Computation of Capital gain in case of conversion of investments in to stock in trade :-

Bai Shirin Bai K Kooka v/s CIT

In this case, the assessee was holding shares of various companies started the business of trading shares. The assessee has converted the investment in shares in to stock in trade of this newly started business. Latter, these shares are sold by the assessee.

As we know, stock in trade of business is not a capital asset and hence the question of capital gain does not arise. Since the assessee is in the business of buying & selling shares, the gain to be chargeable to tax under the head Profits & Gains of Business or Profession. Now, there is no doubt regarding the sale price of shares, however, the question arises as to what is to be taken as cost of these shares. Is it the original purchase price to be considered or the market value of these shares as on the date of conversion in to stock in trade to be considered?

As per the Supreme Court ruling [1962] on the above case, cost to be considered is the market price as on the date of conversion and not the original purchase price. Also to note that the appreciation on the value of stock between the market price of shares as on the date of conversion and the original purchase price is not chargeable to tax.

However, the above decision was nullified by the Income Tax Amendment [1984] which is as below:-

1. Conversion of Investments in to stock in trade will be considered as transfer Sec 2[47].

2. The notional gain arising from the above transfer representing the difference between Market value as on the date of transfer and the original purchase price will be taxable in the year in which the stock is sold by the assessee Sec 45[2] as capital gain.

3. The difference between the sale price of shares and the Market price as on the date of conversion will be taxed under the head ‘ Profits & Gains of Business or Profession’.

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