tenant, the entry being "Tekan and others, Gairmaurasian first through Ganeshi Gair Maurasi second-half. The appellant is thus a tenant of the land of which he has taken lease and cannot be a landowner keeping in view the definition of that term in the Act and in the Punjab Land Revenue Act. The appeal therefore fails and is hereby dismissed with costs.

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Tekan v. Ganeshi

Wanchoo J.

Appeal dismissed.

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February 23.

(S. K. DAS, J. L. KAPUR, P. B. GAJENDRAGADKAR, A. K. SARKAR, K. SUBBA RAO, K. N. WANCHOO and N. RAJAGOPALA AYYANGAR, JJ.)

Income-tax—Profits—Shares purchased by assessee for investment—Sales of Shares subsequently as trading activity—Computation of profit.

The assessee purchased shares by way of investment in 1939-40 at a cost price which was much less than their market value on April 1, 1945. Her dividend income therefrom was assessed to income tax. In the financial year 1945-46 the assessee converted these shares into her stock-in-trade and carried on business in the shares. Per income for the assessment year 1946-47 was computed on the basis of the profits which she made by the sale of her shares as a trading activity. The assessee contended that the cost price of the shares for computing the profits was their market value at the beginning of the year when she started the trading activity, i. e., on April 1, 1945. The Department contended that the cost Price of the shares was the actual price for which they were purchased by the assessee, no matter when she bought them and for what purpose.

Held (per Das, Kapur, Gajendragadkar, Subba Rao, Wanchoo and Ayyangar, JJ. Sarkar, J., contra), that the profits

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of the assessee from her business or trading activity must be computed on the basis that the market value of the shares as on April 1, 1945, was the cost price of the shares for the business. The basis must be the ordinary commercial principle on which actual profits are computed, and normally, the commercial profits out of a transaction of sale of an article are the differences, between what the article cost the business and what it fetched on sale. In *Kikabhai Premchand* v. *Commissioner of Income-tax,* the Supreme Court was considering the converse case and the principles laid down in that case were (1) that there was no general principle of taxation under income-tax law under which the State could assess a person on the basis of business profits that he might have made but had not chosen to make, and (2) that it was unreal to separate the business from its owner. Those principles have no application in the present case which is not a case of any potential future advantage; the admitted position in the present case is that there was a sale of the shares in question in pursuance of a trading or business activity and actual profits had resulted from the sale. The question here is how such commercial profits are to be calculated. In a trading or commercial sense the only fair measure of assessing such trading profits is to take the market value at one end and the actual sale proceeds at the other. This is more in accord with reality than fiction.

Sir Kikabhai Premchand v. *Commissioner of Income-tax (Central), Bombay,* [1954] S. C. R. 219, *Sharkey* v. *Wernher* (1955) 36 T. C. 275, referred to.

Per, Sarkar J.—The assessee's taxable profits on the sale of the shares earlier held as investment are the difference between the sale price and the price at which she had actually bought those shares. The profits could not be computed on the basis of a fictional sale by the assessee to herself on April 1, 1945. The case was governed by the principles laid down by the Supreme Court in Kikabhai's case. The decision of the House of Lords in *Sharkey* v. *Wernher,* which took a contrary view, was not preferable to that of the Supreme Court in Kikabhai's case.

Sir Kikabhai Premchand v. *Commissioner of Income-tax (Central), Bombay,* [1954] S. C. R. 219, followed.

Sharkey v. *Wernher,* [1955] 36 T.C. 275, not approved.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 133 of 1958.

Appeal by special leave from the judgment and order dated March 6, 1956, of the Bombay High Court in I. T. R. No. 49 of 1955.

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Commissioner of Income-Tax, Bombay, City I v. Bai Shirinbai K. Kooka

H. N. Sanyal, Additional Solicitor-General of India, K. N. Rajagopal Sastri, R. H. Dhebar and *P. D. Menon,* for the appellant.

N. A. Palkhivala, B. K. B. Naidu and *I. N. Shroff,* for the respondent.

1962. February 23. The Judgment of Das, Kapur, Gajendragadkar, Subba Rao, Wanchoo and Ayyangar, JJ., was delivered by Das, J., Sarkar, J. delivered a separate judgment.

Das J.

S. K. DAS, J.—This is an appeal by special, leave granted by this Court on September 17, 1956. The Commissioner of Income-tax, Bombay, City I, is the appellant before us. The respondent is Bai Shirinbai K. Kooka, who will be referred to in this judgment as the assessee.

The assessee is a Parsi lady who held by way of investment a large number of shares of different companies. These shares were purchased before the end of and after 1939-40 at a cost-price which was much less than their market value on April 1, 1945. Her dividend income was assessed to income-tax for several year prior to April 1, 1945; but in the assessment year 1946-47, the relevant accounting year being financial year 1945-46, the Income-tax Officer found that the assessee had converted her shares into her stock-in-trade and carried on a trading activity, viz. a business in shares. Her income for the assessment year 1946-47 was therefore computed on the basis of the profits which she made by the sale of her shares as a trading activity, the profits being calculated on the difference between the ruling market price at the beginning of the account year and the sale proceeds. For the assessment year 1947-48, the relevant accounting year being the financial year 1946-47, it was found by the Income-tax Officer that the sale proceeds of the shares which the assessee had sold amounted to

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Rs. 5,49,487/-. The Income-tax Officer calculated the profits in the following manner :

Sale proceeds	...	Rs. 5,49,487
Cost calculated on the basis of the market price of the shares at the beginning of the account year	...	Rs. 4,50,822
		Rs. 98,655
Less : Forward business loss	...	Rs. 25,344
Net profit	...	Rs. 73,321

The assessee then appealed to the Appellate Assistant Commissioner who enhanced the income of the assessee by a sum of Rs. 2,91,307/- including a capital gain of Rs. 37,590/-. The Appellate Assistant Commissioner proceeded on the footing that the profit earned by the assessee on the sale of the shares was the difference between the original cost price of the shares and the sale proceeds. He further held that the some of the shares which were sold in the account year 1946-47 were the assessee's stock-in-trade, while some other shares were her investment shares. Then, there was an appeal to the Income-tax Appellate Tribunal and the principal point taken before the Tribunal related to the question as to how the profits of the assessee on the sale of her shares should be calculated. The Judicial Member of the Tribunal accepted the view expressed by the Appellate Assistant Commissioner and held that the original cost price of the shares must be taken in order to find out the profits which the assessee had made on the sale of the shares. The Accountant Member agreed, however, with the view of the Income-tax Officer and held that the market value of the shares as on the date when

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they were converted into stock-in-trade by the assessee should be taken into consideration for the purpose of ascertaining the profits made by the assessee on the sale of those shares. On this difference between the two members of the Tribunal, the matter was referred to the President of the Tribunal. The President agreed with the view of the Accountant Member. The Tribunal was then moved by the appellant to state a case to the High Court of Bombay on the question of law which arose out of the Tribunal's order, namely, what should be the basis of computation of the profits made by the assessee by the sale of her shares in the relevant year. The Tribunal came to the conclusion that the question as to when the assessee became a dealer in shares or when the assessee turned her investment shares into her stock-in-trade, was a question of fact, and the only question of law that arose was as to how the profit was to be computed. Accordingly, the Tribunal framed the question of law in the following terms :

> "Whether the assessee's profit on the sale of shares is the difference between the sale price and the cost price, or the difference between the sale price and the market price prevailing on 1-4-1945 ? "

The aforesaid question of law was then referred the High Court of Bombay under s. 66(1) of the Indian Income-tax Act, 1922 (XI of 1922). This was Income-tax Reference No. 49 of 1955. The reference was heard by a Division Bench consisting of Chagla, C. J. and Tendolkar, J. By its judgment and order dated March 6, 1956, the High Court answered the question in favour of the assessee and held that the assessee's assessable proft on the sale of shares was the difference between the sale price and the market price prevailing on April 1, 1945. The appellant having unsuccessfully moved the High Court for a

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certificate under s. 66A (2) of the Income-tax Act, applied for special leave to this Court. Such leave was granted by this Court by an order dated September 17, 1956.

This appeal was heard in part by a Bench of three Judges presided over by the learned Chief Justice, who directed that it be posted for hearing before a Bench consisting of seven Judges, presumably because one of the points urged before the Bench was whether the majority decision of this Court in *Sir Kikabhai Premchand* v. *Commissioner of Income tax (Central), Bombay*(1) required reconsideration. It may be here stated that the learned Judges of the High Court had before them the decision in *Kikabhai's case* (1) and they considered that decision carefully and held that the decision could be distinguished, firstly, on the ground that the problem which the High Court had before it in the present case was the content of taxable profits in a commercial sense out of the amount actually received by the assessee by a sale of her shares, whereas the problem in *Kikabhai case* (1) was of a different nature, namely, whether it was open to the department to tax an assessee on a fictional sale or potential profits, and, secondly, on the ground that the principle laid down in *Kikabhai's case* (1) had no application to a case where real or actual profits, as distinguished from fictional profits, have to be allocated or attributed to the trading activity. One of the points which we have to consider in this appeal is whether, on principle, the distinction drawn by the High Court is correct or whether the ratio of *Kikabhai's case* (1) should govern the present case.

As we have stated earlier, the problem is how should the profit made by the assessee by a sale of her shares as a trading activity be computed, it being not in dispute that there was in this case a real

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sale resulting in actual profits. The High Court first emphasised the point, which has not been controverted before us, that in order to arrive at real profits one must consider the accounts of the business on commercial principles and construe profits in their normal and natural sense, a sense which no commercial man will misunderstand. It then pointed out that what the shares cost originally to the assessee at a time when she had no business or trading activity, could not, in a commercial sense, be said to be the cost of the shares to the business which started on April 1, 1945, the original cost was really a matter of historical record and it had no relevance in the determination or ascertainment of profits which the business made. Obviously, the whole of the sale proceeds or receipts could not be treated as profits and made liable to tax, for that would make no sense a portion only of the receipts can be treated as profit but what portion? Normally, the commercial profits out of the transaction of a sale of an article is the difference between what the article costs the business and what it fetches on sale. The High Court pointed out that when the assessee purchased the shares at a lesser price, that is what they cost her, and not the business; but so far as the business was concerned, the shares cost the business nothing more or less than their market value on April 1, 1945.

The learned Additional Solicitor General who has appeared on behalf of the appellant in this case has contested the correctness of the above line of approach. He has submitted, firstly, that the distinction drawn by the High Court between *Kikabhai's case* [1] and the present case is not warranted on principle: secondly, he has contended that the ratio in *Kikabhai's case* [1] should apply in the present case also; and thirdly, he has contended that in holding that the price of the shares should be the market price as on April 1, 1945, when the shares were converted into stock-in-trade the High Court

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in effect held by a legal fiction that the assessee had realised the potential profits on the said shares on that date which she had not actually done and hence the very basis of the judgment of the High Court is vitiated by the assumption of a fiction. The learned Additional Solicitor-General has also submitted that there was no warrant for the High Court to introduce a legal fiction that there was a notional sale of the shares on April 1, 1945, by the assessee and that the gains which accrued to the assessee on that sale were capital gains; this notional sale it is submitted, violates the basic principle that a man cannot sell to himself nor can he make a loss or profit out of transactions with himself.

We propose now to examine these arguments in some detail. The question raised is a short question but a difficult one. In order to examine the arguments urged on behalf of the appellant, it is necessary first to refer to the decision of this Court in *Kikabhai's case* (1). The facts of that case were these. The assessee there was a dealer in silver and shares and he maintained his accounts according to the mercantile system and valued his stock at cost price both in the beginning and at the end of the year. During the relevant accounting year he withdrew some silver bars and shares from the business and settled them on certain trusts in which he was the managing trustee and in his books of account he credited the business with the cost price of the silver bars and shares so withdrawn. The income-tax authorities assessed him to tax on the basis of the difference between the cost price of the silver bars and shares and their market value at the date of their withdrawal from the business. The High Court of Bombay upheld the action of the income tax authorities. This Court, however, by a majority decision came to the conclusion that the assessee was entitled to value the silver bars

(1). [1954] S.C.R. 219.

and shares withdrawn at cost price and was not bound to credit the business with their market value at the close of the year for ascertaining the assessable profits for the year. Bhagwati, J., who expressed the dissentient view said that so far as the business was concerned it made no difference whether the stock-in-trade was realised or withdrawn from the business and the business was entitled to be credited with the market value of the assets withdrawn as at the date of the withdrawal, whatever be the method employed by the assessee for the valuation of its stock-in-trade on hand at the close of the year. The majority view was expressed by Bose, J., who dealt with the two contentions of the learned Attorney General who appeared for the Revenue (respondent) in that case. The Attorney General's first contention was that as the silver bars and shares were brought into the business, any withdrawal of them from the business must be dealt with along ordinary and well-known business lines, namely, that if a person withdraws an asset from a business he must account for it to the bnsiness at the market rate prevailing at the date of the withdrawal. This contention was repelled by the majority on the ground that the transaction of withdrawal was not a business transaction and by the act of withdrawal the business made no profit or gain nor did it sustain a loss and the assessee derived no income from it. It was pointed out that the assessee might have stored up a future advantage for himself but as the transactions of withdrawal were not business transactions and as the assessee derived no immediate pecuniary gain, the State could not tax them; for under the Income-tax Act the State has no power to tax a potential future advantage, all it can tax is income, profits and gains made in the relevant accounting year. In other words, the ratio of the decision as respects the first contention of the learned Attorney General was that there was no general principle of taxation

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under income-tax law under which the State could assess a person on the basis of business profits that he might have made but had not chosen to make. It was also pointed out that it was unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a fictional profit which in truth and in fact was non-existent. It was pointed out that a man could not trade with himself nor could he make profit or loss out of transactions with himself. The second contention of the learned Attorney General was that if the act of withdrawal was at a time when the market price was higher than the cost price then the State was deprived of a potential profit. This contention was dismissed as unsound because, for income-tax purposes each year is a self-contained accounting period and one must take into consideration income, profits and gains made in that year and the assessing authority was not concerned with potential profits which might be made in another year.

From what has been stated above it would at once appear that *Kikabhai's case* (1) was the converse of the present case. In *Kikabhai's case* (1) a part of the stock-in-trade was withdrawn from business, there was no sale nor any actual profit. The ratio of the decision was simply this: under the Income-tax Act the State has no power to tax a potential future advantage and all it can tax is income, profits and gains made in the relevant accounting year. In the case under our consideration the admitted position is that there has been a sale of the shares in pursuance of a trading or business activity and actual profits have resulted from the sale. The question in the present case is not whether the State has a power to tax potential future advantage, but the question is how should actual profits

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be computed when admittedly there has been a sale in the business sense and actual profits have resulted therefrom. We agree with the High Court that in this respect there is a vital difference between the problem presented by *Kikabhai's case* (1) and the problem in the present case. We further agree with the view expressed by the High Court that the ratio in *Kikabhai's case* (1) need not necessarily be extended to the very different problem presented in the present case, not only because the facts are different, but because there is an appreciable difference in the principle. The difference lies in this : in one case there is no question of any business sale or actual profits and in the other admittedly there are profits liable to tax, but the question is how the profits should be computed. We must, therefore, overrule the first two arguments of the learned Additional Solicitor General that the distinction drawn by the High Court between *Kikabhai's case* (1) and the present case is not warranted on principle and that the ratio of the decision in *Kikabhai's case* (1) must necessarily apply to the present case also.

While we are on this question we must refer to a decision of the House of Lords in *Sharkey* v. *Wernher* (2) to which our attention has been drawn. Briefly put, the facts of that case were these : the wife of the assessee there carried on a stud farm, the profits of which were agreed to be chargeable to income-tax under case 1 of Schedule D. She also carried on the activities of horse racing and training, which were agreed not to constitute trading. Five horses were transferred from the stud farm to the racing stables. The cost of breeding these horses was debited to the stud farm accounts. On the question of the amount to be credited as a receipt the assessee contended before the Special Commissioners that the proper figure to be brought in respect of the transferred horses was the cost of

(1) [1954] S.C.R. 219. (2) (1955) 36 T.C. 275.

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breeding. The Crown contended that the market value of the animals, which was considerably higher, was the proper figure. The Commissioners decided in favour of the assessee and the Crown demanded a case. The case was first heard by Vaisey, J., who following the decision in *Watson Bros.* v. *Hornby* (1), held that the market value of the five horses transferred from the stud farm was the proper figure that should be credited in the accounts. Vaisey, J. based his decision on the ground that the case was indistinguishable in principle from an earlier decision, namely, that of Macnaghten, J., in *Watson Bros.* v. *Hornby* (1). We may here state that in *Watson Bros.* v. *Hornby* (1) the assessee carried on the business of poultry breeders and dealers. In addition to keeping birds on their farm for laying purposes, they had a hatchery which produced chicks primarily for sale as 'day-old chicks'. Some of these chicks were transferred to brooder houses and became part of the stock on the farm. The assessees were assessed to income-tax under schedule Din respect of the profits of the hatchery part of their business and under Schedule B in respect of the profits of the farm. The question that arose in that case was whether the day-old chicks transferred to the farm should be credited as stock at the average price at which they were sold and could have been bought in the open market, namely, 4d. per chick, and that the difference between that price and the admitted cost of production of each saleable day-old chick, 7d., was an allowable loss. The Crown contended that the hatchery and the farm were two activities of the same person who could not make a loss by transferring from one department to the other and therefore the chicks should be credited to the hatchery account at production cost. It was held by Macnaghten, J., that in the notional sale between the hatchery and the farm, which should be treated as separate entities, the price to be credited was the "reasonable price" laid down by s. 8 of the

(1) (1942) 24 T.C. 506.

Sale of Goods Act, 1893, and that on the admitted evidence this reasonable price must be the market price of 4d. per chick. This was the decision which Vaisey, J. followed. From the decision of Vaisey, J. there was an appeal to the Court of Appeal. The Court of Appeal referred to two of its own decisions, namely, *Laycock* v. *Freeman, Hardy & Wills* (1) and *Briton Ferry Steel Co. Ltd.* v. *Barry* (2) and held that the principle stated and the reasoning underlying the judgment of Sir Wilfrid Greene, M.R. in the *Briton Ferry Steel Co. Ltd.* v. *Barry* (2) were inconsistent with the conclusion in *Watson Bros.* v. *Hornby*(3). The Court of Appeal accordingly allowed the appeal. Sir Raymond Evershed, M.R., (as he then was) said, however, that if the matter were *res integra,* he would have been inclined to hold that for the purpose of the stud farm account if one were seeking to put a value on the animals transferred the value must be that which the animals were in fact worth. He expressed the view, however, that the matter was not *res integra* and as a result of the authorities referred to above which expounded the general principle to be applied, he allowed the appeal. The case was then taken to the House of Lords. The House of Lords decided in favour of the Crown, Lord Oaksey dissenting. Viscount Simonds thus expressed his views in his speech at page 299 of the report:

> "But it appears to me that when it has been admitted or determined that an article forms part of the stock-in-trade of the trader, and that upon his parting with it so that it no longer forms part of his stock-in-trade some sum must appear in his trading account as having been received in respect of it, the only logical way to treat it is to regard it as having been disposed of by way of trade. If so, I see no reason for ascribing to it any

(1) 22 T.C. 288. (2) 23 T.C. 414.
(3) (1942) 24 T.C. 506.

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other sum than that which he would normally have received for it in the due course of trade, that is to say, the market value. As I have already indicated, there seems to me to be no justification for the only alternative that has been suggested, namely, the cost of production. The unreality of this alternative would be plain to the taxpayer. If, as well might happen, a very large service fee had been paid so that the cost of production was high and the market value did not equal it."

Lord Radcliffe pointed out that when a horse was transferred from the stud farm to the owner's personal account, there was a disposition of trading stock, though the disposition might not be by way of trade. He then referred to three methods of recording the result of the disposition in the stud farm trading accounts. One of them was that there might be no entry of a receipt at all and Lord Radcliffe pointed out that this method would give the self-supplier an unfair tax advantage. The second method would be to enter the cost price; this again would be fictional, because, no sale in the legal sense had taken place, nor had there been any actual receipt. The third method was to enter as a receipt a figure equivalent to the current realisable value of the stock item transferred. Lord Radcliffe gave two grounds in favour of the third method. The first ground was that it gave a fairer measure of assessable trading profit as between one taxpayer and another, for it eliminated variations which were due to no other cause than any one taxpayer's decision as to what proportion of his total product he would supply to himself. The second ground was that it was better economics to credit the trading owner with current realisable value of any stock which he had chosen to dispose of without commercial disposal than to credit him with an amount equivalent to the accumulated expenses in respect of that stock.

It is worthy of note that the facts in *Sharkey* v. *Wernher* (1) were similar to the facts of *Kikabhai's case* (2). In both those cases what had happened was that a part of the stock-in-trade was withdrawn and the question was at what figure in the trading accounts the withdrawal should be accounted for. In *Kikabhai's case* (2) this Court came to the conclusion that the withdrawal should be at the cost price. In *Sharkey* v. *Wernher* (1) the house of Lords held that the proper figure should be the market value which gave a fairer measure of assessable trading profit. It is significant that the House of Lords reached that conclusion not without dissent. If the facts of the case which we are now considering were similar to the facts of *Kikabhai's case* (2), it might have been necessary for us to re-examine the ratio of the decision. It is necessary to state here, however, that the decision of the House of Lords in *Sharkey* v. *Wernher* (1) is an authority which is binding on us. It is only an authority of persuasive value entitled to great respect.

In an earlier part of this judgment we have taken pains to point out the distinction between *Kikabhai's case* (2) and the case under our consideration. In view of that distinction, we do not think that it is really necessary in the present case to re-examine the ratio of the decision in *Kikabhai's case* (2). What then is the basis for computing the actual profits in the present case ? We think that the basis must be, as the High Court has put it, the ordinary commercial principles on which actual profits are computed. We think that the approach of the High Court was correct and normally the commercial profits out of the transaction of sale of an article must be the difference between what the article cost the business and what it fetched on sale. So far as the business or trading activity was concerned, the market value of the shares as on April 1,

(1) [1955] 36 T.C. 275. (2) [1954] S.C.R. 219.

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1945, was what it costs the business. We do not think that there is any question of a notional sale here. The High Court did not create any legal fiction of a sale when it took the market value as on April 1, 1945 as the proper figure for determining the actual profits made by the assessee. That the assessee later sold the shares in pursuance of a trading activity was not in dispute; that sale was an actual sale and not a notional sale; that actual sale resulted in some profits. The problem is how should those profits be computed? To adopt the language of Lord Radcliffe, the only fair measure of assessing trading profits in such circumstances is to take the market value at one end and the actual sale proceeds at the other, the difference between the two being the profit or loss as the case may be. In a trading or commercial sense this seems to us to accord more with reality than with fiction.

For these reasons we hold that the answer given by the High Court to the question of law referred to it was correct. The appeal accordingly fails and is dismissed with costs.

Sarkar J.

SARKAR, J.—Two questions arise in this Appeal. The first is whether the judgment of the Court below is against the decision of this Court in *Sir Kikabhai Premchand* v. *Commissioner of Income-tax*.(1) The second is, if so, does the decision in *Kikabhai's case*(1) require reconsideration? It appears that in *Sharkey* v. *Wernher*(2) where the question was the same as in *Kikabhai's case*(1) and which was decided a little later than that case, the House of Lords took a view contrary to that taken in Kikabhai's case. It was on the basis of the reasoning on which *Sharkey's case* (2) was founded that the learned advocate for the respondent contended that Kikabhai's case requires reconsideration.

The assessee in the present case is a lady of

(1) [1954] S.C.R. 219; [1957] 23 I. T. R. 506.
(2) [1956] A.C. 58; 36 T.C. 275.

some means. For many year past she had been holding various shares by way of investment on the dividends of which she was being charged to income-tax. In assessing the tax for the assessment year 1946-47, the accounting period of which was the financial year 1945-46, it was found that the assessee had been carrying on business with some of the said shares since April, 1945. It is not in dispute that in the accounting year 1946-47 also, which is the year with which we are concerned, she carried on the business with various such shares.

A question arose in connection with the assessment of tax for 1946-47 as to how the profits of her trading activities were to be ascertained. The trade was one of purchase and sale of shares. It is common ground that the profits of such a trade are the difference between what the thing sold fetched and what it cost to acquire. The question arose because difficulty was felt in fixing the cost of acquisition. In regard to shares acquired by the assessee for her trade after she started it, the position was not in controversy, for the cost in respect of such shares was admittedly what he bought them for. The controversy concerned the shares with which she traded in this year and which, prior to April 1, 1945, she had been holding as investment, having acquired them, it may be, quite a few years ago. The assessee contended that the cost of acquisition of this latter variety of shares—and with these alone we are concerned in this appeal, was their market value on the date when she started her business and thereby converted them from investment into stock-in-trade of her business. The State contended that the cost of acquisition of these shares would be what she bought them for, no matter when she bought them and for what purpose. The Tribunal accepted by a majority the contention of the assessee. At the instance of the State the Tribunal then referred the following

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question to the High Court at Bombay under s.66(1) of the Income-tax Act:

> "Whether the assessee's assessable profits on the sale of shares is the difference between the sale price and the cost price, or the difference between the sale price and the market price prevailing on 1-4-1945."

The High Court held that the assessable profits were the difference between the sale price and the market value of the shares prevailing on April 1, 1945. The State has filed this appeal against the decision of the High Court.

The State contends that the High Court's decision is against the judgment of this Court in *Kikabhai's case.*(1). That is the first question which I propose to discuss. The assessee in Kikabhai's case was a dealer in shares and silver. The method employed by him in keeping his accounts was to enter the cost price of his stock at the beginning of the year, to credit the sale proceeds of the stock sold during the year and value the unsold stock at the end of the year at cost price, these latter being carried forward as the opening entries of the next year's accounts. It appeared that the assessee had withdrawn some silver and shares from his business and settled these upon certain trusts. In the accounts he entered the silver and shares so withdrawn at their cost price. The State contended that these should have been entered in the accounts at their market value on the date they were withdrawn from the business. This Court found this contention unacceptable and held that the entry should be of the cost price and not of the market value on that date.

It had been contended on behalf of the State that "As this is a business, any withdrawal of the assets is a business matter and the only feasible way of regarding it in a business light is to enter

(1) (1954) S.C.R. 219; [1957] 23 I.T.R. 506.

the market price at the date of the withdrawal," and that "if a person withdraws an asset from a business, he must account for it to the business at the market rate prevailing at the date of the withdrawal." In dealing with these contentions this Court observed, " It is impossible to get away from the fact that the business is owned and run by the assessee himself. In such circumstances we are of opinion that it is unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a ficàtional profit which in truth and in fact is non-existent. Cut away the fictions and you reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the fact of it is not only absurd but against all canons of mercantile and income-tax law."

The decision in *Kikabhai's case* (1) was however by a majority, Bhagwati J. having taken a contrary view. For the purpose of the present question I will have to confine myself to the judgment of the majority.

It seems to me that the argument of the respondent in the present case is the same as that of the Attorney-General in Kikabhai's case. She says that she is entitled to debit the accounts of her business with the market value of the shares as on the date of their conversion into stock-in-trade, that is, April 1, 1945. She can no doubt do that if she had acquired them on that date, from the market. But this she did not do. So she is compelled to rely on a fictional purchase by her from herself at the market rate of that date to sustain her contention. Kikabhai's case definitely held that no one can be supposed to be trading with himself for the purpose of ascertaining taxable profits. A fiction therefore that one has done so is not permissible. To hold that the assessee is entitled to enter in the

(1) [1954] S.C.R. 219; [1957] 23 I.T.R. 506.

accounts of her business, the market value of the shares on April 1, 1945, would be to go directly against the decision in Kikabhai's case and the ratio on which it was based.

It was said that Kikabhai's case dealt with a fictional sale and potential or notional profits whereas in the present case there was actual trading in the shares and the problem here is to ascertain the profits of that trade. I am not sure that the distinction so sought to be made is really possible. Both the cases dealt with the assessment of the profits of an entire trading activity of a person. There were real profits in both cases and the question in each was, how to assess them. The difficulty in one case arose because a particular stock acquired for the trade had been withdrawn from it and in the other, because a particular stock not acquired for the trade had been used for its purposes. The question in each case was, what value was to be put on the stock concerned for assessing the profits of the trade as a whole. It would be incorrect to split up the entire trade and to treat the deal in each stock separately and I do not think *Kikabhai's case* (1) did so. So considered the State would have no basis for any claim in Kikabhai's case for then there would have been no business at all to tax. It was therefore that in Kikabhai's case the State contended that the stock had been "brought into the business" and on that basis only could it advance by argument. It was this argument advanced on that basis that this Court considered and rejected. The Court did not consider the profits of a particular item of trade by itself. So the Court did not consider notional profits in the sense indicated by the distinction now sought to be made between the two cases. The present case is the same, for here also the question is what are the profits of the assessee's entire trade, that is, how is the cost price to be calculated for

(1) [1954] S.C.R. 219; [1957] 23 I.T.R. 506.

that purpose ? Here also, if the sale of the investment shares by themselves was concerned there would in all probability have been no trading and no question of assessing the profits of such trading would have arisen. Therefore both cases dealt with the assessment of actual profits ; none was concerned with assessment of notional profits.

But suppose the two cases are different as suggested, that does not seem to me to make any distinction. In *Kikabhai's case* (1) it had been held that the withdrawal was not trading because a man could not trade with himself. In the present case the assessee did no doubt trade by selling her shares to a stranger. There was no fiction in this trade. But when the assessee contends that in ascertaining the profits of a trading transaction actually done by her she should be permitted to value the stock involved in that trading activity which she had not acquired in the course of her trade at the market value of the date of the commencement of that trade.

She really says that she should be allowed to proceed on the basis of a fiction that she had purchased from herself on that date for she had not then purchased it at all. She would be asking us to hold that which Kikabhai's case refused to hold. I am unable to agree that in the case of a real sale Kikabhai's case does not forbid a dichotomy between the owner of a business and the business itself for ascertaining the profits of that sale as the assessee wants us to do.

It was also said that to apply the principle that one cannot trade with himself to the present case would be overlooking the actual fact that money's worth was brought into the business. I am unable to appreciate this contention. There is no overlooking of the money's worth brought in, for

(1) [1954] S. C. R. 219; [1957] 23 I. T. R. 506.

that money's worth is value at the cost at which the stock concerned was actually acquired from the market, may be as an investment and not as a stock in trade. I am unable to appreciate how it can be said that any money's worth would be overlooked—which, I will assume, no businessman will do in calculating his profits—if the shares are not valued at the market value of the day on which they are brought into the trade but are valued at the price at which actually they had been previously acquired by the assessee. The real question is what were the shares' worth in money for calculating the profits. The contention of the respondent assumes that the money's worth must be calculated as on the date of the commencement of the trade and hence really begs the question.

Chagla, C.J. who delivered the judgment of the High Court, said that he did not understand *Kikabhai's case* (1) to mean that even for the purpose of accountancy or for the purpose of ascertaining commercial profits it is not open to the court to value the shares at the market price of the date on which they were brought into the business. I am unable to agree. Accountancy, I suppose, is not based on fiction but deals with realities. We are concerned with accountancy only for the purpose of ascertaining commercial profits, and it was only for that purpose that this Court held that you cannot enter in your accounts the market value of goods on the fictional basis that you sold them to yourself. Chagla, C.J., thought that Kikabhai's case was not dealing with commercial profits. I think that since that case was considering profits for income-tax purposes it was not dealing with anything else. I am also unable to agree with the view of Chagla, C.J., that the ratio in the decision of Kikabhai's case has no application to the present case. The ratio was that for the purpose of ascertaining taxable profits it is not possible to conceive of one trading

(1) [1954] S. C. R. 219. [1957] 23 I. T. R. 506.

with himself and it would apply here, for here also taxable profits are being ascertained.

Chagla, C.J. observed that what has to be ascertained is what an article costs the business and not the owner, but in *Kikabhai's case* [1] it was expressly said that when the business is owned by the assessee himself it is unreal to separate the business from its owner and treat them as if they were different entities trading with each other.

Chagla, C.J. also said that for Income-tax purposes profits of a business have to be understood in a way that a man of business would understand it. I am not aware that a commercial man must compute profits on the basis of a fiction that he has bought from himself and cannot compute his profits by deducting from the sale proceeds the price for which he had actually acquired the goods.

Kikabhai's case said that you cannot assess taxable profits on the basis of a fictional sale. If you cannot do that, neither do I think can you assess such profits on the basis of a fictional purchase in the market. And that is what the assessee wants us to do. I am for myself entirely unable to make any distinction between Kikabhai's case and the present case.

I have now to refer to *Sharkey's case* [2] and examine whether on the reasoning on which it was based it is necessary to reconsider Kikabhai's case. That is the second question which arises in this case. I do not find the reasoning of that case so strong as to lead me to the opinion that the decision in Kikabhai's case was wrong. I first note that one of the learned Judges Lord Oaksey, took the same view as was taken by this Court in Kikabhai's case. In dealing with Sharkey's case I will be referring to the judgment of the majority.

(1) [1954] S.C.R. 219, [1957] 23 I.T.R. 506.
(2) [1956] A.C. 58 36 ; T.C. 275.

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Now, *Sharkey's case* (1) also dealt with the withdrawal of assets from a taxable business. There a lady owned two enterprises, one a stud farm the income of which was liable to tax and another a racing establishment, which was recreational and therefore not liable to tax. The lady transferred some horses from the stud farm to the racing establishment. In assessing the income of the stud farm a question arose as to what value should be put in its accounts for the horses transferred to the racing establishment. It will be noticed that by the transfer to the racing establishment of which she was the owner, the lady had only withdrawn the horses from her taxable undertaking. The problem there was therefore just the same as in *Kikabhai's Case*(2).

It was held by the House of Lords that the value to be put on the horses withdrawn from the stud farm was their market value at the date of the transfer and not the cost incurred on them for breeding and otherwise till the transfer. The House of Lords observed that in Income-tax Law a dichotomy between the owner of a business and the business is possible and presumably therefore trading between the two could be conceived for tax purposes in certain cases and referred to some English authorities in support of this view. I will assume that such a dichotomy is possible in some cases but the question is whether it is possible in a case like Sharkey's case. On that question I do not find the House of Lords giving any special reason to make that dichotomy. I also note that the House of Lords did not dispute that as a general rule the dichotomy cannot be made.

Apart from the general observation mentioned above the House of Lords based its decision on two grounds. What the House of Lords thought strongly supported its view first that since it was conceded before them that some entry had to be made

(1) [1956] A.C. 58; 36 T.C. 275.
(2) [1954] S.C.R. 219; [1957] 23 I.T.R. 506.

in respect of the horses withdrawn, and that whether the entry was of the cost incurred for breeding the horses transferred or of their market value on the date of the transfer, the entry would in either case be fictional for they were not in fact transferred at any of those prices and therefore it was more real to enter the market value. Now, as Lord Radcliffe himself noted, the entry of the cost price would really be cancelling the entry of the cost in breeding the horses which had been made in the accounts of the farms. He however found no explanation why cancellation should take place. I think it can be legitimately said that there is an explanation and as was said in *Kikabhai's case,* that is that the cancellation had to take place because assets were withdrawn from the trade, unless entries were made cancelling the cost of items of stock brought into the trade when they were taken out of the trade, the accounts would not give the real picture of the profits of the actual trade.

A second reason which appears only in the judgment of Lord Radcliffe is that if the market value of the date of withdrawal is not entered, there will be an inequitable distribution of the burden of tax. This is not very clear to me. Learned advocate for the assessee said that Lord Radcliffe was contemplating the case of two traders who started their business on the same day one of whom bought his stock in trade from the market on that date, of course at the market value, and the other started his business by converting what he was earlier holding for his personal purpose, into stock-in-trade. It was said that unless the latter was permitted to value his stock in trade at the market rate on the date of conversion, he would be subjected to a tax different in amount from that of the tax on the former and this would result in inequitable distribution of the burden of taxation. Again I am not convinced that this reasoning is conclusive. Take the case of two traders. One by his shrewd business method or by friendly contacts, or may be by means not very creditable may on the same day acquire goods necessary for his trade at a much cheaper rate than the other. The profits of the two would then be different. I do not imagine that any income-tax law would find this objectionable. Furthermore, I am not sure that this anxiety for an equitable distribtuion of the burden of tax justifies departure from a cardinal rule which is accepted in many cases in England also, that a man cannot be said to trade with himself so as to make taxable profits.

Lord Radcliffe realised the difficulty of tho problem which he had to solve and said so. I do not think I will be wrong in saying that he put his decision on the ground of the best practical solution of that difficulty. Tho majority judgment in Sharkey's case does not lead me to the conclusion that our decision in *Kikabhai case* (1) was wrong. I respectfully prefer the view taken in Kikabhai's case and by Lord Oaksey in *Sharkey's case*(2). Bhagwati, J. in his minority judgment in Kikabhai's case based himself on the arguments of the Attorney General. It is not necessary to specifically deal with his views for they have been dealt with in that case and with what have been said there I am in complete agreement.

Before leaving Sharkey's case it would be of some interest to point out that Lord Simonds did not think that any distinction was possible between the case that he had before him and a case like the one now before us for he said: "And so also, as I have more than once pointed out in this case, it is conceded by the tax-payer that some figure must appear in the stud farm accounts as receipt in respect of the transferred horses, though Lady Zia in her capacity as transferee did not carry on a taxable activity. In the same way, it would, I suppose, be claimed that, if Lady Zia were to transfer or retransfer a horse from her racing establishment to her

(1) [1954) S.C.R. 219. (2) [1956] A.C. 58; 36 T.C. 275.

stud farm some figure would have to appear in the stud farm accounts in respect of that horse though it cost her nothing to make the transfer: If it were not so and she subsequently sold the transferred horse and the proceeds of sale were treated as receipts of the stud farm, she could justly complain that she had been charged with a fictitious profit."

In the course of arguments a case was suggested of a man who had inherited or received by way of gift, a certain commodity with which after a lapse of some time he started a trade. It was said that it would be impossible in such a case to say that the cost of acquisition of his stock-in-trade was nil and the entire sale proceeds received by him in respect of that thing in his trade were his profits. Now, it seems to me that even if it were so, it would not follow that his stock-in-trade had to be valued at the date on which he started his trade with that. So to hold would be against *Kikabhai's case*(1). That being so, this illustration would only beg the question and not prove that Kikabhai's case is wrong. I think a businessman would in such a case enter into his accounts as the price for which he acquired his stock-in-trade its value in the market on the date on which he received it free. That would not involve going against Kikabhai's case, for it would not be based on a fictional trading by a man with himself. If you cannot distinguish a business from its proprietor, then the cost of a thing for the purpose of the business would be its value at the time the proprietor of the business acquired it. Such value from a businessman's point of view would in my opinion be the value for which he acquired it when he did so for value, or its market value on the date of acquisition, when he paid no value for it.

I would therefore allow this appeal and answer the question framed by the Tribunal by saying

(1) [1954] S.C.R. 219.

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that the assessee's Taxable profits on the sale of the shares earlier held as investment are the difference between the sale price and the cost price, that is, the price at which she had actually bought those shares.

BY COURT: In accordance with the opinion of the majority, this appeal is dismissed with costs.

Appeal dismissed.

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February 23.

S. S. MUNNA LAL

v.

S. S. RAJKUMAR AND OTHERS

(S. K. DAS, M. HIDAYATULLAH and J. C. SHAH, JJ.)

Hindu Law—Jains—Adoption—Widow, if can adopt without express authority of husband—Preliminary decree for partition declaring widow's share—Whether share "possessed" by widow—Death of widow—If share reverts to estate—Hindu Succession Act, 1956 (30 of 1956), ss. 4, 14, 15 and 16.

G, a Digamber Jain of the Porwal sect, died in 1934 leaving behind his widow Smt. K, his son G who died in 1939 and three grandsons M, P and R. In 1952 M's son S filed a suit for partition of the joint family properties. Rajkumar, claiming to be a son of P adopted by his widow, claimed a 1/4th share in the joint family property. The adoption was challenged on the ground that no express authority had been given by P to his widow to adopt. The trial court held that no express authority was required by a sonless Jain widow to adopt a son and that the adoption was duly and properly made. Accordingly, a preliminary decree declaring the shares of Smt. K, the branch of M, the branch of R and of Rajkumar to be 1/4th each was passed. M and others preferred an appeal to the High Court mainly against the findings on the question of adoption. During the pendency of the appeal, the Hindu Succession Act, 1956, came into force. Shortly thereafter Smt. K died. The High Court upheld the decision of the trial court on the question of the adoption of Rajkumar. With respect to the share of Smt. K the High Court held that her interest declared by the preliminary decree was inchoate, that she never became "possessed",