

## COMMISSIONER OF INCOME TAX, NAGPUR

v.

## SUTLEJ COTTON MILLS SUPPLY AGENCY LTD.

July 25, 1975

[A. N. RAY C. J., K. K. MATHEW, V. R. KRISHNA IYER AND  
S. M. FAZAL ALI, JJ.]

*Income-tax—Jurisdiction of a High Court on reference—Scope of—A single adventure—Tests for determining whether in the nature of business.*

The assessee acquired shares in a newly floated sister concern and later sold a part of its stock at a profit. The Income-tax Officer assessed the profit to tax on the basis that it was profit accruing to the assessee from an adventure in the nature of business, and the order was confirmed by the Appellate Assistant Commissioner. On appeal the Appellate Tribunal held that the transaction was in the nature of business adventure; that the assessee by its Memorandum of Association was authorised to buy and sell shares; that there was a specific resolution to buy and sell shares; that the assessee included the profit on the sale of shares in its profit and loss account without showing it in any reserve account, that the shares were purchased from borrowed funds and not with ready cash; that the sales were not on account of any pressing necessity; that it kept the profit in cash in a bank and that the assessee had in the past dealt with shares as a business transaction.

On reference, the High Court held that there was no provision in the Memorandum of Association which authorised the carrying on of the business of purchasing and selling shares; that the inclusion of the profit in the profit and loss account was not conclusive of the question whether it was capital asset or revenue receipt; that the nature and character of the money should be determined by its inherent character; that there was no evidence that the shares were purchased out of borrowed funds; that a solitary transaction could not be taken as conclusive of the fact that the sale of shares was an adventure in the nature of trade and that in any case the dominant intention of the assessee in acquiring the shares was to boost the shares of a sister concern and when once that was achieved the assessee started selling the investments.

On appeal to this Court it was contended by the respondent that the profit can be taxed only if the dominant intention of the assessee was to carry on an adventure in the nature of business and not otherwise.

Allowing the appeal,

HELD : 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. [134F]

(1) (a) 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 the Tribunal has considered the evidence on record and applied the correct test, there is no scope for any interference with the finding of the Tribunal. [134G]

*C.I.T. v. Ashoka Marketing Co.* [1972] 83 I.T.R. 439, referred to.

(b) The whole conclusion of the High Court was based on an unwarranted assumption of facts. The danger of failing to recognise that the jurisdiction of the High Court in these matters is only advisory and that conclusion of facts are conclusions on which the High Court is to exercise the advisory jurisdiction is illustrated by this case. At no time had the assessee a case that the shares were purchased with a view to help a sister concern. Nowhere in the statement of the case or the supplementary statement of case prepared by the Tribunal and filed in the High Court was there a finding on the question.

[134E; D]

A (2) The tests for the purpose of ascertaining whether profits made upon a sale of an article are taxable profits are :

(i) if a transaction is in the assessee's ordinary line of business it is in the nature of trade. [131B—C]

B (ii) it is not necessary, to constitute trade, that there should be a series of transactions, both of purchase and sale. A single transaction of purchase and sale outside the assessee's line of business may constitute an adventure in the nature of trade; [131C—D]

*Venkataswami Naidu & Co. v. C.I.T.* [1959] 35 I.T.R. 594, followed.

*I. R. v. Reinhold* 34 T. C. 389, 392, referred to.

C (iii) where the purchase of any article or of any capital investment is made without the intention to resell at a profit the resale under changed circumstances would only be a realisation of capital and would not stamp a transaction with a business character. [131G]

*C.I.T. v. P. K. N. Co. Ltd.* [1966] 60 I.T.R. 65 (S.C.) referred to.

(iv) a transaction is not necessarily in the nature of trade because the purchase was made with the intention of resale. [131H]

D *Jenkinson v. Freeland* 39 T.C. 636 (C.A.); *Radha Debi Jalan v. C.I.T.* [1951] 20 I.T.R. 176; *India Nut Co. Ltd. v. C.I.T.* [1960] 39 I.T.R. 234; *Sooniram Poddar v. C.I.T.* [1939] I.T.R. 470, 478-9; *Ajax Products Ltd. v. C.I.T.* I.T.R. 297, 310; *Ghustad Irani v. C.I.T.* [1957] 31 I.T.R. 92 and *Mrs. Alexander v. C.I.T.* [1952] 22 I.T.R. 379, 402, referred to.

(v) a capital investment and resale do not lose their capital nature merely because the resale was foreseen and contemplated when the investment was made and the possibility of enhanced value motivated the investment [132B]

E *Leeming v. Jones* 15 T.C. 333; *Saroj Kumar Mazumdar v. C.I.T.* [1959] 37 I.T.R. 242, 250-1; *I. R. v. Fraser* 24 T. C. 498, 502; *Jankiram Bhadur Ram v. C.I.T.* [1965] 57 I.T.R. 21, referred to.

(vi) the 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. [132D—E]

F *Leeming v. Jones* 15 T.C. 333, referred to.

(vii) The intention to resell would, in conjunction with the conduct of the assessee and other circumstances, point to the business character of the transaction. [132F—G]

G In the instant case, the assessee had been dealing in shares. (i) In an earlier assessment year the assessee had shown in its profit and loss account and the balance sheet a loss in dealing of shares which showed that the assessee had been buying and selling shares even though as an isolated adventure in the nature of business. The debit on account of devaluation of shares shown in the profit and loss account was permissible only on the footing that the shares constituted the stock-in-trade of the assessee, (ii) in view of the resolution of the assessee authorising the director to purchase and sell shares in the view of the High Court that the memorandum of association did not authorise the company to acquire and sell shares had no-relevance; (iii) the finding that the shares were purchased with borrowed funds on which the assessee was paying interest, was a finding supported by evidence. The Tribunal was correct in holding that H the assessee had not invested its funds with a view to earn dividend; (iv) the Tribunal found that the shares were not sold to liquidate the debts of the assessee as the balance sheet showed that the proceeds were kept as cash in bank.

[133A—H]

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1877 of 1970. A

From the judgment and order dated the 10th January, 1968 of the Madhya Pradesh High Court at Jabalpur in Misc. Civil Case No. 221 of 1962.

*V. S. Desai, B. B. Ahuja and S. P. Nayar*, for the appellant. B

*M. C. Chagla, B. Sen, A. K. Chitale, A. K. Verma, Ravinder Narain, J. B. Dadachanji and O. C. Mathur*, for respondent. C

The Judgment of the Court was delivered by

MATHEW, J.—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. Sotlej Cotton Mills Supply Agency Ltd. (hereinafter referred to as the 'assessee') by the Income Tax Appellate Tribunal (hereinafter referred to as the 'Tribunal') under s. 66(1) of the Indian Income Tax Act. The question referred was : D

"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?" E

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. F

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 25-8-1947 with a paid up capital of Rs. 5 lakhs made up of 50,000 ordinary shares of Rs. 10/- each. In the year ending 31-12-1951, the Rayon Company issued certain new shares for paid up capital of Rs. 1,17,25,000/- made up as follows : G

	Rs.
7,60,000 Ordinary shares of Rs. 10/- each fully paid up.	76,00,000
1,50,000 Ordinary shares of Rs.10/- each with paid up at Rs. 2/8/- each.	3,75,000
1,50,000 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

H

A 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. 8,72,500/ as application money on the 25th and 27th February, 1951, and paid Rs. 26,17,500/- as final call money on 10-8-1951. These purchases were authorized by a resolution of the assessee dated 7-2-1951. The assessee sold a part of its stock *viz.*, 1,58,200 shares at a profit of Rs. 2,13,150/-.

B For the assessment year 1956-57 (accounting year ending on 31-3-1956), 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 filed an appeal before the Appellate Assistant Commissioner. He confirmed the order. The assessee then went up in appeal before the Appellate Tribunal.

C 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 of 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 shares 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.

D E F G H 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 profit 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 moneys 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 liabilities." 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 mean time enhanced in value.

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.*<sup>(1)</sup>. The learned judge said that for the purpose of ascertaining whether profits made upon a sale of an article are taxable profits, the question to be asked is : "Is the 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*<sup>(2)</sup> 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

(1) 9 T. C 141

(2) 5 T. C. 159.

**A** 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?”

**B** 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 facts and circumstances of each case whether the transaction is in the nature of a trade.

**C** It is not necessary to constitute trade that there should be a series of transactions, 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 transactions is necessary to constitute a transaction an adventure in the nature of trade. If there is 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*(1)].

**D** 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.*(2), 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.

**E** Where the purchase of any article or of any capital investment, for instance, shares, 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.*(3)].

**F** 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

(1) 34 T. C. 389, 392.

(2) [1959] 35 I. T. R. 594.

(3) [1966] 60 I. T. R. 65 (S. C.).

was made with the intention of resale [see *Jenkinson v. Freeland*(<sup>1</sup>); *Radha Debi Jalan v. C.I.T.*(<sup>2</sup>); *India Nut Co. Ltd. v. C.I.T.*(<sup>3</sup>); *M/s. Sooniram Poddar v. C.I.T.*(<sup>4</sup>); *Ajax Products Ltd. v. C.I.T.*(<sup>5</sup>); *Gustad Irani v. C.I.T.*(<sup>6</sup>); and *Mrs. Alexander v. C.I.T.*(<sup>7</sup>)].

A capital investment and resale do not 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*(<sup>8</sup>) and also the decisions of this Court in *Saroj Kumar Mazumdar v. C.I.T.*(<sup>9</sup>) and *Janki Ram Bhadur Ram v. C.I.T.*(<sup>10</sup>)].

In *I. R. v. Fraser*(<sup>11</sup>) 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 this 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. . . .”

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*(<sup>8</sup>) 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 the nature of trade in respect of his investments, but *per se* it leads to no conclusion whatever.”

This Court laid down in *Venkataswami Naidu & Co. v. C.I.T.*(<sup>12</sup>) 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.

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

In the light of the principles above referred to, it is necessary to examine whether the Tribunal had approached the question from the right perspective, *viz.*, 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.

(1) 39 T. C. 636 (C. A.).

(3) [1960] 39 I. T. R. 234.

(5) [1961] 43 I. T. R. 297, 310.

(7) [1952] 22 I. T. R. 379, 402.

(9) [1959] 37 I. T. R. 242, 250-1.

(11) 24 T. C. 498, 502.

(2) [1951] 20 I. T. R. 176.

(4) [1939] I. T. R. 470, 478-9.

(6) [1957] 31 I. T. R. 92.

(8) 15 T. C. 333.

(10) [1965] 57 I. T. R. 21.

(12) [1959] 35 I. T. R. 594, 610, 622.

- A** 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 assessment year 1951-52, the assessee claimed a sum of Rs. 1,29,214/- which was shown in the profit and loss account and the balance sheet of the company for the year ending 31-3-1951 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 the 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 claim 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 resolutions passed by the assessee authorising one of its directors to purchase and sell the shares in the Rayon Company.
- B**
- C**
- D** The finding of the High Court that the clauses of the Memorandum of Association viz., clauses 10, 12, 13, 28 and 29 do not authorize 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. Pilani Investment Corporation
- E** on the basis that they had fallen in value.

Secondly, the Tribunal said that from 1947 to 1956, no dividend had been declared 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 liabilities 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.

**H** 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 21-3-1956 showed that the proceeds were kept as liquid cash in the United Commercial Bank Ltd.

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.”

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 was 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 is 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 the High Court is to exercise the advisory jurisdiction is illustrated by this case.

Mr. Chagla for the respondent contended that the only question to be asked and answered is : What was the dominant intention of the assessee when it purchased the shares ? If the dominant 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.

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.*(1)).

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.

P.B.R.

*Appeal allowed.*

(1) [1972] 83 I. T. R. 439.