Supreme Court of India
M/S Orient Trading Company Ltd vs Commissioner Of Income ... on 21 January, 1997
Bench: S.C. Agrawal, G.T. Nanawati

PETITIONER:
M/S ORIENT TRADING COMPANY LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAXCALCUTTA

DATE OF JUDGMENT: 21/01/1997

BENCH:
S.C. AGRAWAL, G.T. NANAWATI

ACT:

HEADNOTE:

JUDGMENT:

J U D G M E N T This appeal by the assessee arises out of Income Tax Reference No. 279 of 1973 made at the instance of the assessee which was disposed of by the Calcutta High Court by the impugned judgment dated August 25, 1978. Out of the two questions referred to it for its opinion, the High Court declined to answer question No. 1 as it did not arise from the judgment of the Income Tax Appellate Tribunal (hereinafter referred to as `the Tribunal') and question No. 2 was answered against the assessee and in favour of the Revenue. The said question was in these terms:-

> "Whether the Tribunal was right in holding that on the facts and circumstances of the case the exchange of one security for another could be described as realisation of the security resulting in profit?"

The matter relates to the assessment year 1963-64 for the relevant previous year ended on July 31, 1962. The assessee is a company dealing in shares. It was holding 14500 shares of Asiatic Oxygen & Acetylene Company Limited (hereinafter referred to as `the first Company'), of the face value of Rs. 10/- each as its stock-in-trade. The said shares were valued by the assessee at Rs. 1,45,000/- (the cost price) at the end of the assessment year 1962-63 and were included in the closing stock. In the assessment year under reference a new company, Asiatic Oxygen Ltd. (hereinafter referred to as `the second Company') had made an offer to obtain shares of the first Company in exchange for the allotment of its own shares at the rate of 38 equity shares in the second company for 10 equity

shares in the first company. The assessee accepted the said offer and received 55,100 shares of the second company in exchange of the aforesaid holding of 14,500 shares in the first company. The face value of the shares of the second Company was Rs. 10/- per share. The assessee, however, valued the shares of the second Company also at Rs. 1,45,000/- being the cost price of the shares of the first Company. The Income Tax Officer did not accept the contention of the assessee that it had not earned any profit in the transaction. He found that the market quotation of the shares of the second Company, as on 11th August, 1962, i.e., only 11 days after the close of the relevant previous year, was Rs. 10.12 per share. He valued the shares of the second company of Rs. 10/- per share and held that Rs. 5,51,000/- was the value of the shares of the second Company. He, therefore, held that the assessee had earned a profit of Rs. 4,06,000/- in the said transaction and brought that amount to tax as the assessee's income from share dealings. The appeal filed by the assessee was dismissed by the Appellate Assistant Commission and on further appeal the Tribunal rejected the contention of the assessee and that the transaction did not result in any profit. The Tribunal rejected the application of the assessee for referring to the High Court for its opinion the questions raised by the assessee but the High Court by order dated February 18, 1974 directed the Tribunal to state a case and refer the two questions raised by the assessee and consequently the two questions were referred by the Tribunal out of which question No. 2 has been answered against the assessee by the High court by the impugned judgment.

Shri H.K. Puri, the learned counsel for the assessee, has urged that the High Court was in error in answering the said question against the assessee. According to Shri Puri, since the assessee has been found to be a dealer in shares and the shares of the first Company held by assessee were part of its stock-in-trade, the fact that those shares were exchanged with the shares of the second Company would not, by itself, mean that the assessee had earned a profit in that transaction. According to Shri Puri, the assessee could be said to have earned profit in the transaction only when it would have sold the shares of the second Company at a price higher than that entered in its books. Shri Puri has also submitted that the process of obtaining the shares of the second Company in exchange for the shares of the first Company does not constitute a sale and has placed reliance on the decision of this Court in Commissioner of Income Tax, Andhra Pradesh v. Motors & General Stores (P) Ltd., (1967) 66 ITR 692. Shri Puri has also placed reliance on the decision of the House of Lords in British South Africa Co. v. Varty (Inspector of Taxes), 1966 AC 381, and has submitted that the decision of the House of Lords in Westminster Bank, Ltd. v. Osler (Inspector of Taxes), (1933) 1 ITR 65, referred to in the impugned judgment of the High Court, has been distinguished by the House of Lords in the subsequent decision in the case of British South Africa Co. v. Varty (Inspector of Taxes) (supra).

The question that arises for consideration is whether the surrendering of its shares in the first Company in exchange for the shares of the second Company by the assessee can be regarded as realisation of the security on the date of such surrender and exchange. If it can be so regarded that the sum of Rs. 4,06,000/-, the difference between the book value of 14,500 shares of the first Company and the market value of the 55,500 shares of the second Company as on the date of the such realisation, will have to be treated as profit earned by the assessee in that transaction.

In the impugned judgment the High Court has agreed with the decision of the Tribunal that the exchange of the shares of the first Company with the shares of the second Company is to be treated

as realisation of the security. The said view of the High Court, as will be presently seen, is in consonance with the established principles governing the law in this field.

In Westminister Bank, Ltd. v. Osler (Inspector of Taxes) (supra) the appellant was holding National War Bonds which were surrendered in exchange for conversion loan and war loan and the value of the stock received in exchange was greater than the cost to the Bank of the National War Bonds. The question was whether the excess amount could be regarded as profit of the Banker's trade for the purpose of income tax. On behalf of the Bank it was argued that the nature of the transaction was equivalent to a mere exchange of an item in the stock-in-trade of the trader and that in fact there was no realisation of profit and there was a mere accretion of capital value which could not be brought into account until in fact it had been realised.

Dealing with the said contention Lord Buckmaster said: "The exchange effected in the present case was in fact the exact equivalent of what would have taken place had instructions been given to sell the original sock and invest the proceeds in the new security. The investment represented by the original War Bonds came to an end as soon as the new securities were taken in its place, when a new venture was begun in relation to the new holding, and the fact that this transformation took place by the process of exchange does not in any opinion avoid the conclusion that there has been what is described as a realisation of the security."

[pp. 68, 69] The decision of Rowlatt, J. in Royal Insurance Co. Ltd. v. Stephen, 14 Tax Cases 22, was approved in the said case. In the case of Royal Insurance Co. Ltd. v. Stephen (supra) the appellant company had, under the Railways Act, 1921, to accept new stocks in the amalgamated companies in exchange for the stock held in the companies which were absorbed and which resulted in loss to the appellant-company. The claim of the appellant-company for deduction of such loss was upheld by Rowlatt, J. who held:-

> "At the bottom of this principle of waiting for a realisation, I think there is this idea; while an investment is going up or down for Income Tax purpose the Company cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end, when that investment is wound up I will say - "wound up" is an unfortunate expression perhaps and I will say when an investment ceases to figure in the Company's affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the Company, and then the Company starts so far as that portion of its resources is concerned with a new investment. Then one knows where one is and it is no longer a question of paper, it is a question of fact and that is a realisation. I think that is the point of view from which it ought to be looked at, and looking at it from that point of view the Company is right. It has done with the investments in the companies. They have disappeared. It is known exactly in money. It is known now exactly what their holding of them has meant to the Company. They will never more go up or down. What will go up or down now are the different shares in the new companies, altogether different investments really, and therefore I think that the old investment is closed and realised and a new investment is started."

[pp. 28, 29] Similarly in California Copper Syndicate v. Harris, 5 Taxes Case 159, decided by the Court of Ex-chequer in Scotland, Lord Trayner has said:-

> "But it was said that the profit - if it was profit - was not realised profit and, therefore, not taxable. I think the profit was realised. A profit is realised when the seller gets the price he had bargained for. No doubt here the price took the form of fully paid shares in another company, but, if there can be no realised profit, except when that is paid in cash, the shares were realisable and could have been turned into cash, if the appellants had been pleased to do so. I cannot think that Income Tax is due or not according to the manner in which the person making the profit pleases to deal with it."

[p. 167] These observations have been quoted with approval by this Court in Raja Mohan Raja Bahadur v. Commissioner of Income Tax, U.P. (1967) 66 ITR 378. In that case, the assessee, carrying on business of money lending, had obtained a decree against a debtor and had received Encumbered Estate Bonds of U.P. Government in part satisfaction of the liability of the debtor. The said Bonds were sold by the appellant in the year relevant to the assessment year subsequent to the year in which they were received. It was held that the Bonds were a fresh security the liability of the original debtor having been substituted by an obligation by the State and since the Bonds were convertible in terms of money, income was realised by the assessee when the bonds were received.

The subsequent decision of the House of Lords in British Sough Africa Co. v. Varty (Inspector of Taxes) (supra) does not lend assistance to the submission of Shri Puri. In that case the appellant-company in 1953 had lent 200,000 pounds to a gold mining company and in return had received, inter alia, an option to subscribe for 100,000 shares in the mining company at 1 pound per share, the value of the shares then being 19 S.6 d a share. In 1954 when the value of the shares ad gone up to 43 S.6 d a share the appellant exercised the option and obtained shares worth 217,500 pounds for which they paid 100,000 pounds. The company was assessed for income tax on a profit of 117,5000 pounds. On behalf of the company it was urged that upon the exercise of the option there was a realisation because the option which was a "trading asset" or an item of "stock-in- trade" was exchanged for or was replaced by a different item of stock-in-trade which had a value in money's worth. The said contention was rejected by the House of Lords (Lord Guest dissenting). IT was held that the appellant-company never, in fact, realised their option in the sense of passing it on, for a consideration to someone else and that there was neither a sale of the option or its exchange for something else and that when the company exercised their option or used or availed themselves of their rights they did not make the end of the trading transaction and that there was merely the end of the beginning of a trading transaction. It was emphasised that there was no element of exchange as there was in Royal Insurance Co. Ltd. v. Stephen (supra) and in Westminister Bank, Ltd. v. Osler (Inspector of Taxes) (supra). [See : Lord Morris of Borth-Y-Gest at pp.394-395]. Lord Guest, in his dissenting judgment, however felt that the option was a trading asset of the appellant- company and, applying the principles laid down in Royal Insurance Co. Ltd. v. Stephen (supra) and Westminister Bank, Ltd. v. Osler (Inspector of Taxes) (supra), held that the exercise of option amounted to a realisation of the option which resulted in a trading profit of 117,5000 pounds. This would show that the principles laid down in Royal Insurance Co. Ltd. v.

Stephen (supra) and Westminister Bank, Ltd. v. Osler (Inspector of Taxes) (supra) have been affirmed by all the law Lords and the difference amongst them was only as regards the applicability of the said principles to the facts of that case.

Commissioner of Income Tax, Andhra Pradesh v. Motors & General Stores (P) Ltd. (supra) relates to the interpretation of the word "sale" in Section 10(2)(vii) of the Income Tax Act, 1922. The said decision has no bearing on the present case.

Having regard to the principles laid down in the decisions aforementioned, it must be held that the High Court has rightly taken the view that as a result of their having taken the shares in the second Company in exchange of the shares of the first Company the assessee had made realisation of the value of the shares of the first Company and the difference between the price of the shares of the first Company and the second Company on the date of such exchange, i.e., Rs. 4,06,000/-, has to be treated as a profit of the assessee and has been rightly assessed as income of the assessee. We, therefore, do not find any merit n the appeal and the same is accordingly dismissed. But in the circumstances no order as to costs.

The assessee has also made an application for urging additional grounds wherein it is requested that additional question as mentioned in paragraph 9 of the said application may be framed or directed to be called for by the High Court from the Tribunal. We have perused the said application. We do not find any merit in the same. It is accordingly dismissed.