CBDT clarifies on the issue of taxability of surplus on sale of shares and securities

Background

As per Section 2(14) of the Income-tax Act, 1961 (the Act), the term 'capital asset' includes property of any kind held by a taxpayer, whether or not connected with his/her business or profession, but does not include any stock-in-trade or personal assets subject to certain exceptions. With reference to shares and other securities, the same can be held as capital assets, stock-in-trade or both.

Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has been a subject matter of litigation.

Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The Central Board of Direct Taxes (CBDT) has also issued Instruction\(^1\) and Circular\(^2\) dealing with the same.

The CBDT Circular\(^3\)

In this background, the CBDT recognises that no universal principal in absolute terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), and realises that major part of shares/securities transactions take place in respect of the listed ones.

With a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, the CBDT further instructs that the Assessing Officer (AO) in holding whether the surplus generated from sale of listed shares or other securities would be treated as capital gain or business income, shall take into account the following:

- Where the taxpayer itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer of such shares/securities would be treated as its business income,

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\(^1\) Instruction No. 18/27 of 1989

\(^2\) Circular No. 4 of 2007 dated 15 June 2007

\(^3\) Circular No. 6/2016, dated 29 February 2016
In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the taxpayer desires to treat the income arising from the transfer thereof as capital gain, the same shall not be put to dispute by the AO. However, this stand, once taken by the taxpayer in a particular year, shall remain applicable in subsequent years also, and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;

In all other cases, the nature of the transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid circulars issued by the CBDT.

The above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of long-term capital gain/short-term capital loss or any other sham transactions.

The above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from the transfer of shares and securities.

All the relevant provisions of the Act shall continue to apply to the transactions involving the transfer of shares and securities.

Our comments

Shares and other securities can be held either as capital asset or stock-in-trade/trading asset or both. However, the Act does not contain any specific guidelines with reference to the characterisation of any particular investment as capital asset or stock-in-trade/trading asset. While this characterisation is essentially a facts-specific determination, the absence of thorough legislative guidance has resulted in prolonged litigation.

The Easwar Committee has recommended that the surplus arising on transfer of shares and securities held for a period exceeding 12 months will be chargeable as capital gains if they are not held as stock-in-trade.
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