

M/s. Ramnarain Sons (Pr.) Ltd.

Vs

Commissioner of Income Tax, Bombay

Civil Appeal No. 698 of 1957

(J.L. Kapur, M. Hidayatullah, J.C. Shah JJ)

05.12.1960

JUDGMENT

SHAH, J. -

The High Court of Judicature at Bombay answered the following two questions referred by the Income Tax Appellate Tribunal, Bench "B", Bombay, under section 66(1) of the Indian Income Tax Act, 1922 :

- (1) Whether the acquisition of the managing agency of the Dawn Mills Co., Ltd., was in the nature of a "business" carried on by the assessee company ?
- (2) If the answer to the first question is in the affirmative, whether the loss suffered by the assessee company of Rs. 1,78,438 on purchase and sale of 400 shares of the Dawn Mills Co., Ltd., being incidental to its business of acquiring the managing agency, was a loss of a revenue nature ?

as follows :

- (1) Acquisition of the managing agency was an acquisition of a capital asset;
- (2) The loss in respect of the 400 shares was of a capital nature.

Against the order of the High Court, this appeal is preferred with special leave.

The appellants are a private limited company registered under the Indian Companies Act, 1913, and carry on business as brokers, managing agents and dealers in shares and securities. One of the objects for which the appellants were incorporated was to acquire managing agencies. The appellants also carried on business in shares of different companies, and were assessed to income-tax as dealers in shares and securities.

M/s. Sassoon J. David & Co., Ltd. were the managing agents of the Dawn Mills Ltd. - a public limited company - and they held 2,507 out of a total issue of 3,200 shares. On September 28, 1946, the appellants purchased from M/s. Sassoon J. David & Co., Ltd. 1,507 shares of the Dawn Mills at the rate of Rs. 2,321-8-0 per share and having obtained a controlling voting right, acquired the managing agency rights of the Mills. The remaining one thousand shares were acquired from M/s. Sassoon J. David & Co., Ltd. by the Directors of the appellants at the rate of Rs. 1,500. At the material time, the ruling market price of the shares of the Dawn Mills was Rs. 1,610. In December, 1946, the appellants sold 400 out of the shares purchased by them, and thereby suffered a loss of Rs.

1,78,438. The loss suffered by the appellants in the year of account January 1, 1946, to December 31, 1946, by sale of shares including 400 shares of the Dawn Mills was Rs. 1,92,834. Crediting Rs. 1,05,907 earned as profit in certain other share transactions, the net loss suffered in the share transactions in the year of account amounted to Rs. 86,927. The appellants valued their shares at the end of the year of account at cost or market price whichever was lower. By this method of valuation, the books of account the appellants showed a loss of Rs. 7,97,792 which included a loss of Rs. 7,04,000 on the valuation of the Dawn Mills shares held by the appellants at the end of the year of account.

In the income-tax assessment of the year 1947-48, the appellants claimed Rs. 86,927 as loss on sales in trade in shares and Rs. 7,97,792 as loss on valuation of stock-in-trade. The Income Tax Officer, Companies' Circle III(1), Bombay, disallowed the loss suffered by the appellants in the sale of the Dawn Mills shares, because in his view those shares were purchased by way of capital investment and the loss suffered by sale thereof could not be allowed as a trading loss. He also held that the appellants were not entitled to depart from the method adopted in earlier years and to valid the closing stock of shares in the year of account at cost or market price whichever was lower and to claim the difference between the opening and closing valuation as a trading loss. The Appellate Assistant Commissioner confirmed that order. In appeal, the Income Tax Appellate Tribunal held that the managing agency of the Dawn Mills was acquired by the appellants as a part of their business activity and the shares of the Mills having been purchased in the regular course incidental to their business of acquiring the managing agency, the loss on the sale of those shares was allowable as a revenue loss; but the shares of the Dawn Mills were not the stock-in-trade of the appellants' business and they were not entitled to treat the difference between the purchase price and the value at close of the year of those shares, as a trading loss. Accordingly, the Tribunal allowed Rs. 1,78,438 as loss on sale of 400 shares of the Dawn Mills, but did not allow Rs. 7,04,000 as loss arising out of the valuation of the Dawn Mills shares at the end of the year of account. On the application of the Commissioner of Income Tax, the Tribunal referred to the High Court the questions set out hereinbefore. In the High Court, the appellants took out a notice of motion for directing the Tribunal to refer certain questions which the appellants claimed arose out of the order of the Tribunal and which the Tribunal did not refer.

The High Court agreed with the opinion of the Tribunal that the shares of the Dawn Mills were not the stock-in-trade of the appellants and that those shares were purchased by the appellants with the object of acquiring the managing agency. The High Court, however, held that the shares acquired by the appellants formed a capital asset and the loss suffered by sale of 400 out of those shares in the year of account being a capital loss, was not in the computation of income a permissible deduction. The High Court dismissed the notice of motion taken out by the appellants.

In considering whether a transaction is or is not an adventure in the nature of trade, the problem must be approached in the light of the intention of the assessee having regard to the "legal requirements which are associated with the concept of trade or business". The inference on this question raised by the Tribunal on the facts found is of mixed law and fact and is open to challenge before the High Court on a reference under section 66 of the Income Tax Act - *G. Venkataswami Naidu & Co. v. Commissioner of Income Tax* ([1959] Supp. 1 S.C.R. 646.). It was held in *The Oriental Investment Co., Ltd. v. The Commissioner of Income Tax, Bombay* ([1958] S.C.R. 49.), that the question whether the appellants' transactions amounted to dealing in shares and properties or to investment, is a mixed question of law and fact, and that the legal effect of the facts found by the Tribunal on which the assessee could be treated as a dealer or an investor, is a question of law. The Tribunal held that the shares of the Dawn Mills purchased by the appellants did not become their

stock-in-trade. But they held that the transaction having been effected in the regular course of the business of the appellants, viz., the acquisition of managing agencies, the loss resulting from the sale of shares was incidental to that business and was a revenue loss. It is not easy to appreciate the process by which this conclusion was reached. The shares were purchased for the purpose of acquiring the managing agency of the Dawn Mills; they were not purchased in the course of the appellants' business as dealers in shares. By purchasing the shares which facilitated acquisition of the managing agency, a capital asset was acquired and merely because the managing agency could be utilised for earning profit, the acquisition of the shares which led to the acquisition of the managing agency could not, in the absence of an intention to trade in those shares, be regarded as acquisition of stock-in-trade of the share business. The appellants had undoubtedly purchased the shares of the Dawn Mills with money borrowed at interest, but that circumstance by itself does not evidence an intention to trade in the shares. Nor is the fact that the appellants are dealers in shares and their Memorandum of Association authorises them to carry on business in shares of any importance in the circumstances of this case. The appellants by entering the shares of the Dawn Mills in their statement of shares in which trading transactions were carried on could not alter the real character of the acquisition. The appellants were undoubtedly dealers in shares; but the transaction in the Dawn Mills shares was ex facie not a business transaction. The current market rate at the date of purchase was Rs. 1,610 per share whereas the appellants acquired the shares at the rate of Rs. 2,321-8-0 per share. Even assuming that the appellants acquired the entire block of 2,507 shares from M/s. Sassoon J. David & Co., Ltd. - the shares transferred to the names of the directors being held by them merely as nominees of the appellants - the price per share was considerably in excess of the prevailing market rate. The only reason for entering into the transaction which could not otherwise be regarded as a prudent business transaction, was the acquisition of the managing agency. If the purpose of the acquisition of a large block of shares at a price which exceeded the current market price by a million rupees was the acquisition of the managing agency, the inference is inevitable that the intention in purchasing the shares was not to acquire them as part of the trade of the appellants in shares. The Tribunal found that the Dawn Mills' shares were acquired by the appellants for obtaining the managing agency of the Mills. The agency was acquired by virtue of the voting power which the appellants obtained having purchased a very large block of shares, and for acquiring the managing agency, the appellants did not pay any distinct consideration. The managing agency is manifestly the source of profit of the appellants; but the shares purchased and the managing agency acquired were both assets of a capital nature and did not constitute stock-in-trade of a trading venture. If the shares were acquired for obtaining control over the managing agency of the Dawn Mills, the fact that the acquisition of the shares was integrated with the acquisition of the managing agency did not affect the character of the acquisition of the shares. Subsequent disposal of some out of the shares by the appellants could also not convert what was a capital acquisition into an acquisition in the nature of trade.

The High Court was therefore right in holding that the acquisition of the managing agency was an acquisition of a capital asset and the loss incurred by sale of the 400 shares was of a capital nature. The High Court was also right in dismissing the notice of motion for an order directing the Tribunal to refer the question suggested by the appellants. If the acquisition of the shares was not acquisition of a stock-in-trade, but of a capital asset, the appellants, by valuing the shares at cost or market price whichever was lower, could not bring the difference between the purchase price and the valuation made by them into their trading account.

The appeal therefore fails and is dismissed with costs.

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