COMPUTATION OF CAPITAL ASSETS AND PROFIT GAINS: A SCRUTINY

By B. Jayaprad and G. Srividhya Iyer  
B.B.A; L.L.B(Hons), Sastra Deemed To Be University

ABSTRACT

Any person who wishes to exploit, use or develop any capital asset is given the privilege to use Section 45(2) of the Income Tax Act. But before the enactment of this section there were some judgments which discussed about the computation of capital and profit gains which were contradictory in nature. Thus, this paper throws light on the present provisions and comparative study with past cases which initiated the enforcement and necessity of this provision.

I. INTRODUCTION

Generally, in business, the capital assets are converted into stock in trade and then sold or stock in trade are converted into capital assets, the primary question before the enactment of section 45(2) was when should the profit be taxable, how to compute profit were posted before the Supreme court of India, these challenging questions were answered by the Court, and the rulings and guidelines given by the Hon’ble court is still in practise and gave rise to a new ruling. So these questions were initially emerged in the years, before the enactment of the provisions regarding the conversion of capital asset to stock in trade, and assessing its taxability. The legislators carefully examined the difference between tax evasion and tax avoidance that would cause if the capital gains were taxed and not taxed. This paper detailly discusses about the landmark case which gave rise to legal provision and its significance.

II. THE LANDMARK JUDGMENT-
COMMISSIONER OF INCOME-TAX v BAI SHRINIBAI K.KOOKA1

This case involves a question of law, involving general public importance and as there were no relevant provisions on computing profits when the dispute arose, the interpretation of the court on how to calculate stands relevant and astonishing, creating a major impact on taxation law. Before 1984, there were no provisions relating to taxability during conversion, so when such sort of questions came up during the early 40’s and 50’s the court had an obligation to settle the dispute with its interpretation and use those as precedents till a new law was made. This case is a classic example of judge made law and is still used in our country. This interpretation has also given rise to emerging of new section 45(2) in the future amendments. Thus, this case stands as a landmark judgment in bringing in a provision on computation of taxability based on conversion of capital asset into stock in trade. This judgment also differentiated what is capital gain, what is profit and when is it taxable. Any business or profession generally involves capital assets, profits and taxation. This case elucidates the importance of these and relates it with taxation law.

This paper involves substantial and debatable question of law, giving rise to new milestone amendment in taxation law. Also, this

---

1 (1962) 46 ITR 86 (SC)
judgment was held relevant till the year 1984, whereby stating that only the profits gained out of the business is taxable and mere conversion or capital gains are free from taxability. This was the main ruling held by the instant case, and this case is still used as a landmark judgment in computing the capital gains, profits in a business and its taxability. Also, this case held guidelines which gave out a fair means of computing profits as well as favouring the assessee. Only because the legislators found the importance of the case, they framed sections in the upcoming amendments to answer the unanswered issues of conversion to stock in trade. Thus, I felt the case was so basically important to address the unanswered issue, save the rights of the parties and give rise to new provisions and interpretation rewardingly.

III. BACKGROUND OF THE CASE

The analysis mainly deals with the case of Commissioner of Income-Tax, vs. Bai Shirinbai K. Kooka which is a landmark judgement on taxation law. Only because of this case, a new legal provision of section 45(2) emerged. Thus, basically this case deals with how profits should be computed, what is a real and notional profit? What are all taxable and so on? This case is compared with that of Kikabhais v Premchand case, and the relevancy and contrary statements are distinguished. This case is also compared with the present legal provision and present-day cases on the same issue and by this comparison we can understand what important role this case plays even today. Also, the grounds for reversing this case, pros and cons of this case, how interpretation could have been made is also discussed

The present case has an unexplainable significance than other judgments because of the Judges made law with the interpretation can be seen. Due to the absence of legal provision, in computation of profit gains after conversion of capital assets into stock in trade, the court made an interpretation with reference to the other provisions of Income tax act, and held the case in favour of the assessee. The present case differs from other cases because, this case involves a substantial question of law, and this significance was even understood by the Hon’ble Supreme court of India. Because of this, this case was heard by seven Judges Bench in the Apex court. The case involves. Question of law, a new question where no provision explains about it and the courts are obligated to make laws accordingly. The case also involves a debatable issue of how to assess the profits? And what should be taxed. This in turn affects the rights of the parties, and this significance was understood by the court. The guidelines given by the court in computation of the profit was held relevant till the year of 1984 (till the new provisions addressing this issue were enacted). The case also states that, potential profits should not be taxed, but only the real profits should be taxed, which is again an important principle to be followed. Also, the new provision of section 45(2) addressed this issue on computation of profits, where the sole reliance was made upon the present case to form the section. This itself proves the significance of this case. Also, even in the present day the courts use this case as a precedent to compute taxation on the profit gains in a business. Thus with all the above points, it can be self-explanatory to show the significance of the present case.

IV. SIGNIFICANCE OF THE CASE:

V. FACTS OF THE CASE
(i) The assessee was a Parsi lady, who had purchased shares by way of investment in the year 1939-40 at a cost price which was very much less compared to the market price value on April 1, 1945. Her dividend income therefrom was assessed to income tax. In the financial year of 1945-46 the assessee converted the shares into stock in trade and carried on her business in the shares. The income of the corresponding assessment year 1946-47 was computed on the basis of the profits which were made by the sale of shares as a part of her trading activity. The assessee made contentions that the cost price should be the actual market price at the beginning of the year, and not the original value of share for which she brought the share initially. But the department opposed her saying the original amount for which she brought would be considered cost price, no matter when was the shares brought or its purpose. This led to over arbitrary levy of tax and showed net profit of Rs. 73,321.

(ii) Before the Tribunal:

This was challenged before the tribunal where two contentions were submitted, the President of the tribunal held the case in favour of the assessee, and held the case involved “question of law” and framed issues which helped the Bombay High Court in its appeal.

"Whether the assessee's profit on the sale of shares is the difference between the sale price and the market price prevailing on said date of 1-4-1945 or difference between the sale price and the original cost price of the shares?“ The tribunal held that, the date of share prevailing on 1-4-1945 should be taken into account.

(iii) Before the Hon’ble High court of Bombay:

With the appeal and the questions from the Tribunal, the appeal moved to the Bombay High Court.

This case was heard by the Division bench which held the case in favour of the assessee, and held that the prevailing market price of shares should be taken as the price and should be subtracted from the sale price and the amount is said to be profit and is taxable. This was again challenged by the Appellants.

(iv) Before the Hon’ble Supreme Court of India:

The special leave was granted on 1956, and the Court found the importance of the case, involving question of law, where there were

(i) Absence of legal provisions for computing the profits
(ii) Involving and affecting rights of the parties
(iii) Having question of greater public importance

Thus, the Court admitted the case and was heard by three judges constituting the Hon’ble Chief Justice of India. This was then shifted to seven judge benches as the Kikabhai was cited.’

The main question was how such commercial profits are to be calculated. In a trading or commercial sense, the only fair measure of calculating such trading, commercial profits is to consider the market value at one end and the actual sale proceeds at, the other. The profits should be understood in its true and natural meaning which no commercial man will misunderstand, and stays clear to all.

VI. QUESTIONS FOR CONSIDERATION

(1) How and when to compute taxability?
(2) How profits should be calculated?
(3) Whether the decision of the court in present case is against the decision of Sir Kikabhai Premchand v. Commissioner of Income-tax, if so, does the decision in Kikabhai's case require reconsideration?

Arguments for the assessee:

Nani Palkhivala argued for the assessee stating that the profit must be calculated from the date of conversion and not the original cost price. He stated that, Kooka’s profit was the difference between the selling price and the market value of shares on the date of April 1, 1945. The original cost price should not be considered for computing the profits. The basis must be only on the ordinary commercial principles on which actual profits are computed. Normally the commercial profits out of the transaction of sale of an article must be the difference between what the article cost the business and what it fetched on sale. So far as the business or trading activity was concerned, the market value of the shares as on 1st April, 1945, was what it cost the business. There is no question of a notional sale here. The High Court did not create any legal fiction of a sale when it took the market value as on 1st April, 1945, as the proper figure for determining the actual profits made by the assessee. That the assessee later sold the shares in pursuance of a trading activity was not in dispute; that sale was an actual sale and not a notional sale; that actual sale resulted in some profits. The only fair measure of assessing trading profits in such circumstances is to take the market value at one end and the actual sale proceeds at the other, the difference between the two being the profit or loss, as the case may be. In a trading or commercial sense this seems to accord more with reality than with fiction.

The difference between the original cost and the market value as on the date of conversion of asset into stock-in-trade was not taxable as capital gain either.

Arguments by the Appellants:

The department of income tax conversely argued that, the profits must be assessed from the selling price and the original cost price of the shares on which it was bought. That is on the Assessment year of 1939-40. The department also quoted the judgement of Kikabhai2, which stated about when the profitability should be assessed.

The Additional Solicitor-General, who appeared for the appellant in the present case, challenged the correctness of the approach taken by the Supreme Court. He contended that, initially, that the distinction drawn by the Hon’ble High Court of Bombay between Kikabhai's case and this instant case is not acceptable on principle; also, he argued that the ratio in Kikabhai's case should apply in the current case also; and thirdly, he put forth his contentions that in holding the price of the shares should be the market price as, on April 1, 1945, when the shares were converted into stock-in-trade, the High Court in effect held by a legal fiction that the assessee had realised the potential profits on the said shares on that date, which she had not actually done and hence the very basis of the judgment of the High Court is vitiated by the assumption of a fiction. The learned Additional Solicitor-General has also stated that there was a notional sale of the shares on April 1, 1945 by the assessee and the gains which were accrued to the assessee on that

---

2 Sir Kikabhai Premchand v. CIT (1953) 24 ITR 506 (SC)
sale are deemed to be capital gains, this notional sale, violates the basic principle that a man cannot sell anything to himself nor can make a loss or profit out of transactions with himself. Additionally, the High court introduced notional profits and fiction which cannot be warranted nor accepted. In order to examine, it is obligatory first to refer to the decision of this court in Kikabhai’s case. And accordingly, same principles should be followed as that of Kikabhai’s case.

VII. FINDINGS OF THE COURT

The Supreme Court felt the importance of the case and felt that the above said Kikabhai Judgement was converse to this case. The main question in the present case was how to assess the profit, but main question of the Kikabhai judgement was regarding non-taxability of future profit or potential advantage. The court tried to differentiate between notional profits and real profits. One could escape from not paying notional profits, but in the present case, it involves real profits so it should be taxable. The Kikabhai judgement cannot be relied as it did not discuss about the real profits and its taxability but discussed about the fictional and notional profits. So the main question of computing the taxability on the basis of profit arose.

Normally, the commercial profits out of any transaction of a sale are the difference between what the article costs the business and what it fetches on sale. The High Court pointed out that when the assessee purchased the shares at a lesser price, that is what they cost her, and not the business; but so far as the business was concerned, the shares cost the business nothing more or less than their market value on April 1, 1945. Tax should be levied in such a way that no one can misunderstand and the tax stands clear. The original cost is just to know the history and is irrelevant in finding the profits. The Whole of the sale proceeds or receipts could not be treated as profits and made liable to tax, this would not make any sense; a portion only of the receipts can be treated as profit—but question arose on what portion was taxable and how to compute tax? Generally, the commercial profits out of any transaction of a sale are the difference between what the article costs the business and what it fetches on sale. But this cannot be relied on taxation and the courts should take a separate view on it.

VIII. JUDGMENT

The arguments placed by Nani Palkhivala was accepted by the court along with other findings and held that, the profits should be assessed only from the date of conversion. The prevailing market price on the year 1945 should be considered and be taken as the cost price. The court held that the profit was the difference between the selling price of the stock in trade and the prevailing market price on the date of 1945, the original cost price need not be considered.

The Supreme Court also added that, because of the absence of provision to compute the profit, this judgment stands relevant and the capital gain need not be taxable. This was extended till 31st of March 1984 where the conversion of capital assets to stock in trade giving rise to “capital gains” was tax free, and only the PGBP i.e., only the profit gains should be considered taxable (till the relevant year 1984). “The difference between one case and another is that, in one case there is no question of any business sale or actual profits and in the other case there are profits liable

3 1953 AIR 509

4 supra
to tax, but the question is how the profits should be calculated. The first two arguments of the learned Additional Solicitor General should be over ruled and also the distinction drawn by the High Court between Kikabhai’s case and the present case is not warranted on principle”. The Supreme court provided a guideline that, the profit is to be computed as the difference between selling price and the prevailing fair market value at the date of conversion. Thus, the appeal was dismissed and the case went in favour of the Assessee.

IX. RATIO:

The present case had a majority stating that, the prevailing market price during conversion should be considered, and the original cost of buying is irrelevant. The profits and the gains are calculated only on the basis of the Fair market value prevailing on the date of conversion of the capital assets into stock in trade and the selling price. The judges held that, this measure would only be an ideal way to measure the profit gains arising out of a business or a profession and the original cost of buying need not be relied upon. Also, this case varies with that of Kikabhai’s case, but both stand similar stating that potential advantages or the future profits need not be taxed. So, during conversion the capital gains need not be taxed and only the profits after selling are to be subjected to tax. This was upheld by all the courts, and no court showed up a contrary opinion. (From the tribunal to the Supreme Court all favoured the assessee).

X. RELATION OF RATIO WITH RESPECT TO TESTS BY JURISTS:

a. Inversion test or the reversal test:

With respect to this test, when the main proposition is reversed, the whole judgement gets collapsed and reversed. This proposition is said to be ratio decidendi. In the present case, the principle of computation of profits by considering the fair market value is said to be Ratio Decidendi.

b. Halsbury test:

Halsbury stated that, the reversion test can be time consuming and cannot be relied upon; instead we can rely on the principles arising out of the judgement. Here the main principle from the judgement is that, profits are the difference between the sale price of the converted stock in trade and the prevailing market value of the stock in trade during the time of conversion. This is the basic principle laid down by the Supreme Court of India, in the present judgement and this is to be considered as ration.

c. Material fact test by Good Hart:

Good hart stated that, the facts changes from case to case and importance should be given on the material facts of the case to decide its ratio and not on any doctrine or principles. Thus in the present case, the main material fact that differentiates itself from that of the Kikabhai’s case is that, here in this case, there is an actual sale of the stock after conversion. Thus the case signifies these material facts and hence the ratio of this case is to decide on the taxability of the profit gains and how it should be computed. Thus, the answer for this is said to be Ratio Decidendi for this particular case.

Thus, these are the different tests given by eminent jurists to find the Ratio of any case.
and such tests are used to compare the ratio with the present judgement.

XI. INTERPRETATION

According to the general rule of interpretation, the taxing statutes are to be strictly construed and the court cannot interpret the liability beyond what is said in the provision. Statutes imposing taxes or monetary burdens are to be strictly construed.

• The main logic behind this principle is that imposition of taxes is also a kind of obligation of penalty which can only be levied if the language of the statute unambiguously so says. A person cannot be taxed unless the language of the statute explicitly imposes the obligation without pulling itself.

• CIT vs. A.Raman &Co⁶ it was stated by, the Hon’ble SC observed that payment of tax could be lawfully avoided by properly arranging and distributing the commercial affairs. The tax payer has a right to divert his income without floating the provisions of the income tax Act, but evasion is not permissible.

• Mangalore Chemicals & Ltd v Deputy Commissioner of Commercial Taxes⁷, the SC observed that, “the choice between a strict and a liberal construction arises only in case of doubt in regard to the intention of the legislature manifest by the statutory language. Indeed, the need to resort to any interpretive process arises only where the meaning is not manifest on the plain and clear and directly convey the meaning, there is no need for any interpretation”

• Strict interpretation of the taxing statute is mandatory and no further interpretation can happen. In case of any ambiguity in the provision of charging sections in a taxing statute, then the interpretation should favour the assessee. In case of ambiguity in any exemptions, then it should favour the revenue. This was the general rule of interpreting a taxing statute⁸.

• “There cannot be any interpretation which encroaches the assessee’s legal right or claim which are legal arising out of diverse sections which are not overridden by deeming provision”⁹.

• Here since there was not any provision regarding how it should be taxed, it clearly means that the words cannot be taken in its natural or plain meaning, rather interpretation should be made to solve the dispute. The case went in favour of the assessee where the profits equal difference between sale price and the Fair market value at the time of conversion. This clearly favours the assessee. So, from the interpretation of taxing statute, the case has done justice by favouring the assessee in time of ambiguity in the charging provision.

XII. COMPARISON WITH KIKABHAI’S CASE

The present case has some similarity with that of the Kikabhai’s case¹⁰, where, only profits can be subjected to taxation and mere

---

⁶ AIR 1968 SC49
⁷ AIR 1992 SC152
⁸ Associated Cement Co. Ltd vs. Commercial Tax Officer AIR 1981 SC 1887
⁹ Dempos P Ltd –SC – 387 ITR 354
¹⁰ 1953 AIR 509
future advantage cannot be deemed to be profit nor is taxable. So this basic principle is accepted in both the cases. In the first case, the assessee was a merchant having gold and silver bars which he converted and gave to a trust. The state contented that, the conversion amounts to profit and is to be taxable. The Hon’ble Supreme court held that, future profits or potential advantages cannot be subjected to taxability, and the Court dismissed the contentions of the state, saying the state has no authority to impose tax on future profits. This was upheld to some extent in the present case that is why the conversion of the capital asset into stock in trade was not taxable, as it did not give any immediate or real profits. Thus, in this strand both the cases have a similar view. But also, contrarily the latter case gets real profits after the sale. Now the question of taxability arises and this was not discussed in the earlier judgment. So, the main focus of the Court shifted to computation of profits and its taxability. Also, with respect to the present legal provisions on the taxability of capital gains and profits, the latter case holds more significance over the first case, as the legal provisions were made mainly with reference to this judgement and is still cited in cases involving question of taxability in conversion of capital assets to stock in trade. So, this comparison shows the similarity and significance of both the cases and how these vary with respect to time of accruing profits.

XIII. LEGAL PROVISION:

Section 2(47)(iv) defined the term “Transfer” with respect to a capital asset includes, case of transferring the capital asset or stock in trade in a business carried by him.11

Section 45(2): “Notwithstanding anything contained in sub-section (1), the profits or gains arising from the transfer by way of conversion by the owner of a capital asset into, or its treatment by him as stock-in-trade of a business carried on by him shall be chargeable to income-tax as his income of the previous year in which such stock-in-trade is sold or otherwise transferred by him and, for the purposes of section 48, the fair market value of the asset on the date of such conversion or treatment shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.”12

From the plain reading of section 45(2) and 2(47) (iv) above it is clear that if a capital asset is converted into stock in trade of a business carried on by the assessee then it is considered as a transfer of such capital asset and capital gain or loss as the case may be shall be computed in the year of sale of such converted capital asset. The consideration in such case for the purpose of computing capital gain/loss shall be equivalent to the fair market value of such asset as existing on the date of such conversion.

Section 2(22B) defines what a Fair Market value is in relation to that of a capital asset.

There must be a capital asset: Only if the assessee has any capital asset on his own, the said section 45(2) may be attracted, if not then even after the conversion he cannot take the advantage provided under the said section.

Capital Gain shall be computed in the year only when such converted asset is sold: Although conversion of any capital asset into stock in trade in a business or

11 Section 2(47), The income tax act, 1961
12 Section 45(2) , Income tax act, 1961.
profession is treated as transfer but the section 45(2) provides that the capital gain/loss shall be calculated on any converted asset in the year only when it is actually sold.

The Cost of indexation shall be done till the year of conversion of assets: Although the transfer of capital asset into stock in trade, is presumed to have taken place in the year of conversion but the capital gain/loss is computed only in the year of sale of the said asset. This is done by considering the C.I.I of the year of conversion.

Business Income also to be calculated in the year of sale: After the conversion of capital asset into stock in trade of business or profession of an assessee, the Fair Market Value (FMV) on the date of conversion is considered as full sale consideration of the capital asset for the purpose of capital gain computation, such fair market value is considered as cost of such asset as converted into stock in trade in the books of accounts and will be deducted from the fair market value of such asset as existing on the date of conversion and the profit arising, if any shall be treated as Income under business or profession

XIV. COMPARITIVE STUDY:

The case has been a milestone in giving rise to new provisions in the taxation, including section 45(2). All the rulings and guidelines have been followed and implied in the said section. But the major difference is that, till 31st March, 1984 the case was held to be relevant and the capital gains were not taxable. Only the profit gains were taken into consideration. But the present law of taxation, taxes both the capital gains after the conversion as well as the profit gains. This latter has a major setback as mere conversion does not amount to taxability generally with the earlier judgments as they are fictional profits. Only the real profits in hand can be computed easily and will be justifiable. The present law involves complex process of calculating the index price, acquisition price which increases the amount of tax burden on the assessee. Section 45(2) of the Act, does not deviate from the principles laid down by the Hon’ble Supreme Court. Since market value is adopted on conversion of investment into stock-in-trade, it is considered fair that after the provisions of taxation law on computing the capital gains, the assessee is obliged to pay tax on capital gains also. But the tax on capital gains should be paid only during the time of sale and not during conversion. This differs from the case, as the present case did not discuss about the computation of capital gains nor talks about the taxation. The case held that only profits were taxable and the capital gains were not subjected to tax. The present legal provisions, but enforces obligation of taxation on both capital gains, which is computed after the conversion with respect to the capital index and profits. This has several advantages as it reduces the tax burden improves the economy and avoids double taxation, as the assessee should pay the tax on capital gains as well as the profits only during the time of sale and not during the conversion. The date of conversion of the assets is deemed to be the capital gains with respect to the capital index and acquisition index. But this can be computed only after the sale.

Thus in the present case with respect to the legal provisions, the tax liability lies as follows on conversion of a capital asset into stock-in-trade, and sale:

(i) One would be liable to pay tax on capital gains only after the sale is complete, but the old case did not
mention about the taxability of capital gains. Thus, the capital gains will be the difference between the cost of capital asset and the market value of such capital asset on the date of its conversion into stock-in-trade.

(ii) The profit gains are calculated from the business and deemed to be accrued from the business. The profits are calculated on the basis of difference between the sale price of the converted stock in trade and the prevailing fair market value at the time of conversion.

(iii) This has several benefits when compared to the case as it takes in both the capital gains as well as the profits accrued from the business. This is taken as full consideration arising out of the business.

In the present context, it must be cherished that while framing the provisions of section 45(2) on relance of this case, a broader and practical view has been adopted, taking into account both the capital gains as well as the profit gains from the business.

XV. VALUE AS PRECEDENT:

The case is still used as a precedent in deciding the cases involving conversion of assets into stock in trade. The guidelines laid by the Apex court in deciding the number of profits and its taxability is still in force and are relevant. The same is applied in the section and impliedly the case has given rise to this section. The computation of profits is taken as a difference between the selling price and the prevailing market price during the conversion. The capital gains can be taxed only if it is sold. So these principles are used even now, and have relevance. Some of the cases are:

(1) CIT Vs Saffire Hotels P.Ltd

This case basically deals with selling of land property after conversion into stock in trade. The basic question was when should the amount be taxable? The court relied upon the case of CIT v. Bai shirinbai K. Kooka and section 45(2), and held that the profit and “capital gains” should be taxed only after the sale has taken place. This is in relation with the case, because Kooka case, explained the same and till date the case is being used as a precedent in ruling the taxability.

(2) CIT Vs Najoo Dara Deboo

The same principle was laid down in the case, where only the capital gains cannot be charged if there is no consideration. Section 45(2) gets attracted only if there is a sale after conversion of an asset into stock in trade. Thus, if there is no consideration and only agreement lies, then it is not taxable. This was the principle laid down in Kooka’s case, and the same is being implemented in this case also.

(3) CIT Vs Rajesh Bahadur and Others

When the capital assets are converted into stock-in-trade, the assessee is entitled to adopt the market value of the asset as on the date of conversion and this principle has been approved by the Apex Court, in the case of CIT Vs Bai Shirinbai K. Kooka

---

13 [2015] 116 DTR 385 (Bom)
14 (1962) 46 ITR 86 (SC)
15 [2013] 218 Taxman 473 (All)
16 [2007] 294 ITR 297 (Del)
XVI. REASONS FOR OVER RULING:

The said judgement can be reversed or over ruled on the reasons that it is to an extent inconsistent with that of the present legal provisions. Generally, one could compute the profits only on the basis of difference between the selling price and original cost price, considering the prevailing market value during conversion seems irrelevant. The capital gains along with the profit acquired will only be a wise way to decide the taxability, just relying on the real profits might lead to tax evasion. Just calculating only, the profit gains in a business or profession (PGBP) can favour the assessee, but there occurs tax evasion, and affects the economy as a whole. During the conversion of assets into stock, generally the fair market value is not seen and this can lead to cheating and evasion, where the books of accounts will show an amount of sale which is actually lesser than that of the original market value. Generally capital assets and capital gains are also deemed to be a profit, and without making profits he can invest it under any land or property which exempts taxability and evade or avoid taxation. This practise shows less profit and the assessee escapes from liability to pay higher tax, but presently not only the profit gains are taken, but the capital gains are also added, which is taxable at the time of sale. The present law helps the government to collect tax which avoids such tax evasion, additionally the present law helps in developing our economy and our nation as the tax collected in a country can promote the whole country. Under section 54 of the Income tax act, one could claim exemption by re investing the capital gains. This clearly is avoidance of tax, where reduces the revenue of the State. Also the article 265 can be cited “where no tax shall be levied without the authority of law”\(^{18}\). Here there is no proper law regarding the conversion of stock in trade and its taxability. So, the question is itself ultra vires and he should be completely exempted and tax should not have been imposed at all. Thus, a fair assessing of taxability should be taken. There has actually been a notional profit at the time of 1945, which is deemed to be a capital gain and one cannot exempt from taxability. But the present case has ignored the concept of capital gains and focusses only on the profit gains in a business, which is arbitrary and violating the basic principles of taxation law.

XVII. CONCLUSION:

With the above discussions and analysis made, we can conclude that, the case has set an example on how any ambiguity in the provision should be interpreted and has helped the legislators to frame a section in upcoming amendments. The amendments were solely made on the reliance of this case, and this case is still practically used as a precedent in the present-day cases dealing with the conversion of capital gains into stock in trade.

If one desires to exploit or develop any capital asset held by him, he may use the full advantage of provisions of section 45(2) of the Income tax act. The person may use this advantage after conversion of capital assets into stock in trade or vice versa. The person has an advantage where he need not pay any tax for the conversion of capital assets acquiring capital gains. He gets an advantage where only during the time of sale; one gets

\(^{18}\) Article 265, of the Constitution of India
the liability of taxation and not during mere conversion.

The assessee will have an additional advantage of computation of profits as a difference of sale price and prevailing market price during the date of conversion which is comparatively lesser than computation of difference between sale price and the actual price. So this computation serves a greater advantage on the assessee, and reduces the tax burden.

He has an advantage to pay the capital gains only after the stock in trade is sold, so this avoids double taxation and reduces the burden. Thus, the tax payers may derive a lot of benefits only through this section 45(2) of the Income tax act.

*****