IN THE INCOME TAX APPELLATE TRIBUNAL
PUNE BENCH "A", PUNE

Before Shri Shailendra Kumar Yadav Judicial Member
and Shri R.K. Panda Accountant Member

ITA NO. 356/PN/2011
(Assessment Year 2007-08)

DCIT Circle 1 1(1), Pune .. Appellant

Vs.

KRA Holding & Trading Pvt. Ltd.,
12, Riverside Estate, Boat Club Road, Pune. .. Respondent
PAN No.AAACK 7301F

ITA NO. 240/PN/2011
(Assessment Year 2007-08)

KRA Holding & Trading Pvt. Ltd.,
12, Riverside, Estate, Boat Club Road, Pune. .. Appellant
PAN No.AAACK 7301F

Vs.

DCIT Circle 1 1(1), Pune .. Respondent

Assessee by	:	Sri M.P. Mahajani & Sri R.D. Onkar
Department by	:	Sri Mukesh Verma, CIT
Date of Hearing	:	09-07-2012
Date of Pronouncement	:	25-07-2012

ORDER

PER R.K. PANDA, AM :

These are cross appeals. The first one is filed by the Revenue and the second one filed by the assessee and are directed against the order dated 29-10-2010 of the CIT(A)-I, Pune relating to the Assessment Year 2007-08. For the sake of convenience, these were heard together and are being disposed of by this common order.

ITA No. 356/PN/2011 (By Revenue) :

2. Grounds raised by the Revenue are as under :

"1. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) erred in treating the income earned from sale and purchase of shares as Capital gain instead of business income as found out by the AO when the assessee had carried out transaction on a large scale in a systematic and continuous manner and with the motive of earning profit.

2. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) grossly erred in relying order of the ITAT in assessee case for the A.Y. 2004-05 for which the appeal to the High Court filed by the department is still pending.

3. On the facts and circumstances of the case, the learned Commissioner of Income Tax (Appeals) grossly erred in not considering the assessee's nature of business, the magnitude of purchases and sale of shares and the ratio between purchases and sales of the holdings".

3. Facts of the case, in brief, are that during the assessment proceedings the AO noted that the assessee has declared Short term capital gain on sale of shares and mutual funds at Rs. 5,30,14,183/- and Long term capital gain at Rs. 1,42,31,801/-. The Short term capital gain was offered to tax whereas the assessee claimed the Long term capital gain as exempt. The assessee has treated the entire activity of dealing in shares and units as investment activity and not business activity. Following the order for A.Y. 2004-05, 2005-06 and 2006-07 the AO considered the capital gains declared by the assessee as business income and treated the profit of Rs. 6,72,45,984/- as business income.

4. In appeal the learned CIT(A) following the decision of the Tribunal in assessee's own case vide ITA No. 500/PN/2008 order dated 31-08-2009 for A.Y. 2004-05 allowed the claim of the Short term capital gain and Long term Capital gain as computed by the assessee by holding as under :

"I have carefully considered the facts of the case and the applicable law. The Assessing Officer as well as the assessee are in agreement that the facts of the case and the applicable law is same was existing while making the assessment years 2004-05 to 2006-07. The Assessing Officer after making a detailed discussions in the order passed for A.Y. 2004-05, on which the reliance has also been placed while completing the assessments for A.Y. 2005-06 to 2007-08, has held that the income arising from the sales of shares/mutual funds etc. is assessable under the head 'purchase and profession' as the assessee is engaged in this activity in an organised manner with the motive to earn regular income and the same is discernible from the volume, regularity, frequency and continuity of the transactions with the held of portfolio managers. The above finding of the Assessing Officer has been already confirmed by my learned predecessor in A.Y. 2004-05 to A.Y. 2006-07. However, it has been brought on record by the assessee that the Hon'ble ITAT, 'B' Bench, Pune in an appeal filed by the assessee against the order of the Ld. CIT(A)-I, Pune for A.Y. 2004-05, has allowed the appeal on this issue in ITA No. 500/PN/2008 (A.Y. 2004-05) dated 31-08-2009. In view of the above, the assessee has made prayer to follow the finding of the Hon'ble ITAT, Pune given in this case on this issue It has been found out that the Department has preferred an appeal against the above order of the ITAT and the matter is pending for adjudication with the Hon'ble High Court. However, as the order of the ITAT given on this issue in the case of the assessee is enforceable and has not been stayed, the judicial discipline demands that the same is required to be followed despite the opinion of this forum. There is no dispute that

the facts and law are same and in view of the same following the judgment of the Hon'ble ITAT, the appeal is allowed subject to the final finding of the Superior Courts.

4.1 Aggrieved with such order of the CIT(A) the Revenue is in appeal before us.

5. We have heard the rival arguments made by both the parties, perused the orders of the AO and the CIT(A) and the Paper Book filed on behalf of the assessee. We have also gone through the decision of the Tribunal in assessee's own case. Both the parties fairly conceded that the issue stands covered in favour of the assessee by the decision of the Tribunal in assessee's own case for A.Y. 2004-05. We find the Tribunal in assessee's own case for A.Y. 2004-05 vide ITA No. 500/PN/08 order dated 31-08-2009 allowed the claim of Short term capital gain and Long term capital gain on sale of shares and redemption of mutual funds. We find following the said decision the Tribunal vide ITA No. 1320/2008 and ITA No. 434/2009 allowed the claim of Short term capital gain and Long term capital gain for A.Y. 2005-06 and 2006-07. Although the department has challenged the order of the Tribunal before the Hon'ble High Court on this issue and the Hon'ble High Court has only admitted the appeal, however no decision reversing the decision of the Tribunal was filed before us. Therefore, respectfully following the decisions of the Tribunal in assessee's own case and in absence of any contrary material brought to our notice against the order of the Tribunal we uphold the order of the learned CIT(A) on this issue. Grounds raised by the Revenue are accordingly dismissed.

ITA No. 240/PN/2011 (By Assessee) :

6. The only effective ground raised by the assessee reads as under :

"1. On the facts and in the circumstances of the case and in law the learned CIT(A) erred in confirming the view of the learned Assessing Officer that the fees paid to ENAM Asset Management Company Pvt. Ltd. were not allowable in computing the assessee's income whether under the head "Business" or under the head "Capital gains".

7. Facts of the case, in brief, are that the AO during the course of assessment proceedings noted that the assessee has claimed an amount of Rs. 2,11,95,334/- as portfolio management fees paid to the portfolio managers. On being questioned by the AO it was submitted that the same has been paid to the portfolio managers/which includes performance fees and fees for maintenance. It was submitted that the payment to Enam AMC Pvt. Ltd. has been made in terms of investment management agreement made on 01-01-2005. However, the AO was not convinced with the explanation given by the assessee. He noted that similar issue was decided against the assessee for assessment year 2004-05 to 2006-07 wherein the payments has been disallowed and added back to the business income of the assessee which has been confirmed by the CIT(A) and the matter is pending before the Tribunal for adjudication. Therefore, he disallowed the payment of Rs. 2,11,95,334/- treating the same as termination fees computed on profit sharing basis and not specifically provided in the agreement and not as per SEBI rules and regulations.

8. In appeal the learned CIT(A) upheld the action of the AO by holding as under :

> *"I have carefully considered the above ground along with the findings given by the Assessing Officer, the learned CIT(A) and the Hon'ble ITAT, Pune till date in AYs. 2004-05 to the present appeal. It is observed that the assessee has engaged the services of portfolio managers to whom different kinds of payments totalling to Rs. 2,11,95,334/- was made in this assessment year. This has been disallowed on various reasons including the reason that the payments were not as per the guidelines of the SEBI. It's a fact that the assessee has been following a peculiar method of accounting for claiming that the above expenditure under the head 'capital gains'. The Assessing Officer has considered the claim mainly under the head 'business and profession' as he has assessed the income from share trading under the said head. There cannot be any dispute to the facts that the requirement of law for allowing an expenditure is dependent on the head under which an income is held as assessable. However, such an expenditure would become inadmissible under either of the heads if the same is against the guidelines of the regulator, i.e. SEBI. In addition to the same, in my considered opinion, the method employed by the assessee to load these expenses to the investments which are sold during the year as well as to those which are continued to be carried forward in the stock-in-trade/investment block, is clearly under a strategy to make such expenses claimable under the head 'capital gains' even though the provisions don't seem to be allowing them. The assessee has not shown the fees paid to the portfolio managers as an expenditure in the P&L account. The same has been loaded on the purchase price of shares, which are either sold or carried*

forward to next year. In this context, they have tried to place reliance on the judgment of the Hon'ble Gujarat High Court given in the case of Rajkot District Gopalak Cooperative Milk Producers Union Ltd. Vs. CIT (1993) 204 ITR 590 and the judgment of the Hon'ble Bombay High Court in the case of CIT Vs. Shakuntala Kantilal (1991) 190 ITR 56 (Bom.). Both these judgments have been found to be on different issues and on different sets of facts and therefore, cannot be considered to be applicable in the case of the assessee. The finding given by the Assessing Officer has been upheld by my Ld. Predecessor in the earlier years, which inturn remained unreversed and therefore, they are enforceable. In view of the discussions made above, I am of the opinion that these expenses are not allowable under either of the heads for the reason that they are against the guidelines of the SEBI and are also not allowable under the head 'capital gains'. The computation under this head do not provide for this expense to be considered while computing the income. They can neither constitute cost of investment or improvement nor an expenditure incidental to sale. The payments are made for different services, which are distinct from the act of purchase or sale. They are incurred even without the actual incidence of sale or purchase. The assessee loads these expenses the cost from year to year in respect of shares held for longer than a quarter. The argument and the accounting entries are clearly intended to change the colour of payment. These cannot be allowed under the head 'capital gains'. In view of the above, Ground No. 2 is treated as dismissed".

8.1 Aggrieved with such order of the CIT(A) the assessee is in appeal before us.

9. We have heard the rival arguments made by both the sides, perused the orders of the AO and the CIT(A) and the Paper Book filed on behalf of the assessee. We find the Tribunal in assessee's own case vide ITA No. 500/PN/2008 for assessment year 2004-05 has decided the issue and allowed the claim of portfolio management fees by holding as under :

"19. We heard the parties and perused the orders of the revenue. Allowability of the fee paid to the M/s Enam, the portfolio manager for purchase and sale of the securities under section 48 of the Act is the issue for adjudication before us. The stands of the parties on this issue are as follows.

> As per the Revenue, while the AO made disallowance for couple of reasons: (i) the payment is not as per the agreement, as the agreement was never terminated in reality; (ii) the payment was not authorized by the SEBI Regulations, 1993, CIT(A) authority confirmed the said disallowance also for another reasons that the said payment attracts provisions of the Explanation to sub-section (1) of section 37 of the IT Act. The said fee is not allowable in view of the decision of the Tribunal of Mumbai Bench in the case of Davendra Kothari (136 TTJ 188) where the Tribunal held that when the assessee failed to demonstrate the nexus of the said expenditure with the purchase and sale transactions of the said capital assets ie securities, the fee paid to the portfolio managers is not an allowable expenditure u/s 48 of the Act.

20. Per contra, the case of the assessee is that the said decision of the Mumbai Bench Tribunal is distinguishable on facts relating to discharge of onus relating to nexus issue and also in matters of global turnover based claim of fee including the miscellaneous receipts such as dividends and interest. As per the assessee,

there are other decisions to support the claim of the assessee. Further, assessee's stand is that revenue authorities have listed three reasons cumulatively for denial of deduction ie not as per the agreement; (ii) not authorized by the SEBI Regulations, 1993 and therefore it attracts the provisions of the Explanation to sub-section (1) of section 37 ie infringements of the law, and the said reasons do not stand the test of legal scrutiny as the IT authorities misinterpreted the facts. In this regard, the facts are that the fee paid to assessee as per the agreement ie at the expiry of the agreement period and expiry of the agreement is different from the expiry the agreement. In the earlier case, the agreement does not expire and only the period expires. Secondly, regarding the allegation of SEBI Regulations, assessee's stand is that the said clause 14(3) has been amended to include the payment of fee on 'profits sharing basis' too. Therefore, there is not infringement of the said clause and consequently, the invoking by the CIT(A) of the provisions of Explanation to section 37(1) of the Act does not arise.

21. In the context of the above rival positions, we proceed to examine the scope of the provisions of section 48 of the Act, amended SEBI regulations in matters relating to fee payable to Portfolio managers, the matters relating to the distinguishing of the decisions cited by the revenue etc. A. Scope of the Provisions of section 48 of the Act:

22. Section 48 provides for the method of computation of capital gains. The relevant provisions read as follows:

> "The income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:
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> > (i) expenditure incurred wholly and exclusively in connection with such transfer,
> >
> > (ii) the cost of acquisition of the capital asset and the cost of any improvement thereto." Hon'ble Jurisdictional High Court has an occasion to explain the above provisions of section 48 of the Act in the case of CIT v Shakuntala Kantilal 190 ITR 56 (Bom) explained the same and held that the deductibility of certain expenditure must considered favorably to the assessee as the provisions of clause (i) and (ii) are wider. As the Hon'ble High Court, "such type of payments are deductible in two ways, one by taking full value of consideration ie net of such payments or deducting the same as expenditure incurred wholly and exclusively in connection with the transfer." In other words, so long as the expenditure in question is genuine and are incurred in connection with the transfer of the securities, the expenditure is allowable from the 'full value of the consideration received or accruing', itself. Meaning thereby, the impugned expenditure is reduced from the 'gross value of the consideration received or accruing, and the 'net value of the consideration received or accruing' will be further reduced by the expenditure mentioned in clauses (i) and (ii) of section 48 of the Act. The second way of dealing with the said genuine expenditure relates to the one specified in clause (i) and clause (ii). The assessee must be given benefit of the deduction as the same is incurred wholly and exclusively for the transfer of the securities. For thesake completeness of this order, relevant para 5 & 6 are reproduced as follows:
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> > > "5. It must be stated in fairness to Dr Balasubramanian for the Revenue that he did not dispute the fact of payment or even the necessity of making such a payment. His contention is that the language in which section 48 is

> couched does not contemplate deduction of such an amount. Reference in this regard was made to section 48 of the Act to show that the payment herein could be neither be termed as expenditure incurred wholly and exclusively for the transfer or the cost of acquisition or of any improvement thereto……..
>
> 6. In order to appreciate DR …… submission, it is desirable to refer to the provisions of section 48 which read as under:……

The section (section 48) broadly contemplates three amounts for the purpose of computing income chargeable under the head "Capital gains". The first is the full value of the consideration for which the capital asset has been transferred. The second is the expenditure incurred wholly and exclusively in connection with such transfer and the third and the last is the cost of acquisition of the capital asset including the cost of any improvement thereto. We have already referred to the facts of the case in detail earlier. It cannot be disputed that unless the assessee had settled the dispute with Radia and Sons (P) Ltd., the sale transaction with M/s.Cosmos Co-op Housing Society Ltd. under the agreement dated March 30,1967, would not, rather could not, have materialized. If this transaction had not materialized there would perhaps have been no question of capital gains. The sale would then have taken place at the rate of Rs 29 per sq. yard as against Rs 51 per sq. yard. One way of looking at the problem could be to say that the full value of the consideration in this case was not the apparent consideration, i.e. Rs2,58,672/-, but Rs 2,23,168/- (i. e 2,58,672 minus Rs 35,501). The Legislature, while using the expression 'full value of consideration', in our view, has contemplated both additions as well as deductions from the apparent value. What it means is the real and effective consideration.

That apart, so far as clause (i) of section 48 is concerned, we find that the expression used by the Legislature in its wisdom is wider than the expression "for the transfer". The expression used is "the expenditure incurred wholly and exclusively in connection with such transfer". The expression "in connection with such transfer" is, in our view, certainly wider than the expression "for the transfer". Here again, we are of the view that any amount the payment of which is absolutely necessary to effect the transfer will be an expenditure covered by this clause. In conclusion, it is respectfully submitted that the fees paid have been correctly claimed as deduction in the computation of capital gains……"

23. The scope of section 48 as per the binding judgment of the Hon'ble High court is that the claim of bona fide or genuine expenditure should be allowable in favour of the assessee so long as the incurring of the expenditure is a matter of fact and the necessity of making such a payment is the imminent and the requirement for the transfer the transfer of the asset. It is now binding on our part to take the view that the expressions 'in connection with' has wider meanings than the expression 'for the transfer'. The Revenue's contention is that the language in which section 48 does not contemplate deduction of such an amount was overruled and allowed the deduction of the fee incurred by the assessee for removal of the encumbrances, which is necessary for transfer of the asset in that case.

24. We have also perused some of the other citations relied upon by the parties to draw the boundary lines for the kind of expenditure which fall within the scope of the allowable expenditure u/s 48 of the act in computation of the capital gains.

We find that all these citations invariably followed the jurisdictional high court judgment in the case of Santhilal Kantilal (supra).

A. Calcutta High Court held in the case of Gopeenath Paul and sons & Anr (278 ITR 240) that "when assets of the assessee GNP, earlier carrying on business in the name of GSM could not be sold as going concern under orders of Court without meeting the liabilities of GSM towards the Bank, payments for meeting such liabilities of GSM towards bank was expenditure incurred wholly and exclusively in connection with the transfer, hence deductible u/s 48(i) of the Act."

B. AAR held in the case of Compagnie Financiere Hamon, In Re (310 ITR1), that the 'professional fee paid to the lawyers distinctly related to and integrally connected with the transfer of shares is admissible for deduction u/s 48(i) of the Act' AAR held that the what is attributable to the final act of transfer of shares is admissible for deduction provided the intimate connection between the expenditure and the act of transferring shares is established.

C. In the case of Bradford Trading co P Ltd, the Madras High court held that the "amount paid by the assessee to a third party to settle the pre existing claims against the transfer of the assets as also litigation expenses constituted expenditure incurred wholly and exclusively for transfer of capital asset and was deductible in computation of capital gains; the amount reimbursed by vendee to the assessee towards such claim constituted part of sale consideration but deductible while computing capital gains".

D. Bombay High Court in the case of Abrar Alvi (247 ITR 312) held that the amount paid by the assessee to his son to resolve the property dispute was an allowable expenditure in computing the capital gains. Same High court in the case of Miss Piroja C Patel (242 ITR 582) held that the compensation paid by the assessee to the hutment dwellers is an allowable expenditure in computing the capital gains.

E. In the case of Motilal Kothari vs DCIT (136 TTJ 188), the Mumbai Tribunal held that the payment of fee to the PMS to discharge his contractual liability did not amount to diversion of income by overriding title. It is a case of application of income. In this case, the assessee claimed expenditure of the fee paid to PMS on his global turn over and assessee failed to discharge onus in establishing the nexus of the expenditure with the asset's transfer. Tribunal did not refer to the explanation given by the binding jurisdictional High Court on the provisions of section 48 of the Act.

25. From the above, it is invariably learnt that the scope of the provisions of section 48 are explained by the jurisdictional High Court and it is binding on us as they remain undisturbed as informed to us. The citation at E above did not have benefit of the said explaining of the provisions of section 48 of the Act. For allowing the claim of deduction in the computation of the capital gains, the expenditure has to be distinctly and intricately linked to the asset and its transfer and the Onus is on the assessee to demonstrate the said linkage between the expenditure and the asset's transfer. It is evident and binding that the expenditure if undisputedly, necessarily and genuinely spent for the asset's transfer within the scope of the provisions of section 48 of the Act, the claim cannot be disallowed for want of the express provisions in section 48 of the Act.

26. Wholly and Exclusively: In this regard, it is a settled law that the expression 'wholly and exclusively' is explained for the purpose of the identical expressions used in section 37 of the Act. In the case of Sasoon j David & Co P Ltd v CIT 118 ITR 261(SC), Hon'ble Supreme Court explained the twin adverbs stating that the first adverb, 'wholly' refers to the quantum of the expenditure, the sum of money

spent and the second adverb 'exclusively' has reference to the 'purpose' behind the expenditure and 'not the motive or object' of expenditure.

27. After explain the scope of section 48 of the Act, we shall now proceed to examine the facts of the case in general and the applicability of the provisions of section 48 in particular.

28. We have already detailed the facts of the impugned payments in the preceding paragraphs. To sum up the same, the undisputed facts are: (i) the assessee made the payment of fee to M/s Enam, the Asset Management Company and the genuineness of the said payment is undisputed; (ii) the revenue authorities have also not disputed the requirement or necessity of the said payments; (iii) quantitatively speaking in view of the adverbial expression, 'wholly' used in section 48(i) of the Act, we find that the payment of fee @ 5% only restricted to the NAV of the securities and not only the global turn over including the other income; (iv) regarding the purpose of payment in view of the adverbial expression, 'exclusively used in section 48(i) of the Act, we find that the same is intended only twin purpose of the acquisition of the securities and also for sale of the same; (v) the NAV is defined in Para 1(d) as the 'net asset value of the securities of the client' and the assessee calculated the impugned fee is linked to the securities value only and not includes other income such interest or dividend etc; (v) considering the contents of the para 7.01(c), "termination fee upto 5% will be payable on the net asset value (NAV) of the Portfolio of the client as on the date of termination of the agreement period and not the agreement itself and therefore payment is period specific; (vi) it is a fact that the clause 14(3) was amended subsequently and therefore, the action of the revenue is based on the inapplicable or pre-amended facts. The details are detailed below.

Clause 14(3) of SEBI (Portfolio Managers) Rules & Regulations 1993:

29. Revenue is of the bona fide belief or opinion that the clause 3(a) prohibits the payment of fee on the basis of 'returns sharing basis' as they relied on the original clause 14(3) of SEBI (Portfolio Managers) Rules & Regulations 1993 which governs the portfolio manager which bans the payment of fee to the portfolio manager. In this regard, Ld Counsel filed a Gazette copy showing the amended clause 3 vide SEBI (Portfolio Managers) (Amendment) Rules, 2002 which provides for return based fee also. The said clause originally came into force with effect from 7.1.1993, a date of publication in the official Gazette, whereby the SEBI provided for the fee relating to the portfolio managers vide para 3(a) which has come into effect w.e.f. 11.10.2002. The Securities & Exchange Board of India (Portfolio Managers) Regulations, 1993 provide that the discretionary portfolio manager is obliged to individually and independently manage the funds of each client in accordance with the needs of the client. These Regulations, 1993 provide that fee to be charged may be a fixed amount or a return based fee or a combination of both. We have extracted the amended clause 14(3) and the same is as follows.

> "(3)(a) : The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both." Thus, in our opinion, the amended provisions allows the payment of fee to AMC on 'return based fee' and therefore, all the three reasons of the revenue for denying the claim of deduction in favour of the assessee, as discussed in the above paragraphs of this order, require to be rejected and in favour of the assessee.Capital gains vs Deductions

30. We have discussed in the preceding paragraphs that the profits earned by the assessee is chargeable to tax under the head 'capital gains'. It is so ordered by this Tribunal vide the order dt 31.8.2009 in connection with appeals ITA No 499/PN/08 in the case of ARA Trading & Investments P Ltd. and ITA No

500/PN/08 in the case of KRA Holding & Trading P. Ltd. Relevant para 27 of the said order was already extracted in the preceding paragraphs. In the light of the above undisturbed proposition, our attention is restricted to the limited issue of if the impugned fee paid to the M/s Enam is allowable u/s 48 of the Act or not.

Loading of the expenditure to the cost of the shares, distinguishing of the Tribunal's order in the case of Devendra Kothari (supra):

31. Ld DR for the Revenue relied on the above decision of the Tribunal and mentioned that the order of the CIT(A) does not call for any interference despite the fact that the order is not considered the above citations. In this regard, Ld Counsel filed at our request a brief note on the issue of loading and other ancillary issues and the relevant portions are imported for this order and the same are as under:

> "The method of accounting followed by the company in respect of fees paid is to proportionately load these types of fees as part of the purchase cost of the securities during the given period. Automatically these fees are taken into account for computing capital gains or the carrying cost of unsold investments.
>
> There is a direct and proximate nexus between the fees paid and the process of acquisition and sale of the securities which is a causative factor for making capital gains and that the fees are paid wholly and exclusively for earning the income offered to tax under the head capital gains.
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> Reliance is placed on the decision in the case of CIT v. SHAKUNTALA KANTILAL [1991] 58 Taxman 106/190 ITR 56 (Bom.) where it was held that amount paid for removing an encumbrance was allowable u/s 48(i). In coming to this view the Court observed that without this payment the sale could not have been materialized and hence there would have been no question of the capital gains being brought to tax. In the present case the capital gains have arisen as a result of the efforts of the PM for which the fees have been paid.
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> A Mumbai Bench of the Tribunal in the case of DAVENDRA KOTHARI (136 TTJ 188) has confirmed disallowance of PMS fees while computing capital gains.
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> In that case fees were paid based on value of the assets. The Honourable Bench has observed at Para 7 of the said order that the CIT(A) found that the,-
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> quantification of fees: was based only on either the market value of the asset or the net value of the assets of the assessee as held either at the beginning or at the end of each quarter.
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> At Para 8 of the Order, the Honourable Bench has observed that the CIT(A) held that the assessee was paying the fees as aforesaid to portfolio managers even on the interest/dividend received on the investments and therefore the CIT(A) came to hold that it could not be said that there was nexus between the PMS fees paid and purchase and sale of investments.
>
> The Honourable Mumbai Tribunal has laid stress on the said findings of the CITA.
>
> Present case of the appellant is clearly distinguishable in the light of the fact that return based fees is also payable in respect of profits earned on sale of investments and therefore the PMS fees has a direct nexus with the purchase and sale of investments during the year and fees is not paid on interest and dividend received by the appellant.

It is respectfully submitted that the said decision is not applicable as it turns on its own facts apart from being patently wrong.

The assessee in that KOTARI'S case had failed to demonstrate the nexus between the fees paid and the activity of purchase and sale.

The assessee could not explain how the fees paid on such explicit basis could be considered differently so as to constitute cost of either acquisition or as expenditure in connection with transfer.

The assessee could not demonstrate how allocation of fees had been made. It could not furnish details of how or the basis on which allocation of said fees was possible.

Further fees had to be paid even when no purchase or sale took place.

The CIT(A) had held that it was not possible to break up the fees so as to hold that the same was relatable to purchase or sale of shares.

Further, fees were paid even on interest accrued and dividend received.

The Tribunal held that the basis on which fees were paid is such that there was no relationship with either purchase or sale. In view of this it held that there was no nexus with purchase or sale.

It is respectfully submitted that the Honourable Tribunal ought to have independently determined whether the fees were paid for an activity which had a direct nexus with the purchase or sale of the shares instead of allowing itself to be persuaded merely by the difficulty in allocating such fees to purchases by a directly conceivable basis.

In the present case before You Honours the annual termination fee is to be determined with reference to the NAV of the portfolio which has been defined to been the market value of the Securities as on the relevant date. No fees were paid on interest accrued and dividend received. It is further submitted that the Act does not define the expressions 'cost of acquisition' or 'cost of improvement' referred to in section 48. These expressions thus have to be given their natural commercial meaning as men of trade and commerce would unmistakably understand. Investments in securities are valued at cost by the appellant.

In view of the direct nexus between the fees and the role of the PM established by us it is not difficult to appreciate that such fees form part of the cost of acquisition of the portfolio.

The SC in the case of BHARAT EARTH MOVERS (245 ITR 428)(SC) in the context of allowability of provision for leave encashment referred to the following passage from its decision in the case of Calcutta co. Ltd vs. CIT (1959) 37 ITR 1 (SC) wherein it was held that merely because there is some difficulty in the estimation of the liability would not convert the accrued liability into a conditional one; it was always open to the tax authorities concerned to arrive at a proper estimate of the liability having regard to all the circumstances of the case.

In the present case merely because some mathematical exercise is involved in loading such fees to individual transactions of purchase would not mean that such fees do not form part of cost of acquisition or have nexus therewith Accounting Standard 13 (Accounting for Investments)

issued by ICAI provides that cost of an investment includes acquisition charges such as brokerage, fees and duties. The method of accounting followed by the company in respect of fees paid is to proportionately load these fees on the securities handled by the Portfolio Manager during the year [i.e. opening portfolio plus investments made during the year]. Automatically these fees are taken into account for computing capital gains or the carrying cost of unsold investments.

The Supreme Court in the case of UP State Industrial Development Corporation (225 ITR 703) was dealing with the case of an underwriter of shares who had to subscribe to shares in the event of under subscription by the public. The issue before the SC was whether in respect of such devolved shares whether the underwriting commission received from the client, should be treated as an item of income or an item that would go to reduce the cost of acquisition of such devolved shares. The Supreme Court, applying the well accepted proposition that for the purposes of ascertaining profits and gains ordinary principles of commercial accounting should be applied so long as they are not in conflict with any express provision of the Act upheld the contention of the assessee which it found to be in consonance with the general principles of accountancy governing underwriting contracts.

In the present case since the Department is not contending that the accounting practice followed by the company is contrary to general principles of accountancy governing PM contracts the above ratio would squarely apply. As a matter of fact the lower authorities have not disputed the correctness of the method of allocation of PMS fees or found it contrary to accounting practice.

The Hon'ble Pune Tribunal in case of S.Balan (308 ITR 151 (T PUNE) held that interest paid on monies borrowed for acquisition of shares would form part of cost of acquisition.

Undoubtedly loading interest on individual transaction of purchase would necessarily involve an exercise of allocation which did not deter the Pune Tribunal from upholding the claim. The Hon'ble Pune Tribunal observed that Interest having nexus with the cost of acquisition has to be taken into account for the purpose of computation of capital gains prescribed u/s 48 (ii). The Hon'ble Bench inter alia referred to the decision of the Hon'ble Delhi High Court in the case of Mithilesh Kumari reported in 92 ITR 7 and the observation of Their Lordships that-

> it will not make any difference whether the interest was paid on the date of purchase or whether it is paid subsequently to exclude the interest amount from the actual cost would lead to anomalous results.
>
> In the case of CHALLAPALLI SUGARS LTD (98 ITR 167) the SC held that interest paid on borrowed money for purchasing plant and machinery before commencement of production would form the part of actual cost for the purpose of depreciation allowance. It held so following the accepted accountancy rule for determining the cost of fixed assets.
>
> In this case preoperative interest would have to be allocated to the cost of individual fixed assets acquired during construction period of a new company (this was before the block of assets concept was introduced) and yet the Court held so.
>
> By the same logic expenses incurred in relation to the portfolio should be allowed to be capitalized in terms of AS 13.

> It will be appreciated from the submissions made above that this is not so in the present case where a live nexus has been clearly established and on that basis even the accounts have been maintained; investments have been accounted for inclusive of proportionate fees and said fees are also loaded to unsold investments as at the year end.
>
> It is respectfully submitted that in the present case assessee has demonstrated how there is a nexus between the fees and the role of the PM directly affecting purchases and hence cost of acquisition."

32. From the above, it is evident that the unlike in the transactions involving acquisition and sale of the land buildings, the loading of the expenses ie fee paid to the AMC is done in accordance with the AS-13 ie cost of an investment includes acquisition charges such as brokerage, fees and duties. Further, once the liability to incur is certain the quantification does not bar the assessee from claiming the expenditure. The claim of the assessee must be allowed once the basis of quantification is scientific and reasonable. The method of accounting followed by the company consistently in respect of fees paid is to proportionately load these fees on the securities handled by Portfolio Manager during the year.

FINDINGS OF THE TRIBUNAL

33. Thus, the issue for adjudication relates if the payment of fee paid to the portfolio manager ie Enam for the twin purposes of (i) purchase of investments/securities and (ii) sale of the same is an allowable deduction u/s 48 of the Act or not. The same has to be decided in the context of settlement of the disputes relating to correct head of income. In other words, the issue relating to 'head of income' for taxing the gains on sale of the said investments/securities has been decided by the Tribunal in the first round of the appeals and the Tribunal held that the portfolio investment is not the business activity but it is an investment activity & relevant gains are taxable under the head 'capital gains' as accounted by the assessee. It is so held in the own case of the assessee vide 499 & 500/p/2008 and the same affirmed by a decision of the Tribunal-Mumbai Bench vide I.T.A No. 5382 Mum/2009 dated 30th November, 2010 in the case of Radha Birju Patel. Thus, it is the settled position at the level of the Tribunal that the Portfolio management activity is an **investment activity** and neither the business activity nor the activity amounting to 'an adventure in the nature of trade'. Therefore, the securities in question are held to be the investments by the Tribunal in the first round and consequently, when such securities are transferred by way of sale, the resultant gains have to be dealt with as per the provisions of section 48 of the Act.

34. The provisions of section 48 of the Act have already been analysed in the preceding paragraphs in the light of the explaining by the jurisdictional high court in the case of Shantilal Kantilal (supra). It is a settled issue now at the level of the jurisdictional High Court in the case of Shantilal Kantilal (supra) that the rightful expenditure incurred in connection with the transfer of the capital asset/securities should be allowed notwithstanding the inadequacy of the express provisions of section 48 of the Act. It is also binding on us to interpret the said provisions of section 48 that the same are read down by the Hon'ble High Court in that case and the same remains undisturbed till date. Consequently, the expenditure which is distinctly and directly connected to the transfer, which is interpreted to be of wider meaning and connotation, are required to be allowed. We also interpreted in the preceding paragraphs that the expression 'wholly and exclusively in connection with such transfer' as wider in scope and in our opinion, it is no so narrow to not to accommodate the 'portfolio fee', which is paid undisputedly and obviously for acquisition and sale of the securities/unit if any. Therefore, we are of opinion that the impugned expenditure is (i) directly connected to the asset and its transfer, (ii) it is genuinely incurred as accepted by the revenue; (iii) it is a bona fide payments made as per the norms of the 'arm's length principle' since

the M/s Enam and the assessee are unrelated; (iv) necessity of incurring of expenditure is imminent and it is in the normal course of the investment activity; and (v) read down provisions of section 48 of the Act in view of the said ratio in the case of Shantilal Kantilal (supra) accommodate the claim of such expenditure legally.

35. Further, the decision of the Tribunal in the case of Devendra Kothari (supra), which was heavily relied upon by the Ld DR for the revenue unfortunately did not refer to the said 'read down' interpretation in the cited judgment of the jurisdictional High Court in the case of the Shantilal Kantilal (supra). In any case, we find the said order of the Tribunal is distinguishable on fact in general and the discharging of the onus of the assessee in demonstrating the direct linkage of the expenditure to the shares as well as the claim of fee on the entire turnover on global basis ie not restricted to investments only. As such, it is a settled issue that the expression 'in connection with such transfer' enjoys much wider meaning and therefore, the fee paid to the portfolio manager in our opinion has to be construed to have been expended for the purposes of acquisition and transfer of the investment of the securities. Consequently, adjudication of the issue of allowability of the said expenditure under clauses (i) or (ii) of section 48 of the Act is merely an academic exercise. Therefore, considering the fact there is no such specific issue raised before us in the grounds, we refrain from entering into that zone in this order. It is also relevant to mentioned that the on facts, the expenditure is for the twin purpose of acquisition and sale of the securities and hence, it cannot be held the whole of the impugned expenditure is spent for transfer of asset or it should be loaded to the cost of the securities.

36. Non-allocability of the Expenditure: It is an agreed position between the parties the payment of the Portfolio management fee was paid to M/s Enam and others and the same is in accordance with the contents of the bilateral agreement. The services rendered by M/s Enam are also undoubted. The twin services relating to the said portfolio management include (i) acquisition of securities for the assessee-client and (ii) sale of the said securities for the assessee-client. The payment of fee is undisputedly unspecific to the individual shares/securities. In fact, the revenue takes an argument before us that to become the part of the cost of the acquisition of the asset, the expenditure ie fee paid the Enam, has to be asset-specific or share-specific per the provisions of section 48 of the Act. In our opinion, the same is absurd given the facts of the case where the portfolio investment attracts the provisions of section 48 of the Act and the asset involved is not land or building and in fact the assets involved are the securities/shares/mutual funds etc. In matters of transactions involving securities/shares/mutual funds etc, expenditure/fee paid to portfolio manager is never each share specific and in fact they are paid on volume based. Therefore, the revenue's argument has to be rejected on the ground of impracticability or non-existent in this line of investment activity alone. Considering the genuineness and essentiality of the payment of fee to the Portfolio manager ie ENAM and undisputedly for the predominantly for the said twin purposes of acquisition and sale of the securities, the claim has to be allowed. Further, it is an admitted fact that the bifurcation of expenditure is not possible in the given facts of the case and the payment is for composite services, wholly and exclusively in connection with transfer of the transfer of the securities. The expenditure is undisputedly for the twin purposes of acquisition of the securities and the sales of the same. The expenditure is arrived at on profits sharing basis, which is now allowable basis by the SEBI. The expenditure is composite one as it is for the both the purposes. There is no bifurcation either by the assessee or by the revenue. In our opinion, there is no requirement of bifurcation of the expenditure ie a segment to form part of the cost of acquisition and other segment relating to transfer of securities to reduce the profits as it is not the case of the revenue that it shall make some difference from the tax point of view. Therefore, we resist from entering into that controversy.

37. Next, we proceed to explain the expression 'such transfer' used in section 48 of the Act. The expression 'transfer is defined section 2(47) of the act and it is an inclusive one. However, there is no explanation as to from which point the concept of 'transfer' begins. Does it start from the point of acquisition of the asset/share? Thus, in our opinion, the expression 'transfer' involves various subcomponents and the first sub-component must of purchase and possession of the impugned securities. Unless the assessee is in possession of the asset, he cannot transfer the same. Therefore, the expression 'expenditure incurred wholly and exclusively in connection with 'such transfer' read with 'as a result of the transfer of the capital asset' mentioned in section 48 and 48(i) of the Act must necessarily encompasses the transfer involved in the stage of acquisition of the securities till the stage of transfer involved in the step of sale of the impugned securities. Such an interpretation of sec 48 of the Act is the necessity here to avoid the likely absurdity.

38. In the peculiar circumstances of the present case, in our considered opinion the claim of the must not be rejected for want of the express provisions in section 48 of the Act and such an interpretation goes with the spirit of the judgment of the Jurisdictional high court in the case of M/s Shakunthala Kantilal (supra). Further, as per the principles of accounting ie AS-13, as discussed above, the expenditure of this kind is allowed to be loaded to the cost of acquisition of the securities. Therefore, in principle, the claim of the assessee is allowable under the provisions of section 48 of the Act. Hon'ble Supreme Court in the case of UP State Industrial Development Corporation (225 ITR 703) was dealing with the issue of loading of an underwriter commission to the cost of shares, held that the general principles of accounting have to be observed. Regarding the objections of the revenue regarding the quantification of the claims of expenditure, in our opinion, the judgments of the Supreme Court in the cases of Bharat Earth Movers Ltd (supra) and the Culcutta Co Ltd (supra) helps the assessee and therefore, the claim of the assessee is allowable. Accordingly, relevant ground relating to the second issue.

10. The above decision of the Tribunal was not available before the CIT(A) while adjudicating the issue. We find the revenue has gone on appeal against the order of the Tribunal on the issue of treatment of income from Portfolio Management Scheme as "Capital gain" or "Business income". The relevant order of the Hon'ble High Court in ITA No. 3482 of 2010 dated 19-07-2011 reads as under:

"Heard. Admit on the following question of law :-

"Whether on the facts and circumstances of the case, the ITAT was justified in holding that the income earned by the assessee by the portfolio management scheme was liable to be assessed under the head "capital gains" instead of being assessed under the head "profit &gains of business or profession"?

Nothing was filed before us to substantiate that the Revenue has gone on appeal against the order of the Tribunal allowing the claim of Portfolio Management fees as an expenditure from such capital gains.

11. The decision of the Mumbai Bench of the Tribunal in the case of Homi K. Bhabha Vs. ITO was brought to our notice by the learned DR wherein it was held that Portfolio Management Scheme fees is not deductible against capital gains. The decision of the Pune Bench of the Tribunal in the case of KRA Holding & Trading was not followed by the Mumbai Bench in the above cited decision. The Mumbai Bench following other decisions of the coordinate Benches of the Tribunal declined to follow the decision in the case of KRA Holding & Trading (Supra). It is the settled proposition of law that when two view are possible on the same issue the view which is favourable to the assessee has to be followed. [CIT Vs. Vegetable Products 88 ITR 192 (SC)]. Further, in the instant case the Tribunal in assessee's own case has already taken a view in favour of the assessee. Since the AO & CIT(A) have followed the order for earlier year in case of the assessee and since the order of CIT(A) for earlier year has been reversed by the Tribunal, therefore, unless and until the decision of the Tribunal is reversed by a higher court, the same in our opinion should be followed. In this view of the matter, we, respectfully following the order of the Tribunal in assessee's own case for A.Y. 2004-05 allow the claim of the Portfolio Management fees as an allowable expenditure. The ground raised by the assessee is accordingly allowed.

12. In the result, the appeal filed by the revenue is dismissed and the appeal filed by the assessee is allowed.

Pronounced in the open court on this the 25th day of July 2012

Sd/-	**Sd/-**
(SHAILENDRA KUMAR YADAV)	**(R.K. PANDA)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Pune Dated: the 25th July 2012
satish

Copy of the order forwarded to :

1. Assessee
2. Department
3. CIT(A) I Pune
4. The D.R, "A" Pune Bench
5. Guard File

By order

// True Copy //

Senior Private Secretary
ITAT, Pune Benches, Pune