
A.P. State Financial Corpn. Vs Commissioner of Income Tax

Reference Case No. 230 of 1978

Court: Andhra Pradesh High Court

Date of Decision: July 9, 1984

Acts Referred:

Income Tax Act, 1961 "Section 256(1)"#State Financial Corporations Act, 1951 "Section 25, 3

Citation: (1985) 20 TAXMAN 67

Hon'ble Judges: Jeevan Reddy, J; Anjaneyulu, J

Bench: Division Bench

Advocate: Y. Sivarama Sastry and Y. Venkata Sastry, for the Appellant; M.S.N. Murthy, for the Respondent

Judgement

Jeevan Reddy, J.

The question referred for opinion u/s 256(1) of the income tax Act, 1961 ("the Act") is:

Whether, on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the surplus realised on the sale of

securities partook the character of trading profits ?

The assessee is the Andhra Pradesh State Financial Corpn. Ltd., Hyderabad, incorporated u/s 3 of the State Financial Corporation Act, 1951.

According to section 25 of the State Financial Corporation Act, one of its objects is:

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

2. The assessee held certain securities in the form of Andhra Pradesh State Development Loan in 1970 and 1980. These securities were

purchased by the assessee for a sum of Rs. 30,51,734 in the year 1969. During the accounting year relevant for the assessment year 1974-75, the

assessee required certain funds for meeting its obligations, viz., for advancing loans to industrial concerns. For that purpose, it sold the aforesaid

securities, thereby making a profit of Rs. 2,54,466 (the securities were sold for a sum of Rs. 33,02,220). In its return submitted for the assessment

year 1974-75, the assessee showed an amount corresponding to the said amount of Rs. 2,54,466 as capital gains. The ITO was, however, of the

opinion that the entire amount of Rs. 2,54,466 represents the income of the assessee from business and, accordingly, included the same in its

taxable income. This was appealed against by the assessee. The AAC accepted the assessee's contention that, inasmuch as the assessee is not a

dealer in securities and also because the purchase of the said securities was by way of investment, the assessee was right in showing the relevant

amount as capital gains. The AAC also relied upon the fact that in the entire history of the assessee, there were only three instances of encashing

securities, viz., on two occasions they were redeemed on their maturing, and on one occasion they were sold. This very limited number of

encashment of securities was held to be indicative of the fact that the sale of the securities in question was not closely connected with the

assessee's business, nor can it be regarded as a normal step in the carrying on of its business as per the tests propounded by the Supreme Court in

its decision in *Sardar Indra Singh and Sons Ltd. Vs. Commissioner of Income Tax, West Bengal*, The revenue appealed to the Tribunal. The

Tribunal mainly relied upon the decision of the Rajasthan High Court in *RAJASTHAN FINANCIAL CORPORATION Vs. COMMISSIONER*

OF Income Tax, NEW DELHI., and held that, inasmuch as one of the main objects of the assessee was advancing loans to companies upon

which it earns interest and also because the sale of securities was effected for the purpose of carrying on its business, it must be held that the sale of

securities was closely linked with the business of the assessee-corporation; and if so, according to the principle enunciated by the Supreme Court

in *Sardar Indra Singh & Sons Ltd.'s* case (supra), the profit made must be treated as trading profit. On the above reasoning, it allowed the appeal

whereupon the assessee applied for and obtained the present reference to this Court.

3. From the facts found in the orders of the Tribunal and the authorities below, it is evident that the assessee had certain funds available with it

meant for advancing loans to industries in the interest of industrial growth of the State. Because there were certain surplus funds after meeting its

obligations, the assessee invested them in the aforesaid securities in the year 1969. During the accounting year 1973-74 relevant for the assessment

year concerned herein, when the assessee required funds for advancing loans to industries, it encashed the securities. Based on the above facts, we

have to decide whether the profit made by the assessee on the sale of the securities constitutes its trading receipt or capital gain? (It is not

necessary for the purpose of this case to enquire further, whether the income so arising is income from business or income from securities. The

main question in this case being whether it constitutes a gain from the sale of a capital asset, i.e., whether it is a capital gain ? It must be

remembered that the assessee is a financial institution, one of its main purposes being lending of moneys to industries, no doubt in the interest of

industrial progress of the State. At a certain point of time, it had certain moneys in its possession which were not lent for one or the other reason.

Instead of keeping these moneys idle, the assessee invested them in securities which could be easily converted into cash, as and when the assessee

required funds for carrying on its business, viz., lending moneys to industries. Reference may be made in this context to the letter of the assessee

dated 7-1-1975 stating that the securities were pledged with the RBI and that they were sold as the assessee was in need of funds for meeting its

obligations. Can it be said, in such a situation, that the assessee wanted to create a capital asset; or, should it be said that the assessee merely

invested its surplus funds in easily convertible securities as an interim measure until such time as it required funds for lending moneys to industries ?

The fact to be remembered in this connection is that in the case of financing and lending institutions, like the assessee herein, money itself constitutes

its stock-in-trade, and that even if its surplus funds are kept in easily convertible securities, it is only one form of holding the cash. In such cases, it

must be held that the investment in the securities is closely connected with the business of the assessee. Reference may be had, in this connection,

to the decision of the Privy Council in Punjab Co-operative Bank Ltd. v. CIT AIR 1940 PC 230. There the business of the bank consisted, in

essence, of dealing in money and credits. It was obliged to keep enough cash or easily realizable securities to meet any probable demand by

depositors. In such a situation, it was held that, if some securities are realised in order to meet withdrawals by depositors, it is a normal step in

carrying on the banking business. It was held that it was an act done in, what is in truth, carrying on of the banking business. This decision was

affirmed by the Supreme Court in Sardar Indra Singh & Sons Ltd. 's case (supra), the following paragraph brings out the ratio of the decision:

The principle applicable in all such cases is well settled and the question always is whether the sales which produced the surplus were so

connected with the carrying on of the assessee's business that it could fairly be said that the surplus is the profits and gains of such business. It is

not necessary that the surplus should have resulted from such a course of dealing in securities as by itself would amount to the carrying on of a

business of buying and selling securities. It would be enough if such sales were effected in the usual course of carrying on the business or, in the

words used by the Privy Council in Punjab Co-operative Bank Ltd. v. CIT [1940] 8 ITR 635, if the realisation of securities is a normal step in

carrying on the assessee's business. Though that case arose out of the assessment of a banking business, the test is one of general application in

determining whether the surplus arising out of such transactions is a capital receipt or a trading profit. The question is primarily one of fact and there

are numerous cases falling on either side of the line but illustrating the same principle. On the facts found in regard to the nature and course of the

company's business, there can be no doubt that the present case falls on the revenue's side of the line.

4. Applying the aforesaid principles, it is evident that the assessee in the present case, instead of keeping moneys idle, invested the same in

securities, which were easily convertible into cash, with the idea that as and when moneys are required for the purpose of lending, it could encash

the securities and lend money. It cannot be said, in such a situation, that the investment in securities was intended to create a capital asset.

5. The same principle underlies the decision of the Rajasthan High Court in Rajasthan Financial Corpn.'s case (supra), which has been followed by

the Tribunal. There the Rajasthan Financial Corpn., established under the State Financial Corporations Act and for the very same purpose, as the

assessee herein, had invested its surplus funds in Government securities. In May 1958, it sold those securities in order to meet certain financial

commitments and thereby incurred a loss of Rs. 21,770. It claimed the said loss as a business deduction. But the ITO disallowed the same treating

it as a capital gain. When the matter came to the Rajasthan High Court, it held that, inasmuch as the main function of the corporation was to help

industrial concerns in various ways including by way of advancing loans, and also because the sale of securities was mainly to find necessary funds

for meeting its financial commitments, the sale of securities was closely linked with the business of the corporation and, accordingly, the loss

suffered on that account must be allowed as a trading loss. We are in complete agreement with the ratio of the judgment. It must, therefore, be held

in this case as well that the profit made by the assessee by the sale of the securities was trading receipt and constituted its revenue but not a capital

receipt.

6. Before concluding, it is necessary to deal with certain decisions cited by Mr. Y. Sivarama Sastry. The first decision cited is in Madhya Pradesh

Financial Corporation Vs. Commissioner of Income Tax, Though the said decision relates to the financial corporation of Madhya Pradesh, we find

that the department conceded there that the surplus realised by the sale of bonds was a capital receipt. In view of the said concession, there was

no occasion for the High Court to consider the question on merits. It answered the question relying upon the concession to the effect that it was a

capital receipt. The next decisions cited are in Commissioner of Income Tax Vs. Guest Keen and Nettlefold Ltd., , Raja Bahdur Kamakhya

Narain Singh Vs. The Commissioner of Income Tax, Bihar and Orissa, , Rameshwar Prasad Bagla Vs. The Commissioner of Income Tax,

Lucknow, and Commissioner of Income Tax (Central), Calcutta Vs. Associated Industrial Development Co. (P.) Ltd., All these cases deal with

the question whether a particular transaction is an adventure in the nature of trade or not. Here, it is not the case of the department that the

transaction in question constituted an adventure in the nature of trade, nor is it the case of the department that the assessee is engaged in sale and

purchase of the securities. It is, therefore, unnecessary to deal with the facts or the principles of the said decisions at any length. We must,

however, deal specifically with one decision, viz., Guest Keen & Nettlefold Ltd.'s case (supra). The assessee was carrying on business as an

investment company and the transaction involved was one of sale of shares effected by the assessee to the extent of less than 10 per cent of the

total holding of the shares. It was found that prior to their sale, the shares were held by the assessee for a fairly long period. On these facts, it was

held that the assessee was not engaged in the purchase and sale of shares and that its main business being only of an investment company, the

profit made by the sale of shares is a capital gain and not a business profit. It is significant to notice that in this case, the Tribunal found on the

material before it that the surplus in the hands of the assessee by reason of transaction was a capital gain and not a business profit, and the High

Court merely held that the said finding cannot be said to be one not based on any material, or as perverse. For the above reasons, we answer the

question referred to us in the affirmative, i.e., in favour of the revenue and against the assessee. However, in the circumstances of the case, we

direct the parties to bear their own costs.