying share trading business.
- The intention of the appellant was not to make investment in shares for a long run benefit, but to earn quick profit by frequently buying and selling the shares.
- The shares were traded by the PMs who acted as an agent of the appellant and gains are to be assessed as business income.

Tribunal ruling

- The intention of the appellant was to avail investment advisory and portfolio management services for the purpose of investment to be made in securities for wealth creation.
- The finding of the AO that the PMs were agents, working for and on behalf of the appellant was incorrect. All the decisions regarding investments, its timings, etc. are made by the PMs and not by the appellant.
- Holding period of scripts is not relevant since it was not in the control of the appellant as PMs were taking such decisions of buying and selling on their own.
- The entire investment has come out of the corpus fund and there were no borrowed funds.
- Therefore, the transactions have resulted into capital gains.

Conclusion

The issue, whether the income from sale and purchase of shares in a particular case should be treated as capital gains or as business income, has been a debatable issue and there are conflicting decisions of the Tribunal on this issue. The Mumbai bench of Tribunal had not considered volume, periodicity, frequency, etc. as relevant factors and upheld the intention of the appellant to hold the shares/scripts, decision to buy/sell shares, method of valuation, investment through own funds or borrowed funds, etc. as key factors to decide upon the nature of income from sale of shares/scripts. The decision of the Tribunal is fact specific and one will need to address each situation independently.

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