

(1966) 08 RAJ CK 0006

Rajasthan High Court

Case No: Income Tax Reference No. 28 of 1962

RAJASTHAN
FINANCIAL
CORPORATION

APPELLANT

Vs

COMMISSIONER OF
Income Tax, NEW
DELHI.

RESPONDENT

Date of Decision: Aug. 31, 1966

Acts Referred:

- State Financial Corporations Act, 1951 - Section 24, 25, 28, 3, 34

Citation: (1967) 65 ITR 112

Hon'ble Judges: Kan Singh, J

Bench: Division Bench

Judgement

KAN SINGH J. - This is a reference u/s 66(1) of the Indian Income Tax Act, 1922, and raises a short question whether the loss amounting to Rs. 21,770 sustained by the assessee as a result of sale of certain Government securities between May 8, 1958, and May 25, 1958, could be treated as a trading loss or the same was capital loss which could not be claimed as a set-off against the income of the assessee. The question referred is in the following terms :

Whether, on the facts and circumstances of the case, the loss of Rs. 21,770 suffered by the corporation on the sale of securities of the amount of Rs. 30,00,000 has been rightly treated as capital loss ?

The assessee is the Rajasthan Financial Corporation, Jaipur, herein after to be referred as the "corporation" and the relevant assessment year is 1959-60, the relevant previous year being the financial year 1958-59. The facts of the matter were as follows:

The corporation was established by the State Government in exercise of its power u/s 3 of the State Financial Corporation Act, 1951, hereinafter to be referred as the "Act", in the year 1955. In accordance with the provisions of the Act, the corporation was body corporate and it had an authorised capital of rupees two cores and its subscribed capital was rupees one crore. 95.45 per cent. of the issued capital has been subscribed by the State Government, the Reserve Bank and the scheduled banks, while the balance 4.55 per cent. of the issued shares have been subscribed by private persons. Thus the corporation is a public undertaking in every sense of the term. The corporation commenced advancing loans in the financial year 1955-56 and the position of the advances made by it up to the end of the assessment year was as per sub-joined statement :

Assessment Year	Previous Year	Loans advanced Rs.	Proposals received Rs.	Proposals sanctioned Rs.	Proposals rejected Rs.
1956-57	1955-56	1,85,000	43,78,06,000	77,28,000	10,12,46,000
1957-58	1956-57	7,32,000	27,92,02,000	10,22,85,000	25,39,87,000
1958-59	1957-58	26,05,000	12,24,72,500	9,31,39,000	4,18,11,000
1959-60	1958-59	11,29,700	21,39,28,060	9,14,70,000	17,34,52,500

(Vide page 3 of the statement of the case).

The state of its affairs up to the end of the relevant account year will be evident from the annual reports which have been made part of the statement of the. Up to May 22, 1955, the corporation had advanced loans aggregating to Rs. 16,67,000 and invested its surplus funds amounting to Rs. 66,70,000 in Government securities as follows :

S.No.	Name of the securities	Face value Rs.	Book value Rs. As. Ps.
1.	National Plan Bonds Second Series (1965)	30,00,000	29,55,000-0-0

2.	4% Saurashtra State Government Loan, 1967	10,00,000	13,89,125-0-0
3.	4% Bombay State Government Loan, 1967	3,35,000	3,35,837-8-0
4.	4% Rajasthan State Development Loan, 1968	20,00,000	19,90,000-00
		67,35,000	66,69,962 - 8 - 0

The securities of the face value of Rs. 30,00,000 which were purchased for Rs. 29,55,000 were sold by the corporation between May 8, 1958, and May 22, 1958, for Rs. 29,33,230 which resulted in a loss of Rs. 21,770. The corporation claimed this as a trading loss when it filed the return of its income for the assessment year 1959-60. The Income Tax Officer, however, disallowed this claim and observed as follows :

"The assessee has claimed a loss of Rs. 21,770 on sale of Government securities. This is a capital loss as the corporation does not deal in securities. Its primary object is to grant loans to the industrial undertakings. Hence, the loss claimed is disallowed, being a capital loss.

The corporation then went up in appeal to the Appellate Assistant Commissioner. The Appellate Assistant Commissioner Noted that the corporation was brought into being as a part of the scheme to establish financial corporations in different States for advancing or guaranteeing loans to industries and the nature of the business was analogous to that of a banking concern and it had to keep its funds in easily realisable securities and he observed that the corporation had to dispose of the securities as it was necessary for meeting its obligation. The Appellate Assistant Commissioner took note of what was laid down in Punjab Co-operative Bank Ltd. v. Commissioner of Income Tax, and came to the conclusion that, having regard to the nature of the corporations business, the loss in question deserved to be allowed as revenue loss in spite of the fact that in the balance-sheet of the corporation it has not been shown as stock-in-trade, but only as an investment. In the result, the Appellate Assistant Commissioner accepted the appeal and ordered that the total income of the corporation be reduced by Rs. 21,770. The Income Tax Officer went up in appeal against this order to the Income Tax Appellate Tribunal, Delhi Bench "A".

The Tribunal considered the plea raised on behalf of the corporation that it was engaged in banking business and, therefore, its investments in securities were to be regarded as stock-in-trade, but it did not agree with the conclusion reached by the Appellate Assistant Commissioner and held that corporation could not be regarded

as carrying on banking business because it did not find that its constitution permitted banking business, nor did it actually carry on such banking business. The Tribunal then considered the dicta laid down by the Privy Council in the leading case of Punjab Co-operative Bank as also those of the Supreme Court in Sardar Indra Singh & Sons Ltd. v. Commissioner of Income Tax, and observed that, even though the corporation may not be regarded to have banking business, yet its claim for the loss being allowed as trading loss has to be considered in the light of the principles authoritatively settled in these cases, viz., whether the sale of securities was so connected with the assessee's business that it could be regarded as a normal step in the carrying on of that business. The Tribunal recognised that the decision of each case would depend upon its individual facts. It then considered the nature of the business carried on by the corporation and, after contrasting it with the business of a bank, observed as follows :

In the case of the assessee before us, the position is altogether different. Its business entirely depends upon its capital. The loans to be advanced can be regulated and are known and processed in advance. There can hardly be any necessity for maintaining large cash on hand or investing funds in easily realisable securities, when all the loans to be given would be properly planned out in advance. The assessee-company did not require a very large portion of its issued capital for a long period to come. If it had called up its capital as and when required, no occasion would have arisen at all for any investment in securities is the result of excess of capital over its immediate requirements and not the result of the peculiar nature of the business carried on by it.

It will be observed from this passage that while the Tribunal did not dispute the relevance of the dicta laid down in Punjab Co-operative Banks case, as affirmed by the Supreme Court in Sardar Indra Singhs case, in its view the necessary conditions for their application were not satisfied by the facts disclosed in the present case. According to the Tribunal, (i) the investment in securities was in respect of the unutilised excess capital not immediately needed by the corporation; (ii) the investment could have been avoided and instead capital could have been called as reasonably needed; and (iii) the immediate cause for the sale of the securities was not to meet any business liability, but only to avert further loss in the value of the securities and to earn higher interest. In a nutshell, according to the Tribunal, neither the initial investment in securities nor their subsequent sale could be said to have been actuated by the exigencies of business. In the result, the Tribunal held that the loss claimed by the corporation was not a trading loss but a capital loss and consequently it set aside the order of the Appellate Assistant Commissioner and restored that of the Income Tax Officer.

Mr. M. D. Bhargava, appearing for the corporation, has strongly contended before us, in the first instance, that the corporation was carrying on the business of banking and therefore the whole of its investments which were made to keep

money readily available for the requirements of its business was the stock-in-trade should be treated as a business loss. He urged that the characterizing of the part of the stock-in-trade of this nature as investment was of no consequence. He took us through the provisions of the Banking Companies Act and the statutory form in which the balance sheet was to be prepared and he pointed out that the balance-sheet uses the expression "investment" for the securities that a bank keeps and yet such securities are regarded as stock-in-trade. Mr. Bhargava also urged, in the second place, that what the Tribunal has observed relates only to commercial banking and not to development banking which has been brought into existence by the Act.

We find it difficult to accede to the first part of the argument advanced by Mr. Bhargava. In a very recent case before the Court of Appeal in England, *United Dominions Trust Ltd. v. Kirkwood*, that court had occasion to consider what were the characteristics of banking. The concern whose business was examined was United Dominions Trust Limited, which was a large financing company, who described itself as bankers and was maintaining an important financial house. It has a high standing, including the Bank of England amongst its shareholders. It used to receive money on deposit and paid interest on it against deposit receipts. The learned Lords laid down that the characteristics usually found in a bankers business at the present day were : (a) to accept money from and to collect cheque for customers and to place the cheques to the customers credit in a running account; (b) to honour cheques or orders drawn on the bankers by their customers when presented for payment and to debit their customers in the running account accordingly and to help customers running accounts in which credits and debits are entered. The majority opinion in the case was that the United Dominions Trust Limited had not been able to establish that its business was really that of banking. It may be noted that there was no statutory definition of the term "banking" in England. On the other hand, in India, section 5(1) (b) of the Banking Companies Act, 1949, defines "banking" as "accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheques, draft or otherwise". We are, therefore, unable to hold that the corporation was doing a banking business as commonly understood. At best, it may be regarded as doing business analogous to that of a banker in some particulars. However, this is immaterial for the purposes of the present reference, as the Tribunal has itself recognised that the true test was to find out whether the sales of securities were connected with the assessee's business so that the same could be regarded as a trading loss.

In *Punjab Co-operative Bank Limited v. Commissioner of Income Tax*, the Punjab-Co-operative Bank Limited had made certain profits on the sales of investment. The bank contended that the profits it had derived were not in the nature of income, but in the nature of capital gain and thus were not taxable. The Income Tax department, on the other hand, contended that the investments were

intimately connected with the running of banking business and thus the profits earned as a result of sale of securities were business income. Their Lordships of the Privy Council observed that, "the true principles to be applied to such cases is that enhanced values obtained from realisations 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 the carrying out, of a business". Their Lordships further observed that in the ordinary case of a bank, the business consists, in its essence, of dealing with money and credit. The banker has always to keep enough cash or easily realisable securities to meet any probable demand by depositors, and if some of the securities are realised in order to meet withdrawals by depositors, this is clearly a normal step in carrying on the banking business. In other words, it is an act done in what is truly the carrying on of the banking business. In the light of the facts of the case, their Lordships found that the purchase and sale of shares and securities by the Punjab Co-operative Bank Limited were so much linked with the deposits and withdrawals of clients that they were part of the assessee's business of banking, and the profits arising therefrom were consequently assessable to Income Tax.

In *Sardar Indra Singh's* case, their Lordships of the Supreme Court followed the Privy Council case of *Punjab Co-operative Bank Limited*, and observed that the test laid down in that case was one of general application in determining whether the surplus coming out of such a transaction is a capital receipt or a trading profit. Their Lordships, however, added that such a question is primarily one of fact. The position has been clarified in subsequent cases that such a question is a mixed question of law and fact : vide *Commissioner of Income Tax v. National Finance Limited*, *Janki Ram Bahadur Ram v. Commissioner of Income Tax*, and *Commissioner of Income Tax v. P. K. N. Company Limited*. It has further been laid down in these cases that for a proper determination of such a question, the collective effect of all the facts and circumstances of the case has to be seen.

We may now turn to the material facts and circumstances relied on by learned counsel on either side with a view to seeing whether the Tribunal has correctly determined the question. Mr. Bhargava contends that in the beginning of the financial year 1958-59, the year in which the securities were sold, the corporation had only Rupees two lakhs in deposit with the banks and only Rs. 25,000 in cash. At the same time, it had to grant substantial loans during that year and, therefore, if with a view to discharge its primary functions of advancing loans to industrial concerns it had to sell its securities, then such a sale was closely related to the carrying on of the business of the corporation. Mr. Bhargava points out that the Tribunal has not properly appreciated the letter of the managing director dated May 25, 1957, inasmuch as it has completely overlooked what was mentioned in the opening paragraph of the letter. He has also invited us to go through the annual reports of the corporation for the relevant years and he submits that these reports had not been considered at all by the Tribunal.

Mr. Chandmal Lodha for the Income Tax department, on the other hand, submits that the securities were sold as their value was going down and the corporation wanted to earn more interest as the new loans would carry higher rate of interest. He also submits that when the investments were made in the beginning, it was out of the surplus capital of the corporation and the investments were made with a view to earning profits only. Thus, according to Mr. Lodha, the immediate cause for the sale of the securities was only the desire to avert further loss in the value of the securities and to earn higher interest and, therefore, the losses could not be regarded as business losses as distinguished from capital losses.

It will be pertinent, therefore, at this stage to refer to the relevant provisions of the Act. Chapter III of the Act provides for the powers and duties of the corporation. Section 24 of the Act lays down that the board of directors shall act on business principles, due regard being had by it to the interests of industry, commerce and the general public. Section 25 lays down as to what business is to be transacted by the corporation and it is as follows :

- (a) the guaranteeing on such terms and conditions as may be agreed upon of loans raised by industrial concerns which are repayable within a period not exceeding twenty years and are floated in the public market;
- (b) the underwriting of the issue of stocks, shares, bonds or debentures by industrial concerns;
- (c) the receipt in consideration of the services mentioned in clauses (a) and (b) of such commission as may be agreed upon;
- (d) the retention as part of its assets of any stock, shares, bonds or debentures which it may have to take up in fulfillment of its underwriting liabilities; provided that it disposes of the stocks, shares, bonds or debentures so acquired as early as practicable and in any case within a period of seven years from the date of such acquisition;
- (e) the granting of loans or advances to, or the subscribing to debentures of, industrial concerns, repayable within a period not exceeding twenty years from the date on which they are granted or subscribed to, as the case may be; and
- (f) generally, the doing of all such acts and things as may be incidental to or consequential upon the exercise of its powers or the discharge of its duties under this Act.

A perusal of this section shows that the main function of the corporation is to help industrial concerns in various ways. Section 28 prohibits the corporation from accepting deposits except as provided by the Act, or to subscribe directly to the shares or stock of any company, or to grant any loan or advance on the security of its own shares. Section 34 provides that the financial corporation may invest its funds in the securities of the Central Government or of any State Government.

It appears that in order to ensure that the corporation works on sound business principles as contemplated by section 24 of the Act, the Government issued a directive to it by its order dated July 15, 1957, available at page 52 of the record. This was done by the Government in exercise of its powers u/s 39 of the Act. It was directed that the corporation should so arrange their investment of surplus funds that they may not have to sell their investments or to borrow frequently against them. It was further noted that the loans from the Reserve Bank were to be repaid within 90 days and the corporation, in the nature of things, may have to sell securities which, under the existing market conditions, may cause capital loss to them. It was, therefore, desired that a working balance in such short term deposits with banks up to about a years requirement of funds by the corporation would be desirable. Accordingly, it was stressed that investments in Government securities should be made with due care to avert capital depreciation and, in view of the type of business the corporation was engaged in, investment in long-dated Government securities was obviously unsuitable and, therefore, it was emphasised that it would be best to invest in short term Government securities of not more than 2 to 3 years maturities, in consultation with the Reserve Bank of India. A perusal of the annual report of the year 1957-58, that is, immediately preceding the year of account, shows that the corporation had to borrow Rs. 2,50,000 from the Reserve Bank of India against Government securities as the liquid funds had exhausted and the corporation was to meet certain commitments on account of the sanctioned loans : (vide page 6 of the report). The report for the year 1958-59 shows that during the year 21 loan applications seeking loans from the corporation to the extent of Rs. 39 lakhs and odd were received. At the commencement of that year, 17 loan application for a loan aggregating to Rs. 42 lakhs and odd were pending from the previous year. In other words, there was a demand of Rs. 81 lakhs and odd. Out of these application, 17 applications were either rejected or withdrawn and 35 were granted. The total amount of loans sanctioned aggregated to Rs. 76,39,000 and the amount disbursed stood at Rs. 46,51,700 : (vide pages 4 and 5 of the report). It was also noted that the speed of establishment of new industries in the State was low, mainly on account of scarcity of cheap power and lack of means of transport, but it was hoped that with the augmentation of electric supply in the State from Chambel Valley and Bhakra projects, the rate of industrial development would increase. It was also expected that 7 industrial estates at various places in Rajasthan would be established. Thus, there can be no gainsaying the fact that the commitments the corporation had to meet in the year 1958-59 were substantial and the cash in hand was very insignificant to meet those commitments.

We may now turn to the letter of the managing director dated May 25, 1957 (exhibit "C" on the record). It is mentioned that up to date, that is, up to May 25, 1957, loans aggregating to Rs. 16,67,000 had been disbursed and the balance, Rs. 66,70,000, had been invested in Government securities and the remaining amount of Rs. 12,20,000 out of the working capital was invested in short term deposits with banks.

It was then pointed out that the total sanctioned loans aggregated to Rs. 46,74,000 out of which Rs. 30,07,000 had to be disbursed. It was further anticipated that loans worth Rs. 25,00,000 might be sanctioned during the current year (viz., 1957-58). As such, the total loans to be advanced were to amount to Rs. 70 lakhs. As against these sanctioned loans, it was expected that about Rs. 38 lakhs were likely to be disbursed during the current financial year. At the time Rs. 18 lakhs were in deposit with the banks and therefore, the corporation required Rs. 20 lakhs more for disbursement during the year. It was in this background that it was proposed that the corporation should sell its securities. Out of the several securities, those bearing lowest interest were chosen, namely, National Bonds Second Series (1965), which carry 3 1/2 per cent. interest. It was, after noting these facts, that it was observed as follows :

"We, therefore, propose that the bonds may be sold gradually and the proceeds may be invested by us in short term deposits with banks for the time being and when new loans are floated, we may invest Rs. 10 lakhs in such loans, as we hope the new loans may carry higher rate of interest.

Formerly our short deposits with banks were at 3 1/2% P. A. interest. Later on we could secure 3 3/4% P. A. and now we have been able to get 4% P. A. from the banks. As such there will be a gain of 1/2% P. A. at least, though we shall try to get a little bit more if possible.

We do not need any fresh permission from the Reserve Bank of India for putting more funds with the bank as the unavailed limit of deposits with scheduled banks sanctioned by the Reserve Bank of India is to the tune of Rs. 89,00,000.

We may have waited to place this matter at the next meeting of the board but it is likely that by that time the prices of the 3 1/2% National Plan Bonds Second Series (1965), which are quoted at Rs. 98 at present, may still go down and we may lose the advantage of the higher rate of interest allowed by the banks on short deposits.

If approved action may be taken for getting the following resolution passed by circulation :

RESOLVED that the managing director is hereby authorised to take suitable steps for the sale of 3 1/2% National Plan Bonds Second Series (1965), and invest the proceeds in short deposits with banks or purchase new Central or State loans - if floated at better rates.

The department for its arguments relied on this passage and submits that, in selling the securities, the corporation was not actuated by the exigencies of business, but it wanted to save itself from losses in the value of the securities and also to earn higher interest.

Having given our most careful consideration to the matter, we are unable to agree that this is a correct appraisal of the position. The governing consideration for

selling the securities was the necessity to find money for disbursing the sanctioned amount of loans to the extent of Rs. 38 lakhs. Thus there was a pressing demand for sale of securities and if, in doing so, such securities as carried the lowest interest were chosen and further if such securities were going down in value, then it cannot be predicated that the dominant intention stood transformed from that of advancing loans to one of saving the loss on securities or for earning more interest. As this money had to be advanced within a year, there is nothing wrong if it was contemplated that if not disbursed the money would be deposited in short term deposits with banks. It was also expected that new loans were to be floated in which Rs. 10 lakhs might be invested, but this again is nothing but a proposal for utilisation of money if it ever were to remain unutilised after disbursement of the sanctioned loans. In dealing with the case of the corporation, one cannot legitimately ignore the statutory functions that it has to discharge, that is, of helping industrial concerns and in doing so it has to have due regard to the interest of the industry, commerce and the general public. It has not been provided that the avowed object of the corporation was money-making as such, though in trying to advance loans to the industries it would certainly earn interest. This is an important activity that the State has undertaken to help industrial growth in the State and, therefore, we cannot impute such motives to it as animate a private financier or a money-lender. Functions envisaged u/s 25 of the Act are nothing but the activities of a Welfare State and, therefore, the corporation could not put off the question of disbursing sanctioned loans by waiting for the investment in securities to mature. In this context we are satisfied that the sale of the securities was closely linked up with the business of the corporation, so that, according to the principles laid down by the Privy Council and the Supreme Court, loss suffered on account of such a sale of securities was a trading loss.

In view of what we have observed above, our answer to the question is in the negative. We leave the parties to bear their own costs.

Question answered in the negative.