The Commissioner of Income-Tax, Nagpur

Vs

M/s. Sutlej Cotton Mills Supply Agency Ltd.

Civil Appeal No. 1877 of 1970

(CJI A. N. Ray, K. K. Mathew, Syed Faza Ali, V. R. Krishna Iyer JJ)

25.07.1975

JUDGMENT

MATHEW, J. –

1. This is an appeal from the judgment of the High Court of Madhya Pradesh in a reference made at the instance of the assessee M/s. Sutlej Cotton Mills Supply Agency Ltd. (hereinafter referred to as the 'assessee') by the Income-Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') under Section 66(1) of the Indian Income-tax Act. The question referred was :

> Whether the inference of the Tribunal that the profit of Rs. 2,13,150 arising from the sale of 1,58,200 shares of the Gwalior Rayon Silk Manufacturing (weaving) Co. Ltd., is assessable as business profit is correct ?

2. When the reference came up for hearing before the High Court, the High Court found that although the Tribunal was of the view that the question referred was a mixed question of law and fact, it had not stated all the facts and circumstances on which it based its conclusion that the profit of Rs. 2,13,150 was a business profit and so the Court called for a supplementary statement of the case and a supplementary statement of the case was submitted to the Court by the Tribunal.

3. The material facts in the statement of the case were as follows. The assessee is a public limited company and it is controlled by the Birlas. The assessee applied for certain shares of the Gwalior Rayon Silk Manufacturing (Weaving) Company Limited (hereinafter referred to as the "Rayon Company"), also a company controlled by the Birlas. This company was floated on August 25, 1947 with a paid-up capital of Rs. 5 lakhs made up of 50,000 ordinary shares or Rs. 10 each. In the year ending December 31, 1951, the Rayon Company issued certain new shares for paid-up capital of Rs. 1,17,25,000 made up as follows :

> # Rs.7,60,000 Ordinary shares of Rs. 10 each fully paid up. 76,00,0001,50,000 Ordinary shares of Rs. 10 each with paid up at Rs. 2/8/- each. 3,75,0001,50,000 6% preference shares of Rs. 100 each paid up at Rs. 25 each (redeemable at par at the company's option after a specified date by giving one year's notice). 37,50,000##

4. The assessee which was interested in the Rayon Company and which had already purchased 1,000 ordinary shares, subscribed for 3,49,000 shares of the new issue and paid Rs. 8,71,500 as application money on February 25 and 27, 1951, and paid Rs. 26,17,500 as final call money on August 10, 1951. These purchases were authorised by a resolution of the assessee dated February 7, 1951. The assessee sold a part of its stock viz., 1,58,200 shares at a profit of Rs. 2,13,150.

5. For the assessment year 1956-57 (accounting year ending on March 31, 1956), the Income-Tax Officer sought to assess the amount on the basis that it was profit accruing to the assessee from an adventure in the nature of business. The assessee contended that the amount represented capital gain as the shares were purchased by way of investment and that the same cannot be taxed as revenue receipt. The Income-Tax Officer rejected the contention. The assessee field in appeal before the Appellate Assistant Commissioner. He confirmed the order. The assessee then went up in appeal before the Appellate Tribunal.

6. The Tribunal came to the conclusion, after considering all the circumstances, that the transaction was in the nature of a business adventure and that profits were liable to be taxed. The reasons which induced the Tribunal to come to this conclusion were : The assessee was authorised by Clauses 12, 13, 28 and 29 of paragraph 3 of its Memorandum of Association to buy and sell shares; there were specific resolutions of the company authorising a director of the assessee to purchase and sell these shares; the assessee had included the profit or Rs. 2,13,150 in the profit and loss account without taking it to any reserve account or specifically set it apart for any other purpose; the assessee had purchased the share from borrowed funds and not with money readily available to it; the assessee did not make the sales on account of any pressing necessity to meet existing liabilities but had in fact kept a part of the sale-proceeds as liquid cash in the United Commercial Bank Ltd.; the assessee had, in the past, dealt in shares as business transaction and had claimed for the assessment year 1951-52 Rs. 1,29,214 as loss on account of its dealing in shares of M/s. Titagarh Paper Mills Ltd.; it also claimed Rs. 6,30,000 as loss on account of devaluation of the shares of M/s. Pilani Investment Corporation though that was not allowed; there had recently grown a business practice of investing large sums of money in shares in new ventures with an eye on their appreciation for obtaining by sale substantial profits in future.

7. The High Court, in its judgment, said that there was no provision in Clauses 10, 12, 13, 28 and 29 of paragraph 3 of Memorandum of Association of the assessee which authorised the carrying on of the business of purchasing and selling shares, although some of these clauses did authorise the assessee to acquire and sell shares in other similar companies; that the inclusion of the profits of Rs. 2,13,150 in the profit and loss account without taking it into any reserve specifically was not conclusive of the question whether it was a capital asset or a revenue receipt; that the true nature and character of the money received was to be determined not by the manner in which the assessee treated it but by its inherent character, and, that it was wholly immaterial as to how the assessee treated the amount in question; and that there was no evidence that the shares were purchased out of borrowed funds as the assessee had a fixed deposit of Rs. 31,75,000 in the United Commercial Bank Ltd. and a deposit of Rs. 8,76,008-2-0 in the current account of the bank. The High Court was of the view that the finding of the Tribunal that the sale of shares in 1955 was made not on account of any pressing necessity to meet existing liabilities was based on materials placed before the Tribunal. The Court however, said :

> It may be that, at that time, the liabilities of the assessee company existed, but it is quite another matter to say that it was obliged to sell the shares in order to meet those libilities.

The High Court was also of the view that the conclusion of the Tribunal that the assessee had claimed Rs. 1,29,214 as loss on account of dealing in shares of M/s. Titagarh Paper Mills Ltd. for the assessment year 1951-52 and that the claim was allowed by the Income-Tax Officer must be accepted as correct, but said that this solitary transaction cannot be taken as conclusive of the fact that the sale of shares in question here was an adventure in the nature of trade. The main reason

which impelled the High Court to hold that the transaction was not an adventure in the nature of trade was that the dominant intention of the assessee in acquiring the shares was to boost the shares of a sister concern viz., the Rayon Company, and thus render it assistance for setting it up as a going concern and when that was accomplished, the assessee started selling the investment which had in the meantime enhanced in value.

8. The question which the Tribunal had to consider in the appeal and which was referred to the High Court was a mixed question of law and fact, namely, whether the profit from sale of the shares in question was a revenue or a capital receipt. The distinction between capital accretion and income has been explained by Rowlatt, J. in Thew v. South West Africa Co. Ltd. ((1924) 9 TC 141) The learned Judge said that for the purpose of ascertaining whether profits made upon a sale of an article acquired for the purpose of trade". If it is, the profit arising from its sale must be brought into revenue account and that the profit is chargeable as capital gains if the sale is of a capital asset, and as business profit if the sale is in the course of business or the transaction constitutes an adventure in the nature of trade. The line between capital sales and sales producing income has been drawn by Lord Justice Clerk in Californian Copper Syndicate v. Harris ((1905) 5 TC 159) in a passage which has become classical :

> 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 it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit . . . 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 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 . . . What is the line which separates the two classes of cases may be difficult to difine, 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 ?

9. In the absence of any evidence of trading activity in cases of purchase and resale of shares, it has been held that profit arising from the resale is an accretion to the capital. If a transaction is in the assessee's ordinary line of business there can be no difficulty in holding that it is in the nature of trade. But the difficulty arises where the transaction is outside the assessee's line of business and then, it must depend upon the fact and circumstances of each case whether the transaction is in the nature of a trade.

10. It is not necessary to constitute trade that there should be a series of transaction, both of purchase and of sale. A single transaction of purchase and sale outside the assessee's line of business may constitute an adventure in the nature of trade. Neither repetition nor continuity of similar transaction is necessary to constitute a transaction an adventure in the nature of trade. If there us repetition and continuity, the assessee would be carrying on a business and the question whether the activity is an adventure in the nature of trade can hardly arise. A transaction may be regarded as isolated although a similar transaction may have taken place a fairly long time before. (see I. R. v. Reinhold ((1953) 34 TC 389, 392)

11. The principles underlying the distinction between a capital sale and an adventure in the nature of trade were examined by this Court in Venkataswami Naidu & Co. v. C. I. T. ((1959) 35 ITR 594 : 1959 Supp 1 SCR 646 : AIR 1959 SC 359), where this Court said that the character of a transaction

cannot be determined solely on the application of any abstract rule, principle or test but must depend upon all the facts and circumstances of the case. Ultimately, it is a matter of first impression with Court whether a particular transaction is in the nature of trade or not. It has been said that a single plunge may be enough provided it is shown to the satisfaction of the Court that the plunge is made in the waters of the trade; but mere purchase sale of shares - if that is all that is involved in the plunge - may fall short of anything in the nature of trade. Whether it is in the nature of trade will depend on the facts and circumstances.

12. Where the purchase of any active or of any capital investment, for instance, share, is made without the intention to resell at a profit, a resale under changed circumstances would only be a realisation of capital and would not stamp the transaction with a business character (see C. I. T. v. P. K. N. Co. Ltd. ((1946) 60 ITR 65 (SC) : AIR 1966 SC 1256)).

13. Where a purchase is made with the intention of resale, it depends upon the conduct of the assessee and the circumstances of the case whether the venture is on capital account or in the nature of trade. A transaction is not necessarily in the nature of trade because the purchase was made with the intention of resale (see Jenkinson v. Freedland ((1961) 39 TC 636 (CA)); Radha Debi Jalan v. C. I. T. ((1951) 20 ITR 176 (Cal)); India Nut Co. Ltd. v. C. I. T. ((1960) 39 ITR 234 (Ker). Mrs. Sooniram Poddar v. C. I. T. ((1939) 7 ITR 470, 478-9 (Rang)); Ajax Products Ltd. v. C. I. T. ((1961) 43 ITR 297, 310 (Mad); Gustan Irani v. C. I. T. ((1957) 31 ITR 92 (Bom); and Mrs. Alexander v. C. I. T. ((1952) 22 ITR 379,402 (Mad)).

14. A capital investment and resale, do to lose their capital nature merely because the resale was foreseen and contemplated when the investment was made and the possibility of enhanced values motivated the investment (see Leeming v. Jones ((1930) 15 TC 333) and also the decisions of this Court in Saroj Kumar Mazumdar v. C. I. T. (and Janki Ram Bahadur Ram v. C. I. T. ((1965) 57 ITR 21 : (1953) 3 SCR 604 : AIR 1965 SC 1898)).

15. In I. R. v. Fraser ((1942) 24 TC 498,502), Lord Norman said :

> The individual who enters into a purchase of an article or commodity may have in view the resale of it at a profit, and yet, it may be that is not the only purpose for which he purchased the article or the commodity, nor the only purpose to which he might turn it if favourable opportunity for sale does not occur. An amateur may purchase a picture with a view to its resale at a profit, and yet he may recognise at the time or afterwards that the possession of the picture will give him aesthetic enjoyment if he is unable ultimately, or at his chosen time, to realise it at a profit. . . .

16. An accretion to capital does not become income merely because the original capital was invested in the hope and expectation that it would rise in value; if it does so rise, its realisation does not make it income. Lord Dunedin said in Leeming v. Jones (supra) at p. 360 :

> The fact that a man does not mean to hold an investment may be an item of evidence tending to show whether he is carrying on a trade or a concern in a nature of trade in respect of his investment, but per se it leads to no conclusion whatever.

This Court laid down in Venktaswami Naidu & Co. v. C. I. T. (Supra Note 4, pp. 610, 622) that the dominant or even sole intention to resell is a relevant factor and raises a strong presumption, but by itself is not conclusive proof, of an adventure in the nature of trade.

17. The intention to resell would, in conjunction with the conduct of the assessee and other circumstances, point to the business character of the transaction.

18. In the light of the principles above referred to, it is necessary to examine whether the Tribunal and approached the question from the right perspective, whether on the basis of its finding on questions of fact, the inference that the transaction was an adventure in the nature of trade was justified.

19. The Tribunal relied on the following circumstances for coming to the conclusion. The assessee has been dealing in shares from 1951 to 1953. For the assessee year 1951-52, the assessee claimed a sum of Rs. 1,29,214 which was shown in the profit and loss account and balance-sheet of the company for the year ending March 31, 1951 as a loss in the dealing of shares of M/s. Titagarh Paper Mills Ltd. This claim was allowed by the Income Tax Officer. According to the Tribunal, this would show that the assessee had been buying and selling shares even though as an isolated adventure in to nature of business. The High Court has not upset this finding, but has only said that this is an isolated transaction. That apart, in the same year, a sum of Rs. 6,30,000 was debited to the profit and loss account on devaluation of the shares of M/s. Pilani Investment Corporation. Such a debit was permissible only on the footing that the shares constituted the stock in trade of the assessee. It is no doubt true that the department did not allow this claim. But that was on the basis that the shares have fallen in value was not proved to the satisfaction of the Income-Tax Officer, and not on the basis that the shares were not held as stock in trade as the High Court wrongly thought. The Tribunal also referred to the resolution passed by the assessee authorising one of its directors to purchases and sell the shares in the Rayon Company. The finding of the High Court that the Clauses of the Memorandum of Association, viz., Clauses 10, 12, 13, 28 and 29 do not authorise the company to acquire and sell shares as business has no relevance in view of the aforesaid resolution of the assessee and of the fact that it had been dealing in shares in a commercial spirit as is evident from its claim for loss in dealings in the shares of M/s. Titagarh Paper Mills Ltd. and devaluation of shares of M/s. Plani Investment Corporation on the basis that they had fallen in value.

20. Secondly, the Tribunal said that from 1947 to 1956, no dividend had been by the Rayon Company and that the money which went into the purchase of these shares was borrowed by the assessee. In other words, the view of the Tribunal was, it was with borrowed funds that the assessee purchased the shares. It is no doubt true that there was no evidence to show that the money was specifically borrowed for the purpose of buying shares. But there was evidence before the Tribunal for its finding that the abilities of the assessee exceeded its assets. The finding, therefore, that the shares were purchased with borrowed funds on which the assessee was paying interest, was a finding supported by evidence. The reasoning of the Tribunal that it is most improbable that the assessee would be investing borrowed money on which interest would have to be paid in shares which yielded no dividend, was correct. We cannot say that this was not a relevant circumstance for the Tribunal to take into consideration for coming to the conclusion that the transaction was an adventure in the nature of business. Looking into all the circumstances, the Tribunal negatived the case of the assessee that it had invested its funds with a view to earn dividend.

21. The case of the assessee throughout was that the purchase of the shares was by way of investment and the sale was forced by necessity because the creditors were pressing for repayment of the loan. The Tribunal found that the shares were not sold to liquidate the debts of the assessee as the balance-sheet as on March 31, 1956 showed that the proceeds were kept as liquid cash in the United Commercial Bank Ltd.

22. As already stated, the main reason why the High Court came to a different conclusion, is stated as follows in the judgment :

> . . . . Undoubtedly, there are some elements which are contra-indicative of investment but there are other considerations which detract from their value as elements indicating an adventure in the nature of trade, the main being, that the assessee company, which is controlled by the Birlas, purchased the shares with a view to assisting a sister company controlled by the same persons, and not to embark upon a venture in the nature of trade.

23. At no time had the assessee a case that the shares were purchased with a view to help a sister company controlled by the Birlas. No such case was set up by the assessee either before the Income-Tax Officer or the Appellate Assistant Commissioner; nor as it urged before the Appellate Tribunal. Nowhere in the Statement of case or the supplementary, statement of case prepared by the Tribunal and filed in the High Court was there any finding on the question. The whole conclusion of the High Court based on unwarranted assumption of facts which must have been taken from the argument of the assessee before the High Court. The danger of failing to recognize that the jurisdiction of the High Court in these matters is only advisory and that conclusion of facts are conclusions on which High Court is to exercise the advisory jurisdiction is illustrated by this case.

24. Mr. Chagla for the respondent contended that the only question to be asked and answer is : What was the dominant intention of the assessee when it purchased the shares ? If the document intention was to carry on an adventure in the nature of business, the profit can be taxed : otherwise not. In other words, the question is whether the assessee purchased the shares in a commercial spirit with a view to make profit by trading in them. The Tribunal found, after taking into account all the relevant circumstances that the dominant intention of the assessee was to make profit by resale of the shares and not to make an investment.

25. The finding that loss or profit is a trading loss or profit is primarily a finding of fact, though in reaching that finding the Tribunal has to apply the correct test laid down by law. When we see that the Tribunal has considered the evidence on record and applied the correct test, there is no scope for interference with the finding of the Tribunal (see C. I. T. v. Ashoka Marketing Co. ((1972) 83 ITR 439 : (1972) 4 SCC 426 : 1974 SCC (Tax) 158)).

26. We do not think that the High Court was right in interfering with the judgment of the Tribunal. In the result we reverse the judgment of the High Court and allow the appeal with costs.

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