New Savan Sugar and Gur Refining Co. Ltd

Vs

Commissioner of Income- Tax, Calcutta. [1969] 71 I. T. R. (Sh. N.) 34

Civil Appeal No. 1593 of 1968

(J.C. Shah, V. Ramaswami - I, A.N. Grover JJ)

19.02.1969

JUDGMENT

RAMASWAMI J. -

This appeal is brought by certificate from the judgment of the Calcutta High Court dated 20th September, 1963, in Income-tax Reference No. 23 of 1960.

The appellant (hereinafter referred to as "the assessee") was carrying on the business of crushing sugarcane and gur refining. M/s. Andrew Yule & Co. were acting as the managing agents of the assessee. In a letter dated 5th February, 1946, addressed to the shareholders of the assessee the managing agents referred to the alarming increase of Government interference in the affairs of the sugar industry in Bihar and the increase of wages of the workers, as well as the levy of a cess of Government and deterioration in the cane crops. In view of this state of affairs, the managing agents apprehendeed a loss and suggested that the company's affairs should be put on a "less discouraging basis" by accepting the offer a lease of the company as a running concern from the Standard Refinery & Distiller Ltd. At an extraordinary general meeting of the shareholders of the assessee-company held on 5th March, 1946, it was decided to authorize the directors to enter into a lease with the said Standard Refinery & Distillery Lt

For the assessment year 1955-56 the relevant accounting year of the assessee ended on 31st May, 1954. In the assessment proceedings for 1955-56 the assessee's main contention was that the lease granted under the indenture of 15th March, 1948, was a lease of a commercial asset and therefore the income arising from the lease should be assessed under section 10 of the Income-tax Act and assessee should be allowed depreciation and development rebate in accordance with clause (via) and clause (vib) of sub-section (2) of section 10 of the Income- tax Act. The Income-tax Officer assessed the income under section 12 of the Act as being income under the head "other sources" and held that no additional depreciation or development rebate could be allowed as claimed by the assessee. According to the assessee, the income derived from the lease of the sugar factory was income from business because the factory was leased as a going concern and the rent of the building, machinery, plant and spare parts was fixed at a certain

> "(1) Whether, on the facts and in the circumstances of the case, the income of the assessee-company was liable to be assessed under section 12 of the Indian Income-tax Act and not under section 10 of the said Act ?
>
> (2) Whether, on the facts and in the circumstances of the case, additional depreciation and development rebate can be allowed as a deduction ?"

The High Court answered both the question against the assessee holding that the income was liable to be assessed under section 12 and that no additional depreciation and development rebate could be allowed.

Section 10 of the Act stood as follows at the material time :

> "10. (1) The tax shall be payable by an assessee under the head 'profits and gains of business, profession or vocation' in respect of the profits or gains of any business, profession or vacation carried on by him.
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> (2) Such profits or gains shall be computed after making the following allowances, namely :-
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> (vi) in respect of depreciation of such buildings, machinery, plant or furniture being the property of the assessee, a sum equivalent, where the assets are ships other than ships ordinarily paying on inland waters, to such percentage on the original cost thereof to the assessee as may in any case or class be prescribed and in any other case, to such percentage on the written down value thereof as may in any case or class of cases be prescribed :
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> and where the buildings have been newly erected, or the machinery or plant being new, not being machinery or plant entitled to the development rebate under clause (vib), has been installed, after the 31st day of March 1945, a further sum (which shall however not be deductible in determining the written down value for the purposes of this clause) in respect of the year of erection or installation equivalent, -
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> (a) in the case of buildings the erection of which is begun and completed between the 1st day of April, 1946, and the 31st day of March, 1956 (both days inclusive), to fifteen per cent. of the cost thereof to the assessee;
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> (b) in the case of other buildings, to ten per cent. of the cost thereof to the assessee;
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> (c) in the case of machinery or plant, to twenty per cent. of the cost thereof to the assessee :
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> Provided that -.....
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> (c) the aggregate of all allowance in respect of depreciation made under this clause and clause (via) or under any Act repealed hereby, or under the Indian Income-tax Act, 1886 (II of 1886), shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant or furniture, as the case may be;
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> (via) in respect of depreciation of buildings newly erected, or of machinery or plant being new which has been installed after the 31st day of March, 1948, a further sum (which shall be deductible in determining the written down value) equal to the amount admissible under clause (vi) (exclusive of the extra allowance for double or multiple shift working of the machinery or plant and the initial depreciation allowance admissible under that clause for the first year of erection of the building or the installation of the machinery or plant) in not more than five successive assessments for the financial years next following the previous year in which such buildings are erected and such machinery and plant installed and falling within the period commencing on the 1st day of April, 1949, and ending on the 31st day of March, 1959;

(vib) in respect of machinery or plant being new, which has been installed after the 31st day of March, 1954, and which is wholly used for the purposes of the business carried on by the assessee, a sum by way of development rebate in respect of the year of installation equivalent to twenty-five per cent. of the actual cost of such machinery or plant to the assessee :

Provided that no allowance under this clause shall be made unless the particulars prescribed for the purpose of clause (vi) have been furnished by the assessee in respect of such machinery or plant,....."

Section 12 was to the following effect : "12. (1) The tax shall be payable by an assessee under the head 'income form other sources' in respect of income, profits and gains of every kind which may be included in his total income (if not included under any of the preceding heads).....

(2) Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains.....

(3) Where an assessee lets on hire machinery plant or furniture belonging to him, he shall be entitled to allowances in accordance with the provisions of clauses (iv), (v), (vii) of sub-section (2) of section 10.

(4) Where an assessee lets on hire machinery. plant or furniture belonging to him and also buildings, and the letting off the buildings is inseparable from the letting of the said machinery, plant or furniture, he shall be entitled to allowances in accordance with the provisions of clauses (iv), (v), (vi) and (vii) of sub-section (2) of section 10 in respect of such buildings."

The main contention of the assessee was that the lease as contemplated in the indenture date 15th March, 1948, was a lease of a commercial asset, and, therefore, the income arising from the lease should be assessed under section 10(1) of the Act and not under section 12(1). In order to examine the validity of this argument it is necessary to set out the relevant clauses of the indenture of lease. Clause (1) of the lease provided that the lease was for a term of five years and thereafter two further options of five years in each case on the same terms and conditions subject to higher payment of rates of royalties.

Clause 2 : The lessee shall be entitled to run the said sugar factory and all other machinery annexed to the same and use all the tools and implements, buildings and premises, offices, and erection and utensils and all other things which are now in or upon the said premises and which may be added form time to time thereto provided always that the lessees shall not at any time remove the plant and/or machinery etc., hereby demised or any part thereof from the said premises elsewhere for the purpose of or in connection with the lessee's other interests.

Clause 3 : The lessees shall at the time of taking over possession of the factory from the lessors be entitled free of payment to the goods already manufactured during the cu rent crushing season, i.e., 1945-46 or in the process of manufacture and/or to be hereafter manufactured by the lessees and the lessees shall have absolute discretion to sell and deal with the same in such manner as they think fit and proper.

Clause 5 : The lessees shall also be entitled to erect, construct and maintain any other machinery as the lessees may think fit and proper. All machinery brought in the erected by the lessees would

remain the lessees' property and after the termination of the lease the lessees shall be entitled to remove the same provided always that the lessees shall forthwith repair and make goods all damage caused to the demised premises by such removal of the lessee's machinery.

Clause 7 : provided for the payment of royalty. The royalty on sugar was to be computed at the rate of rupees seventy-five per 100 maunds of sugar manufactured for the first five years as well as next five years, then at the rate of rupees eighty-two and annas eight per 100 maunds of sugar manufactured for the third five years and Rs. 90 for the fourth five years. The royalty on molasses was computed at three pies per maund on all molasses sold during each year of the original lease period and any renewals thereof, subject to the payment of a minimum royalty of Rs. 6,500 per annum.

Clause 8 : This clause provides that the lessee shall in addition to the royalty reserved be responsible for all the running expenses of the factory including salaries and wages and all factory staff and labour and shall pay all sugar excise duty, etc., excepting the ground rents payable to the land-lords and taxes on income chargeable to the lessors and shall fully reimburse the lessors in respect of such expenses which have already been incurred by the lessors since the first day of one thousand nine hundred and forty-five and property tax.

Clause 17 : (a) The lessors will keep the demised premises insured in the full value thereof and shall pay all expenses which will be incurred for insuring the demised premises.

(b) The lessors shall pay all expenses of running the lessors' company, e.g., directors' fees, audit fees, ground rents, etc., but not the running expenses of the factory and premises hereby demised and shall also pay for all the expenditure for additions, alterations, breakdown and/or renewals and replacement of capital nature (i.e., debatable to block account) to buildings and machineries, etc., and other similar expenses of a capital nature on the demised premises.

It appears from clause 2 and 5 that the existing machinery which was owned by the lessor could not be removed and that the lessees would be entitled to set up additional machinery without interference from the lessor and that on the termination of the lease the lessee would be entitled to remove the same without causing any damage to the property demised. Clause 3 contemplates that if during the period 1945-46 the lessors sell the commodity manufacture the price thereof should go back to the lessee. Mr. Choudhury referred to clause 6 which entitled the lessee to use the railway siding during the period of the lease. But the right of use of railway siding by the lessee under this clause cannot in any way be construed as the exercise of control over the business of the assessee. The provision for minimum royalty of Rs. 65,000 per annum indicates that the assessee had no direct interest in the production of the factory. The cumulative effect of clause 11, 12, 13 and 14 is that the lessor will have no concern wi es cannot bear the character of profits of business. As we have already shown there is no direct nexus between the income of the assessee and the production of the factory. The royalty payable to the assessee was not paid under clause 7 of the indenture of lease for the production in the factory. The production was only a measure of the royalty to be paid and, in any event, the measure of payment had nothing to do with the character of the payment as a receipt from business or from other sources. It follows that, in the circumstances of this case, the income of the assessee cannot be characterised as income from the activity of the assessee carrying on any business. The High Court was therefore right in holding that the income of the assessee was liable to be assessed under section 12 and not under section 10 of the Act.

On behalf of the assessee reference was made to the decision of this court in Commissioner of

Excess Profits Tax v. Shri Laxmi Silk Mills Ltd. in which the respondent company which was formed for the purpose of manufacturing silk cloth installed a plant for dyeing silk yarn as a part of its business during the relevant chargeable accounting period. Owing to the difficulty in obtaining silk yarn on account of the war it could not make use of this plant which had remained idle for some time. In August, 1943, the plant was let out to antoher company on a monthly rent. The question arose whether the income received by the respondent company in the chargeable accounting period by way of rent was income from business and assessable to excess profits tax. It was held by this court that a part of the assets did not cease to be commercial assets of that business merely because it was temporarily put to a different use or let out to another and accordingly the income from the assets would be profits of the business ir

For the reasons already expressed our conclusion is that the intention of the assessee was not to treat the factory, etc., as a commercial asset during the subsistence of the lease. In other words, the intention of the assessee was to go out of the business altogether so far as the factory and the machinery was concerned with effect from 1st June, 1945, and the intention was to use the income arising from the royalty in its capacity as the owner of the factory. It follows therefore that the first question was rightly answered by the High Court in favour of the Commissioner of Income-tax.

As regards the second question the argument was stressed by Mr. Choudhury that clauses (via) and (vib) of section 10(2) are ancillary to clause (vi) and should be taken to be included within clause (vi) as mentioned in sub-section (3) of section 12. It appears that clause (via) was inserted by section 11 of the Taxation Laws (Extension to Merged States and Amendment) Act, 1949. Clause (vib) was inserted by section 8 of the Finance Act, 1955, with effect from 1st April 1955. At the time of making the amendment under the said Acts, no amendment was made to section 12(3) of the Act. It was argued by Mr. Choudhury that, although this was not done specifically, it followed by impliction that additional depreciation allowance in respect of new assets and development rebate would come within the ambit of section 12(3). It appears to us that clauses (via) and (vib) are not ancillary to clause (vi) because the scheme of clauses (via) and (vib) is somewhat different. Clause (via) which was inserted in 1949 gives addit

For these reasons we hold that the judgment of the High Court dated 20th September, 1963, is correct and this appeal must be dismissed with costs.

Appeal dismissed.

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