Shekhawati General Traders Ltd., Etc.

Vs

Income Tax Officer, Company Circle-1, Jaipur

Civil Appeals Nos. 2039-2040 of 1968

(K. S. Hegde, A. N. Grover JJ)

04.10.1971

JUDGMENT

GROVER, J. –

1. These appeals by certificate from a judgment of the Rajasthan High Court involve a common question relating to the computation of capital gains in respect of sale of certain shares.

2. It is necessary to refer to the facts in Civil Appeal No. 2039/68 only. The assessee is a company incorporated under the Indian Companies Act, 1956, having its registered office at Jaipur. For the assessment year 1962-63, relevant to the previous year ending March 31, 1962, the assessee filed its return before the Income-tax Officer, Company Circle No. 1, Jaipur. On March 29, 1949, the assessee had acquired 12,000 ordinary shares of the Orient Paper Mills of the face value of Rs. 10 each. On this holding it received 12,000 bonus shares on or about April 28, 1951. It again received 60,000 bonus shares on or about June 4, 1954 and further acquired 25,200 right shares on June 26, 1961. It sold 22,000 shares during the assessment year 1962-63. It is common ground that these shares which were sold were out of the 24,000 shares which it held prior to January 1, 1954. The price realized on account of the sale of 22,000 shares during the assessment year 1962-63 was Rs. 8,45,110/-. The assessee calculated the cost price of 22,000 shares sold by it at the market rate prevailing on January 1, 1954, which came to Rs. 8,63,500/-. The assessee had also acquired 15,000 ordinary shares of Birla Jute Manufacturing Company before January 1, 1954. It got 41,250 bonus shares on original holding after January 1, 1954. It further got 22,500 right shares for the nominal value of Rs. 3,60,000/-. The assessee sold 15,000 shares during the assessment year 1962-63 and the sale price realized was Rs. 4,54,130/-. The assessee calculated the cost price of 15,000 shares sold by it at the market-value prevailing on January 1, 1954, which came to Rs. 6,45,000/-. Thus according to the assessee the cost of acquisition of the said shares in the two companies came to Rs. 15,09,400/- while they were sold for Rs. 12,09,240/- and thereby the assessee suffered a capital loss of Rs. 2,10,160/-. The assessee filed a statement giving all these details. From that statement it was clear that the 22,000 shares of the Orient Paper Mills and the 15,000 shares of the Birla Jute Mfg. Co. which were sold during the assessment year 1962-63, were those which it had acquired or received by way of bonus shares prior to January 1, 1954.

3. The Income-tax Officer by his assessment order, dated July 20, 1964, accepted the statement furnished by the assessee and held that it had suffered a capital loss of Rs. 2,10,160/- which was directed to be carried forward. By means of a notice, dated January 4, 1967, the Income-tax Officer informed the assessee that he had reasons to believe that income chargeable to tax for the assessment year 1962-63, had escaped assessment within the meaning of Section 147 of the Income-tax Act, 1961, hereinafter called the "Act". This notice was accompanied by a letter in which it was stated :

> "While working out the cost you claimed the prevalent market price as on January 1, 1954, in complete disregard of the fact that the same shares had been given bonus shares in the subsequent years after January 1, 1954". The Supreme Court had laid down in the case of Dalmia Cement, (1964) 52 ITR 567, that while working out the capital gains the cost has to be worked out by averaging cost of the original shares amongst the original shares, and bonus shares taken together. Your claim of the cost, therefore, was incorrect. By following erroneous method you claimed and were allowed loss of Rs. 2,10,160/- in assessment year 1962-63 and Rs. 45,176/- in assessment year 1964-65. Against this the cost in assessment year 1962-63 would come much less and instead of capital losses a figure of capital gain will get computed".

The assessee sent a letter, dated February 9, 1967, to the Income-tax Officer saying that it had exercised its option under Section 55(2) of the Act and in accordance therewith the cost of acquisition of the ordinary shares of the two companies which has been acquired and held by the assessee long before January 1, 1954, was taken at the fair market-value as on that date and the capital loss was computed accordingly. It was pointed out that the judgment of the Supreme Court referred to in the letter of the Income-tax Officer had no relevance in the present case and that the notice which had been issued under Section 147 of the Act was illegal and without jurisdiction. Subsequently the assessee filed a petition in the High Court under Article 226 of the Constitution challenging the legality and validity of the notice issued under Section 147 of the Act.

4. The High Court was of the view that since the acquisition of bonus and right shares acquired by the assessee on the original holding had not been shown in the income-tax return it could be said that the Income-tax Officer had reason to believe that the income chargeable to tax had escaped assessment by reason of the omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for its assessment. It was contended on behalf of the assessee before the High Court that it was altogether unnecessary for the assessee to have shown the acquisition of bonus shares in the return filed by it of the determination of the cost of acquisition of the shares held by it and therefore the notice issued by the Income-tax Officer was without jurisdiction. G. M. Mehta, J., disposed of the matter by saying, "prima facie it cannot be said that the Income-tax Officer had no reason to believe that there was an escapement of assessment on account of omission or failure on the part of the assessee to disclose fully or truly all material fact necessary for the assessment for the years 1962-63 .... requiring notice under Section 148 of the Income-tax Act. The other learned judge D. M. Bhandari, J., wrote a separate judgment expressing the opinion that the case of the assessee was covered by Section 147(a) and that it did not fall within Section 147(b) of the Act. The writ petition was dismissed.

5. It is somewhat unfortunate that the real points which arose for determination in the present case did not engage the attention of the learned judges of the High Court. Section 45 of the Act provides that any profits and gains arising from the transfer of a capital asset affected in the previous year shall, save as otherwise provided in Sections 53 and 54 be chargeable to income-tax under the head "Capital gains" and shall be deemed to be the income of the previous year in which the transfer took place. Section 48 deals with the mode of computation and deductions. It says that income chargeable under the head "Capital gains" shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset following amounts, namely : (i) expenditure incurred wholly and exclusively in connection with such transfer, and (ii) the cost of acquisition of the capital asset and the cost of any improvement thereof. The meaning of the cost of acquisition is explained by Section 55(2) and for our purpose that sub-section with clause

(i) need by reproduced :

> "Section 55(2). - For the purposes of Sections 48 and 49, 'cost of acquisition', in relation to a capital asset, -
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> (i) where the capital asset became the property of the assessee before the 1st day of January 1954, means the cost of acquisition of the asset to the assessee or the fair market-value of the asset on the 1st day of January, 1954, at the option of the assessee;
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> #(ii) ...."##

The assessee had exercised the option of the fair market value of the assets. The shares which had been sold by it of both the companies had indisputably become its property before the first day of January, 1954. Therefore all that had to be determined was the fair market-value on the first day of January, 1954 of those shares. This was duly determined and it was not disputed that determination was not made according to the rates prevailing in the market on the aforesaid date by the Income-tax Officer when he made his assessment order on July 20, 1964. Once the market-value of the share was ascertained or determined on the date given in clause (i) of Section 55(2) that would be the cost of acquisition in relation to capital assets. Up to this point there is no controversy between the Revenue and the assessee but on behalf of the Revenue an almost startling position has been advanced that while determining the fair market-value on January 1, 1954, the issuance of bonus or right shares after that date on the basis of the holding of the assessee prior to January 1, 1954 should have been taken into account. In other words as was explained in the letter of the Income-tax Officer, dated January 4, 1967, while working out the capital gains the cost had to be worked out by averaging the cost of the original shares amongst the original shares and the bonus shares taken together. Thus, according to the Revenue, after the issue of bonus shares the cost of the original holding had to be spread over all the shares inclusive of the bonus or the right shares acquired on the original holding. Support for this view appears to have been found in the decision of this Court in Commissioner of Income-tax, Bihar v. Dalmia Investment Co. Ltd. (52 ITR 567)

6. The question which had to be decided in the above case was entirely of a different nature. The assessee there held ordinary shares in Rohtas Industries Ltd., apart from holding shares by way of investment and also as stock-in-trade of its business as a share dealer. In 1944 the assessee acquired 31,909 of these shares and was holding them in January, 1945. In that month the Rohtas Industries Ltd., distributed bonus shares at the rate of one ordinary share for each original share. So the assessee got 31,909 bonus shares. Between that time and December 31, 1947, the assessee sold 14,650 of the original shares. The assessee acquired some newly issued shares in the years 1945 and 1947. The total holding of the assessee on January 1, 1948 came to 1,10,747 shares which in its book had been valued at Rs. 15,57,902/-. In arriving at this figure the assessee had valued the bonus shares at the face value of Rs. 10/- each and the other shares at the actual cost. On January 29, 1948, the assessee sold all these shares for the total sum of Rs. 15,50,458/- and in its return for the year 1949-50 claimed a loss of Rs. 7,444/- on the sale. It was held by the majority that the bonus shares had to be valued by spreading the cost of the old shares over the old shares and the bonus shares taken together if they ranked pari passu and if they did not the price might have to be adjusted either in proportion of the face value they bore or on equitable consideration based on the market price before and after issue. We have set out the facts of this case in detail in order to demonstrate that decision was not at all apposite for the purpose or deciding the point which has arisen in the present case. No question arose there of the calculation of the capital gain or loss in accordance with the

statutory provisions in pari materia with Sections 48 and 55(2) of the Act. In the present case we are confined to the express provisions of Section 55(2) relating to the manner in which the cost of acquisition of a capital asset has to be determined for the purpose of Section 48. Where the capital asset became the property of the assessee before the first day of January, 1954, the assessee has two options. It can decide whether it wishes to take the cost of the acquisition of the asset to it as the cost of acquisition for the purpose of Section 48 or the fair market-value of the asset on the first day of January, 1954. The word "fair" appears to have been used to indicate that any artificially inflated value is not to be taken into account. In the present case it is common ground that when the original assessment order was made the fair market-value of the shares in question had been duly determined and accepted as correct by the Income-tax Officer. Under no principle or authority can anything more be read into the provisions of Section 55 (2)(i) in the manner suggested by the Revenue based on the view expressed in the Dalmia Investment Co.'s case (supra). The High Court completely overlooked the fact that for the ascertainment of the fair market-value of the shares in question on January 1, 1954, any event prior or subsequent to the said date was wholly extraneous and irrelevant and could not be taken into consideration. If the contention of the Revenue were to be accepted the acquisition of bonus shares subsequent to January 1, 1954, will have to be taken into account which on the language of the statute it is not possible to do. On this view of the matter there was no question of the case of the assessee falling within clauses (a) or (b) of Section 147 of the Act. The assessee is bound to disclose under clause (a) only such material facts which are necessary for its assessment for the assessment year and not those facts which are irrelevant and extraneous for the purpose of assessment. As regard clause (b) also the information must be such as should lead the Income-tax Officer to believe that income chargeable to tax has escaped assessment. The information, in the present case, relating to the acquisition of the bonus shares subsequent to January 1, 1954, could possibly furnish no reason to the Income-tax Officer to form the belief that income chargeable to tax had escaped assessment for the assessment year in question.

7. For the reasons given above the appeals are allowed and the judgment of the High Court is set aside. The impugned notice issued to the assessee in each case shall stand quashed. The assessee shall be entitled to its costs in this Court. Hearing fee, one set.

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