

(1991) 01 KAR CK 0020
In the Karnataka High Court
Case No : IT Reference Case No. 116 of 1984

Mysore Rolling Mills (P.) Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 14-01-1991

Acts Referred:

Citation : (1992) 63 TAXMAN 416

Hon'ble Judges : R. Ramakrishna, J;K. Shivashankar Bhat, J

Bench : Division Bench

Advocate : Sarangan and Gajendra Rao, for the Appellant; Chandrakumar and S.R. Shivaprakash, for the Respondent

Judgement

K. Shivashankar Bhat, J.—The following question has been referred u/s 256(2) of the income tax Act, 1961 ("the Act"): Whether, on the facts and in the circumstances of the case, the loss of Rs. 10,86,300 claimed by the assessee could be disallowed by applying Explanation 2 to section 73 of the income tax Act, 1961?

The assessee is a private limited company. The assessment year is 1978-79. The assessee-company purchased 12,070 shares of another company called "P.G. Textile Mills Ltd., Baroda", in April and September 1976 at the rate of Rs. 100 per share; but subsequently sold them to one N.L. Rungta of Bangalore and Rajesh Engg. Co. Ltd., Bangalore, at the rate of Rs. 10 per share. These sales were in April and August 1977. In this process, the assessee-company sustained a loss of Rs. 10,86,300. This the assessee claimed as a "short-term capital loss". 2. The assessing authority held that as per the memorandum of association of the assessee-company, its objects include dealing in shares. Therefore, he treated the loss sustained by the assessee-company as a speculation loss within the meaning of Explanation to section 73 of the Act and permitted the said loss to be carried forward to be adjusted in future towards the profits from speculation, if any.

3. The Commissioner (Appeals) held that the assessee-company was not dealing in shares at all at any time and the transactions in question were solitary transactions and that the assessee-company did not purchase the shares of the P.G. Textile Mills, Baroda, with a view to speculate at all. The said company wanted to modernise the plant and the assessee-company acquired the shares as investment. The Commissioner further observed that just because one of the objects of the company includes dealing in shares, it cannot be said that the dealing in shares was part of the assessee's business. The Commissioner further found that the Baroda company was a sister-concern of the assessee-company and that it was obvious the assessee intended to help the sister-concern to come out of its difficulties. Having realised that it was not possible to revive the Baroda company and the shares were worthless, the assessee-company sold them again. Consequently, the appeal was filed by the revenue.

4. The Tribunal accepted the appeal of the revenue. The Tribunal observed that Explanation to section 73 was added with effect from 1-4-1977 with a view to curb attempts to reduce the profits by venturing into share transactions. Thereafter, the Tribunal observed that-

The question before us is whether the purchase of shares in P.G. Textile Mills Ltd., amounts to an investment or is a speculative venture.

After referring to the losses sustained by the Baroda company during the years 1972 to 1977, the Tribunal observed that the assessee knew this fact all along and held:

It is difficult for us to believe that the assessee realised that its investment was bad and, therefore, had to be got rid of at the earliest opportunity, only after purchasing the shares. The facts clearly indicate that the purchase of shares is speculative venture.

The Tribunal further observed that strictly speaking although the clause in the memorandum of association comes under "objects incidental or ancillary to the attainment of the main objects", the transaction in question cannot be held to be incidental or ancillary to the main object because the main object of the company is manufacturing of aluminium and other allied activities. Therefore, the purchase of shares was not at all necessary in order to further object of the company. Therefore, the Tribunal found that the transaction in question was speculative "venture". Thereafter, again the Tribunal states that the assessee acquired shares not as an investor but as a dealer and did not deal with the shares as an investment. The following sentence is very material in the order of the Tribunal:

It may not be speculation in the sense that the transactions are put through without actual delivery of the commodity but price differences are settled.

However, it concluded that Explanation to section 73 is squarely applicable to the facts of the case.

5. We find it difficult to appreciate the reasoning of the Tribunal. The reasoning

referred to above, looks to us, contrary to each other. The Tribunal assumes that the assessee-company purchased the shares as a dealer, but not as an investor is not an (sic) an investor. It is not possible for us to agree that a dealer is not interested in profit-making. Profit-making is the very purpose of dealing. The Tribunal has also not considered the third aspect that it is possible for a sister-concern to purchase the shares of the said concern to aid its developmental activities. In such a situation, it may not be strictly as an investment or as a dealer, but as a person interested in rescuing another person who is closely related to the former. The Commissioner (Appeals) has found that the assessee-company was interested in the Baroda company and obviously purchased the shares to help the said Baroda company to modernise its plants. "Having realised that it was not possible to develop the said company, immediately the assessee-company sold the same after about one year.

6. The short question for us is the interpretation of Explanation to section 73 because the question referred to us is entirely based on Explanation 2 of section 73. The relevant provision leads thus:

73. Losses in speculation business. -(1) ****

(2) Where for any assessment year any loss computed in respect of a speculation business has not been wholly set off under sub-section (I), so much of the loss as is not so set off or the whole loss where the assessee had no income from any other speculation business, shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and-

(i) it shall be set off against the profits and gains, if any, of any speculation business carried on by him assessable for that assessment year; and

(ii) if the loss cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following assessment year and so on.

Explanation : Where any part of the business of a company... consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

7. The Explanation is attracted only when the part of the business of the assessee-company consists in the purchase and sale of shares of other companies; it is only in such a situation that such dealing in shares is deemed to be carrying on the speculation business. According to Mr. Chandrakumar, the learned counsel for the revenue, the definition of "business" is quite wide and any particular venture will fall within the definition of "business". The learned counsel referred to the definition in section 2(13) of the Act wherein "business" includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. It is to be noticed that any kind of venture will not fall within this inclusive definition. The venture or the adventure

will have to be in the nature of trade, commerce or manufacture. Basically the concept of business involves a frequent activity of a particular nature. An isolated activity is opposed to the concept of business. As observed by an English Court (extracted from p. 114 of Kanga and Palkhivala's the Law and Practice of income tax, Vol. 1, 7th edn.)-

"...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 trade; but the sale of a piece of property - if that is all that is involved in the plunge - may easily fall short of anything in the nature of trade. Transactions of sale are characteristic of trade, but they are not necessarily distinctive of it; much depends on the circumstances"...." (p. 114)

The learned authors further state:

...Unless ex facie the single transaction is obviously commercial, the profit from it is more likely to be an accretion of capital and not an yield of income." (p. 115)

8. The decision in Commissioner of Income Tax Vs. Bhikamchand Jankilal, is based on the facts of the said case. In fact, the Bench observed that,-

...Our conclusion, therefore, is that if the transaction under which the assessee paid Rs. 13,500 to M/s. Rallis India Ltd. amounted to a speculative transaction it also amounted to speculation business attracting the operation of section 73(1) and the loss of Rs. 13,500 could not be set off against the profits of the other business of the assessee." (p. 559)

9. Commissioner of Income Tax Vs. Sri Venkateswara Rice and Oil Mills, is a decision of the Andhra Pradesh High Court. The question arose was u/s 43(5) of the income tax Act. The Bench found that the transaction in question could not be held to be a speculative transaction and, therefore, the revenue's contention was negatived. In the said case the assessee was carrying on business in the manufacture and sale of groundnut oil and in that connection it had entered into a number of contracts for the purchase as well as sale of the aforesaid commodities. In respect of a small portion of the contract, delivery did not take place and for the reasons beyond the control of the assessee, the assessee committed breach of the contract. While considering the facts, the Court also considered the claim u/s 73. The Bench observed after referring to section 73(1) and Explanation 2 to section 28 of the Act thus:

...In our opinion, it is necessary to examine the nature and the course of speculative transactions in any given year in order to determine whether the assessee is carrying on speculation business. Section 73(1) of the Act provides that any loss, computed in respect of a speculation business carried on by the assessee, shall not be set off except against profits and gains, if any, of another speculation business. While section 43(5) of the Act provides an artificial definition of "speculative transaction", section 73(1) does not in terms provide that any loss in respect of a speculative transaction carried on by the assessee

shall not be set off except against the profits and gains, if any, of another speculative transaction. The expression used in section 73(1) is "speculation business". If speculation business is to be understood in the normal commercial parlance, the ingredients are totally different and a "speculative transaction" artificially defined in section 43(5) of the Act does not amount to "speculation business" as is commercially understood. A full Bench of the Gujarat High Court in *Pankaj Oil Mills Vs. Commissioner of Income Tax, Gujarat*, has succinctly explained what is understood to be a speculative transaction in the ordinary commercial sense. We may quote below the observations of the Gujarat High Court (p. 828):

"In speculative transactions the modus operandi of persons indulging in them is that when one enters into a contract of purchase, he also simultaneously enters into one or more contracts of sale against the same quantity deliverable at the same time either to the original vendor or to someone else, so as either to secure profit or to minimise loss, before the vaida day; and similarly when he enters into a contract of sale, he simultaneously enters into one or more contracts to purchase the same quantity before the vaida day. The result of such dealings, when the sale and purchase are to and from the same person, has the effect of cancelling the contracts leaving only differences to be paid - vide *Tod. v. Lakhmidas Purshotamdas* [1892] ILR 16 Bom. 441, *Perosha Cursetji Parakh v. Manekji Dossabhai Watcha* [1898] ILR 22 Bom. 899 and *Sassoon v. Tokersy Jadhawjee* [1904] ILR 28 Bom. 616"." (p. 765)

Again the Bench concluded:

...What is required for speculation business is that the course of speculative transactions carried on by an assessee is of such a nature as to constitute a business. It is, therefore, necessary in each case to examine and find out whether the speculative transactions carried on by an assessee are of such a nature as to constitute a business. It may be that, in a given case, a single speculative transaction, on application of proper tests, may be found to constitute "speculation business". It may equally be true that a plurality as speculative transactions, on application of proper tests, constitute "speculation business". It would depend upon the facts of each case. It is not possible to accept the submission of the learned standing counsel for the revenue that no recognised tests are applicable for the purpose of determining whether an assessee is carrying on speculation business by reference to the nature of the speculative transactions carried on by him...." (p. 766)

10. It is, thus, clear that facts of each case will have to be examined to arrive at a conclusion whether the transaction in question is speculative venture or business. The nature of the assessee's business in general, the purpose behind the particular transaction, the effect of the transaction etc., are all to be considered. As Mr. Sarangan contended that no company would throw away large sums of money by purchasing shares and later sell the same at a loss and then claim the said loss to reduce the tax burden because the loss sustained in the

process will be far more than the actual tax relief. Unless it is conclusively established that the assessee entered into the transaction clearly as a speculative venture, the courts cannot infer the transaction to be a speculative venture only because the assessee derived subsequently benefit of tax reduction. In fact the crucial time and the stage is the time when the assessee purchased the shares and, if possible, to find out the intention behind such a purchase, and not to draw an inference of speculation from the fact that subsequently the shares were sold at a low price.

11. For the reasons stated above, we cannot agree with the finding of the Appellate Tribunal. Therefore, the answer to the question referred to us is in the negative and against the revenue.