

GUIDANCE ON CHARACTERISATION OF SURPLUS ON SALE OF SHARES AND SECURITIES



BACKGROUND

The Income Tax Act, 1961 (the IT Act) defines ‘capital asset’¹ to include property of any kind held by the taxpayer, whether or not connected with his business or profession. It specifically excludes stock-in-trade or personal assets subject to certain exceptions. As regards shares and securities, they can be held as stock in trade and/or as investments (capital assets). The characterization being essentially a fact specific matter, there has been a lot of litigation with respect to characterisation of income as business income or capital gains in the absence of any legislative guidance and differing views of various judicial forums.

To reduce litigation with respect to listed shares and securities, the CBDT has issued a Circular² in partial modification of its earlier circulars³ that provided guiding factors for classification of shares and securities as business assets or capital assets.

THE CIRCULAR

The Circular has instructed the Tax Officers to take into account the following to determine as to whether surplus on sale of listed shares or other securities would be treated as capital gains or business income.

Treatment by Taxpayer	Holding period	Nature of income arising from transfer	Stand by Tax Officer
Opts to treat listed shares and securities as stock in trade	Not relevant	Business Income	
Desires to treat income as capital gains*	More than 12 months immediately preceding the date of transfer	Capital Gains	Tax Officer not to dispute treatment as capital gains

¹ Section 2(14)

² Circular No 6/2016 dated February 29, 2016

³ Instruction No 1827 dated August 31, 1989 and Circular No 4 of 2007 dated June 15, 2007

**Once this stand is adopted in a particular fiscal year, the same shall apply to subsequent years also and the taxpayer shall not be allowed to take a different/contrary stand.*

In all other cases, the nature of transaction will be decided as per earlier circulars issued. The Circular further provides that above mentioned guidance will not apply where the genuineness of the transaction itself is questionable like bogus or sham transactions.

BDO COMMENTS

This Circular, alongwith legislative amendment in relation to treatment of securities held by Foreign Institutional Investor as capital asset⁴ is likely to enhance certainty in treatment and reduce litigation as regards listed shares and securities. Interestingly, this Circular will have restricted application to listed shares and securities and thus, characterisation of surplus from non-listed shares and securities will continue to be decided based on facts of each case and guiding principles under earlier circulars. Therefore, litigation in this area is expected to continue.

This Circular is differing from the recommendations of Income Tax Simplification Committee report that had suggested treatment of surplus arising from transfer of shares and securities to provide clarity and bring certainty. The Report had recommended chargeability as capital gains for shares and securities held for more than 12 months and as capital gains for surplus upto Rs.5 Lakhs for shares and securities held for less than 12 months (if not held as stock in trade).

HOW BDO CAN HELP

We assist Indian and Foreign companies in tax advisory and compliance services in line with the business requirement and regulatory environment.

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⁴ Vide Finance (No.2) Act, 2014