

(1951) 06 P&H CK 0025
In the Punjab And Haryana At Chandigarh
In Re: Kishan Parshad and Co. Ltd.

Date of Decision : 18-06-1951

Acts Referred:

Income Tax Act, 1961 — Section 3, 66(1)

Citation : (1952) 21 ITR 303

Hon'ble Judges : Weston, C.J;Falshaw, J

Bench : Full Bench

Judgement

Weston, C.J.—This is a reference u/s 66(1) of the Income Tax Act made by the Income Tax Appellate Tribunal Allahabad Bench. The questions of law as formulated by the Tribunal are these:

(1) Whether on a proper construction of the relevant clauses of the applicant company's Memorandum of Association and Article of Association and on a consideration of the circumstances in which the shares of Sarswati Sugar Syndicate were purchased and sold, it could be held that the purchase and sale of such shares was part of applicant company's business activities and was a business deal?

(2) Whether in the circumstances of the case, the excess of Rs. 20,000 realised in the assessment year 1942-43 and Rs. 2,26,701 in the year 1944-45 was a revenue receipt chargeable to tax u/s 3 of the Income Tax, Act and was not mere appreciation of capital.

2. The facts which have given rise to the reference are these. The assessee is a public limited company incorporated in the year 1917 with the following objects:

(a) To undertake and carry on the general business and trade of commission agents, insurance agents, commercial agents, export and import agents, clearing and forwarding or house and land agents, bankers and merchants of every description or any other work calculated directly or indirectly, to benefit the company ; to raise or take up or advance moneys on loan, deposit, debentures, securities or otherwise, and to deal in money, notes, bills, hundies and other securities.

(b) To take on lease, trust or in exchange and otherwise acquire lands, buildings, machinery, manufactures and other property ;

(c) To encourage, originate, finance or undertake the management of commercial and industrial undertakings, and to help or to support any charitable educational or public objects and institutions; and

(d) To generally do and perform all such acts and things as may be necessary, incidental or conducive to the attainment of the above and to do any other work or business of any other nature or description the company may decide to do.

3. The initial capital of the company was five lacs. It appears that the company began business and has been doing business but the exact nature of the business done is not apparent from the balance-sheet filed. In the year 1933 another public limited company was incorporated by name the Sarswati Sugar Syndicate Limited. Under the Articles of Association of the assessee company the directors had powers inter alia to do all such things and acts necessary for carrying on the Objects of the company as defined in the Memorandum of Association of the company which I have set out earlier. Lala Kishan Prasad, a director of the assessee company, entered into negotiations with the Sarswati Sugar Syndicate Limited and the following terms were agreed to in March, 1933, by Lala Kishan Prasad on behalf of the assessee company on the one part and the Sarswati Sugar Syndicate Limited on the other part:

(a) That the assessee company should invest five lacs of rupees in the Sarswati Sugar Syndicate Limited ;

(b) That the assessee company would be given the managing agency of the third mill of the Sarswati Sugar Syndicate Limited, when that third mill would be erected, on the same terms as given by the, Sarswati Sugar Syndicate Limited to their other managing agents;

(c) That of the five lacs invested by the assessee company in the Sarswati Sugar Syndicate Limited one lac was considered as shares taken on account of the offer of managing agency.

(This term it appears was inserted in view of the Articles of Association of the Sarswati Sugar Syndicate Limited which required managing agents to hold shares to the value of one lac of rupees.)

(d) That the investment of five lacs by the assessee company was conditional on the Sarswati Sugar Syndicate Limited receiving other applications for shares to the amount of at least seven lacs;

(e) That the third mill was to be erected, if possible, in the year 1983. If it was not so erected the assessee company was to be paid Rs. 15,000 as commission on the shares taken by them.

4. These terms were later modified to this extent that the assessee company was to subscribe only for shares to the extent of three of rupees, but undertook to

sell shares to the amount of further lacs of rupees. The assessee company took up shares in the Saraswati Sugar Syndicate Limited to the value of three lacs of rupees, and would appear, performed their other obligations under the agreement. The third mill was not erected by the Sarswati Sugar Syndicate Limited within the year and the Syndicate paid to the assessee company Rs. 15,000 as commission in accordance with the terms of the agreement. Lala Kishan Prasad was made a director of the Sarswati Sugar Syndicate Limited but died in the year 1940. The assessee company desired that another of their directors should be made a director of the Sarswati Sugar Syndicate Limited, but negotiations fell through and the assessee company then decided to sever all connection with the Sarswati Sugar Syndicate Limited and to realise their share. In May, 1941, they sold two thousand of their shares in the syndicate and realised an amount of Rs. 2,000 in excess of what they had originally paid for the shares. The remaining one thousand shares held by the assessee company in the syndicate were not sold until the year 1943. A suit had been filed by a person who claimed to have entered into a contract with the assessee company to buy their shares and an injunction had been issued by the Court restraining the assessee company from selling their remaining shares. When the injunction was discharged in the year 1943 the shares of the syndicate had greatly appreciated and the amount realised for the one thousand shares exceeded the price originally paid for them by no less than Rs. 2,26,700. The question which has given rise to this reference is whether the two amounts of excess realisation, namely Rs. 20,000 and Rs. 2,26,700, were liable to Income Tax. The Income Tax Officer held that these amounts were so liable and his decision was confirmed in appeal by the Appellate Assistant Commissioner and again by the Income Tax Appellate Tribunal. On application by the assessee company the Tribunal has made the reference to us in the terms already set out.

5. Section 3 of the Income Tax Act is the charging section and Section 4 of the Act provides that the total income of any previous year of any person, which is the income liable to tax u/s 3, includes all income, profits and gains from whatever source derived, subject to certain matters of residence and place of accrual which are not material in the present case. Sub-section (3) of Section 4 however exempts from inclusion in total income any income, profits or gains falling within certain clauses. The only one of those clauses which is relevant to the present matter is Clause (vii) which clause reads as follows:

(vii) Any receipts not being capital gains chargeable according to the provisions of Section 12B and not being receipts arising from business or the exercise of a profession, vocation or occupation, which a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee.

6. Section 12B is a special section making chargeable to tax capital arising from the sale, exchange or transfer of a capital asset effected after the 31st day of March, 1946, and before the 1st day of April 1948. This has no application to the present matter. The claim of the assessee company to exemption from tax of the

two amounts of Rs. 20,000 and Rs. 2,26,700 rests on their assertion that these were not receipts arising from business and were of a casual and non-recurring nature. That these two receipts were of a casual and non-recurring nature does not appear to have been disputed by the Department at any stage and is not disputed before us. I think therefore the question of law which can arise before us on the facts of this case can be simply stated as:

Whether there was material upon which the Income Tax Officer was entitled to hold that the two receipts were arising from the business of the assessee company ?

7. A large number of authorities have been cited before us. Mr. Bajaj for the assessee company has endeavoured to make out a case that, as the assessee company had consistently shown in their balance sheets the shares held by them in the Sarswati Sugar Syndicate Limited under the heading "Investments " and no question to this had been raised previously by the Income Tax authorities, the latter were bound to recognise the transaction as what it had always been shown and admitted to be. Against this argument of estoppel a similar argument could well be raised by the Income Tax Department, for in the two balance sheets of the material years the two amounts of Rs. 20,000 and Rs. 2,26,700 appear as " profits on sale of shares". I think, however, the question falls to be decided on the true nature of the two receipts and not on any statements made in balance sheets by the assessee company.

8. Mr. Baja relies very strongly upon a decision of the Privy Council, Commissioner of Income Tax, C.P. and U.P. v. Motiram Nandram [1940] 8 ITR 132. That was a case of a Hindu undivided family and not a company. The assessee carried on business in cloth, yarn and money-lending. In the year 1930 they made a deposit with a limited company of Rs. 50,000 in consideration of an agreement by which inter alia the assessee were appointed organising agents of the company for five years for a particular area. They were to recommend selling agents to the company but sales were to be conducted entirely by the company and the selling agents. The assessee were to receive commission on all goods sold by the selling agents within the area and on sales of oil made by the company within the area. The deposit was to remain with the company and was to carry interest at seven per cent. The assessee were entitled to recoup this deposit from deposits made with them by the selling agents. The assessee recovered part of their deposit but the company went into liquidation. The assessee obtained a decree against the company in respect of the balance of their deposit for an amount of Rs. 39,500 and they claimed in the year 1932 that this amount should be deducted from their other income as a loss in business. This was a case therefore u/s 10(2)(ix) of the Income Tax Act which provides that in computing the profits or gains of the business allowance should be made for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of earning such profits or gains. The judgment of the Board was delivered by Sir George Rankin and the material part of the

judgment reads:

The Rs. 50,000 was doubtless laid out with a view to earning profits in the business of organising agents in addition to the interest of 7 per cent., but it was not so laid out with reference to any particular transaction carried out in the course of such business. It was in one aspect a loan made to the company, but it was not a loan made in the course of carrying on the business of organising agents or in the course of the business of a money-lender. It was not a recurring expenditure. On the other hand, it was contemplated that in whole or in part the deposit should be returned to the assesseees by the receipt of deposit from selling agents; so that if the Rs. 50,000 does fall to be regarded as invested in a business of organising agents, it was invested with a prospect that it might be a temporal investment and not a permanent one--in other words that the capital might later be withdrawn from the business. The question in such a case as the present must be "what is the object of the expenditure ?" and it must be answered from the standpoint of the assesseees at the time they made it--that is, when they were embarking upon the business of organising agents for the company. The deposit was clearly acted by the company as a condition of the assesseees being given agency which they hoped to manage profitably. Their Lordships think that the purpose of being permitted to engage in such a business must be considered to be a purpose of securing an enduring benefit of a capital nature, and that the deposit cannot, upon a true view of the terms of the agreement and the circumstances of the case, be regarded as an expenditure made in the course of carrying on an existing agency, or any other business.

9. From this passage it would appear that some stress at least was laid on the circumstance that this adventure was something entirely outside the ordinary business of the assesseees. In the present instance there is no difficulty at all in placing the transaction between the assessee company and the Sarswati Sugar Syndicate Limited within the objects of the assessee company as set out in their Memorandum of Association although as I have mentioned earlier the exact nature of other business done by the assessee company does not clearly appear from the record before us. Some argument was advanced before us that the word " securities " appearing in the first of the objects of the company would not include shares. The word "securities" must, be taken in its general meaning. The decision in *W.M.G. Singer v. A.W. Williams* (1920) 7 Tax Cas 419 is a decision relating to the interpretation of the word "securities " appearing in Schedule D. It is true Lord Justice Scrutton said:

The word "securities" seems to me quite inappropriate and inaccurate to describe shares in companies. Shares in companies and the income therefrom are not secured on anything. The share is a part of the capital--not a security.

10. But the word " securities " in the context of Schedule D is quite another matter to the same word as understood in ordinary parlance or as appearing in the Memorandum of Association of an Ambala company. The point, however, is not of great importance. I should not be disposed to place the adventure made

by the assessee company in connection with the Sarswati Sugar Syndicate Limited as one of dealing in shares. The obvious intention and purpose of the adventure was to obtain the managing agency of a sugar mill and also it would appear a directorship in the Sarswati Syndicate Limited. This object clearly falls within object (c) of the four objects I have set out, "to undertake the management of a commercial undertaking." a suggestion has been made that it was only necessary for the assessee company to take up shares to the amount of one lac of rupees in the Sarswati Sugar Syndicate Limited to qualify the assessee company as a managing agent. But I think there can be no doubt that the taking up of shares to the amount of three lacs was an essential part of the arrangement arrived at and there is no question of placing shares to the amount of two lacs of rupees outside the agreement. I think therefore that the true nature of the transaction was not one of investment but of acquisition by the assessee company of the managing agency of a commercial undertaking. It was an adventure contemplated by the Memorandum of Association of the assessee company and under these circumstances whether the adventure was the first of its kind does not seem to be material.

11. The dictum of Lord Justice Clerk in *Californian Copper Syndicate v. Harris* (1904) 5 Tax Cas 159, at p. 165, has often been quoted and may be repeated:

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 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 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 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.

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?

12. It is perfectly true that the gain made by the present assessee company may well not have been contemplated at the time the assessee company entered into the agreement with the Sarswati Sugar Syndicate Limited. As I think, the agreement was entered into with the object and hope of making gain from the managing agency, the acquisition of which was the object of the agreement. It is

not necessary that, in order to be taxable, the profit from an adventure in business must come from an anticipated source, In *Imperial Tobacco Co. Ltd. v. Kelly*¹, it was held that the profit made by the Imperial Tobacco Company on an enforced sale of dollars, held by the company in America to finance tobacco purchases, must be considered a profit of the company's trade and liable to Income Tax. In the present case the assessee company embarked upon an adventure which was intended not to be of the nature of investment, but to be the acquisition of an agency which was hoped to be profitable. This adventure was part of the business of the company. The main purpose of the adventure was not realised, and when its realisation became impossible the assessee company withdrew, realising the shares, the purchase of which had been an essential incident of the adventure. They realised a profit which may well have been unexpected, but this profit, I think, must be regarded as a profit of the adventure, and therefore of the business of the company.

13. I think therefore that the conclusion should be that there was material on which the Income Tax Officer was entitled to hold the two receipts of Rs. 20,000 and Rs. 2,26,700 were arising from business, and I consider the two questions formulated by the Tribunal should be answered in the affirmative. The assessee company must pay the costs of the Department before us which I would assess at Rs. 150.

Falshaw, J.

14. I agree.