Karanpura Development Co Ltd.

Vs

Commissioner of Income-Tax, West Bengal

Civil Appeals Nos. 376 to 379 of 1960

(P. B. Gajendragadkar, M. Hidayatullah, K. Subha Rao JJ)

31.08.1961

JUDGMENT

HIDAYATULLAH –

These are four appeals filed by the assessee company (Karanpura Development Co., Ltd.) in respect of two assessment years, 1949-50 and 1950-51, and two chargeable accounting periods under the Business Profits tax Act, January 1, 1948, to December 31, 1949. By these appeals, the assessee company impugns the judgment of the High Court of Calcutta dated September 18, 1958, answering a common question "whether on the facts and in the circumstances of the case, the sums received as salami by the assessee for granting sub-leases were trading receipts in its hands and the amount of profits therein is assessable under the Indian Income-tax Act" in the affirmative and against the assessee company. The case was certified to this court by the High Court under section 66A (2) of the Income-tax Act and presumably also read with section 19 of the Business Profits Tax Act.

The facts of the case are as follows : In 1915, the court of wards representing the proprietor of the Ramgarh estate granted a prospecting licence to Messrs. Bird & Co., of an areas of coal-bearing glands described as the Karanpura Coal Fields. The licence was for 12 years but was renewable for another term of 12 years. The licence was transferable. The assessee company was incorporated in 1920. The objects for which the assessee company was formed, inter alia, were :

> "(1) to purchase and acquire from the owners or proprietors thereof or other persons interest therein underground coal mining, relative rights of and in the Karanpura Coal Fields in the Province of Bihar and Orissa at such price or prices for such period or periods and generally upon such terms and conditions as the directors may determine and for that purpose to adopts, enter into and carry into effect all contracts, agreements and other documents, and in particular to enter into and carry into effect, with or within modifications, either before or after the execution thereon, the agreement referred to in article 3 of the company's articles of association.
>
> (2) To sell, dispose of an otherwise deal in all such underground coal mining and relative rights upon such terms and conditions as may appear for the benefit of the company.
>
> (3) To carry on the trades or business of colliery proprietors, coal merchants, miners, smelters, engineers, limeburners and manufacturers of brick, tile cement, lime, coke and other bye-products of coal in all their respective branches...

(6) To prospect for, crush, win, get, quarry, smelt, calcine, refine, dress, amalgamator, manipulate and prepare for market coal, ore, metal, and mineral substances of all kinds, and to carry only other prospecting, mining or metallurgical apportions, which may seem conducive to any of the company's objects and to buy, sell, manufacture, and deal in minerals, plants, machinery implements, conveniences, provisions, and things capable of being used in connection with prospecting, mining or metallurgical operations or required by workmen or others employed by the company...

(34) To acquire by purchase, lease, exchange, or otherwise, lands, buildings, and hereditaments of any tenure or description and any estate or interest therein, and any rights over or interest therein, and any rights over or connected with lands, and either to retain the same for the purpose of the company's business or to turn the same to accounts as may seem expedient....

(52) To sell, improve, manager, develop, exchange, lease, mortgage, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the company."

On May 30, 1921, Messrs. Bird and Co. assigned their rights under the prospecting licence to the assessee company. The assessee company then acquired from time to time diverse coal mining leases over areas aggregating 20,000 standard bighas. The assessee company developed these coal fields by providing means of communication, etc., and then sub-leased them to collieries and other companies. In the head leases which the assessee company had obtained, the term was 999 years. In the sub-lease the term was the balance of the period minus 2 days. Apart from obtaining heads leases, developing the coal fields and sub- leasing its rights, the assessee company admittedly did not do any business. It never worked the coal fields with a view to raising coal; nor did it acquire or sell coal raised by the sub-lessees. As a condition of the acquisition of the head leases, the assessee company had paid salami at the rate of Rs. 40 per standard bigha, and had agreed to pay royalty at certain rates. From the sub-lessees, the a

The Tribunal as well as the High Court held that in acquiring the head leases and in granting the sub-leases, the assessee company was carrying on a business within its memorandum of association and the increased salami received from the sub-assesses represented profits of that business liable to be included in the assessable income for income-tax purposes and in the profits, for purposes of the business profits tax. The case of the assessee company was that it was holding its capital asset, namely, the mining leases through its sub-lessees during the relevant accounting years, and its activities were the management of the lease-hold right, selection of sub-lessees, collection of rents or royalties which did not amount to the carrying on of a business. In return for the charge of salami, the assessee company transferred only the general right to the benefits under the leases, and that was a realisation of its capital within the ruling of the Privy Council in Kamakshya Narain Sings v. Commissioner of Income- t

The word "income" has not been defined in the Income-tax Act. In the definition which is enacted, certain receipts are said to be included in the concept of income; but it does not say what "income" itself means. Certain working definitions have been given by courts, chief among which is by the Judicial Committee in Commissioner of Income-tax v. Shaw Wallace & Co. where it was held that by income is meant a periodical monetary receipt, not in the nature of a windfall but coming in with some sort of regularity or expected regularity. In business, it was also pointed out, income was the

produce of something "loosely spoken of as capital". This income in business is profits which is earned by a process of production, or in other words, by the continuous exercise of an activity. These observation of the Privy Council were quoted with approval by this court in many cases and recently in Senairam Doongarmall v. Commissioner of Income-tax. In the last case, it was also pointed out that the addition of the words "pr

But whatever "income" may include or mean, it is, however, clear that it does not include fixed capital or the realising of fixed capital by turning it into some other form of capital or money. Fixed capital is something which the owner keeps in his possession but turns to profit; circulating capital, however, is turned over in the process of profit making. It may sometimes happen that in the process of production, fixed capital may be consumed or wasted, but that is a reduction of capital and not an expenditure in the business climbable as an allowance in the reduction of assessable income in the shape of profits of the business.

The profits of business are calculated under section 10 of the Act. Under that section, tax is payable by a company under the head "profits and gains of business..." in respect of the profits and gains of any business carried on by the company. In section 2 (4) of the Indian Income-tax Act, "business" has been defined to include any trade, commerce or any manufacture or any adventure or concern in the nature of trade, commerce or manufacture. In all cases where an assessee questions the finding that assessable profits and gains have been made in a business, it is customary to find the assessee questioning that a business has at all been carried on, and further that the return is on the capital account and not revenue. This well- trodden path was also followed in this case, and the assessee company has raised three contentions. It contends that the return to it as salami represented merely a capital return because in acquiring the mining lease the assessee company acquired two distinct rights, (a) the general

No doubt, in Kamakshya Narain Singh v. Commissioner of Income-tax, the Privy Council made a distinction between sums received as royalties and salami by the proprietor of the Ramgarh estate holding the former to be income from other sources within section 12 of the Act, and the latter as a payment on capital account; but the facts were different. Since the case is relied upon by the assessee company, it is necessary to consider it in some detail. The court of wards, acting on behalf of the proprietor of Ramgarh estate, granted leases for 999 years to certain companies including the assessee company. Under the terms of the leases, the lessees agreed to pay to the lessors royalties at certain rates per ton of different kinds of coal raised and a fixed salami or premium, the royalty being subject always to a minimum annual sum. It was contended on behalf of the proprietor that none of the sums was taxably as income. The contention of the proprietor with regard to the royalty per ton and the minimum royalty was

> "The salami has been, rightly in their Lordships' opinion, treated as a capital receipt. It is a singled payment made for the acquisition of the right of the lessees to enjoy the benefits granted to them by the lease. That general right may properly be regarded as a capital asset, and the money paid to purchase it may properly be held to be a payment on capital account."

In that case, the general right was, in effect, sold by the proprietor of the estate. In his hands as a landowner, the coal bearing lands were property and when he sold the right to the lessees to enjoy the benefits, he sold his property but he was not doing business. The proprietor parted with the general right, but in his hands it was not the stock-in-trade of any business. If the lessees treated these lands, so to speak, as the stock-in-trade of their business and turned them to account at a

profits, the profit so gains may legitimately be considered as the profit of business. It is contended that there is no difference between a landowner and a company which owns land or leases in land, and reliance is placed upon the case of Balgownie Land Trust Ltd. v. Commissioner of Inland Revenue. In that case, the owner of an estate left his landed estate to the trustees "with a direction to realise". The trustees were unable to dispose of the land on the market and formed a company to deal in real property to whic

The actual decision is against the assessee company, but what is relied upon is a passage in the judgment of the Lord President (Clyde) in the Court of Session (Scotland) at page 692, where it is observed :

> "One is not, however, entitled to infer from the circumstance that a company is professedly formed with trading purposes in view and for trading objects that the transaction in which it engages necessarily constitute a trade or business; because it does not follow from the fact that it has objects and powers such as I have indicated that it actually uses them for the purpose of conduction the usual business of a company trading in real estate."

If the assessee company was not doing business but was merely realising the property which it had acquired, this passage might have been of some use; but, as will be shown later, there was more than mere realising of its property in the present case, and the further observations of the Lord President apply, which run :

> "But the professed objects of a company are not, for that reason, to be left out of account; on the contrary, they must be kept in view when considering the transactions in which the company is proved to have been engaged."

Reliance is also placed upon certain observations of Lord Warrington of Clyffe in Fry v. Salisbury House Estates Ltd. where it was said :

> "Assuming the memorandum of association allows it, and in this case it unquestionably does, a company is just as capable as an individual of being a landowner, and as such deriving rent and profits from its land, without thereby becoming a trader, and in my opinion it is the nature of its operations, and not its own capacity, which must determine whether it is carrying on a trade or not."

We need not pause to consider the facts in that case, because we shall deal with it in detail presently; but it is clear even from this passage that the deciding factor is not ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them. The objects of the company must also be kept in view to interpret the activity. As was observed by Lord Sterndale M. R. in Commissioners of Inland Revenue v. Korean, Syndicate Ltd. :

> "If you once get the individual and the company spending exactly on the same basis, then there would be no difference between them at all. But the fact that the limited company comes into existence in a different way is a matter to be considered. An individual comes into existence for many purposes, or perhaps sometimes for none, whereas a limited company comes into existence for some particular purpose, and if it comes into existence for the particular purpose of carrying out a transaction by getting possession of concessions and turning them to account, then that is a matter to

> be considered when you come to decide whether doing that is carrying on a business or not."

The decision in this case must, therefore, turn upon the objects for which the company was formed, and whether one of the objects of the company was to develop and sell leases and leaseholds with an eye to making profits and what its activity was, in relation to its objects, Before, however, we analyse the objects for which the assessee company was formed and scan its activities, it is instructive to refer to two cases to which the learned Attorney-General for the department called our attention and which have also formed the basis of the decision of the High Court and before the Tribunal.

The first is the well-known case of Californian Copper syndicate v. Harris. There, the assessee company was formed, inter alia, with the following objects :

> "(1) To acquire copper and other mines, mining rights, metalliferous and auriferous land, in California or elsewhere in the United State of America, and any interest therein, and in particular to acquire the mines know as (here follow some names) situate in the county of....
>
> (17) To sell, lease, charter or otherwise dispose of absolutely or conditionally, or for any limited interest, the whole or any part of the undertaking, property, rights, concessions, or privileges of the company for such consideration in cash, shares or otherwise as the company may think fit..."

The company acquired 480 acres of copper-bearing land for Pounds 24,000 and spent money on development. Later, 80 acres of this land were sold to Fresco Copper Co. Ltd. for Pounds 105,000 payable wholly in fully paid shares of the Fresno Copper Co. Later, the company sold the remaining 400 acres for Pounds 195,000 payable wholly in fully paid shares of Fresno Copper Co. The Fresno Co. had 400,000 shares of Pound 1 each, and of these, 300,000 were allotted to the company. The company made no profits assessable to income-tax, and the question was whether the net gain derived from the sale of the property could be deemed to be profit. The company contended that this was only a conversion of one kind of capital into one of another kind. In the court of Exchequer (Scotland) Lord Justice Clerk distinguished between two kinds of case - (a) where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at; and (b) where the act is done not merely as

> "There are many companies which in their very inception are formed for such a purpose, and in these cases it is not doubtful that, when they make a gain by a realisation, the gain they make is liable to be assessed for income-tax."

The learned Lord Justice observed that the line might be difficult to draw and each case must be decided on its own facts and posed the question, which is the question to ask here : "Is the sum of gain that has been made a mere enhancement of value by realising a security, or for profit-making ?" The facts in the case were held to indicate a highly speculative business, and it was said that the mode of the actual procedure employed also indicated a trading venture. Lord Trayner also greed, observing that it was "a proper trading transaction" and one which was not only within the power of the company but also authorised by the articles.

The next case is British South Africa Co. v. Commissioner of Income- tax. In that case, the assessee

was the British South Africa Co., which was incorporated, inter alia, for carrying into effect concessions and agreements which had been made by certain chiefs of South Africa and such other concessions which the company might acquire. After acquiring such concessions and mining rights, the company gave special grants to other companies in return for fully paid shares and annual payments over a fixed number of years. The income-tax authority in Rhodesia treated these sums as profits, and assessed to income-tax the full par value of the shares. It was held that the sums were not capital receipt but income from business. The High Court of Rhodesia and the Rhodesian Court of Appeal affirmed the view of the income-tax authorities. On appeal, the Privy Council did not endorse the view of the Rhodesian courts on certain aspects of the case, with which we are not here concerned, but went on to inquire into the nature

The case, of course, is one to which the warning often given that it is not desirable to rely upon decisions under different taxing statues would seem applicable; but in the judgment of the Privy Council, it is made clear that the Rhodesian Act was not different from the British law. The decision also rests, not upon the provisions of any special enactment but upon the more general consideration whether such receipts can be considered in a business sense as belonging to capital account or revenue and in what circumstances.

These two cases and particularly the Californian Copper Syndicate case cited by the learned Attorney-General do establish that if a company sold its assets as a part of its business with the objects for which the company was formed, the excess receipts over the expenses of acquisition can be regarded as profits and gains of the business.

The case of Californian Copper Syndicate Ltd. is so similar in facts as to be almost decisive; but the assessee company relies upon Tebrau (Johore) Rubber Syndicate Ltd. v. Farmer as lying down the principle which should govern this case. In that case, a company was formed with the object of acquiring estates in the Malay Peninsula and developing them by planting and cultivating rubber trees. The memorandum of association contained a power to sell the property in the following terms :

> "(12) To sell or other side dispose of, as a going concern or otherwise, the whole or any part of the business undertaking and property of the company for such consideration as the company shall think fit...."

Two estates were purchases, but for want of adequate capital were sold to another company for consideration in the shape mainly of share in the second company. The return thus exceeded the amount of capital expended in making the acquisitions. Before the sale, however, a considerable part of the estates had been planted with rubber tress but no rubber had been produced and the first company had not reached the production stage. The company had thus not earned any income except what it got by the sale. This was claimed to be an increased of capital. The Surveyor or Taxes relied, inter alia, upon the Californian Copper Syndicate case. It was held by the Court of exchequer (Scotland) that the profit on sale was merely an appreciation of capital and not profit assessable to income-tax. Lord Salvesen observed that he was unable to distinguish the position of the company from that of a person who acquired property by way of investment and who realised it afterwards at a profit. He, however, observed :

> "No doubt if it is part of his business to deal in land or investments, any profits which in the course of that business he realises from part of his income; but the mere fact that a person or company has invested funds in the purchase of an estate which has

> subsequently appreciated and so has realise a profit on his purchase does not make that profits liable to assessment."

The Californian Copper Syndicate case was distinguished, because in that case, Lord Trayner had found that business was being done, and the following observations from Lord Trayner's judgment were emphasised : "I am satisfied that the appellant company was formed in order to acquire certain mineral fields or workings - not to work the same themselves for the benefit of the company, but slowly with the view and purpose of reselling the same at a profit." Lord Salvesen pointed out that such an inference could not be drawn about the case before him.

These two sets of case illustrate forcefully the changing circumstances in which annexes return may be treated as an appreciation of capital or as profit. If the sale is after a company is wound up and business has stopped, it may (subject to special statutory provisions) be said that any excess amount received over and above the capital of the company is merely an appreciation of capital; but the same cannot be said if business is being done in lands, mineral concession, smiling rights, with a view to making profits. In the latter case, a sale at an enhanced price is not appreciation of capital but profit in the way of business, and the sale is, so to speak, of stock-in-trade.

Mr. Mitra relies upon three case to establish that no business at all was being done. He contends that the assessee company was merely granting sub-leases of property of which they had the reverter and all that the assessee company did was to collect rents and royalties. Before dealing with the cases, it is necessary to point out that the ultimate reverter has no significance. The term is 999 years less a few days. Even if it was shorter, a possible reverter is not material. The observations of the Judicial Committee in the case from Rhodesia quoted earlier have our assent.

The first case relied upon is East India Prospecting syndicate v. Commissioner of Excess Profits Tax. In that case, the facts were very different. In 1919, V. C., a limited company, obtained a prospecting licence from the Raja of Talchar in respect of some 8 sq. miles of coal bearing lands. On August 5, 1920, a partnership was formed which was named the East India Prospecting Syndicate. The objects of the partnership were :

> (1) to purchases from the company their rights under the prospecting licence;
>
> (2) to give effect to the conditions of the said licence; and
>
> (3) to promote a company or companies with limited liability for the purpose of acquiring at a profit to the syndicate all or any of the properties including the benefit of the prospecting licence.

The syndicate acquired the prospecting licence from the company, V. C. In 1921, the syndicate obtained a mining else from the Raja of Talchar over about 500 acres for 30 years with option to renew. The syndicate then promoted a company called the Talchar Coalfield Ltd. (shortly T. C.) and sub-let the mining property to it. They received payment in cash, in the shape of share in T. C. and certain amounts periodically which were in excess of the amounts payable for a like period to the Raja of Talchar. The contention of the syndicate was that they were not carrying on any business. It was held that the activities of the syndicate did not amount to a business and their receipts could not be regarded as profits of business and were not chargeable to excess profits tax. It was conceded by the department in that case that the functions of the syndicate, which was a partnership, and neither a limited company nor an incorporated society, consisted wholly in the holding of property, and that

they had no other functio

> "Provided that where the functions of a company or of a society incorporated by or under any enactment consist wholly or mainly in the holding of investments or other property, the holding of the investments or property shall deemed for the purpose of the definition to be a business carried on by such company or society."

Harries and Chatterjee held that, on the principle expression units exclusio alter us, the fiction in the proviso was not applicable to individuals and other bodies. It was, however, pointed out that :

> "If this sub-lease had been granted by a limited company or by an incorporated society the net profit could be regarded as profits for the purposes of Excess Profits Tax Act by reason of the proviso to section 2 (5) of the Act."

The case was thus decided on the words of section 2 (5) of the Excess Profits Tax Act and the fact that the syndicate was a partnership. The High Court then went on to consider the nature of rents and royalties received by the syndicate, and held on the authority of In re commercial Properties Ltd. that for income-tax purposes the income would fall to be considered under section 9 and not section I0.

It will be noticed that there was but one property which the syndicate held that the whole of that property was sub-let to T. C. Before it was so sub-let, it was not being used for any business and all that the syndicates did with it was to lease it out. It was, in these circumstances, that it was held to yield income from property and not profits and gains from business. The case is analogous to In re commercial Properties Ltd. which is also cited by the assessee company. There, the object of the registered company was to acquire land, build houses and let premises to tenants in Calcutta and elsewhere. The sole assets were three properties which were let out and all that the registered company did was the management and collection of rents. Rankin held that the receipts were income from property within section 9 of the Income-tax Act, that letting out such property and collecting rents was not doing business, and that profits and gains from business were very different from income from property. These two c

The last case relied upon is Fry v. Salisbury House Estates Ltd. already mentioned in this judgment. Salisbury House was a building with 800 rooms. A company was formed for the express purpose of acquiring it and utilising it. The rooms were let unfurnished to tenants, but there was some slight service in the shape of heating and cleaning. The company also retained some rooms as its offices. The company was first assessed under rule 8 (c) (i) of Schedule A. VII of the English Income-tax Act of 1918, which provided for assessment of landlords instead of tenants in the case of any house or building let in apartments or tenements. The company paid the tax assessed on it. Then a notice was sent under Schedule D. The company admitted that it had to pay tax under Schedule D on profit it might have made from the services it rendered, but contended that income which had been taxed under Schedule A could not be taxed under Schedule D. The company demanded a case. Rowlatt held against the company, but his decision was

> "Further, in my view, the perception of rents as land-owners is not an operation of trade within the meaning of the Act. If this be so, I am produce profits taxable under schedule D can affect the nature of the operation, or how the legal significance of the perception is altered for the purpose of income-tax if the recipient is a limited company rather than an individual."

As has been already pointed out in connection with the other two cases where there is a letting out of premises and collection of rents the assessment on property basis may be correct but not so, where the letting or sub-letting is part of a trading operation. The dividing line is difficult to find; but in the case of a company with its professed objects and the manner of its activities and the nature of its dealings with its property, it is possible to say on which side the operations fall and to what head the income is to be assigned.

Ownership of property and leasing it out may be done as a part of business, or it may be done as land owner. Whether it is the one or the other must necessarily depend upon the object with which the act is done. It is not that no company can own property and enjoy it as property, whether by itself or by giving the use of its to another on rent. Where this happens, the appropriate head to apply is "income from property" (section 9), even though the company may be doing extensive business otherwise. But a company formed with the specific object of acquiring properties not with the view to leasing them as property but to selling them or turning them to account even by way of leasing them out as an integral part of its business, cannot be said to treat them as landowner but trader. The cases which have been cited in this case both for and against the assessee company must be applied with this distinction properly borne in mind. In deciding whether a company dealt with its properties as owner, one must see not to

We shall now turn to the present case, because it remains to consider what the assessee company was doing with the head leases. The relevant clauses of the memorandum of association of the assessee company have already been quoted. They show the various objects for which the assessee company was incorporated. Though power was taken under clauses (2), (3), (6) and (34) to do business of coal-raising, etc., the assessee company did not do the sort of business authorised there. It restricted its business to clauses (1) and (52). Under clause (1), power was taken to purchases and acquire underground coal mining and relative rights. Under clause (52), power was taken to sell, improve, manage, develop, exchange, lease, mortgage, dispose of, turn to account or otherwise deal with all or any part of the property and rights of the company. Business was done extensively within these two clauses. Annexure "F" shows the areas which were sub-leases were granted, because the assessee company wanted, as a matter of busines

In the result, the appeals fail, and are dismissed with costs.

Appeals dismissed.

</html