Kishan Prasad & Co. Ltd. vs Commissioner Of Income-Tax, Punjab on 11 November, 1954

Equivalent citations: AIR1955SC252, [1955]25COMPCAS9(SC), [1955]27ITR49(SC), AIR 1955 SUPREME COURT 252

Author: Mehr Chand Mahajan

Bench: Chief Justice

JUDGMENT

Mehr Chand Mahajan, C.J.

1. This appeal is preferred against the judgment of the High Court of Punjab at Simla, dated 18th June, 1951, delivered on a reference under section 66 of the Indian Income-tax Act whereby the High Court answered the following two referred questions in the affirmative :-

> "(1) Whether on a proper construction of the relevant clauses of the appellant company's memorandum of association and articles of association and on a consideration of the circumstances in which the shares of the Sarswati Sugar Syndicate were purchased and sold, it could be held that the purchase and sale of such shares was a part of Appellant company's 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. 2,26,700 in the year 1944-45 was a revenue receipt chargeable to tax under section 3 of the Income-tax Act and was not a mere appreciation of capital ?"

> (2) The questions arose in the following circumstances : The assessee, a public limited company, which is the appellant before us, was formed in 1917 with the following objects :
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> "(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 or 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, hundis and other securities.
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> (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 institution.

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

3. In 1933, another public limited company was incorporated by the name of Sarswati Sugar Syndicate Ltd., hereinafter called the sugar company. Lala Kishan Prasad, managing director of the assessee company, entered into an agreement with the sugar company in March, 1933, whereby the assessee company was to invest Rs. 5,00,000 in the sugar company in lieu of which it was to be given the managing agency of the third mill of the sugar company - not in existence at the time but expected to be erected in 1933 - when such mill was erected, on the same terms as given by the sugar company to other managing agents of their two other existing mills. The investment of Rs. 5,00,000 by the assessee company was made conditional on the sugar company receiving other applications for shares to the tune of at least Rs. 7,00,000. It was further agreed that if the third mill was not erected then the sugar company was to pay to the assessee company Rs. 15,000 as commission upon the moneys invested by them in shares. There was subsequently a modification to the effect that the assessee company would themselves subscribed to shares worth Rs. 3,00,000 and the remaining shares of Rs. 2,00,000 will be subscribed to by their friends. 3,000 shares of the value of Rs. 3,00,000 were purchased and share certificates duly issued by the sugar company to the assessee company. Lala Kishan Prasad was made a director of the sugar company. The third mill was, however, not erected and the agreement about acquiring the managing agency fell through. Lala Kishan Prasad died in December, 1940, and the assessee company decided to sell all the shares in 1941. It is admitted that 2,000 shares were first sold and brought an excess amount of Rs. 20,000 over the original cost price. The remaining 1,000 shares were sold in 1943 and they brought in an excess realisation of Rs. 2,26,700. Both these amounts were taxed by the Income-tax Officer, Ambala, as revenue receipts, the first in the assessment year 1942-43 and the second in 1944-45. The assessee company's contention that the excess was in the nature of capital appreciation was not accepted. This order was confirmed by the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal. The latter then referred at the instance of the assessee company the two questions set out above to the High Court of Punjab.

4. The assessee company claimed exemption from tax in respect of the aforesaid amounts on the ground that they were not receipts arising from business and were of a casual and non-recurring nature. This claim was founded upon the exemption contained in section 4, sub- section (3) (vii), which reads thus :-

"Any receipt not being capital gains chargeable according to the provisions of section 12B and not being receipts arising from business..... which are of a casual and non-recurring nature...."

5. Admittedly the first portion of this clause does not apply to the case for the shares were purchased before the period mentioned in section 12B. It was also agreed that the two receipts were of a casual and non-recurring nature and this fact is noticed by the High Court in their judgment. The only question for consideration therefore is whether it is a receipt from business and not a mere appreciation in capital.

6. An argument was put forward at one stage on behalf of the revenue that the assessee company, by virtue of its memorandum of association, was allowed to deal in money, notes, bills, hundis and other securities and that the shares which were purchased and sold fell within the category of securities. The High Court negatived this contention and Mr. Joshi on behalf of the respondent has also conceded this point. The High Court held., however, that the intention and purpose of the adventure was to obtain the managing agency of the sugar mill and the directorship in the sugar company and this fell within the object (c) "to undertake the management of a commercial undertaken" and therefore the true nature of the transaction was an ordinary business operation well within its powers and not one of investment. If the acquisition by the assessee company of the managing agency of a commercial undertaking were outside the objects clause of the memorandum of association then such acquisition would have been wholly ultra vires. The circumstance whether a transaction is or is not within its powers has no bearing on the nature of the transaction, or on the question whether the profits arising therefrom are capital accretion or revenue income. The High Court recognized the fact that the main purpose of the assessee company was to acquire a managing agency and a directorship but held that as that object was not achieved because the acquisition of the managing agency became impossible and as it withdrew the shares and sold them at a profit, it must be regarded as the profits of the business or the adventure. We think that in so holding the High Court fell into an error.

7. The exact nature of the business which the assessee company was doing is admittedly not clear from the record but it is not denied that the memorandum of association of the assessee company did not authorise it to purchase and/or sell shares as dealers nor is it denied that beyond this isolated transaction of purchase and sale the assessee company did not deal in shares. It seems that the object of the assessee company in buying shares was purely to obtain the managing agency of the third mill which no doubt would have been an asset of an enduring nature and would have brought them profits but there was from the inception no intention whatever on the part of the assessee company to re-sell the shares either at a profit or otherwise deal in them. Naturally when the third mill was not erected and the object of securing the managing agency became impossible of fulfilment the assessee company withdrew the shares and sold them at a profit. After conceding that the taking up of the shares of Rs. 3,00,000 by the assessee company in the sugar company was an essential part of the arrangement arrived at, the only reasonable conclusion to which the High Court should have come was that the investment of the money in the purchase of shares was of a capital nature and the profits arising out of the sale of the shares in the circumstances of this case were accretions to capital and were not liable to tax. This view of the agreement was not seriously challenged before us on behalf of the respondent but it was contended that out of Rs. 3,00,000 to be invested only Rs. 1,00,000 was invested for acquiring the managing agency and the remaining Rs. 2,00,000 was for the purpose of making a profit. We do not think that this would be a correct interpretation of the terms of the agreement. The letter dated 14th March, 1933, which admittedly

embodies the terms of the agreement between Lala Kishan Prasad and the directors of the sugar company clearly says that the assessee company would invest Rs. 5,00,000 of their own. It is no doubt mentioned that out of this amount Rs. 1,00,000 will be considered as contribution on account of the managing agency but the letter goes on to say "the third mill will be erected and Messrs. Lala Kishan Prasad & Co. will be appointed managing agents on the same terms as given to the other two managing agents. If it is not erected this year Messrs. Kishan Prasad & Co. will be paid Rs. 15,000 as commission on the shares that have been put in by them." To this letter the assessee company replied on 17th March, 1933, that they would themselves subscribed to shares worth Rs. 3,00,000 and the remaining shares worth Rs. 2,00,000 they will sell to their friends. These two letters leave no doubt that the transaction was one and indivisible and the sole object of the agreement was to acquire the managing agency as an asset of a permanent character in order to have a hold on the directors. It is not permissible to split up the agreement into two parts as has been sought to be done on behalf of the respondent.

8. We accordingly reverse the decision of the High Court and hold that the purchase of shares to the tune of Rs. 3,00,000 was an investment and not an adventure and the two sums which were taxed were not in the nature of income from business and were therefore not liable to tax. We allow the appeal and set aside the judgment of the High Court with costs to the appellant.

9. Appeal allowed.