

have to sentence him to pay a fine within the limits permitted by the section, and having done so the Court may in its discretion call upon the accused to restore the property and in default of either payment of fine or restitution of the property the accused may further be ordered to undergo a sentence of imprisonment in default. This judgment, in our opinion, seems to support the construction which we are disposed to put on s. 105 of the Insurance Act. If the order which the learned Government Pleader wants us to pass against the respondents cannot be passed without infringing the provisions of s. 26 of the General Clauses Act and art. 20 (2) of the Constitution, we must hold that the learned Magistrate was right in acquitting the respondents of the offence charged.

In the result, the order of acquittal passed in favour of the respondents is confirmed and the appeal is dismissed.

*Appeal dismissed.*

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### INCOME-TAX REFERENCE

*Before Mr. M. C. Chagla, Chief Justice and Mr. Justice Tendolkar.*

THE COMMISSIONER OF INCOME-TAX, BOMBAY CITY I, BOMBAY APPLICANT, *v.* BAI SHIRINBAI K. KOOKA, BOMBAY, RESPONDENT.\*

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*Indian Income-Tax Act (XI of 1922), s. 10 (2)—Shares previously purchased by assessee converted into her stock-in-trade of business—Sale of such shares during year of account relevant to assessment year—Assessable profits on such sale, how computed.*

S. E. K., assessee, purchased certain shares for investment and on April 1, 1945 she converted them into her stock-in-trade and carried on business in shares. Some of these shares were sold in the year of account relevant for the assessment year 1947-48. The contention of the assessee that only the difference between the sale price and the market-price prevailing on the date on which the assessee converted them into her stock-in-trade and not the difference between the sale-price and the cost-price could be taxed was upheld by the Income-Tax Appellate Tribunal. On reference at the instance of the Commissioner of Income-Tax, Bombay City I, Bombay,

*Held*, that profits assessable to tax are commercial profits, that is, profits made in a business by the carrying on of the business which a commercial man would accept as profits of that business. The commercial profits on a sale of an article, therefore, can only be the difference between what that article realises and what that article cost the business—not what it had cost someone else.

*Held*, therefore, that the assessee's assessable profits on the sale of shares were the difference between the sale-price and the market price prevailing on April 1, 1945.

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*Kikabhai Premchand v. Commissioner of Income-Tax*,<sup>(1)</sup> distinguished. *Sharkey (Inspector of Taxes) v. Wernher*,<sup>(2)</sup> *Dublin Corporation v. N'Adam (Surveyor of Taxes)*,<sup>(3)</sup> and *Gresham Life Assurance Society v. Styles*,<sup>(4)</sup> referred to.

Bai Shirinbai K. Kooka, assessee, held a large number of shares prior to 1945. On April 1, 1945 she converted her investment shares into her stock-in-trade and carried on business in shares. In the financial year 1946-47, relevant for the assessment year 1947-48, the assessee sold some of her shares and on such sale realised Rs. 5,49,487. The Income-tax Officer determined the assessable profits on such sale at Rs. 98,665 being the difference between the sale proceeds and the market price of the shares as on April 1, 1946. The Income-Tax Officer if he wanted to follow the decision of his predecessor for the previous assessment year ought to have deducted from the sale proceeds the market price prevailing on April 1, 1945 and not on April 1, 1946.

On appeal, the Appellate Assistant Commissioner determined the assessable profits at Rs. 3,52,382 being the difference between the sale price and the original cost price paid by the assessee. On appeal to the Income-Tax Appellate Tribunal, there was a difference of opinion between members constituting the bench, the Judicial member agreeing with the Appellate Assistant Commissioner while the Accountant Member supported the view of the Income-Tax Officer. The President on the case being submitted to him agreed with the opinion of the Accountant member. At the instance of the Commissioner of Income-Tax, Bombay City I, Bombay, the following question was referred to the High Court of Judicature at Bombay:—

“Whether the assessee’s assessable profit on the sale of shares is the difference between the sale price and the cost price or the difference between the sale price and the market price prevailing on April 1, 1945?”

M. P. Amin, Advocate General with G. N. Joshi for the Appellant.

N. A. Palkhiwala with Sir Jamshedji B. Kanga for the Respondent.

Chagla C. J.—The question submitted to us in this reference should have really presented no difficulty but for a recent decision of the Supreme Court reported in *Kikabhai Premchand v. Commissioner of Income-tax*,<sup>(5)</sup> which has been very strenuously relied upon by the Advocate General as supporting his contention. The assessee who is a woman purchased shares for investment and on April 1, 1945 she converted these shares into her stock-in-trade and carried on a business in shares. Some of these shares were sold in the assessment year 1947-48, and the

1. [1953] 24 I. T. R. 506.

2. [1955] 3 All. E. R. 493.

3. (1891) 2 T. C. 387.

4. (1892) 3 T. C. 185.

5. (1953) 24 I. T. R. 506.

question that had to be considered was how was the profit of the assessee to be ascertained with regard to the price realised by her on the sale of these shares? Was the profit to be ascertained on a difference between the price realised and the price at which she had originally bought these shares, or the difference between the price realised and the market price ruling on April 1, 1945 when these shares were converted into stock-in-trade?

Apart from authorities, let us try and understand the real nature of the transaction and the basis on which the profits of the assessee should be subjected to tax. The Department has assessed her under s. 10 (2) of the Income-tax Act and has contended that the profits constituted her business profits. Now, she started her business from April 1, 1945, prior to that she had no business at all, and the profits which can be taxed in the hands of the assessee are realised by carrying on this particular business which as just pointed out commenced on April 1, 1945. It is settled law to which it is hardly necessary to refer that what is to be brought to tax is the real profits of a business. In order to arrive at those real profits you must consider the accounts of that business on commercial principles, and as the Privy Council said in *Gresham Life Assurance Society v. Styles*,<sup>(6)</sup> you must construe the profits in their normal and natural sense, in a sense in which no commercial man will misunderstand. Therefore, it may be said that what is being assessed to tax in a business are not any profits considered from a theoretical, academic or legalistic sense, but profits that are being assessed to tax are commercial profits, profits which are made in a business by the carrying on of the business which a commercial man would accept as profits of that business. It is not the point of view of the Department with regard to the profits which should prevail with the Court; it is the point of view of the commercial man.

Applying that test, what are the profits of this business which are liable to tax? It is said that when the assessee transferred these shares into her business and converted them into her stock-in-trade on April 1, 1945 it did not cost her anything and the shares were brought in as they stood and as they were when she purchased them for her investment, and therefore the proper value to put upon the shares on April 1, 1945 is the actual cost price and not the price prevailing on that day. It is said that to adopt any other method is to introduce a legal fiction which the law does not permit. To say that the shares cost on April 1, 1945 the market price would be to say something which is factually not correct, when as a matter of

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fact these shares were purchased at a time when the price was less than the price prevailing on April 1, 1945. In order to ascertain the real profits or the commercial profits, what has to be ascertained is what an article cost the business and what the business realised by the sale of that article. It is in our opinion irrelevant to consider what that article cost some one else. As a learned Law Lord has said, it is merely a historical record of what was previously spent on that article. That historical record, although of some interest to a student of history, would be of no interest or relevancy to the court which is deciding and determining what the commercial profits of a particular transaction are. The commercial profits of a transaction which is the sale of an article can only be the difference between what that article realises and what that article cost the business. If that be the true view, then it is impossible to contend that these shares cost the business anything less or more than their market value on April 1, 1945. When the assessee purchased these shares at a lesser price, that is what they cost her, not the business. This was long before the business was started, long before the shares were converted into stock-in-trade, but when we come to the relevant point of time which is April 1, 1945, it is then that we have got to make the inquiry what was the value of these shares on that date and what it cost the business, so that we should ultimately be in a position to decide what the real profits were when that asset or article was ultimately sold.

It may also be said that the real question that arises on this reference is what is the content of taxable profits in the amount received by the assessee by the sale of these shares. Admittedly the whole receipt is not profits, admittedly the whole receipt cannot be assessed to tax, only a portion of the receipt which are profits is liable to tax, and the question is what proportion or what portion of the receipt can be considered to be profits which can be brought to tax. The matter may be looked at from another point of view. What the Department has to satisfy us is that the amount out of the sale proceeds of the shares which they seek to bring to tax is an amount which can be properly attributable to the business profits of the assessee. If any part of the amount is not attributable to the business profits of the assessee, then the assessee is not liable to pay tax thereon. The matter may be looked at from a third point of view. The assessee purchased these shares prior to April 1, 1945, and when she converted them into her stock-in-trade they had appreciated and if on that date she had sold these shares she would have realised an advantage which, as there was no capital gains tax then, would not have been liable to tax. It is true that she did not do so and she did not realise those profits,

and therefore her capital appreciation on that date merely remained in the stage of potential profits. But when she does sell these shares the Court has got to consider how these profits should be distributed or allocated. The Income-tax law is familiar both with notional profits and notional distribution of actual profits. The case we have before us is not a case of notional profits at all. The case that we have before us is a case of actual real profits, but what is notional is the distribution or allocation of these profits, and it is difficult to contend in our view that the whole of this actual profit can only be attributed to the business activity of the assessee and could be said to be her trading profit. Quite obviously a portion of these profits must be notionally attributable to the capital appreciation brought about in these shares when they did not belong to the business, when they formed part of the investment of the assessee, and when these shares had nothing whatever to do with the business which she later commenced. If it is open to us to allocate or distribute actual profits notionally, then this is a clear case where all the real profits cannot be allocated to one single aspect of the assessee's activity but must be distributed to the two different activities which resulted in these profits, and these two different activities were, one, as an investor purchasing shares for capital appreciation, and the other for the purpose of making profit by purchase and sale of these shares.

If we have correctly posed the problem which we have to solve in this reference, then in our opinion the decision on which the Advocate General has relied is clearly distinguishable and does not preclude us from coming to the decision which we propose to do. The case that went before the Supreme Court was the converse of the case that is before us and, as we shall presently point out, the question that the Supreme Court had to decide was entirely different from the question that we have to decide. In that case, *Kikabhai Premchand v. Commissioner of Income-tax*,<sup>(7)</sup> the assessee was a dealer in silver and shares and he maintained his accounts according to the mercantile system and valued his stock at cost price both in the beginning and at the end of the year. During the accounting year he withdrew some silver bars and shares from the business and settled them on certain trusts in which he was the managing trustee, and in his books of account he credited the business with the cost price of the bars and shares so withdrawn. The Income-tax authorities assessed him to tax on the basis of the difference between the cost price of the silver bars and shares and their market value at the date of their withdrawal from the business. This Court upheld the

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action of the Income-tax authorities and the Supreme Court came to a contrary conclusion. It will be noticed that this is a case where an assessee took out an asset belonging to the business from the business. It will also be noticed that this is a case where there was no sale of the asset and that the very basis of taxation was a fictional sale. The Income-tax Department and the High Court assumed for the purpose of its decision that on the date that these shares and silver bars were taken out of the business and put into the trust, in the eye of the law there was a sale, and if at that date the market value was higher than the cost price the assessee had made a profit in the business. The Supreme Court rejected the basis which we had taken as the correct basis and what the Supreme Court said was—and we shall presently point out the relevant passages—that you cannot tax an assessee on a fictional sale; you cannot tax an assessee on prospective profits. The Supreme Court pointed out that it is perfectly true that if the assessee had sold his shares and the silver bars on the day when the trust was executed, he would have made a profit, but in fact he did not, and therefore the profits remained in the stage of being potential profits, those profits were never realised, and you cannot tax an assessee on profits which are merely potential and are not realised. This, in our opinion, is the real ratio of the decision of the Supreme Court.

Now, the distinction between that decision and the case we have to consider will be immediately realised. Whereas the Supreme Court was dealing with the case of fictional sale and potential profits, we are dealing with a case of real sale and actual profits. Whereas the Supreme Court was never called upon to consider how trading profits of a business should be determined and what is the commercial basis on which profit should be assessed, we are called upon to decide that very question. It is impossible to suggest, as must be the suggestion underlying the Advocate General's submission, that if that case applied to the facts of this case, the Supreme Court after considering the matter overruled the well settled law both in India and in England, that profits which are assessable under s. 10 (2) are commercial profits, and that the profits should be ascertained on commercial principles. With very great respect, the Supreme Court had never to consider that point or that question, and therefore it would not be correct to say that in giving this decision the Supreme Court overruled the well settled principles of Income-tax law. It will also be noticed that what the Supreme Court was really dealing with was notional profits. It was the demand of the revenue which it repelled, and emphatically repelled, that it had a right not only to tax actual but notional profits. We have no guidance,

again with respect, from the Supreme Court what its answer would have been if the Taxing Department sought to tax real profits and the question that arose was how were the real profits to be allocated or distributed.

The passages relied upon by the Advocate General are these. First is at p. 507:

"In this case, the method employed was the cost price method, that is to say, the cost price of the stock was entered at the beginning of the year and not its market value and similarly the cost price was again entered at the close of the year of any stock which was not disposed of during the year. The entries on the one side of the accounts at the beginning of the year thus balance those on the other in respect of these items with the result that so far as concerned the books show neither a profit nor a loss on them."

At p. 509.

"As regards the first contention, we are of opinion that the appellant was right in entering the cost value of the silver and shares at the date of the withdrawal, because it was not a business transaction and by that act the business made no profit or gain, nor did it sustain a loss, and the appellant derived no income from it."

In saying that, the Supreme Court is emphasising the fact that there was no real sale and the sale relied upon by the Department was a fictional sale. Lower down on the same page is another passage on which very strong reliance is placed by the Advocate General:

"In the present case disregarding technicalities it is impossible to get away from the fact that the business is owned and run by the assessee himself. In such circumstances we are of opinion that it is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a fictional profit which in truth and in fact is non-existent. Cut away the fictions and you reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the face of it is not only absurd but against all canons of mercantile and income-tax law. And worse. He may keep it and not show a profit. He may sell it to another at a loss and cannot be taxed because he cannot be compelled to sell at a profit. But in this purely fictional sale to himself he is compelled to sell at a fictional profit when the market rises in order that he may be compelled to pay to Government a tax which is anything but fictional."

The clear anxiety of the Supreme Court to save the assessee from the inroads of an exacting revenue department is obvious from this passage and the Supreme Court set its face against the taxing department imposing a real tax upon a fictional profit.

The Advocate General says that the real ratio that arises from the judgment is that a man cannot sell to himself, nor can he make a loss or profit out of a transaction himself, and he says that if that ratio is to be applied to what happened on April 1, 1945 then it is clear that the assessee could not have done business with herself in the sense of selling these

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shares to the business at a higher price or could not have made a profit in a transaction with herself. The principle enunciated by the Supreme Court about a person not being able in law to do business with himself or to make profit or loss out of a transaction with himself was enunciated in the context of the fictional sale which the Supreme Court was considering. We do not, with respect, read these observations to mean that even for the purpose of accountancy, that even for the purpose of ascertaining commercial profits, it is not open to the Court to value the shares at a particular price when they are brought into the business merely because those shares belong to the same person who starts the business and who had purchased them at a higher price. We put the question to the Advocate General, and the Advocate General for sometime fought shy of answering the question as to what would have been the position if these shares had been gifted to the assessee and she had brought them into the business, and we asked him that if according to him that was the ratio of the Supreme Court judgment the result would be that for the purpose of assessing her profit the cost of the shares would have to be taken as zero and the whole of the receipt would have to be brought to tax, and the Advocate General had ultimately to concede that that might be the result. A commercial man would be horrified if it was suggested that from the business or commercial point of view the profit made by a businessman who brings into that business a valuable asset which he has obtained free was profit on the basis of treating the valuable asset as of no value at all. We do not think that the Advocate General is really fair to the Supreme Court when he suggests, again with great respect, that the Supreme Court laid down a proposition which would result in business profits being taxed on a basis which is clearly not commercial.

We may also point out that after the Supreme Court delivered that judgment, the House of Lords had to consider a very similar question, and the House of Lords has taken the view which we took and not the view taken by the Supreme Court. Mr. Palkhivala drew our attention to the fact that the House of Lords is a very high authority and we should carefully consider its judgment. The House of Lords may be a high authority, but as far as we are concerned the Supreme Court is a higher authority and we must respectfully accept the law as laid down by that Court. Therefore, to the extent that the House of Lords has taken a different view of the law from that of the Supreme Court, we must accept the law as laid down by the Supreme Court. But there are certain observations in the learned judgments of the Law Lords which have a bearing on the question that we are deciding and perhaps those observations may be

looked at. The decision is reported in *Sharkey v. Wernher*<sup>(8)</sup>. The facts are rather interesting. The assessee transferred five horses from her stud farm to her racing stable. In her farm account she showed the cost of breeding the horses as a debit and she claimed that the same figures should be credited in respect of the transfer for income-tax purposes. And the House of Lords held, Lord Oaksey dissenting, that the horses must be treated as having been disposed of by way of trade, and the sum which should be regarded as having been received on the disposal of the horses must be a sum equivalent to their market value. Now, here was a case of an asset going out of the business of the assessee. This was a case of a fictional sale and to the extent that the House of Lords has taken a contrary view to the view taken by the Supreme Court, the view of the Supreme Court must prevail and with respect we must look upon that view as the only correct view of the law. But apart from this aspect, as we just said, there are certain observations which deal with the question of commercial accounting and they are of help because we have chosen to decide this question on the basis of commercial accounting. Viscount Simonds points out at page 497 that the taxpayer may, in certain cases, be subject to a sort of dichotomy for income-tax purposes and be regarded as selling to himself in one capacity what he has produced in another, and, secondly, that he is regarded as selling what he sells at market price. It is perfectly true that this dichotomy has been rejected by the Supreme Court, but, with respect, it has only been rejected in the case of a fictional sale. If we are applying this dichotomy at all it is entirely to a different case where there is an actual sale and the dichotomy is being applied for the purpose of assessing business profits which are liable to tax. Again, Viscount Simonds looks at this question from the point of view of commercial accounting, as the learned Viscount points out at page 498:

"In the same way, it would, I suppose, be claimed that, if Lady Zia were to transfer or re-transfer a horse from her racing establishment to her stud farm, some figure would have to appear in the stud farm accounts in respect of that horse, though it cost her nothing to make the transfer. If it were not so, and she subsequently sold the transferred horse and the proceeds of sale were treated as receipts of the stud farm, she could justly complain that she had been charged with a fictitious profit."

Therefore, the whole question is, in the business accounts what is the proper figure that should be put down against the purchase price of the shares brought into the business on April 1, 1945? If you do not put down the market price prevailing at that date, then in the language of Viscount Simonds

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the taxing department is charging the assessee on a fictitious profit, a profit which the business did not make. At page 502:

"For we are required to assume, what those decisions in effect denied, that the activities to which the accounts relate do constitute a trade for income-tax purposes; and our problem is to determine what, on that basis, are the proper entries to make in those trading accounts in relation to certain transactions with trade stock."

That is exactly our problem. What are the proper entries to make with regard to the shares which were sold and which have realised a profit. Lord Redcliffe, after citing the proposition of Palles C. B. in *Dublin Corpn. v. M'Adam (Surveyor of Taxes)*,<sup>(9)</sup> that "No man, in my opinion, can trade with himself; he cannot, in my opinion, make, in what is its true sense of meaning, taxable profit by dealing with himself.....", observes:

"So all things considered, I do not think that we ought to treat the respondent's general proposition as precluding the possibility that the income tax scheme may be found to require that, in certain situations, a taxpayer should be treated as if he had dealt with himself on commercial terms."

Lord Radcliffe also points out that this is the only view which would result in the burden of tax being more equitably distributed because, as he points out, any other view would put two assesseees doing the same business in different situations. In this very case we might have had a business man starting a business on April 1, 1945, and buying the stock for the first time in which case undoubtedly the profits would be assessed on the difference between the price of the shares purchased and the price that the shares ultimately realised 'on sale. But the assessee is to be put on a different footing and to be assessed to a higher tax although she starts the business on the same day, brings the same shares into the stock-in-trade, sells them and realises the same price because she had the shares before and she had bought them at an earlier period for a smaller price. The learned Law Lord also points out that

"a tax system which allows business losses to be set off against taxable income from other sources is, in my opinion, bound to reject such a method because of the absurd anomalies that it would produce as between one taxpayer and another. It would give the self-supplier a quite unfair tax advantage."

It may be said that this particular observation is in reference to the view which we accepted and which was rejected by the Supreme Court, but we are merely relying on this observation for the purpose of coming to the conclusion that in deciding what are business profits we should not take a view which would give one business man an unfair tax advantage over another.

It has been very strongly urged by the Advocate General that it is our duty, whatever our own views may be, to give effect to the decision of the Supreme Court. With very great respect, a decision of the highest Court is a decision which is true with regard to the facts on which that decision is based. Logical corollary may follow from that decision and a Court may be asked to accept the logical corollary and to extend the principle of that decision, but the binding nature of the decision depends upon what is the ratio which applies not only to the facts in that particular case but would be applicable to other facts as well. It is perfectly true that no two decisions can have identical facts and it is not in that sense that one decision should be distinguished from another. But once the ratio is discovered then the case is not an authority for a proposition that may seem to follow logically from it, as was stated by Lord Halsbury in *Quinn v. Leatham*.<sup>(10)</sup> We need hardly say that if we were satisfied that the ratio of the Supreme Court judgment applied to the facts of this case, whatever our view might have been we would have unhesitatingly applied it and come to a decision in conformity with the decision of the Supreme Court. But when we are asked to extend the principle of that decision, with very great respect, we hesitate to do so because we feel that if all the aspects of the matter had been present before the Supreme Court they would not have agreed to extend that principle to cases where an asset was realised by a business man and where the question arose as to what were his business profits and how those business profits should be allocated.

Under the circumstances, we must uphold the view taken by the Tribunal and decide the question as follows: "The assessee's assessable profit on the sale of shares is the difference between the sale-price and the market price prevailing on April 1, 1945."

The Commissioner to pay the costs.

*Attorneys for appellant*:—N. K. Petigara.

*Attorneys for defendants*:—Manilal, Kher and Ambalal & Co.

*Order accordingly.*

P. M. P.

10. (1901) A. C. 495.