* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 02.07.2020
Pronounced on: 07.08.2020

\+ **ITA 822/2005**

THE COMMISSIONER OF INCOME TAX-V, NEW DELHI
..... Appellant
Through: Mr.Sunil Agarwal, Senior Standing Counsel with Mr.Tushar Gupta, Junior Standing Counsel for Income Tax Department.

versus

M/S NALWA INVESTMENT LTD. ..... Respondent
Through: Mr.Ajay Vohra, Senior Advocate with Ms.Kavita Jha, Advocate.

\+ **ITA 853/2005**

COMMISSIONER OF INCOME TAX DELHI ..... Appellant
Through: Mr.Deepak Anand, Senior Standing Counsel with Mr.Vipul Agarwal, Junior Standing Counsel.

versus

M/S ABHUINANDAN INVESTMENTS LTD. ..... Respondent

Through: Mr.Ajay Vohra, Senior Advocate with Ms.Kavita Jha, Advocate.

\+ **ITA 935/2005**

COMMISSIONER OF INCOME TAX DELHI ..... Appellant
Through: Mr.Ajit Sharma, Senior Standing Counsel with Ms.Adeeba Mujabhid, Junior Standing Counsel.

versus

M/S JINDAL EQUIPMENT LEAST ..... Respondent
Through: Mr.Ajay Vohra, Senior Advocate with Ms.Kavita Jha, Advocate.

\+ **ITA 961/2005**

COMMISSIONER OF INCOME TAX DELHI ..... Appellant
Through: Mr.Sunil Agarwal, Senior Standing Counsel with Mr.Tushar Gupta, Junior Standing Counsel for Income Tax Department.

versus

M/S MANSAROVAR INVESTMENTS LTD. ..... Respondent
Through: Mr.Ajay Vohra, Senior Advocate with Ms.Kavita Jha, Advocate.

CORAM:
HON'BLE MR. JUSTICE MANMOHAN
HON'BLE MR. JUSTICE SANJEEV NARULA

J U D G E M E N T

SANJEEV NARULA, J.

1. The present appeals under Section 260A of the Income Tax Act, 1961 ('the Act') filed by the Revenue are directed against the common order dated 17th February, 2005, ('impugned order') passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.(s) 1739,1740,1742 & 1743/Del/ 2001 Assessment Year 1997-98 ('AY'), allowing the appeals preferred by the Respondent-assessees against the order of the CIT(A). Resultantly,

additions made by the Assessing Officer ('AO') in the orders of assessment, as confirmed by CIT(A) have been set-aside.

2. The ITAT has decided all the appeals by way of a common order and furthermore since the question of law arising therefrom is identical in all the appeals, the same were heard together and are being disposed of by way of this common judgment. However, for the sake of convenience and to precisely delineate the controversy in the present appeals, factual background in ITA No. 822/2005 is being noted and discussed in detail.

Facts in brief:

3. The Respondent-assessee (Nalwa Investment Limited) belongs to Jindal Group of Companies and is its promoter company. It was holding shares of Jindal Ferro Alloy Ltd. ("JFAL"). Vide amalgamation scheme sanctioned under Section 391-394 of the Companies Act, 1956, JFAL got amalgamated with Jindal Strips Ltd. ("JSL"). Consequently, the Respondent-assessee company transferred its shareholding in JFAL in lieu of receipt of shares of JSL and claimed that the transaction was exempt from capital gain tax under Section 47(vii) of the Act. The AO adopting the value of shares of JSL at the rate of Rs. 218 per share, calculated the profit on receipts of shares of JSL under the scheme of amalgamation at Rs. 5,31,28,579/-, and taxed the same as 'business income'. Revenue contended that since the Respondent-assessee was holding JFAL shares as stock-in-trade and not as capital asset, it was not entitled to exemption under Section 47(vii) of the Act. The statutory first Appellate Authority ['CIT(A)'] upheld the action of AO. In further appeal before ITAT at the instance of the Respondent herein, the Tribunal without recording a categorical finding as to whether the shares qualified as 'capital

asset' or 'stock- in- trade', allowed the appeals in favour of the Respondents, holding that no profit accrues when shares of the amalgamated company are received in lieu of shares of amalgamating company. The relevant portion of the impugned order reads as under:

> *"7. In view of the above decision, it cannot be said that the appellants were holding the shares of JFAL either by way of investment or stock in trade. However, we need not adjudicate upon this issue since the decision on this issue is not of much relevance in deciding the large issue before us. The major question for our consideration is whether any profit accrued to the appellants when they got the shares of amalgamated company in lieu of shares of amalgamating company held by them. In our opinion, no profit accrues unless the shares held by an assessee are either sold or transferred otherwise for consideration irrespective of the nature of holding."*

4. The concluding remarks in the said order are as follows:

> *"10. Before parting with this order, we would like to mention that issue, whether the appellants were holding the shares of JFAL by way of investment or stock in trade, has not been adjudicated by us since assessee has succeed on the legal issue. Accordingly, the said issue would remain open for adjudication in the year or years when such shares are sold. For the similar reasons, we need not adjudicate upon the last contention of assessee's counsel. Subject to the observations made above, appeals of assessee are allowed."*

Question of law:

5. Aggrieved with the aforesaid order, Revenue filed the present appeals questioning the correctness of the reasoning given by the ITAT and raised several questions of law. Vide order dated 5th July, 2006, the present appeals were admitted and substantial question of law was framed as follows:

"Whether the ITAT was correct in holding that where the assessee gets shares of Amalgamated Company in lieu of shares of amalgamating company, no transfer takes place?"

Contentions of the parties:

6. Mr. Sunil Agarwal, learned Senior Standing Counsel led the arguments on behalf of Appellant. He commenced his submissions by referring to the impugned order and contended that the Tribunal has erroneously allowed the appeals in favour of Respondent-assessees without recording a clear-cut finding of fact and resolving the crucial question whether the assessees were holding the shares as 'capital asset' or 'stock-in-trade'. On this aspect he drew our attention to the observations and analysis given by ITAT in Paragraph nos. 7 and 10 of the impugned order which has been reproduced hereinabove. Mr. Agarwal argued that in absence of factual determination on the above-said vital aspect, Tribunal has grossly erred in coming to the conclusion that it did and the same is wholly irrational. He contended that the matter needs to be restored to the file of the Tribunal with a direction to first adjudicate the fundamental factual question that has been left undecided. Without prejudice to his preliminary submission, Mr. Agarwal further argued that the impugned order is unsustainable for the reason that the question of law arising out of the present appeals is entirely covered in favour of Revenue by virtue of decision of the Supreme Court in ***Commissioner of Income-Tax v. Mrs. Grace Collis and Ors.***, *[2001] 248 ITR 323 (SC)*. He submitted that the reasoning of the Tribunal is flawed since it is primarily based on views of the Supreme Court in its earlier decision in the case of ***Commissioner of Income-Tax, Bombay v. Rasiklal***

Maneklal (HUF), *[1989] 177 ITR 198 (SC)* which was decided in context of the Income Tax Act, 1922 ,when the relevant provision was different. Further, the issue as to whether the holding of shares was capital asset or stock-in-trade was not in controversy in the said case. In any event, subsequently, Supreme Court in ***Grace Collis and Others (supra)*** after examining the facts and circumstances in ***Rasiklal Maneklal (supra)*** and on consideration of the provisions of Section 47(vii) of the current Act, held that the receipt of shares of amalgamated company in lieu of shareholding in the amalgamating company, constitutes a 'transfer'.

7. Mr. Agarwal further contended that ITAT should have followed the decision of the Supreme Court in the case of ***Orient Trading Co. Ltd. v. Commissioner of Income-Tax,*** *(1997) 224 ITR 371 (SC)*, since the factual situation in the said case is similar to the one in hand. He argued that since the shares in question were stock-in-trade of the assessees, exemption under Section 47(vii) is not available and thus the transaction is taxable. The order of the ITAT should be reversed and the order of the AO as confirmed by CIT(A) ought to be restored. In the same vein, Mr. Deepak Anand and Mr. Ajit Sharma, learned Senior Standing Counsel on behalf of the Revenue argued that the reasoning of the ITAT was flawed and contrary to the law applicable in the given factual situation. It was contended that the difference between the market value of the shares received by the assessee-companies in exchange of the shares of JFAL and the book value of shares has to be treated as income of the assesses under Section 28 of the Act. The learned AO has treated the shares of JFAL as stock-in-trade and not as capital asset/investment not only in the relevant AY but in the earlier AYs as well.

This finding of fact has been upheld by the CIT(A). The ITAT erroneously held that there is no transfer of shares in the case of amalgamation of company. The judgment relied upon by the ITAT in the case of ***Rasiklal Maneklal (supra)*** does not deal with the issue in hand and is only in respect of exchange and relinquishment within the meaning of Section 12B of the IT Act, 1922.

8. Mr. Ajay Vohra, learned Senior Counsel on behalf of the Respondent-assessees countered the submissions of Revenue and argued that the preliminary objection/ submission of Mr. Agarwal is beyond the scope of appeal. He contended that having regard to the questions of law proposed by the Revenue and the substantial question of law admitted vide order dated 5th July, 2006, Revenue is seeking to expand the scope of appeal by contending that matter has to be sent back to the Tribunal, which is impermissible in terms of Section 260A of the Act.

9. On merits, Mr. Vohra argued that the Respondent-assessees are investment companies of the Jindal Group. The shares of the operating company i.e. JFAL and/or JSL are held as part of the promoter holding, representing controlling interest; the Respondent-assessees had furnished non-disposal undertaking to financial institution and lenders who had lent money to the operating company. Further such shares were reflected as investment in balance-sheet. He argued that irrespective of the fact whether the shares were held as stock-in-trade or capital asset, there is no taxable income arising in the year under consideration on the Respondent-assessees receiving shares in JSL in lieu of shares held in JFAL under the scheme of

amalgamation. On demurrer, he submitted that if it is assumed that shares are held in stock-in-trade as alleged by Revenue, the receipt of shares of JSL, without anything more, could not lead to any addition to the income of the Respondent-assessees since there can be no addition of any notional accretion/notional profit under the head *'profit and gain of business or profession'* under Section 28 of the Act. Only profit on realisation of stock-in-trade by way of sale thereof can be brought to tax under that head. The shares received in JSL on amalgamation were not sold during the relevant previous year and therefore there can be no addition for business profit in the hands of Respondent-assessees, even assuming that there was notional accretion in the value of shares of JSL vis-a-vis value of shares held in JFAL. Mr. Vohra differentiated the judgments relied upon by the Revenue and argued that the decision in the case ***Orient Trading Co. (supra)*** has no application to the facts of the present case. In the said case it was held that the accretion in value of shares received in exchange amounted to realisation of profit and was therefore, taxable as business income. No such situation has arisen in the present case. Mr. Vohra also relied upon the observations made by the Supreme Court in Para 7 in ***Rasiklal Maneklal (supra),*** reproduced hereinabove, to contend that the aforesaid reasoning of the Supreme Court continues to hold the field and the Court correctly laid down the proposition that the amalgamation does not amount to 'exchange'. Without prejudice to the aforenoted contentions, he further argued that the AO has erred in taking the value of shares of JSL at the rate of Rs.218 per share instead of Rs.76 being market price of shares of JSL on 23rd December, 1996 [record date under the scheme of amalgamation] and even

if the value of Rs.76 per share is adopted, the same will result in business loss instead of business profit as worked out by the AO.

10. Mr. Vohra strenuously urged that there is no necessity for determining the nature and character of the shareholding of the assessees i.e. whether it is a capital asset or stock-in-trade. The Tribunal correctly did not go into this controversy and aptly decided the appeals in favour of the Respondent-assessees, on the correct reading of the legal position with respect to the concept of transfer of shares in amalgamation of companies. He submitted that there could be no income of the Respondent-assessees on mere receipt of shares of JSL (in lieu of extinguishment of shares held in JFAL). In the event the shares were held as capital asset, no capital gain would be liable to tax on receipt of shares of JSL in lieu of shares held in JFAL. He referred to Section 45 of the Act which deals with taxing profits and gains arising from 'transfer' of 'capital asset' effected during the relevant year under the head 'capital gain' and further contended that the assessees would be entitled to the exemption under Section 47(vii) of the Act. He also argued that the decision of ***Grace Collis and Ors. (supra)*** has no application to the facts of the present case. He further relied upon the CBDT Circular No.6/2016 dated 29th February, 2016 and argued that although the Tribunal has left the aforesaid issue open for adjudication in the year of subsequent sale of shares, the issue is today no longer *res integra* as in the aforenoted circular, CBDT has clarified as under:

> ***"CIRCULAR NO.6/2016 [F.NO.225/12/2016-ITA-lI], DATED 29-2-2016***
>
> *Sub-section (14) of section 2 of the Income-tax Act, 1961 (Act) defines the term "capital asset" to include property of*

any kind held by an assessee, whether or not connected with his business or profession, but does not include any stock-in-trade or personal assets subject to certain exceptions. As regards shares and other securities, the same can be held either as capital assets or stock-in-trade/trading assets or both. Determination of the character of a particular investment in shares or other securities, whether the same is in the nature of a capital asset or stock-in-trade, is essentially a fact-specific determination and has led to a lot of uncertainty and litigation in the past.

2. Over the years, the courts have laid down different parameters to distinguish the shares held as investments from the shares held as stock-in-trade. The Central Board of Direct Taxes ('CBDT') has also, through Instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15 2007, summarized the said principles for guidance of the field formations.

3. Disputes, however, continue to exist on the application of these principles to the facts of an individual case since the taxpayers find it difficult to prove the intention in acquiring such shares/securities. In this background, while recognizing that no universal principal in absolute terms can be laid down to decide the character of income from sale of shares and securities (i.e. whether the same is in the nature of capital gain or business income), CBDT realizing that major part of shares/securities transactions takes place in respect of the listed ones and with a view to reduce litigation and uncertainty in the matter, in partial modification to the aforesaid Circulars, further instructs that the Assessing Officers in holding whether the surplus generated from, sale of listed shares or other securities would be treated as Capital Gain or Business Income, shall take into account the following—

(a) Where the assessee itself, irrespective of the period of holding the listed shares and securities, opts to treat them as stock-in-trade, the income arising from transfer

of such shares/securities would be treated as its business income,

(b) In respect of listed shares and securities held for a period of more than 12 months immediately preceding the date of its transfer, if the assessee desires to treat the income arising from the transfer thereof as Capital Gain, the same shall not be put to dispute by the Assessing Officer. However, this stand, once taken by the assessee in a particular Assessment Year, shall remain applicable in subsequent Assessment Years also and the taxpayers shall not be allowed to adopt a different/contrary stand in this regard in subsequent years;

(c) In all other cases, the nature of transaction (i.e. whether the same is in the nature of capital gain or business income) shall continue to be decided keeping in view the aforesaid Circulars issued by the CBDT.

4. It is, however, clarified that the above shall not apply in respect of such transactions in shares/securities where the genuineness of the transaction itself is questionable, such as bogus claims of Long Term Capital Gain/Short Term Capital Loss or any other sham transactions.

5. It is reiterated that the above principles have been formulated with the sole objective of reducing litigation and maintaining consistency in approach on the issue of treatment of income derived from transfer of shares and securities. All the relevant provisions of the Act shall continue to apply on the transactions involving transfer of shares and securities."

11. He summed up his submissions by contending that there is no error in the order passed by the Tribunal and the same deserves to be upheld and the appeals of the Revenue should be dismissed.

Analysis:

12. We have given our thoughtful consideration to the contentions of the parties. During the course of final hearing, as the Learned counsel forged ahead with their arguments, the controversy in the present case got streamlined which we shall hereinafter crystalize and then comprehensively deliberate upon the same. However, before we proceed to do that, in order to fully comprehend the controversy, we first need to delve into the facts and note the analysis and findings of the ITAT in the impugned order.

The Controversy and the proceedings before the ITAT:

13. The assessee was holding shares of JFAL. Consequent to the scheme of amalgamation sanctioned under Section 391 to 394 of the Companies Act, 1956, JFAL got amalgamated with JSL and the assessee [Nalwa Investment Limited] received shares of JSL. In terms of the scheme of amalgamation, the shareholders of JFAL were to be allotted 45 shares of JSL in lieu 100 shares of JFAL. The value of shares of JFAL as per assessee's book was Rs. 35/- per share as against which the assessee company got shares of JSL whose market value was Rs. 395/- per share on the date of allotment. Taking note of the above position, the AO issued a show cause notice under Section 143(3) of the Act for AY 1997-98 and observed that as a result of realisation, the assessee-company earned a profit of Rs. 395 - (35 * 2.2) i.e. Rs.318 for each share of JSL. The Respondent-assessee was issued show cause as to why the same should not be treated as income for Financial Year 1996-97. In response thereto, the Respondent-company vide letter dated 16th February, 2000 *inter alia* contented that the assessee has not transferred any share for consideration and drew support from the views of the Supreme

Court in ***Rasiklal Maneklal (supra).*** Respondent-company also contended that nothing in Section 45 of the Act would apply as it is a transfer of a capital asset being the shares held in the amalgamating company and the assessee was entitled to avail benefit of section 47 (vii) of the Act. The Respondent-assessees further contended that if the shares were to be considered as 'stock-in-trade', assessees should be allowed benefit of fall in value of shares after valuing them at cost or market value, whichever is less.

14. The AO considered all contentions raised by the assessees but did not agree with any of them. He relied upon the decision of the Supreme Court in ***Orient Trading Co. Ltd. (supra)*** and held that the Respondent-assessees had earned profit by realising the shares of JSL in exchange for its own shareholding in a planned scheme of amalgamation. With respect to the contentions raised by the assessees regarding applicability of Section 47 of the Act, the AO observed that reliance on aforesaid provision was misplaced as the same related to transfer of capital asset and not to stock held as stock-in-trade. During income tax assessment proceedings for the preceding year, holding of shares were treated as stock-in-trade and not as capital asset. Further relying upon the decision of the Supreme Court in ***G.Venkataswami Naidu Co. v. CIT,*** *(1959) 35 ITR 594, (SC)***,** it was concluded that Section 45 has no applicability to the case of the Respondent-assessees. The appeal before CIT(A) also was rejected and the assessment order passed by the AO was confirmed. When the matter travelled to the Tribunal, the Respondent-assesees assailed the common order of CIT(A) by raising several contentions; the foremost being that shares of JFAL were acquired by way of investment and not as stock-in-trade and that the said issue stands covered

by various decisions of the Tribunal. The Tribunal did not agree with Respondent-assessees on this count and held that reliance on the decisions cited by them was misplaced. Nevertheless, in paragraph 7 of the impugned order, the ITAT concluded that *"in view of the above decision it cannot be said that the appellants were holding the shares of JFAL either by way of investment or stock-in-trade"*. At this stage, the dispute assumed a new dimension. The Tribunal perceived that it need not adjudicate upon this vexed question since the decision on the same is not of much relevance in deciding the larger issue before it. This became the focal point and the principal question for determination was formulated in the following words: *"whether any profit accrued to the appellant when they got the shares of amalgamated company in lieu of shares of amalgamating company held by them?"* (See paragraph 7 of the impugned order of the ITAT). Answering this question, the ITAT observed that *"in our opinion, no profit accrued unless the shares held by assessee are either sold or transferred otherwise for consideration irrespective of the nature of holding"*. It was also observed that since there was no sale of shares in the present case, the only question that arose for consideration was whether it can be said that *"there is transfer of shares where the assessee gets the shares of amalgamated company in lieu of shares of amalgamating company"*. This critical question was answered by relying upon the decision of the Supreme Court in ***Rasiklal Maneklal (supra)*** by decisively concluding that *"there was no transfer of shares and consequently, question of accruing any profit to the appellants would not arise"* (Paragraph 8 of the impugned order).

15. Therefore, before us, there is indeed no factual determination as to whether the shares in questions were being held by the Respondent-assessees as capital asset or stock-in-trade. Nonetheless, even in absence of this factual determination, the legal proposition vis-a-vis the applicability of Section 45 and 47(vii) of the Act is beyond controversy. We shall elaborate why we say this.

If the Shares are held to be Capital Asset – Effect of Section 45 and exception thereto under section 47(vii) of the Act;

16. Mr. Ajay Vohra submitted that if shares were held as capital asset, the assessees are entitled to the benefit of the exemption provided under Section 47(vii) of the Act. At this juncture, let us first take note of Section 45 of the Act, relevant portion whereof is extracted as under:

> *"**Capital gains**.*
>
> *45. (1) Any profits or gains arising **from the transfer of a capital asset** effected in the previous year shall, save as otherwise provided in sections 54, 54B, 54D, 54E, 54EA, 54EB, 54F, 54G and 54H, be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.*
>
> *XXXXX"*
>
> [Emphasis Supplied]

17. The aforesaid Section is under the head of 'capital gains'. Any profit or gain arising from "transfer" of a "capital asset" effected in the previous year shall, save as otherwise provided in the Section, be chargeable to Income

Tax under the head 'capital gains' and shall be deemed to be the income of the previous year in which the transfer took place. Section 47 of the Act enumerates the transactions which are not regarded as 'transfer'. In this provision, we are concerned with sub-section (vii) which read as under:

> ***"47. Nothing contained in section 45 shall apply to the following transfers :—***
>
> *XXXX*
>
> *(vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if—*
>
> *(a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder itself is the amalgamated company, and*
>
> *(b) the amalgamated company is an Indian company;*
>
> *XXXX"*

[Emphasis Supplied]

18. The opening words "nothing contained in Section 45 shall apply to the following transfers" signifies that the said provision is as an exception to Section 45. Meaning thereby that transfers which are enumerated in sub clauses (i) to (xix) as stipulated in Section 47, are exempted from the applicability of Section 45. It also manifests that transfers exempted from applicability of Section 45, nevertheless qualify to be 'transfer'. This is evident from the opening words of Section 47 which stipulate that Section 45 shall not apply to *"following transfers"*. Thus, if the assessees were to contend that the shares in question were held as capital asset, in order to take

benefit of the exemption, the receipt of the shares of the amalgamated company in lieu of the shares held in amalgamating company would have to be regarded as a transfer. Mr. Agarwal, learned Senior Standing Counsel for the Revenue agrees to the aforenoted legal proposition and submits that if the shares were held as capital asset, the transfer would be exempt from the capital gain taxation under Section 47(vii) of the Act and '*Revenue would have no case to argue'*. These precise words are captured from rejoinder written submission of the Revenue filed before this Court. Thus, if the shares in question are a capital asset, there is no disagreement between the parties that the assessees would be entitled to take benefit of exemption under Section 47(vii) of the Act, provided of course, if they fulfil the requirements enumerated therein. This stand of the parties substantially narrows down the gamut of controversy as far as the legal propositions are concerned. Nevertheless, this concurrence between the parties does not resolve the dispute before us since Revenue strongly refutes the factual assertion of the assessees and zealously argues that the shares are 'stock-in-trade'. This contentious fact coupled with the lack of factual determination by the ITAT leaves things in the state of uncertainty. In this backdrop we shall now deal with the analysis of ITAT holding the factual determination *vis-a-vis* the holding of shares as capital asset or stock-in-trade to be a non-issue for taxation, for the reason that there is no transfer of shares in the scheme of amalgamation.

19. Let's now proceed to examine the correctness of the aforenoted conclusion. Section 2(47) defines the concept of 'transfer' in the context of

capital asset by enumerating several sub-sets. The said provision read as under:

*"(47) "**transfer", in relation to a capital asset, includes**, —*

(i) the sale, exchange or relinquishment of the asset; or

(ii) the extinguishment of any rights therein; or

(iii) the compulsory acquisition thereof under any law; or

(iv) in a case where the asset is converted by the owner thereof into, or is treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment; or

(iva) the maturity or redemption of a zero coupon bond; or

(v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or

(vi) any transaction (whether by way of becoming a member of, or acquiring shares in, a co-operative society, company or other association of persons or by way of any agreement or any arrangement or in any other manner whatsoever) which has the effect of transferring, or enabling the enjoyment of, any immovable property.

Explanation 1.—For the purposes of sub-clauses (v) and (vi), "immovable property" shall have the same meaning as in clause (d) of section 269UA.

Explanation 2.—For the removal of doubts, it is hereby clarified that "transfer" includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or

flowing from the transfer of a share or shares of a company registered or incorporated outside India;"

20. The aforesaid inclusive definition clearly demonstrates that the concept of transfer in relation to capital asset is very wide. Transfer takes within its sweep the concept of sale, exchange or relinquishment of the asset as well as extinguishment of any right therein. In fact, under subsection (iv) of Section 2(47) even if an asset is converted by the owner thereof into or treated by him as, stock-in-trade of a business carried on by him, such conversion or treatment would amount to transfer in relation to capital asset. This shows that the transfer of a capital asset is not confined only to sale or exchange but is a concept that would cover several other situations which may not be understood as 'transfer' in common parlance.

21. In the present case, the Tribunal has come to a conclusion that there is no transfer of shares and has primarily relied upon the case of the ***Rasiklal Maneklal (supra).*** First and foremost, the said case does not deal with the issue as to whether amalgamation of company leads to transfer of shares. In the said case, the assessee which was an HUF derived income from interest on security. The assessee purchased shares of Shorrock SPG and MSG.Co Ltd. and later the share was split into 10 shares of Rs. 100/- each and from time to time a total of 80 shares of face value of Rs. 100/- each was issued to the assessee by way of bonus shares. As a consequence, the assessee owned 90 shares in the Shorrock Co. on the face value of Rs. 100/-. It was decided to amalgamate the Shorrock Co. with the New Shorrock Co. and upon petitions filed under Section 391 - 394 of the Companies Act, the Gujarat High Court approved the scheme of amalgamation. Under the scheme of

amalgamation, the undertaking and all the property rights and powers as well as all liabilities and duties of Shorrock Co. were to stand transferred and vest in the New Shorrock Co. Under the scheme of amalgamation, the New Shorrock Co., as the transferee company was directed to allot to the members of Shorrock Co. the transferor company one share in transferee company for every two shares of transferor company held by them. During assessment proceedings, although ITO was apprised of the scheme of amalgamation and the acquisition of 45 shares of New Shorrock Co. but he omitted to consider applicability of section 12B of the Income Tax Act, 1922 (the relevant provision under the said Act dealing with capital gains). The question arose whether in the facts and circumstances of the case the amount representing the capital gain resulting from transaction of acquiring 45 shares of New Shorrock Co. in place of 90 shares held in Shorrock Co. could be assessed in the hands of the assessee as capital gain since it has been accrued by exchange or relinquishment as provided for under Section 12B of the Income Tax Act, 1922. The Supreme Court considered the relevant provision as reproduced in the said judgment and observed as under:

> *"4. During the assessment proceedings for the assessment year 1961-62, the previous year being the financial year ending 31-3-1961, the Income Tax Officer, although apprised of the fact of the scheme of amalgamation and of the acquisition by the assessee of 45 shares of the New Shorrock Co. omitted to consider the applicability of Section 12-B of the Indian Income Tax Act, 1922. On 21-1-1964 the Commissioner of Income Tax issued a notice under Section 33-B of the Act to the assessee stating that the receipt of 45 shares of the New Shorrock Co. "in exchange" of his original holding of 90 shares in the Shorrock Co. in December 1960 had resulted in an assessable profit, and this aspect had been overlooked by the Income Tax Officer when making the regular assessment, and, therefore, he proposed a revision of the assessment. After hearing the assessee, the Commissioner of*

Income Tax passed an order dated 29-1-1964 directing the Income Tax Officer to revise the assessment and to include an amount of Rs 49,350 representing the capital gain resulting from the transaction of the acquisition of 45 shares of New Shorrock Co. in place of the 90 shares held in Shorrock Co. On appeal by the assessee before the Income Tax Appellate Tribunal, the Appellate Tribunal held that the transaction represented neither an exchange nor a relinquishment and, therefore, Section 12-B of the Act was not attracted.

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6. ***Before the High Court the Revenue did not contend that the transaction constituted a sale or a transfer, and the parties confined themselves to the point whether the transaction represented an exchange or a relinquishment for the purposes of Section 12-B****. The High Court took the view that no exchange can be said to have taken place on the allotment of the 45 shares of the New Shorrock Co. under the scheme of amalgamation. Nor, in the opinion of the High Court, did it constitute a relinquishment. In the result, the High Court answered both questions in favour of the assessee and against the Revenue.*

7. The relevant portion of Section 12-B of the Act provides: "12-B. (1) Capital gains.— The tax shall be payable by an assessee under the head 'capital gains' in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place."

8. ***The sole question is whether the receipt of the 45 shares of the New Shorrock Co. upon amalgamation by reason of the shareholding of 90 shares of the Shorrock Co. can be described as an "exchange" or a "relinquishment" within the meaning of Section 12-B of the Act****. It seems plain to us that no exchange is involved in the transaction. An exchange involves the transfer of property by one person to another and reciprocally the transfer of property by that other to the first person. There must be a mutual transfer of ownership of one thing for the ownership of another. In*

the present case, the assessee cannot be said to have transferred any property to anyone. When he was allotted the shares of the New Shorrock Co. he was entitled to such allotment because of his holding the 90 shares of Shorrock Co. The holding of the 90 shares in the Shorrock Co. was merely a qualifying condition entitling the assessee to the allotment of the 45 shares of the New Shorrock Co. The dissolution of the Shorrock Co. deprived the holding of the 90 shares of that company of all value."

[Emphasis Supplied]

22. It is clear from above observations that sole question decided by the Supreme Court related to receipt of shares upon amalgamation in context of "exchange" or a "relinquishment" within the meaning of Section 12B of the Income Tax Act, 1922. In this context, it was observed that no exchange is involved in the transaction and it was further observed that an exchange involves the transfer of property by one person to another and reciprocally the transfer of property by that other to the first person. In essence the Court felt that there must be a mutual transfer of ownership for one thing for the ownership of another.

23. The aforenoted judgment subsequently came up for consideration in a later decision of ***Grace Collis and Ors.*** **(supra)** [Bench strength: 3] where the Supreme Court again dealt with the proposition of transfer of shares in the amalgamation of companies. The Court noticed that the factual situation in ***Rasiklal Maneklal*** **(supra)** was decided in refence to 1922 Act, while observing as under:

"9. ***In CIT v. Rasiklal Maneklal (HUF) [1989] 177 ITR 198, this Court was concerned with a case of acquisition of shares consequent upon a scheme of amalgamation virtually identical to the Scheme before us. At that time, capital gains were chargeable***

to tax by reason of section 12B of the Indian Income-tax Act, 1922, which stated thus*:*

> *"12B. Capital gains.—(1) The tax shall be payable by an assessee under the head 'Capital gains' in respect of any profits or gains arising from the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, and such profits and gains shall be deemed to be income of the previous year in which the sale, exchange, relinquishment or transfer took place."*

The question this Court was called upon to consider read thus: "Whether, on the facts and in the circumstances of the case, the sum of Rs. 49,350 could be assessed in the hands of the assessee as capital gains as having accrued to the assessee by exchange or relinquishment as provided for under section 12B of the Act?" This Court held that no exchange was involved in the transaction*. An exchange involved the transfer of property by one person to another and, reciprocally, the transfer of property by that other to the first person. There had to be a mutual transfer of ownership of one thing for the ownership of another. In the case before the Court, the assessee could not be said to have transferred any property to anyone. When he was allotted shares of the amalgamated company, he was entitled to such allotment because of his holding 90 shares of the amalgamating company. The holding of 90 shares in the amalgamating company was merely a qualifying condition entitling the assessee to the allotment of 45 shares in the amalgamated company. The dissolution of the amalgamating company deprived the holding of the 90 shares of that company of all value.*

10. The learned counsel for the assessees submitted that no capital gains tax could be levied upon the assessees in respect of the sale by them of their shares in the amalgamated company because there was no provision in the Act with regard to the manner of determination of the cost of these shares. This was for the reason that section 49(2) prescribed the mode of determining the cost where the shares in an amalgamated company had become the property of the assessee in consideration of a transfer, as referred to in section 47(vii), that is to say, a transfer by a shareholder in a

scheme of amalgamation of shares held by him in the amalgamating company if the transfer was made in consideration of the allotment to him of shares in the amalgamated company. ***The decision in Rasiklal Maneklal (HUF) 's case (supra) had held that there was no transfer of any property to anyone by the assessee in circumstances identical to those before us."***

[Emphasis Supplied]

24. After taking note of ***Rasiklal Maneklal*** **(supra)** the Court further observed in Para 11 that it was not the end of the matter as Section 2 (47) under the 1961, Act defined transfer to include extinguishment of any right in capital asset. The relevant portion is extracted hereunder:

"11. ***This, however, is not the end of the matter for section 2(47) defines 'transfer' to include 'the extinguishment of any rights' in a capital asset.***

12. In this regard, our attention was drawn by the learned counsel for the assessees to the decision of a Bench of two learned judges of this Court in Vania Silk Mills (P.) Ltd. v. CIT [1991] 191 ITR 647. This was a case in which the appellant-company carried on the business of manufacture and sale of art-silk cloth. It purchased during the year 1957 machinery and gave it on hire to Jasmine Mills at an annual rent. Jasmine Mills, as bailee of the machinery, insured it against fire along with its own machinery. The insurance policy contained a reinstatement clause requiring the insurer to pay the cost of the machinery as on the date of the fire in case of destruction or loss. A fire did break out in the premises of Jasmine Mills causing extensive damage, inter alia, to the machinery which became useless as a result. On settlement of the insurance claim, Jasmine Mills received an amount from the insurance company. From out of it, it paid Rs. 6,32,533 to the appellant on account of the destruction of the machinery. The ITO brought to tax the sum of Rs. 3,50,792, being the difference between the insurance amount received by the appellant for the machinery and the original cost thereof as a capital gain. The Tribunal held that the insurance amount was not received by the appellant on the transfer of a capital asset but on account of the damage to its machinery and

that section 45 of the Act was not attracted. On a reference, the High Court reversed the decision of the Tribunal. This Court held in appeal therefrom that when an asset was destroyed, there was no question of transferring it to others. The destruction or loss brought about the destruction of the right of the owner of the asset in it, but it was not on account of a transfer but on account of the disappearance of the asset. The extinguishment of the right in an asset on account of the extinguishment of the asset was not a transfer of the right but its destruction. The destruction of the right on account of the destruction of the asset could not be equated with the extinguishment of the right on account of its transfer. Section 45 of the Act was, therefore, not attracted. The fact that while paying for the total loss or damage to the property the insurance company took over such property or whatever was left of it did not change the nature of the insurance claim, which was an indemnity or compensation for the loss. The payment of the insurance claim was not in consideration of the property taken over by the insurance company for one was not consideration for the other. This Court then, having so very rightly held that section 45 was not attracted went on to consider the definition of 'transfer' and it said:

> *"It is true that the definition of 'transfer' in section 2(47) of the Act is an 'inclusive' definition and, therefore, extends to events and transactions which may not otherwise be 'transfer' according to its ordinary, popular and natural sense. It is this aspect of the definition which has weighed with the High Court and, therefore, the High Court has argued that, if the words 'extinguishment of any rights therein' are substituted for the word 'transfer' in section 45, the claim or compensation received from the insurance company would attract the said section. The High Court has, however, missed the fact that the definition also mentions such transactions as sale, exchange, etc., to which the word 'transfer' would properly apply in its popular and natural import. Since those associated words and expressions imply the existence of the asset and of the transferee, according to the rule of noscitur a sociis, the expression 'extinguishment of any right therein' would take colour from the said associated words and expressions and will have to be restricted to the sense analogous to them. If the Legislature intended to extend the definition to any*

extinguishment of right, it would not have included the obvious instances of transfer, viz., sale, exchange, etc. Hence, the expression 'extinguishment of any rights therein' will have to be confined to the extinguishment of rights on account of transfer and cannot be extended to mean any extinguishment of right independent of or otherwise than on account of transfer." (p. 653)

13. The learned counsel for the assessees relied upon this decision to contend, again, that there had been no transfer by the assessees of their shares in the amalgamating company and that, therefore, the case would still not fall within the meaning of the expression 'extinguishment of any rights therein' in section 2(47) . By reason of the decision, the expression 'extinguishment of any rights therein' had to be confined to the extinguishment of rights on accounting of a transfer and could not be extended to refer to the extinguishment of rights independent of or otherwise than on account of transfer.

14. The learned counsel for the revenue submitted that having held that the payment in settlement of the insurance claim was not in consideration of the transfer to the insurer of the damaged machinery and that, therefore, there was no transfer within the meaning of section 45, it was unnecessary for this Court in Vania Silk Mills (P.) Ltd.'s case (supra) to go on to consider the definition in section 2(47) and the meaning to be attached to the expression 'extinguishment of any rights therein'. In his submission, the decision in Vania Silk Mills (P.) Ltd.'s case (supra) was to this extent obiter dicta. The definition in section 2(47) of 'transfer' included sale and exchange. In each of those cases there was an extinguishment of the right of the seller or exchanger in the capital asset. To restrict the extinguishment of rights to extinguishment on account of transfer was, in the learned counsel's submission, to render the expression 'extinguishment of any rights therein' otiose and to nullify the effect of their use in the definition.

15. We have given careful thought to the definition of 'transfer' in section 2(47) and to the decision of this Court in Vania Silk Mills (P.) Ltd.'s case (supra) . In our view, the definition clearly contemplates the extinguishment of rights in a capital asset distinct and independent of such extinguishment consequent upon the transfer thereof. We do not approve, respectfully, of the limitation

of the expression 'extinguishment of any rights therein' to such extinguishment on account of transfers or to the view that the expression 'extinguishment of any rights therein' cannot be extended to mean the extinguishment of rights independent of or otherwise than on account of transfer. To so read, the expression is to render it ineffective and its use meaningless. As we read it, therefore, the expression does include the extinguishment of rights in a capital asset independent of and otherwise than on account of transfer.

16. ***This being so, the rights of the assessees in the capital asset, being their shares in the amalgamating company, stood extinguished upon the amalgamation of the amalgamating company with the amalgamated company. There was, therefore, a transfer of the shares in the amalgamating company with the meaning of section 2(47)*** *. It was, therefore, a transaction to which section 47(vii) applied and, consequently, the cost to the assessees of the acquisition of the shares of the amalgamated company had to be determined in accordance with the provision of section 49(2), that is to say, the cost was deemed to be the cost of the acquisition by the assessees of their shares in the amalgamating company."*

[Emphasis Supplied]

25. Admittedly, in the present case we are concerned with the 1961 Act and not the old Act. Notably, in ***Grace Collis and Ors.*** **(supra)** the scheme of amalgamation was virtually identical to the scheme that was in question in ***Rasiklal Maneklal*** **(supra)**. The Court went into the expanded definition of 'transfer' under Section 2 (47) of the Act and extinguishment of rights of assessee in the capital asset, being shares in the amalgamating company, was held to be a 'transfer' within the meaning of Section 2(47). Thus, the judgment of ***Grace Collis and Ors.*** **(supra)** has a direct bearing on the present case, and pertinently because the findings of the ITAT are solely resting on the decision in ***Rasiklal Maneklal*** **(supra)** which has been

considered and not followed in the later decision in ***Grace Collis and Ors.* (supra)**. The upshot of the above discussion is that, the observation of ITAT that there is no transfer in the scheme of amalgamation, is flawed and unsustainable in so far as capital asset is concerned. Therefore, the decision of ITAT is liable to be set aside on this short ground alone. However, since the parties agree that such transfer will be exempted under section 47(vii) of the Act, we will have to examine whether the scheme of amalgamation viz shares held in stock-in-trade results in a taxable event which renders factual determination inconsequential as held by the ITAT.

If shares are held as Stock-in-trade, whether amalgamation would result in income chargeable to tax under the head "profits and gain of business or profession".

26. In case the transaction comes out of the ambit of Section 47(vii), it's taxability would be governed by Section 28 of the Act, where there is no exemption akin to section 47 of the Act. If the shares are held as stock-in-trade, income shall be chargeable to income-tax under the head "profits and gain of business or profession". Here the spotlight should not entirely be on the concept of 'transfer' but instead whether there is business income in hands of the assessee. We, therefore, now proceed to delve into the question as to whether in the scheme of amalgamation, shares of amalgamated company received in lieu of amalgamating company which were held as stock-in-trade, would result in income chargeable to tax under the head "Profits and gain of business or profession".

27. Mr. Vohra relied upon the judgment of the Supreme Court in ***Chainrup Sampantram vs. CIT,*** *1953 24 ITR 481 (SC)* to argue that as long as the

stock-in-trade remain with the trader and if appreciation/ depreciation in its value is notional, it is not subject to taxability. There is no dispute regarding this proposition. It is well settled in law that Income Tax cannot be levied on hypothetical income. But is this a case where there is only a notional/ hypothetical income and no realisation in the hands of assessee? Here, the judgment of the Supreme Court in ***Orient Trading Co. Ltd.*** **(supra)** becomes relevant, which deals with a case where shares/security held in stock-in-trade and were transferred for consideration in kind (exchange or barter). In the said case**,** the Supreme Court was dealing with a case where the assessee was a company dealing in shares. It was holding 14,500 shares in a company of the face value of Rs. 10/- as stock-in-trade. The shares were valued and included in its closing stock. In the AY in question i.e. 1963-64, a new company offered to obtain shares in exchange for allotment of its own shares. The assessee accepted the offer and received shares. The assessee valued the shares at the same amount at which it was holding the exchange shares. The AO found the market quotation of the shares and valued the shares at a higher amount and taxed the difference as profit in the said transaction. Both the Tribunal and High Court upheld the decision of ITO. When the matter reached the Supreme Court, the Court formulated the question whether the surrendering of shares in the first company in exchange of the shares in the second company by the assessee can be regarded as realisation of the security on the date of such surrender and exchange. In such a case, difference between the book value of the shares of the first company and the market value of the shares of the second company as on the date of such realisation will have to be treated as profit earned by the assessee in that transaction. After considering several judgments, the

Supreme Court affirmed the view of the High Court, holding it to be in consonance with the established principles governing the law in this field.

28. At this juncture, we would like to note that the decision in ***Orient Trading Co. Ltd.*** **(supra)**, the Supreme Court has dealt with approval English cases which deal with amalgamation. The relevant portion of the said judgment is reproduced hereinunder:

> *"4. The question that arises for consideration is whether the surrendering of its shares in the first Company in exchange for the shares of the second Company by the assessee can be regarded as realisation of the security on the date of such surrender and exchange. If it can be so regarded that the sum of Rs. 4,06,000/-, the difference between the book value of 14,500 shares of the first Company and the market value of the 55,500 shares of the second Company as on the date of such realisation, will have to be treated as profit earned by the assessee in that transaction:*
>
> *5. In the impugned judgment, the High Court has agreed with the decision of the Tribunal that the exchange of the shares of the first company with the shares of the second company is to be treated as realisation of the security. The said view of the High Court, as will be presently seen, is in consonance with the established principles governing the law in this field.*
>
> *6. In Westminster Bank Ltd.'s case (supra), the appellant was holding National War Bonds which were surrendered in exchange for conversion loan and war loan and the value of the stock received in exchange was greater than the cost to the Bank of the National War Bonds. The question was: whether the excess amount could be regarded as profit of the Banker's trade for the purpose of income-tax? On behalf of the Bank, it was argued that the nature of the transaction was equivalent to a mere exchange of an item in the stock-in-trade of the trader and that in fact there was no realisation of profit and there was a mere accretion of capital value which could not be brought into account until in fact it had been realised.*
>
> *Dealing with the said contention Lord Buckmaster said:*

"The exchange effected in the present case was in fact the exact equivalent of what would have taken place had instructions been given to sell the original stock and invest the proceeds in the new security. The investment represented by the original War Bonds came to an end as soon as the new securities were taken in its place, when a new venture was begun in relation to the new holding, and the fact that this transformation took place by the process of exchange does not in any opinion avoid the conclusion that there has been what is described as a realisation of the security." (pp. 68, 69)

7. ***The decision of Rowlatt, J. in Royal Insurance Co. Ltd. v. Stephen 14 Tax Cas 22, was approved in the said case. In the case of Royal Insurance Co. Ltd. (supra), the appellant-company had, under the Railways Act, 1921, to accept new stocks in the amalgamated companies in exchange for the stock held in the companies which were absorbed and which resulted in loss to the appellant-company. The claim of the appellant-company for deduction of such loss was upheld by Rowlatt, J. who held:***

"At the bottom of this principle of waiting for a realisation, I think there is this idea; while an investment is going up or down for income-tax purposes the company cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end, when that investment is wound up I will say - 'wound up' is an unfortunate expression perhaps and I will say when an investment ceases to figure in the company's affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the company, and then the company starts so far as that portion of its resources is concerned with a new investment. Then one knows where one is and it is no longer a question of paper, it is a question of fact and that is a realisation. I think that is the point of view from which it ought to be looked at, and looking at it from that point of view the Company is right. It has done with the investments in the companies. They have disappeared. It is known exactly in money. It is known now exactly what their holding of them has meant to the company. They will never more go up or down. What will go up or down now are the different shares

in the new companies, altogether different investments really, and therefore, I think that the old investment is closed and realised and a new investment is started." (pp. 28, 29)

Similarly, in California Copper Syndicate v. Harris 5 Tax Case 159, decided by the Court of Exchequer in Scotland, Lord Trayner has said :

*"**But it was said that the profit - if it was profit - was not realised profit and, therefore, not taxable. I think the profit was realised. A profit is realised when the seller gets the price he had bargained for. No doubt, here the price took the form of fully paid shares in another company, but, if there can be no realised profit, except when that is paid in cash, the shares were realisable and could have been turned into cash, if the appellants had been pleased to do so. I cannot think that income-tax is due or not according to the manner in which the person making the profit pleases to deal with it."** (p. 167)*

8. These observations have been quoted with approval by this Court in Raja Mohan Raja Bahadur v. CIT [1967] 66 ITR 378. In that case, the assessee, carrying on business of money-lending, had obtained a decree against a debtor and had received Encumbered Estate Bonds of U.P. Government in part satisfaction of the liability of the debtor. The said Bonds were sold by the appellant in the year relevant to the assessment year subsequent to the year in which they were received. It was held that the Bonds were a fresh security the liability of the original debtor having been substituted by an obligation by the State and since the Bonds were convertible in terms of money, income was realised by the assessee when the bonds were received.

9. The subsequent decision of the House of Lords in British South Africa Co.'s case (supra) does not lend assistance to the submission of Shri Puri. In that case, the appellant-company in 1953 had lent 2,00,000 pounds to a gold mining company and in return had received, inter alia, an option to subscribe for 100,000 shares in the mining company at 1 pound per share, the value of the shares then being 19 s. 6 d. a share. In 1954 when the value of the shares had gone up to 43 s. 6 d. a share the appellant exercised the option and

obtained shares worth 2,17,500 pounds for which they paid 1,00,000 pounds. The company was assessed for income-tax on a profit of 11,75,000 pounds. On behalf of the company it was urged that upon the exercise of the option there was a realisation because the option which was a 'trading asset' or an item of 'stock-in-trade' was exchanged for or was replaced by a different item of stock-in-trade which had a value in money's worth. The said contention was rejected by the House of Lords (Lord Guest dissenting). It was held that the appellant-company never, in fact, realised their option in the sense of passing it on, for a consideration to someone else and that there was neither a sale of the option nor its exchange for something else and that when the company exercised their option or used or availed themselves of their rights they did not make the end of the trading transaction and that there was merely the end of the beginning of a trading transaction. It was emphasised that there was no element of exchange as there was in Royal Insurance Co. Ltd.'s case (supra) and in Westminster Bank Ltd.'s case (supra) [See: Lord Morris of Borth- Y-Gest at pp. 394-395], Lord Guest, in his dissenting judgment, however, felt that the option was a trading asset of the appellant-company and, applying the principles laid down in Royal Insurance Co. Ltd.'s case (supra) and Westminster Bank Ltd.'s case (supra), held that the exercise of option amounted to a realisation of the option which resulted in a trading profit of 11,75,000 pounds. This would show that the principles laid down in Royal Insurance Co. Ltd.'s case (supra) and Westminster Bank Ltd.'s case (supra) have been affirmed by all the law Lords and the difference amongst them was only as regards the applicability of the said principles to the facts of that case.

10. Motors & General Stores (P.) Ltd.'s case (supra) relates to the interpretation of the word 'sale' in section 10(2)(vii). The said decision has no bearing on the present case.

11. Having regard to the principles laid down in the decisions aforementioned, it must be held that the High Court has rightly taken the view that as a result of their having taken the shares in the second company in exchange of the shares of the first company the assessee had made realisation of the value of the shares of the first company and the difference between the price of the shares of the first company and the second company on the date of such

exchange, i.e., Rs. 4,06,000, has to be treated as a profit of the assessee and has been rightly assessed as income of the assessee. We, therefore, do not find any merit in the appeal and the same is accordingly dismissed. But in the circumstances, no order as to costs."

[Emphasis Supplied]

29. As a matter of fact, after reserving the appeals for pronouncement of judgment, we relisted the matter to have the views of the Counsel on the above referred case law. Mr. Vohra attempted to distinguish the decision of ***Orient Trading Co. Ltd. (supra)*** by contending that there is no sale or exchange under the scheme of amalgamation and the factual situation in the said case was entirely different. He also sought to distinguish the case of ***Royal Insurance Co. Ltd. v. Stephen,*** *14 Tax Cases 22* by arguing that there are different provisions of Income Tax Act relating to Insurance Companies and taxation of Insurance Companies are dealt differently. In our considered opinion the fine distinction which Mr. Vohra has tried to bring out to render the said decision inapplicable is not the correct approach. There are separate provisions under the Act for business and investment income. Consequently, the characterization of an item of income determines which tax provision would be applicable to it. A gain may be income from business if it arises from a transaction or adventure or concern in the nature of trade undertaken with the intent of business or making profit. Income is recognised when it is earned or realised irrespective of whether it is in cash or kind. As we can see in ***Orient Trading Co. Ltd. (supra),*** if the shares are exchanged, it can be said the assessee has made realisation of the value of the shares and the difference in the price of the shares would have to be treated as profit of the assessee for the taxation purpose. Assesses also agree that taxable event

would occur under amalgamation if shares are treated as capital asset, but argue to the contrary if the same are treated as "stock-in-trade". Now, can it be said that this concept of extinguishment/transfer would not lose its relevance if the same shares are characterized as stock-in-trade in the hands of assessee? In ***Hindustan Lever versus State of Maharashtra,*** *(2004) 9 SCC 438,* expounding on the concept of amalgamation and whether it amounts to transfer, it was held as under:

> *"9. Section 394 provides that application and order of amalgamation under Section 394 is based on compromise or arrangement which has been proposed for the purpose of amalgamation of two or more companies. The amalgamation scheme, which is an agreement between the companies is presented before the court and the court passes an appropriate order sanctioning the compromise or arrangement. The foundation or the basis for passing an order of amalgamation is agreement between two or more companies. Under the scheme of amalgamation, the whole or any part of the undertaking, properties or liability of any company concerned in the scheme is to be transferred to the other company. The company whose property is transferred would be the transferor company and the company to whom property is transferred would be considered as the transferee company. The scheme of amalgamation has its genesis in an agreement between the prescribed majority of shareholders and creditors of the transferor company with the prescribed majority of shareholders and creditors of the transferee company. The intended transfer is a voluntary act of the contracting parties. The transfer has all the trappings of a sale. The transfer is effected by an order of the court. The proposed compromise or arrangement is subject to verification by the court as provided therein. First is that the scheme of compromise or arrangement proposed for the purposes of amalgamation or in connection therewith, shall not be sanctioned unless the court has received a report from the Company Law Board or the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest; and secondly, that the*

order of resolution of transfer of the company shall not be made unless official liquidator on scrutiny of the books and papers of the company makes a report to the court that the affairs of the company had not been conducted in a manner prejudicial to the interest of its members or to public interest."

30. No doubt, here under the scheme of amalgamation, the amalgamating company is getting extinguished in the sense that the surviving entity now is only the amalgamated company. However, we cannot ignore the fact that the shares that were with the assessees have undergone the amalgamation process whereby they are replaced with new shares which would be valued entirely on different fundamentals. Subsequent to the amalgamation it is not the same stock in the inventory of the assessees. Under the Companies Act, the shareholders who dissent to the scheme of the amalgamation ["dissenting shareholders"] are given the option of receiving cash or equivalent kind as the price for the shares on the basis of exchange ratio. In another words, the dissenting shareholders receive the value of their shareholding while the approving shareholders receive the same value in the form of shares of the amalgamated company. The process of amalgamation in its legal effect from the taxation viewpoint would apply equally, irrespective of the status of the shareholder. The taxable event is not just a matter of entries made in the account books of the assessee but is essentially one of substance and of the real nature of what transpired in the transaction. The income generated from the transaction has to be charged to Income tax as per provisions of law.#The fundamental principle to be followed is that the basic substance for the transaction has to be separated from the form and the taxing statue has to be applied accordingly. In light of the above discussion, the findings of the

Tribunal are plainly erroneous. Thus, question of law formulated before us is answered in favour of the Revenue and against the assessees.

31. Having answered the question of law in the above terms, we are of the view that the matter needs to be remanded back to ITAT since the factual dispute between the parties has not been decided. Accordingly, we restore the matter back to the file of ITAT for fresh adjudication. The Tribunal, after resolving the factual controversy shall proceed to decide the appeals having regard to the views expressed hereinabove. The present appeals are allowed in favour of the Revenue and against the assessees. No order as to costs.

SANJEEV NARULA, J

MANMOHAN, J

AUGUST 07, 2020
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