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COMMISSIONER OF INCOME TAX

v.

RAM KUMAR AGGARWAL AND BROS.

NOVEMBER 2, 1993.

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[B.P. JEEVAN REDDY AND S.P. BHARUCHA, JJ.]

Income Tax Act, 1922 : Partnership firm—Purchasing all equity shares of a company—Taking over its management—Shares of the company held as stock-in-trade—Liquidation of the company—Surplus received on liquidation—Whether includible in the total income of the assessee.

Companies Act, 1956 : Section 511—Shareholding in a company—Distribution of assets—Proportionate to shareholding—After distribution shareholding comes to an end.

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The respondent - Assessee, a partnership firm was dealing in shares. In the year 1945, it purchased all the equity shares of a company and took over its management. In all the subsequent assessment years, he took the stand that he held the said shares as his stock-in-trade and obtained certain benefit on that basis. The Company went into liquidator and the assessee received surplus amount from the liquidator in the previous year relevant to AY 1956-57. In the assessment proceedings for the year 1956-57, the assessee admitted again that the shares of the said company were held by it as stock-in-trade. On that basis, the Income Tax Officer included the surplus amount received by the assessee, from the liquidator of the company, in the total income of the assessee. The assessee preferred an appeal to the Appellate Assistant Commissioner against this inclusion and the same was dismissed. But, on further appeal, the Income Tax Appellate Tribunal ordered the deletion of the addition made by the ITO.

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At the instance of the Revenue, a reference was made to the High Court on the questions whether the shares of the company were held by the assessee as stock-in-trade and whether the surplus amount received on liquidation of that company was not includible in the total income of the assessee. The High Court answered the questions in assessee's favour.

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Being aggrieved by the judgment of the High Court, the Commissioner of Income Tax preferred the present appeal, contending that the

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assets which a shareholder received on the liquidation of a company was in lieu of and on account of the shares held by him, that when a company went into liquidation and the liquidator distributed the assets among the shareholders the company ceased to exist, that it was not necessary that there should be a sale or transfer of shares for the income to arise and once the shares got converted into money (or other assets), by whatever means it may be, the money (or assets) received by the holder of such shares must be held to have realised the value of the said shares.

Allowing the appeal, this Court

HELD : 1.1. The concluding words of section 511 of the Companies Act, 1956, indicate that the assets of a company, on its liquidation, shall be distributed among the shareholders according to their rights and interests in the company which necessarily means according to their share-holding. What each shareholder gets is proportionate to his share-holding in the company. Once the distribution takes place, the shares and the share-holding come to an end. The fact that the shares may technically continue until the name of the company is struck off the register of the company is of little significance. After the distribution of the assets, nothing remains of the shares. [508-F-H]

1.2. So long as money is received in lieu of shares, there is a receipt and where an assessee is a dealer in shares, any surplus amount received by him constitutes his income. Where a company goes into liquidation and the liquidator distributes the assets of the company among the shareholders, what each shareholder gets is in lieu of his shareholding. That is the worth, the value and the price of his shareholding. A shareholder participates in the distribution of the assets of a company on its liquidation by virtue of, and because of, his shareholding. [509-B-D]

1.3. The money received by the assessee in lieu of its share-holding partakes the same character in which he held the shares. If he held the share as stock-in-trade, the money received by it represents his income, i.e., a revenue receipt in its hands. If it held them by way of investment, the money it receives represents a capital receipt by it. [509-E]

Commissioner of Income Tax, U.P. v. Madan Gopal Radhey Lal, 73 I.T.R. 652, Distinguished.

- A *Dalmia Cement Paper Marketing Co. Ltd. v. Commissioner of Income Tax, Bihar and Orissa*, 17 I.T.R. 141, approved.

Hari Prasad Jayanti Lal and Co. v. Income Tax Officer, Ahmedabad and Anr., 59 I.T.R. 794, referred to.

- B *Brogan v. Stafford Coal and Iron Co. Ltd.*, 41 Tax Cases 305, *Commissioner of Inland Revenue v. George Burrell & Anr.*, 9 Tax Cases 27, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1453 of 1976.

From Judgment and order dated 19/20th May, 1975 Calcutta High Court in Income Tax Reference No. 227 of 1968.

- D G.C. Sharma, W.C. Chopra, T.R. Talwar and Ms. A. Subhashini (N.P.) for the Appellant.

P.K. Mukherjee (N.P.) for the Respondents.

The Judgment of the Court was delivered by

- E **B.P. JEEVAN REDDY, J.** This appeal arises from the judgment of a Division Bench of the Calcutta High Court answering the question referred to it in favour of the assessee and against the revenue. The Assessment Year concerned herein is 1956-57. The three questions referred at the instance of revenue, for the opinion of the High Court are :

- F "(1) Whether on the facts and in the circumstances of the case, the Tribunal was justified in investigating the nature of the shares held by the assessee in Chrestian Mica Co. Ltd. when both the assessee and the Income-tax Authorities has treated them as the stock-in-trade of the assessee as a dealer in share for every assessment year since 1949-50 and proceeded on the same basis for the instant assessment year?

- G (2) Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the shares held by assessee in Chrestian Mica Co. Ltd. were not its stock-in-trade for dealing in shares?
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(3) If the answer to question (2) be in the negative then whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rupees Thirty Two lacs twenty five thousand and five hundred and fifty was not assessable in the hands of the Assessee?" A

The assessee is a partnership firm. The accounting year relevant to assessment year 1956-57 was the year ending on December 31, 1955. The Income Tax Officer made an assessment on a total income of Rs. 36,41,544 which included a sum of Rs. 32,25,550 representing the surplus which the assessee received during the previous year from the liquidator of Chrestian Mica Co. Ltd. which went into voluntary liquidation in the year 1955. The assessee preferred an appeal to the Appellate Assistant Commissioner objecting to the inclusion of the said surplus amount. The appeal was dismissed, But on further appeal, the Income Tax Appellate Tribunal agreed with its contention. B
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The assessee was a regular dealer in shares. In the year 1945, it purchased all the equity shares of Chrestian Mica Co. Ltd. which was then a public limited company. The assessee took over its management. In 1947, the company was converted into a private limited company. For the A.Y. 1949-50, the assessee claimed a trading loss of Rs. 29,88,735 stated to be the loss suffered on account of depreciation of the value of the shares of the said company. This claim was made on the basis that all the shares of the company were held by it as stock-in-trade. It's claim was allowed by the Tribunal on appeal. In all the subsequent assessments, the said shares were treated as its stock-in-trade and value of those shares as claimed by the assessee was adopted. D
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In the assessment proceedings relating to the assessment year concerned herein (1956-57), the assessee admitted that the shares of the said company were held by it as stock-in-trade. On that basis, the said surplus amount received by it from the liquidator was included in its total income by the I.T.O. and the A.A.C. On appeal, however, there was a difference of opinion between the Judicial Member and the Accountant Member whereupon the matter was referred to the Vice-President. He upheld the assessee's plea. Then followed the reference to the High Court. F
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Before the High Court, the counsel for the assessee contended that the admission and concession made by the assessee to the effect that the H

- A, said shares were held by it as stock-in-trade was erroneous and was, therefore, not binding upon it. Some decisions relating to adventure in the nature of trade were relied upon in that behalf. The said contention was, however, rejected by the High Court and rightly in our opinion. It was then argued for the assessee that the said shares ceased to be stock-in-trade of the assessee the moment the company was converted from a public limited company to a private limited company. This contention was also rejected by the High Court. The High Court then considered the question whether the amount received by the assessee from the liquidator was in lieu of the shares held by it. Following the decision of the House of Lords in *Commissioner of Indian Revenue v. George Burrell & Anr.*, 9 Tax Cases 27, it held that whatever is received by a share-holder on the liquidation of a company is not the income of the property but the property itself. The High Court referred to certain other English and Indian decisions and observed that as a general rule, what is distributed in a liquidation is capital whatever may have been its source. It also observed that there was no sale or transfer of the shares held by the assessee - "the liquidator sells the assets of the company and not the shares of the shareholder", it observed. Reference was also made to the provisions of Section 211 of the Indian Companies Act, 1913 and Section 511 of the Companies Act, 1956. For all the said reasons, the questions referred were answered in favour of the assessee. Dipak Kumar Sen, J. delivered a separate concurring opinion. The learned Judges did not place much reliance upon the English decisions. He pointed out that in none of the English decisions relied upon before them, did the assessee hold the shares as stock-in-trade. The main ground upon which he held in favour of the assessee runs thus; "where a limited liability company is liquidated and the liquidator distributes the surplus assets, there is no transaction in the trading sense between the liquidator and the shareholders. Irrespective of the decision of the shareholders the liquidator has to carry out his duties and obligation as laid down in the Companies Act. No consideration passes from the liquidator to the shareholder as in the case of sale. Nor can it be said that the liquidator in distributing the surplus assets is realising or redeeming the shares. In law, a shareholder may technically continue to be a shareholder even after he gets his share of the surplus. Till the company is struck off the register, he remains a shareholder in law. He retains his share scrips. By virtue of his holding H shareholder is entitled to surplus assets on the liquidation of company and

such surplus assets it appears to me to be in the nature of and accretion to his share." A

Sri G.C. Sharma, learned counsel of the revenue characterised the view taken the High Court as unsustainable in law besides being unrealistic and hyper-technical. Learned counsel submitted that the assets which a shareholder receives on the liquidation of a company is in lieu of and on account of the shares held by him. Once a company goes into liquidation and the liquidator distributes the assets among the shareholders (after discharging the liabilities, if any) the company ceases to exist, though technically speaking it may continue as such until its name is struck off the register of companies. It is not necessary, submitted the learned counsel, that there should be a sale or transfer of shares for the income to arise. Once the shares get converted into money (or other assets), by whatever means it may be, the money (or assets) received by the holder of such shares must be held to have realised the value of the said shares. B C

Though the respondent was duly served and was represented by Sri P.K.Mukherjee, it was represented by the learned counsel on the last date of hearing that inspite of repeated letters by him, the assessee was not responding and, therefore, he was obliged to report 'no instructions'. Thereafter, he did not participate in the hearing of the appeal. D

Whether shares of a company held by a person constitute his capital or his stock-in-trade, is not a pure question of law but essentially one of fact. While one person may hold the shares of a company by way of investment, the other may hold them as his stock-in-trade. In this case, it is clear beyond any doubt that the assessee has been holding the shares of the aforesaid company as its stock-in-trade. In the earlier years, it claimed a trading loss on the footing that they represented its stock-in-trade. Even in the assessment proceedings for the A.Y. 1956-57 (concerned herein), it took the very same stand though at the stage of Tribunal and his Court, it sought to wriggle out of the said admission unsuccessfully. The High Court has held rightly that it cannot do so and that it is bound by its admission and its course of conduct over the past several years. The High Court, it may be recalled, has also rejected its further submission that the said shares ceased to be its stock-in-trade on the conversion of the company from a public limited company to a private limited company. If so, it follows that if the assessee receives any surplus amount in lieu of the said shares, it E F G H

- A must be held to be a revenue receipt in his hands. It can not be denied that the amount received by the assessee from the liquidator in this case was in lieu of its share-holding. In effect and in truth, the amount received by it represented the recompense for its shares, even though it is true there was no transfer of shares from the assessee to the liquidator or to any one else. It was a case of return for the money paid by the assessee for acquiring the said shares. In one case, the return may be more than what the holder paid for them while in another it may be less, the character of the receipt remains the same. The High Court has however held in favour of the assessee opining that (i) whatever is received by the shareholder on a liquidation of a company is "no income of the property but the property itself", (ii) that whatever is distributed in a liquidation is capital, whatever may have been its source, as held in *Brogan v. Stafford Coal and Iron Co. Ltd.*, 41 Tax Cases 305, (iii) in the course of liquidation of the company the liquidator sells the assets of the company and not the shares of the shareholders; and (iv) where a limited company is liquidated and the liquidator distributes the surplus assets, there is no transaction in the trading sense between the liquidator and the shareholders. By virtue of his holding, a shareholder is entitled to surplus assets on the liquidation of the company and such surplus assets are in the nature of an accretion to the shares held by him.
- E The question is whether the opinion of the High Court is correct in law? We find it difficult to say so. Section 511 of the Companies Act applies to every voluntary winding-up. It says that "subject to the provisions of this Act as to preferential payments, the assets of a company shall, on its winding-up, be applied in satisfaction of its liabilities *pari passu* and, subject to such application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company." The concluding words of this Section indicate that the assets of a company, on its liquidation, shall be distributed among the shareholders according to their rights and interests in the company which necessarily means according to their share-holding. What each shareholder gets is proportionate to his share-holding in the company. Once the distribution takes place the shares and the share-holding come to an end. The fact that the shares may technically continue until the name of the company is struck off the register of the company is of little significance. After the distribution of the assets nothing remains of the shares. To say that the assets a

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shareholder receives on the liquidation of the company are unrelated to his share-holding is to be blind to the reality. Such an argument ignores the basic reality recognised by Section 511 of the Companies Act. The same comment holds good about the argument that the amount received is an accretion to the shares. It is true that a liquidator does not sell the shares. It is equally true that there is no transfer of shares by the shareholder to the liquidator or to any other person. That is not really necessary. So long as money received in lieu of shares, there is a receipt and where an assessee is a dealer in shares, any surplus amount received by him constitutes his income. As stated above, where a company goes into liquidation and the liquidator distributes the assets of the company among the shareholders, what each shareholder gets is in lieu of his share-holding. That is the worth, the value and the price of his share-holding. A shareholder participates in the distribution of the assets of a company on its liquidation by virtue of and because of his share-holding. We, therefore, find it difficult to agree with the High Court that a shareholder participates in the distribution of assets on the liquidation of the company *de hors* his share-holding. Once this is so, it follows that the money received by the assessee in lieu of its share-holding partakes the same character in which he held the share. If he held the shares as stock-in-trade, the money received by it represents his income, i.e., a revenue receipt in its hands. If it held that by way of investment, the money it receives represents a capital receipt by it.

It would be appropriate at this stage to consider the decisions cited by Sri G.C. Sharma and those referred to in the Judgment of the High Court. In *Commissioner of Income Tax. U.P. v. Madan Gopal Radhey Lal*, 73 I.T.R. 652, it was held that though the assessee held certain shares of a company as stock-in-trade, the bonus shares issued by the company and received by him as capital. On the facts of that case, however, it was held that since the assessee had converted the same into his stock-in-trade, the sale proceeds of the said bonus shares represented his business receipts. We are unable to see any relevance of the said proposition to the question at issue herein. At the relevant time, under the Income Tax Act, 1922, issue of bonus share by capitalisation of the accumulated profits was not treated as distribution of dividend. It is the said circumstance which seems to have influenced the decision of this Court. The learned counsel for the revenue brought to our notice a passage from the opinion of Lord Evershed in *Brogan*. At page 333, the following statement occurs :

- A "It cannot now be in doubt that surplus assets in the hand of the liquidator of a limited liability company-whether limited by share capital or by guarantee are in his hands capital. Such a conclusion was laid down by the Court of Appeal in *Commissioner of Inland Revenue v. Burrell*, [1924] 9 T.C.27 and it has never since been questioned. The terms of Section 302 of the Companies Act, 1948, are entirely consistent with this view, for they speak of the "property of the company" being distributed as therein stated. I agree that the fact that the surplus assets of a company upon its winding-up are capital in the hands of the liquidator is not conclusive upon the question whether the respective shares of them handed out to the members are likewise in their respective hands capital also, But *prima facie* beyond doubt they are. Some business may consist of dealing with capital assets : for example a company whose business is that of buying and selling real property or stocks and shares. In case of such a company, no doubt the capital share of the surplus assets in a liquidation would be no less a trading receipt than the proceeds of sale of any other of the assets it had acquired for the purposes of its business."
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- The learned counsel says that the said statement of law runs counter to the decision of this Court in *Madan Gopal Radhey Lal*. He also invited our attention to *Hari Prasad Jayantilal & Co. v. V.S. Gupta, Income Tax Officer, Ahmedabad & Anr.*, 59 I.T.R. 794, to contend that the principle of this decision also runs counter to the decision in *Madan Gopal Radhey Lal*. It is unnecessary for us to go into the said aspect as in our opinion the principle of *Madan Gopal Radhey Lal* has no application to the facts herein.
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- The High Court has placed strong reliance upon the decision of the Court of Appeal in *Commissioner of Inland Revenue v. Burrell*, 9 Tax Cases 27. In that case, the respondents-assessees were partners in a firm which held shares in a number of single-ship companies. On the sale or loss of each ship, each of the companies went into voluntary liquidation, and its surplus assets, including reserves set aside out of profits, and other undivided profits, accumulated and current, were distributed by the liquidator among the shareholders. On those facts, it was held that on the liquidation of a company undistributed profits can no longer be distinguished from the capital and that such portion of the assets distributed by the liquidator as
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represents undistributed profits is not income in the hands of the shareholders which they are required to include in their returns of total income for Super-tax purposes. Firstly, it is not a case where the assessee or the firms of which they were partners held the shares as stock-in-trade. Secondly, the said decision cannot mechanically be applied to the cases arising in this country in view of the definition of the expression "dividend" in Section 2(6A) of 1922 Act had in Section 2(22) of the 1961 Act. The same comment holds good with respect to the decision of the House of Lords in *Brogan*. This was also not a case where the shares were held by the assessee as his stock-in-trade.

Reference may now be made to the decision of the Patna High Court in *Dalmia Cement Paper Marketing Co. Ltd. v. Commissioner of Income Tax, Bihar and Orissa*, 17 I.T.R. 141. In this case, the assessee-company was a dealer in shares and securities. It held the shares of another company of the face value of Rupees four lacs which formed part of the stock-in-trade of the assessee's share-dealing business. The other company went into voluntary liquidation as a result of which the liquidator sold its assets and distributed a certain amount *pro rata* among the shareholders. The assessee received Rs. 4,75,000 in one year and Rs. 8021 in the next year. The Income Tax authorities treated Rs. 75,000 and Rs. 8021 (being the surplus amount over the purchase price of the shares) as revenue receipts and included them in the assessable income of the respective years. It was held by the Patna High Court that the Income Tax authorities acted in accordance with law in doing so inasmuch as the said amount represented revenue receipts in the hands of the assessee. In the judgment under appeal, the Calcutta High Court has disagreed with this view but, for the reasons given hereinabove, we are of the opinion that the view taken by the Patna High Court is the correct one.

For the above reasons, we allow this appeal, set aside the judgment of the High Court and answer all the three questions referred in the negative, i.e., in favour of the revenue and against the assessee. No costs.

V.M.

Appeal allowed.