UNITED BANK OF INDIA LTD. (FOR COMILLA BANKING CORPORATION LTD.) Vs COMMISSIONER OF Income Tax, CALCUTTA.

Court: Calcutta High Court

Date of Decision: Aug. 22, 1962

Acts Referred: Income Tax Act, 1961 â€" Section 66(2)
Reserve Bank of India Act, 1934 â€" Section 42

Citation: (1963) 50 ITR 258

Hon'ble Judges: Sinha, J; Mitter, J

Bench: Full Bench

Judgement

SINHA J. - This is a reference u/s 66(2) of the Indian Income Tax Act. The facts are as follows : The assessee in this case is the Comilla Banking

Corporation Ltd., Calcutta (United Bank of India Ltd.). The said Comilla Banking Corporation Ltd., (hereinafter referred to as the ""bank"") was

incorporated under the Indian Companies Act, 1913, in the year 1914. In December, 1950, it was amalgamated with the United Bank of India

Ltd. u/s 44A of the Banking Companies Act, 1949. The bank invested its surplus funds in Government securities. The bank sold securities and

shares held by it and made new investments. In order to get a proper picture of the transactions, I set out below a table, being annexure ""A"" to the

statement of the case.

Statement of Holding and Sale of Securities :

Year Holding Sale

Rs. Rs.

1933 2,62,375 84,668

1934 3,85,012 72,052

1935 6,45,951 95,213

1936 9,56,935 ...

1937 16,20,718 ...

1938 25,21,278 ...

1939 31,91,375 ...

1940 34,53,785 ...

1941 69,75,176 ...

1942 1,05,56,825 23,484-06-0

1943 2,01,75,130 2,46,732-04-8

1944 3,06,99,956 1,97,205-11-0

1945 5,04,55,271 1,43,517-11-4

1946 6,22,89,842 25,438-00-0

In the course of these transactions, the said bank acquired from time to time certain 3 1/2% Government Promissory Notes of the face value of Rs.

1,88,37,300 at a cost price of Rs. 1,82,27,887. In the year 1946, the Government of India converted certain 3 1/2% Government Promissory

Notes, including those held by the said bank as aforesaid, into 3% Government Promissory Notes styled as ""3% Government Conversion Loan of

1946"". This was effected under notification No. D/4767/- B/46 dated the 24th May, 1946. The holders of the five kinds of 3 1/2% loan

mentioned therein were given the option of converting their holdings either into 3% Conversion Loan of 1946 redeemable at par on 16th

September, 1986, or in 2 3/4% loan 1976 issued at Rs. 99% and redeemable at par on 16th September, 1976. The bank thereupon surrendered

the said 3 1/2% Government Promissory Notes of the face value of Rs. 1,88,37,300 and secured from the Government a fresh set of promissory

notes of the same face value, bearing interest at 3%. In their account books, the bank showed the transactions in the following manner. They

showed the 3% Conversion Loan of 1946 at its face value of Rs. 1,88,37,300 instead of the cost value of Rs. 1,82,27,887 and the balance of Rs.

6,09,413 was transferred to reserve. In making assessment of the Income Tax in respect of the year 1947-48, the Income Tax Officer treated the

said amount of Rs. 6,09,413 as the business income of the assessee. The assessee contended that the amount was not taxable under the Indian

Income Tax Act, being capital gains in the hands of the company. This contention was rejected. The view of the Income Tax Officer was upheld

by the Appellate Assistant Commissioner and also by the Appellate Tribunal. Ultimately, the following question has been referred :

Is the sum of Rs. 6,09,412-10-3 representing the difference between 3% Government Conversion Loan of 1946 at par and the cost of

Government securities held by the assessee and so converted in 1946 assessable income of the assessee or a capital gain ?

The argument on behalf of the assessee is quite simple. It is argued that the bank did not deal in securities and, in any event, there was no sale of securities but the appellant was compelled to give up the securities held previously and to accept the new securities issued by the Government.

Therefore, the bank did not actually earn any profit, and in any event the book entry made in that behalf can only be treated as capital gain. In

other words, it is urged that the bank had certain surplus funds which it invested and there has been an appreciation of the investment but no actual

receipt of profit. It is, therefore, argued that there has been no income which can be the subject-matter of an assessment. As was stated by

Rowlatt J. in Royal Insurance Co. Ltd. v. Stephen, a case where the facts were similar, that a ""nice question"" has been raised and that the argument

that there was no income but merely a capital gain, is rather attractive at first sight. I shall presently deal with the decision of Rowlatt J. in that case.

The first case which is to be considered is a decision of the Privy Council in Punjab Co-operative Bank Ltd. v. Commissioner of Income Tax. The

facts in that case were as follows : The Punjab Co- operative Bank invested large amounts, mainly in India Government securities. Up to 1933,

there was no sale of these securities. From 1934, the securities began to be sold. During the year 1935, the company took advantage of the high

prices prevailing and some 10 lakhs of Government securities were sold. The difference between the cost price of the investment and the price at

which they were sold amounted to Rs. 1,42,588. The bank contended that this profit did not form a part of the profits of business because the

securities were considered as a reserve for emergencies and in 1935, a portion of it was sold to meet heavy withdrawals of deposits and to deposit

Rs. 2,66,000 with the Reserve Bank of India under the provisions of section 42(1) of the Reserve Bank of India Act, 1934. It was contended that

the bank did not deal in shares and securities and that the profit was capital gains and as such not taxable. The Income Tax Commissioner held that

the bank was liable to assessment for the profit which it made in 1934. The Judicial Committee stated as follows :

This may well be the correct view and a sufficient ground for dismissing this appeal; but their Lordships do not wish to give any support to the

contention that in order to render taxable profits realised on sales of investments in such a case as that before them it is necessary to establish that

the taxpayer has been carrying on what may be called a separate business either of buying or selling investments or of merely realising them.

The principle to be applied in such a case is now well settled. It was admirably stated in a Scottish case, Californian Copper Syndicate v. Harris,

and the statement has been more than once approved both in the House of Lords and in the Judicial Committee : see, for example, Commissioners

of Taxes v. Melbourne Trust Ltd. Some dicta which appear to support the view that it is necessary to prove that the taxpayer has carried on a separate or severable business of buying and selling investments with a view to profit in order to establish that profits made on the sale of

investments are taxable, for example, the dicta in the case of Commissioners of Inland Revenue v. Scottish Automobile and General Insurance Co.

cannot now be relied on. It is well established to cite the exact words used in Californian Copper Syndicate v. Harris 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 carrying out, of a business. In the ordinary case of a bank, the business consists in its essence of

dealing with money and credit. Numerous depositors place their money with the bank often receiving a small rate of interest on it. A number of

borrowers receive loans of a large part of these deposited funds at somewhat higher rates of interest. But the banker has always to keep enough

cash or easily realisable securities to meet any probable demand by the depositors. No doubt there will generally be loans to persons of undoubted

solvency which can quickly be called in, but it may be very undesirable to use this second line of defence. If, as in the present case, some of the

securities of the bank are realised in order to meet withdrawals by depositors, it seems to their Lordships to be quite clear that this is a normal step

in carrying on the banking business, or, in other words that it is an act done in what is truly the carrying on of the banking business.

Mr. Mitra has argued that in the present case there has been no withdrawal for the purpose of paying the depositors or for any purpose linked with

the carrying on of the business of the bank. For that purpose, several other cases will have to be decided which are nearer to the facts of the

instant case. The decision of the Judicial Committee, however, establishes the proposition that it is not necessary for the assessee to carry on a

separate business of buying and selling investments. I may at once come to the case of the Californian Copper Syndicate cited by the Judicial

Committee. In that case, a company was formed for the purpose of acquiring and reselling mining property. It resold a certain mining property to a

second company, receiving payment in fully paid shares of the latter company. It was held that the difference between the purchase price and the

value of the shares for which the property was exchanged was a profit assessable to Income Tax. The fact that the profit consisted of shares

appreciated in value and not cash profit was irrelevant. Lord Justice Clerk said as follows :

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 in the sense of Schedule D of the Income

Tax Act of 1842 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 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 ?

As I have already mentioned above, one of the arguments advanced in this case is that the bank did not receive any cash profit but merely

accepted, or was compelled to accept, new stock and, therefore, the difference in value was not assessable income. On this point it is relevant to

cite a decision of the Kings Bench Division, Royal Insurance Company Ltd. v. Stephen. The appellant company in that case held large investments,

including a variety of British railway stocks. Under the Railways Act, 1921, the company was compelled to accept new stocks in the amalgamated

companies in exchange for the stocks previously held in the companies which under the Act were either amalgamated or absorbed. The assessee

had, therefore, to exchange certain British railway stocks for stocks in the amalgamated companies, with the result that at the date of exchange the

market value of the shares received in exchange was less than the original cost. The company claimed that the difference should be allowed as a

deduction in computing its profits. The Crown contended that the company had not actually suffered any loss and that it was merely a claim to

write down the book value of investments still held.

Rowlatt J. said as follows :

It is said for the appellants that that is really nothing more nor less than a barter on a money basis or a barter for something which is moneys worth

of the old investments. That it is compulsory does not matter -numerous cases of the compulsory sales that arose in connection with the War were

cited and I think that is so. That moneys worth was given instead of cash is said to be immaterial on the authority of the Californian Copper

Companys case...... Of course if there is a realisation, there is an end of the old suspense, if I may use that word, and a new starting point is set up

so that there will be a new profit or loss when the substituted stocks are sold by comparison of what they are sold for or realised for with the figure

at which the stocks have now been acquired, the figure at which the disappeared stocks were acquired having become immaterial.

It was held that once there was an exchange of securities although compulsory, the old investments had come to an end and had disappeared. It

must be taken to be a new adventure and the value of the securities held at the date of the exchange is known, so far as the old securities were

concerned. Their value could never more go up or down. What will go up or down would be of the different shares or securities received in

exchange. The old investments must be deemed to be closed and realised. The next case to be considered is a decision of the House of Lords,

Westminster Bank Ltd. v. Osler. The facts in that case were very similar to the present and were as follows : During the years 1917 and 1918, the

appellant bank acquired National War Bonds for a large amount. On April 21, 1992, the Treasury made an offer to the holders of National War

Bonds, entitling them to surrender their holdings in exchange for pound 134, 3 1/2 per cent. Conversion Loan, for each pound 100, 5 per cent.

National War Bonds held by the appellant bank. In response to that offer, the bank surrendered a major portion of its holdings of National War

Bonds and converted the same into war loans. If these transactions amounted to a realisation of the original holdings, the profit would amount to

pound 141,750. The Inland Revenue Authorities treated that amount as the profit of the bank for the purpose of assessment of Income Tax. The

assessee contended that this was a mere accretion of capital and there has been no realisation of profits. It was held that there has been a

realisation, for as soon as the new securities were taken in place of the investments in the original war bonds, a new venture was begun in relation

to the new holdings and the fact that this transformation took place by a process of exchange, did not avoid the conclusion that there had been a

realisation of the securities. The case of Californian Copper Syndicate v. Harris and Royal Insurance Co. v. Stephen were followed. I now come

to a decision of the Supreme Court, Sardar Indra Singh & Sons Ltd. v. Commissioner of Income Tax. The facts in that case were as follows : The

appellant was a private limited company, authorised, inter alia, to carry on business undertaken by bankers, etc. The company held large number

of shares in other incorporated companies and was realising some of its holdings and acquiring large blocks of shares in other companies. In the

return for the assessment year 1938-39, the company showed a loss, as a result of such transactions, and this was allowed as a business loss. In

the assessment year 1941-42, the company claimed that the surplus resulting from similar transactions was not taxable as it amounted to a mere

change of investment and was therefore a capital gain. This contention was rejected by the Income Tax authorities, which held this was assessable as profits and gains of the companys business in dealing in shares. This was upheld by the Appellate Tribunal, whereupon there was a reference

and the Calcutta High Court also affirmed the same. There was an appeal to the Supreme Court. Patanjali Sastri C.J. said as follows :

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 assessees 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. Commissioner of Income Tax, if the realisation of securities is a normal step in carrying

on the assessees 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

companys business, there can be no doubt that the present case falls on the revenues side of the line.

The following propositions may be gathered from the decided cases :

(1) We must consider first, as to whether a particular transaction resulting in profit or loss, is a mere appreciation or depreciation of an investment

by the assessee, or is connected with the assessees business or trade.

(2) If the transaction can be said to have taken place in connection with such trade or business, and in the usual course thereof, then it is assessable

income and not a capital gain.

(3) For this purpose, it is not necessary that the assessee should be carrying on a separate business in dealing with investments.

(4) If the transaction is an exchange, it is immaterial whether it amounts to a barter. The exchange need not always be for cash. Where shares and

securities are being exchanged for other shares and securities, it is immaterial whether this is done voluntarily or by compulsion. In the matter of

such exchange, where one share or security is exchanged for another, then it must be considered as a new adventure. In other words, the old

holding must be deemed to have been realised, and the appreciation and the depreciation, as the case may be, can be at once quantified and must

be considered as profit or loss liable to assessment.

Coming now to the facts of the present case, we find from the table given above, that the bank held certain securities and from time to time sold

and invested the proceeds. The fact that there was no sale between 1936-1941 when the market was low is counter-balanced by the large scale

transactions between 1942-1946 when the market was high. The Tribunal held as a fact that the holding of securities by the assessee was

incidental to the carrying on of its banking business. As stated by the Privy Council in Punjab Co-operative Bank Ltd. v. Commissioner of Income

Tax, the holding of securities is a normal step in carrying on the business of a bank. Banking concerns always hold easily realisable securities so as

to meet probable demands of depositors. It is not at all necessary that this should be a separate business of dealing in securities. The securities

were held in a manner consistent with the normal dealings of a bank and varied from year to year as will appear from the table set out above. The

Tribunal has also pointed out that every bank was required to maintain a certain portion of its total assets in the form of Government securities

(vide section 42 of the Reserve Bank of India Act, 1934). There is no reason why we should go behind those facts as found by the Tribunal. Upon

these facts, we must come to the conclusion that the holding of the securities and the selling and reinvestment of the same and the final exchange

were all done in the due course of business, and applying the tests laid down above, the appreciation in value must be taken as profit which is

assessable.

The question, therefore, is answered as follows :

The sum of Rs. 6,09,412-10-3 representing the difference between 3% Government Conversion Loan of 1946 at par and the costs of

Government securities held by the assessee and so converted in 1946 must be taken to be the assessable income of the assessee and not capital

gain.

The assessee must pay the costs of the Commissioner of Income Tax. Certified for two counsel.

MITTER J. - I agree.