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NEW ERA AGENCIES (PVT.) LTD., BOMBAY

v.

COMMISSIONER OF INCOME-TAX, BOMBAY CITY I, BOMBAY

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November 28, 1967

[J. C. SHAH. V. RAMASWAMI AND V. BHARGAVA, JJ.]

Indian Income-tax Act, 1922—Profit on sale of shares—Whether capital accretion or revenue receipt.

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During the years 1942 to 1948 the dealings in shares of the assessee included dealings in shares of Elphinstone Mills and the profit and loss in the dealings of the Mills was taken by the assessee to its revenue account. M was in control of the assessee-company and he also purchased the control and managing agency of the Mills, and in this managing agency company—the assessee was also a share holder. From 1949 onwards the assessee did not sell the shares of the Mills but added to its holding. In 1953, M sold the entire shares in the Mills with him and under his control including that with the assessee. Along with that M got the vendee and the latter's nominee appointed directors and also got the resignation of the Managing agency-company from the managing agency of the Mill. Out of the total sale price the assessee received certain amount which was in excess of the cost price of the shares. The assessee did not show the excess amount on the sale of these shares in its profit and loss account but took it to the capital reserve account and showed it as a capital reserve in its balance-sheet. The assessee, in appeal, contended that (i) the excess amount received was a capital accretion on the sale of the shares and did not represent income from business in shares; and (ii) the excess amount over and above the market price was paid for the controlling interest which was being transferred along with the shares.

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HELD : The appeal must be dismissed.

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(i) The profit made by the assessee on the sale of the shares was its business income. During the years 1943-48 the profits and losses in these shares had been treated on the same footing as the profit and losses in other shares of the assessee. The circumstance that from 1949 onwards the assessee had not sold the shares of the Mills, but had added to its holding, was not in itself sufficient to reach an inference that the assessee had treated its holding in the shares an investment. During the years 1949-53 the shares had slumped in price and this may be the reason why the assessee did not effect any sales during this period. It was not unreasonable to think that the assessee who was a dealer in shares was making further purchases and accumulating its holding when the market was falling so as to be in a position to sell the shares to its advantage when a suitable opportunity occurred. There was no material on the record to suggest that the main object of the assessee in acquiring the shares was to give support to the Managing Agents. When the managing agency was acquired, there was no need to make any use of the holding of the assessee because the assessee at that time had hardly any shares. Subsequent to the acquisition of the managing agency, until it was relinquished, the managing agency never felt its existence either precarious or in need of support. [488 D—H; 489 B—D]

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Californian Copper Syndicate (Limited and Reduced) v. Harris, 5 Tax Cas. 159, *Commissioner of Taxes v. Melbourne Trust Ltd.*, [1914] A.C. 1001, *Rees Roturbo Development Syndicate Ltd. v. Ducker*, 13 Tax Cas. 366 and *Venkataswami Naidu & Co. v. Commissioner of Income-tax*, 35 I.T.R. 594, referred to.

(ii) No part of the amount received by the assessee could be regarded as consideration for any other valuable right excepting the price of the shares sold by it. No controlling power was held by the assessee itself in the Mills and it was not in a position to procure the resignation of the Directors or bring about the appointment of vendee's nominees as Directors. Nor was it in a position to call upon the Managing Agents to relinquish their offices. All these things were possible to M because of the influence and power he possessed. The part taken by the assessee in the transaction with the vendee was merely a passive part, viz., keeping at the disposal of M its holding in the Mills' share, which it had held in its business as a dealer in shares. Therefore, so far as the assessee was concerned, what it parted with was the shares which it held and what it received was the payment for those shares. [491 D—F]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2462 of 1966.

Appeal from the judgment and order dated April 21/22, 1964 of the Bombay High Court in Income-tax Reference No. 19 of 1961.

Sanat P. Mehta, J. B. Dadachanji and O. C. Mathur, for the appellant.

B. Sen, T. A. Ramachandran, R. N. Sachthey and S. P. Nayar, for the respondent.

The Judgment of the Court was delivered by

Ramaswami, J. The appellant is a Private Limited Company controlled by Mulraj Kersondas and his nominees. It is a dealer in shares, both in forward and ready market. In the year 1942 Mulraj Kersondas obtained control of the Elphinstone Spinning and Weaving Mills (hereinafter referred to as the 'Elphinstone Mills'). He also acquired the managing agency of the Elphinstone Mills for a consideration of Rs. 6 lakhs. In 1943 Mulraj Kersondas assigned the Managing Agency to a Private Company known as Chidambaram Mulraj & Co. Ltd. whose shareholders were Mulraj Kersondas, his nominees and the appellant. During the years 1942 to 1948 the dealings in shares of the appellant included dealings in shares of Elphinstone Mills also and the profit and loss in the dealings of Elphinstone Mills was taken by the appellant to its revenue account during these years. At the end of the year 1948 the appellant held 5,137 ordinary shares and 1131 preference shares of the Elphinstone Mills. During the years subsequent to the year 1948, the appellant did not effect any sale in the Elphinstone Mills' shares, excepting a solitary transac-

- A tion of 160 shares in the year 1952. On the other hand, the appellant purchased some more shares and added to its holdings in the shares of the said mills. Therefore, in the year 1953 the appellant held in all 8693 ordinary shares and 2117 preference shares of the Elphinstone Mills. It appears that during the years from 1948 onwards there was a slump in the price of the shares of the Elphinstone Mills and the prices of the ordinary and preference shares on the material date in 1953 were Rs. 37/- per ordinary share and Rs. 38/- per preference share.

- On September 25, 1953 Mulraj Kersondas wrote a letter to K. D. Jalan, a well known businessman of Calcutta making an offer of sale of 25,000 ordinary shares and 10,000 preference shares of the Elphinstone Mills for a total sum of Rs. 45 lakhs. He stated in that letter that the shares offered stood in the names of himself, his family members and his allied concerns. The offer for sale was accompanied by a further offer that if the offer for sale was accepted, Mulraj Kersondas would obtain the resignation of the present Directors of the Elphinstone Mills and would also get appointed as Directors persons of the choice of K. D. Jalan and that he would obtain the resignation of the present Managing Agents of the Elphinstone Mills, viz., Chidambaram Mulraj and Co. Ltd. It was further stated in the letter that the price to be paid, the transfer of the shares, the resignation of the Directors and the appointment of the new Directors of the choice of the purchaser, and the resignation of the Managing Agents would all be simultaneous. K. D. Jalan accepted the offer and paid the sum of Rs. 45 lakhs out of which Mulraj Kersondas paid Rs. 10 lakhs to Chidambaram Mulraj and Co. Ltd. which relinquished the Managing Agency at his instance. The balance was distributed at Rs. 80/- per ordinary share and Rs. 150/- per preference share of the Elphinstone Mills (as against the prevailing market price of Rs. 37/- and Rs. 88/- respectively) to the respective shareholders whose shares had been sold to K. D. Jalan. In respect of its shares sold to K. D. Jalan, the appellant received Rs. 10,42,990/-, though the appellant recorded its total receipts as Rs. 10,37,775/- and the discrepancy of Rs. 5,215/- has not been explained. The cost price of the shares to the appellant was Rs. 8,03,544/- and the profit on the sale was worked out in the appellant's books at Rs. 2,34,231/-. The appellant, however, did not show the surplus in its Profit & Loss account but took it to the capital reserve account and showed it as a capital reserve in its balance sheet. In the assessment of the appellant for the assessment year 1954-55, the Income Tax Officer treated the amount of Rs. 2,34,231/- as the income of the appellant from the sale of the shares and brought the said amount to tax. The appellant took the matter in appeal to the Appellate Assistant Commissioner who accepted its contention that the said amount

represented a capital gain and did not form part of the income from the business of the appellant and accordingly allowed its appeal. Against the decision of the Appellate Assistant Commissioner the Department appealed to the Income Tax Appellate Tribunal which allowed the appeal, set aside the order of the Appellate Assistant Commissioner and restored that of the Income Tax Officer. Thereafter, at the instance of the appellant the Income Tax Appellate Tribunal stated a case to the High Court under s. 66(1) of the Indian Income Tax Act, 1922 on the following question of law :

"Whether on the facts and in the circumstances of the case the sum of Rs. 2,34,230/- was the income of the assessee ?"

On the direction of the High Court, the Tribunal submitted a supplementary statement of the case and referred the following additional questions of law :

"(2). Whether on the facts and in the circumstances of the case, the amount of Rs. 10,42,990/- received by the assessee, as allotted by Mulraj Kersondas out of the sum of Rs. 45 lakhs received by him from Shri K. D. Jalan represents exclusively the price of the shares or includes therein any consideration for the procuring of the resignation of the present Directors, for obtaining the appointment of the Directors, of the choice of Shri K. D. Jalan and for the resignation of the present managing agents of the Mills.

(3). If so, what in view thereof should be taken as the sale price of each of the ordinary shares and each for the preference shares sold by the assessee in calculating its income arising therefrom ?"

By its judgment dated April 21, 1964 the High Court answered the first two questions against the appellant and held that in view of the answer to the second question the third question did not survive and therefore need not be answered. The present appeal is brought to this Court on a certificate granted by the High Court under s. 66(A) of the Indian Income Tax Act, 1922.

The distinction between investment and stock-in-trade, between fixed capital and circulating capital is well-known. In *Californian Copper Syndicate (Limited and Reduced) v. Harris*⁽¹⁾ Lord Justice Clerk observed :

"It is quite a well settled principle in dealing with questions of assessment of Income Tax, that where the owner of an ordinary investment chooses to realise

(1) 5 Tax Cas. 159, 165-66.

A it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where
B what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business. The simplest case is that of a person or association of persons buying and selling lands or securities speculatively, in order to make gain, dealing in such investments as a business, and thereby seeking to make profits. There are many
C companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, where they make a gain by a realisation the gain they make is liable to be assessed for Income Tax.

D What is the line which separates the two classes of cases may be difficult to define, and each case must be considered according to its facts; the question to be determined being—Is the sum of gain that has been made a mere enhancement of value by realising a security, or is it a gain made in an operation of business in carrying out a scheme for profit-making?"

E The principle stated in this case was approved in *Commissioner of Taxes v. Melbourne Trust Ltd.*, ⁽¹⁾ in *Rees Roturbo Development Syndicate Ltd., v. Ducker*⁽²⁾ and in *Venkataswami Naidu and Co. v. Commissioner of Income-tax*⁽³⁾.

F With regard to the first question, Mr. Sanat P. Mehta appearing on behalf of the appellant argued that the sum of Rs. 2,34,230/- was a capital accretion on the sale of shares and did not represent income from the business in shares of the appellant. It was stated that though the appellant was a dealer in shares it was not acquiring the shares of Elphinstone Mills as its stock-in-trade. The argument was put forward that the appellant was a controlled concern of Mulraj Kersondas and it was a shareholder also of the Managing Agency Company and therefore it was interested in the Managing Agency. The appellant had purchased the shares of the Elphinstone Mills not with a view to deal with them as a dealer in shares but with a view to support the Managing Agents of the Elphinstone Mills. In our opinion there is no justification for the argument put forward on behalf of the
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H appellant. It is admitted that the appellant is a dealer in shares

(1) [1914] A.C. 1001.

(2) 13 Tax Case. 366.

(3) 35 I.T.R. 594.

and that it had actually dealt with the shares of Elphinstone Mills during its business from the years 1943 to 1948. The appellant had carried forward its profits and losses in the entire share business carried on by it to its revenue account including the business in the Elphinstone Mills shares. During the years from 1943 to 1948 the appellant purchased shares of the Elphinstone Mills and also sold them. It is true that at the end of the year 1948 the appellant was possessed of as many as 5137 ordinary shares and 1131 preference shares of the Elphinstone Mills but it is also apparent that in 1944 the appellant had sold 2,000 shares and in 1947 and 1948 the appellant had sold 1,000 shares in each year. During all these years the profits and losses in these shares have been treated on the same footing as the profits and losses in other shares by the appellant. An alternative argument was presented by Mr. Sanat P Mehta that at least from the year 1948 the holding in the shares of the Elphinstone Mills was regarded by the appellant not as a stock-in-trade but as an investment. It was contended that the circumstance that the appellant had been a dealer in shares for some years did not preclude it from being an investor in shares in subsequent years. It is no doubt true that a person who has been a dealer in shares in some years can be an investor in shares in subsequent years. It is also true that it is possible for a dealer in shares to convert a part of its stock-in-trade into investment. But, as has been observed by the Appellate Tribunal there is nothing in the books of the appellant or in its resolutions to show that it had changed its attitude towards the shares of the Elphinstone Mills from the year 1948. The only circumstance pointed out by the appellant is that from the year 1949 onwards the appellant had not sold the shares of the Elphinstone Mills but on the other hand had added to its holding. But this circumstance in itself is not sufficient to reach an inference that the appellant had treated its holding in the shares as investment. It is apparent that during the years 1949-53 the shares of the Elphinstone Mills had slumped in price and this may be the reason why the appellant did not effect any sales during this period. It was pointed out that during this period the appellant had also made further purchases of the shares. But it is not unreasonable to think that the appellant who was a dealer in shares was making further purchases and accumulating its holding when the market was falling so as to be in a position to sell the shares to its advantage when a suitable opportunity occurred. The argument was further stressed on behalf of the appellant that it had purchased the shares of the Elphinstone Mills with a view to support the Managing Agents of the Mills since the appellant itself had an interest in the Managing Agency Company, being one of its shareholders. It was therefore contended that the holding of the appellant in the shares of Elphinstone Mills must be treated as a holding on capital account and the sale thereof must also be

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A regarded as on capital account. We do not think there is any warrant for this argument. As pointed out by the Appellate Tribunal there is no material on the record to suggest that the main object of the appellant in acquiring the shares of the Elphinstone Mills was to give support to the Managing Agents. The conduct of the appellant in disposing of large number of shares of Elphinstone Mills during the years 1943-48 is not consistent with the theory that the appellant was acquiring shares for the purpose of supporting the Managing Agents. There is also nothing on the record to show that during the years 1949-53 when no sales were effected it was necessary to conserve the holding in the shares of the Elphinstone Mills because the Managing Agency was in any way threatened. It also appears that at the time when the Managing Agency was acquired there was no need to make any use of the holding of the appellant in the shares of the Elphinstone Mills because the appellant at that time had hardly any shares. Subsequent to the acquisition of the Managing Agency until it was relinquished in 1953 there is nothing on the record of the proceedings to show that at any time the Managing Agency had felt its existence either precarious or in need of support. We therefore reject the argument of the appellant on this aspect of the case and hold that the profit made by the appellant on the sale of the shares was its business income and the first question was rightly answered by the High Court against the appellant and in favour of the Income Tax Department.

E We proceed to consider the next question, *viz.*, whether the entire amount of Rs. 10,42,990/- which the appellant received for its ordinary and preference shares represented exclusively the price of the shares or whether it constituted a composite payment for the price of the shares and certain other valuable rights. The case of the appellant is that the transaction entered into by Mulraj Kersondas with K. D. Jalan which involved the sale of 25,000 ordinary shares and 10,000 preference shares of the Elphinstone Mills was not merely a transaction for the sale of the shares. The offer which Mulraj Kersondas made on September 25, 1953 consisted of four items, *viz.*, (1) the sale of 25,000 ordinary shares and 10,000 preference shares, (2) procuring the resignations of the present Directors of the Elphinstone Mills, (3) securing the appointment of persons of the choice of K. D. Jalan as Directors of the Mills, and (4) obtaining the resignation of the present Managing Agents of the Elphinstone Mills. It was contended for the appellant that the consideration of Rs. 45 lakhs for this offer was a composite consideration for all the four items. After the offer was accepted by K. D. Jalan and the payment of Rs. 45 lakhs was made by him to Mulraj Kersondas, the latter appropriated Rs. 10 lakhs of the consideration to one of the four items, *viz.*, relinquishment of Managing Agency. He paid the amount to the Managing Agents Chidambaram Mulraj and Co. Ltd.

Deducting the amount of Rs. 10 lakhs from the total consideration of Rs. 45 lakhs, the balance of Rs. 35 lakhs was distributed by Mulraj Kersondas among the 25,000 ordinary shares and 10,000 preference shares. It was pointed out for the appellant that at the material time when the transaction had gone through the market price for Elphinstone Mills shares was Rs. 37/- per ordinary share and Rs. 88/- per preference share, but when Mulraj Kersondas distributed Rs. 35 lakhs among the ordinary and preference shares each ordinary share was paid at the rate of Rs. 80/- and each preference share was paid at the rate of Rs. 150/-. According to the appellant therefore the excess amount paid by the purchaser over and above the market price was paid by him for the controlling interest which was being transferred along with the shares. In other words, the contention of the appellant was that the profit on the sale of the shares made by the appellant must be calculated on the basis of what it got for the sale-price of the shares only and not on the basis of the entire consideration received by it which was a composite payment received for the price of the shares and for parting with the controlling interest. We are unable to accept this argument as correct. It may be that in the total disposal of the entire block of shares in favour of K. D. Jalan the latter may have acquired certain amount of controlling power apart from mere acquisition of shares. It is also conceivable that Mulraj Kersondas, in going through the transaction with K. D. Jalan, might have given to K. D. Jalan not only the shares but also certain other advantages. But the question must be examined from the view-point of the appellant and what we have to see is what the appellant parted with and what the appellant got in return. It should be noticed that the appellant itself had no controlling interest in the Elphinstone Mills. It was not the Managing Agent of the Elphinstone Mills and its holding in the shares of the Elphinstone Mills was only to the extent of 13 per cent which could not give it any controlling power. Mr. Sanat P. Mehta said that though the appellant had not a sufficiently large holding to give it any controlling power, it was a member of the Mulraj Kersondas group and it was working in close concert with Mulraj Kersondas who had considerable controlling power and interest. It was argued that the transaction entered into by Mulraj Kersondas with K. D. Jalan, although entered into by Mulraj Kersondas alone, should be treated as the transaction on behalf of the entire group of Mulraj Kersondas including the appellant. What was therefore being offered by Mulraj Kersondas to K. D. Jalan was an offer on behalf of the entire group which had a built-in power which it was proposing to transfer to K. D. Jalan in the scheme proposed by Mulraj Kersondas who was the representative of the group. It was therefore argued on behalf of the appellant that it would not be correct to say that the appellant had not parted with anything

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- A more than the block of its shares in the present transaction. It is not possible to accept this argument put forward on behalf of the appellant. There is nothing on the record of the case to support the theory that the transaction with K. D. Jalan was not a transaction by Mulraj Kersondas himself but a transaction of the entire group. As appears from the letter of Mulraj Kersondas dated September 25, 1953, the offer was on behalf of Mulraj Kersondas alone. His letter to the Managing Agents was a direction given by him asking them to do certain things to suit his convenience and, as it appears from the record, the direction was promptly obeyed by them. As pointed out by the High Court, the circumstances of the case indicate that Mulraj Kersondas was by reason of his influence and power, in a position to command obedience of his wishes from his nominees and associates concerned. When Mulraj Kersondas decided to enter into a transaction for the sale of the shares to K. D. Jalan he called upon the appellant to keep at his disposal the holding which the appellant had in its shares of the Elphinstone Mills. No controlling power was held by the appellant itself in the Elphinstone Mills and it was not in a position to procure the resignation of the Directors or to bring about the appointment of the persons of the choice of K. D. Jalan as Directors. Nor was it in a position to call upon the Managing Agents to relinquish their office. All these things were, however, possible to Mulraj Kersondas because of the influence and power which he possessed. The part taken by the appellant in the transaction with K. D. Jalan was merely a passive part viz., keeping at the disposal of Mulraj Kersondas its holding in Elphinstone Mills shares which it had held in its business as a dealer in shares. So far as the appellant is concerned, what it parted with was the shares which it held and what it received was the payment for those shares. It follows therefore that the entire sum received by the appellant from Mulraj Kersondas was the price of the shares disposed of by Mulraj Kersondas and consequently the whole of the excess over the cost price of the shares was the profit of the appellant. We accordingly hold that no part of the amount of Rs. 10,42,990/- received by the appellant from Mulraj Kersondas can be regarded as consideration for any other valuable right excepting the price of the shares sold by it.
- G The second question was therefore rightly answered by the High Court against the appellant

For the reasons expressed we hold that the judgment of the High Court is right and this appeal must be dismissed with costs.

Y.P.

Appeal dismissed.