S. G. Mercantile Corporation P. Ltd.

Vs

Commissioner of Income-Tax, Calcutta

Civil Appeals Nos. 1748 to 1750 of 1968

(J. M. Shelat, G. K. Mitter, I. D. Dua, H. R. Khanna JJ)

04.01.1972

JUDGMENT

KHANNA J. -

1. This judgment would dispose of Civil Appeals No. 1748 to 1750 of 1968 filed by special leave against the judgment of the Calcutta High Court whereby the question referred to that court under section 66(1) of the Indian Income-tax Act, 1922, hereinafter referred to as "the Act", was answered in favour of the revenue and against the appellant-company.

The appellant, a private limited company, was incorporated on January 25, 1955. The object for which the company was established were given in the clause of paragraph 3 of the memorandum of association. A number of business activities were mentioned in those clauses. Clauses 6 and 7 of that paragraph were as under :

> "6. To purchase take on lease or otherwise acquire and to hold, cultivate improve, lease, sell, exchange, mortgage, or otherwise dispose of land, houses, mines, minerals, mining and other real and personal property and to deal with the same commercially.
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> 7. To develop the resources of the same property by building, reclaiming, clearing, draining, and otherwise improving, farming and planting on any terms or system that may be considered advisable."

With effect from February 5, 1955, the appellant company took on lease a market plea known as Taltalla Bazar in the City of Calcutta from Shrimati Sujata Tagore and her sons on a month rent of Rs. 3,000 for a term of 50 years, with option to the lessee to renew the lease for the further period of 40 years. The deed of lease in this connection was executed on September 5, 1956. Clauses 4, 5 and 13 of the lease deed were as under :

> "4. The lessee shall have the option to erect, rebuild, remodel and reconstruct and repair the existing structures upon the demised premises from time to time during the term of these present at its own cost in a substantial and workmanlike manner with good material of the several kinds in accordance with the plans elevations sanctions an specifications according to the choice of the lessee (and whenever necessary to get such plans sanctioned by the corporation of Calcutta) under the supervision of a first class engineer to be selected by the lessee on notice to the lessors and shall spend upon sum work such sums as the lessee may in its absolute discretion think fit and

proper but the entire total sum or sums so to be expended by the lessee as aforesaid shall not be less than rupee five lakhs and the same shall be spent within the period of five years from the date of these presents. The lessors shall be at liberty to appoint at their own cost a valued and surveyor to verify such expenditure if required for their satisfaction after the completion of the said work.

5. If the lessee constructs any new structures and/or buildings as mentioned in the preceding clauses the said structures and/or buildings or erections together with all alteration renovation remodeling reconstruction thereto shall belong absolutely to the lessors on the expiration or sooner determine of the term hereby granted and/or the renewed period thereof as hereinafter mentioned.

13. That the lesses shall not assign this lease without first obtaining the permission in writing of the lessors but such consent shall not be unreasonably withheld. The lesses shall prior to any such assignment of this demise give notice thereof to the lessors in writing containing the name of the assignee and furnish other necessary particulars concerning such assignment. Notwithstanding anything hereinbefore contained the lesses shall subject to the conditions and covenants herein contained be entitled to sublet or underlet the demised premises or any part or portion thereof and/or grant sub-leases in respect of the demised premises or any portion or portions there for a term not exceeding or beyond the term hereby granted including the renewed and/or optional period in case or renewal subject to the terms and conditions of these presents."

The appellant-company's activity during the period covered by assessment years 1956-57, 1957-58 and 1958-59 was that of developing the demised premises land letting out portions of the same as shops, stalls and ground spaces to shopkeepers, stallholders and daily casual market vendors. The appellant claimed the its income from the leasehold property for the above mentioned three assessment years should be assessed under section 10 of the Act as letting out of that property was its business authorized by the memorandum of association. The Appellant had shown lesses in its return for all the three years and the above claim was made on its behalf, obviously, of the purpose of carrying forward such losses. The Income-tax Officer rejected the appellant's claim and made assessments under section 12 of the Act. The Appellate Assistant Commissioner in appeal by a consolidated order held that the appellant had been rightly assessed under section 12 of the Act. On further appeal to the Income-tax Appellate Tribunal, to Tribunal referred to clauses 6 and 7 of paragraph 3 of the memorandum of association and came to the conclusion that the activities of the appellant-company in talking the lease and sub-letting the demised premises were undertaken with the object of doing business. The Tribunal observed that normally where the assessee was not the owner of the building but earned rent by sub-letting the same, such income could only charged however under section 12 as income from other sources. The difference however arose in cases where letting out of leasehold property was the business of the assessee. In such cases, according to the Tribunal, the decision could only turn upon the object for which the company was formed and upon the activities of the company during the relevant accounting years. It was held the if the activities of the appellant company amounted to carrying on the business of taking on lease and letting out the leasehold property, the company was not eating as owner but as trader. The income accruing from such a source, in the opinion of the Tribunal, must be held to be income from business assessable under section 10 of the Act. The Tribunal according held that the income of the appellant-company from sub-letting of the stalls in question was income from business taxable under section 10 of the Act.

At the instance of the respondent, the Tribunal referred the following question to the High Court :

> "Whether, under the facts and in the circumstances of the case, the income from sub-letting the stalls of Taltolla Bazar was assessable under section 10 or section 12 of the Income-tax Act, 1922 ?"

The learned judges of the High Court held that the income from sub- letting of the stalls in question was not assessable under section 10 of the Act. In arriving at this conclusion, the learned judges observed :

> "The assessee had taken lease of a market or bazar. After having reconstructed or renovated the buildings, it is letting out shops and stalls to shopkeepers and stallholders. This is a normal activity of an owner or a lessee of such a market or bazar. It could not be said that by letting out the shops and stalls to shopkeepers and stall holders, the assessee was carrying on any activity in the nature of trade and was utilizing or exploiting real estate in the best possible way or in other words, was dealing with it commercially. The ratio of the supreme court decision in East India Housing Estate case is fully applicable to the case before us and it must be held that he tribunal was in error in its conclusion that the income of the assessee from sub-letting the stalls of Taltolla Bazar was assessable under section 10 of the Indian Income-tax Act, 1922. In the premises the question referred to this court is answered in the following manner, that is to say, that the income from sub-letting the stalls of Taltolla Bazar was not assessable under section 10."

We have heard Mr. Chagla on behalf of the appellant and Mr. Manchanda on behalf of the respondent and are of the view that the judgment of the High Court cannot be sustained. Section 6 of the Act enumerates the various heads of income, profits and gains chargeable to income- tax. Those heads are (i) Salaries; (ii) Interest on securities; (iii) Income from Property; (iv) Profits and gains of business, profession or vocation; (v) Income from other sources; and (vi) Capital gains.

Section 9 of the Act deals with income from property. According to that section, the tax shall be payable by an assessee under the head "Income from Property" in respect of the bona fide annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax, subject to certain allowances which are mentioned in that section but with which we are not concerned. It is noteworthy that the liability to tax under section 9 of the Act is of the owner of the buildings or lands appurtenant thereto. In case the assessee is the owner of the buildings or land appurtenant thereto, he would be liable to pay tax under the above provision even if the object of the assessee in purchasing the landed property was to promote and develop market thereon. It would also make no difference if the assessee was a company which had been incorporated with the object of buying and developing landed properties and promoting and setting up markets there on. The income derived by such a company from the tenants of the shops and stall constructed on the land for the purposes of setting up market would not be taxed as "business income" under section 10 of the Act, to which a more detailed reference would be made hereafter, but under section 9 of the Act. A concrete instance of this type is afforded by the case of East India Housing and Land Development Trust Ltd. v. Commissioner of Income-tax. The appellant-company in that case had been incorporated with the objects of buying and developing landed properties and promoting and setting up markets. The company purchased ten bighas of land in the town of Calcutta and set up a market thereon. The

question which arose for determination was whether the income realised from the tenants of ships and stalls was liable to be taxed as business income under section 10 of the Act or income from property under section 9. This court held that the income derived by the company from shops and stalls was income received from property and fell under the specific head described in section 9. It was observed in this connection :

> "Income-tax is undoubtedly levied on the total taxable income of the taxpayer and the tax levied is a single tax on the aggregate taxable receipts from all the sources; it is not a collection of taxes separately levied on distinct heads of income. But the distinct heads specified in section 6 indicating the sources are mutually exclusive and income derived from different sources falling under specific heads has to be computed for the purpose of taxation in the manner provided by the appropriate section. If the income from a source falls within a specific head set out in section 6, the fact that it may indirectly be covered by another head will not make the income taxable under the latter head.
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> The income derived by the company from shops and stalls is income received from property and falls under the specific head described in section 9. The character of the income is not altered because it is received by a company formed with the object of developing and setting up markets."

There is no finding in the present case that the appellant-company is the owner of the property in question or any part thereof. As such, no reference was made to section 9 of the Act in the assessment proceedings. The learned counsel for both the parties agree, and in our opinion rightly, that the question of making the assessment against the appellant, in the circumstances, under section 9 of the Act does not arise. The stand of Mr. Chagla, on behalf of the appellant, is that the assessment against the appellant in respect of the income from the property in question should be made under section 10, while according to Mr. Manchanda, learned counsel for the respondent, the assessment should be under section 12 of the Act.

Section 10 of the Act deals with income from business and the material portion with which we are concerned is given in sub-section (1) of that section. According to that sub-section, the tax shall be payable by an assessee under the head "profits and gains of business, profession or vocation" in respect of the profits and gains of any business, profession or vocation carried on by him. "Business", according to section 2(4) of the Act, includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture. Section 12 of the Act deals with income from other sources. Sub-section (1) of that section reads as under :

> "(1) The tax shall be payable by an assessee under the head 'Income from 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)."

Section 12 deals with the residuary head of income and applies to all such taxable income, profits and gains as are not covered by preceding specific heads. The residuary head of income can be resorted to only if none of the specific heads is applicable to the income in question; it comes into operation only after the preceding heads are excluded.

It is, therefore, manifest that section 12 of the Act can be invoked in the present case only if we exclude the applicability of section 10 by holding that the income of the appellant-company from

the property in question is not income from business. The definition of the word "business", as given in section 2(4) and reproduced above shows its wide amplitude and we agree with Mr. Chagla that it can embrace within itself dealing in real property as also the activity of taking a property on lease, setting up a market thereon and letting out the shops and stalls in the market. The important question which arises in the latter case is whether the acquisition of the property on lease and letting out of the shops and stalls was in the course of investment or whether it was essentially a part of the business and trading operation of the assessee. The paramount consideration which would weigh is whether the acquisition of the property was by way of investment and whether the property was let out because of the assessee having a title in the same or whether the acquisition and letting out of the property constituted the business and trading activity of the assessee. The question as to whether the above activity is being carried on by an individual or a company, and in the latter case, the further question as to whether the carrying on of the said activity was the object of the incorporation of the company as given in the memorandum of association would also have some relevance. Reference in this context may be made to the observation of Lord Sterndale M. R. in the case of 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 may 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 above observations were quoted with approval by this court in the case of Karanpura Development. Co. Ltd. v. Commissioner of Income-tax. The assessee-company in the last mentioned case was formed with the objects, inter alia, of acquiring and disposing of underground coal mining rights in certain coal-fields. The memorandum of association of the company enumerated other objects, such as coal raising, but the assessee restricted its activities to acquiring coal mining leases over large areas, developing them as coal-fields and then sub-leasing them to collieries and other companies. The leases were acquired for a term of 999 years and the coal-fields were sublet for the balance of the term of the respective leases minus two days. The company never worked the coal-fields with a view to raising coal, nor did it acquire or sell coal raised by the sub-lessees. As against a salami of Rs. 40 per bigha which the assessee had paid, it realised from the sub- lessees Rs. 400 per bigha as salami. In addition, the assessee charged certain royalties at rates higher than those it had agreed to pay under the head leases. The question which arose for determination was whether the amount received by the assessee as salami for granting sub-lease were in the nature of trading within the objects of the company and not enjoyment of the property as landowner. It was observed in this connection :

> "An has been already pointed out in connection with the other two cases where there is a letting out of premises and collection of rents of 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 accompany with its professed objects and the manner of its activities and the nature of its dealings with its property, it a 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 it to another on rent. Where this happens, the appropriate head to apply is 'income from property' (section 9), even thought 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 the or turning them to account even by ways of leasing them out as an integral part of its business, cannot be said to treat them as landowner but as trader."

The above observation have a direct bearing. It is not necessary for the purpose of this case to say anything, beyond what has already been said while dealing with section 9 of the Act, about the view expressed in the above passage regarding the rental income of an owner being treated as business income in case it is received as part of trading activity, because we are concerned in the instant case with an assessee who is a lessee and not the owner of the property in question. The assessee, in the cited case of Karanpura Development Co. Ltd., too was lessee of the coal-fields. So far as such assessees are concerned, who as part of their essential trading activity take lease of property and sublet parts thereof with a view to make profits, the dictum laid down above, in our opinion, would hold good and the profits would have to be treated as business income.

The appellant-company, as stated earlier, was incorporated on January 25, 1955. The object for which the company was formed, inter alia, was to take on lease or otherwise acquire and to hold, improve, lease or otherwise dispose of, land, houses and other real and personal property and to deal with the same commercially. Within less than two weeks of its incorporation the appellant-company took on lease the property in question and undertook to spend Rs. 5 lakhs for the purposes of remodeling and repairing the structure on the site. The appellant was also given the right to sublet the different portions. The appellant's activity during the period of three years in question consisted of developing the demised property and letting our portions of the same as shops, stalls and ground spaces. All these facts point to the conclusion that the taking of the property on lease and sub-letting portions of the same was part of the business and trading activity of the appellant. The conclusion of the Tribunal that the activities of the appellant in taking lease and sub-letting the demised premises were undertaken with the object of doing business was warranted on the facts of the case. Likewise, the conclusion of the Tribunal that the appellant company in letting out the leasehold property was not acting as owner but as trader was borne out by the material on record.

Reference on behalf of the respondent has been made by Mr. Manchanda to the decision of the House of Lords in Fry v. Salisbury House Estates Ltd. In that case assessee-company which had been formed to acquire, manage and deal with a block of buildings, let out the rooms as unfurnished offices to tenants. The company provided a staff to operate the lifts and to Act as porters and watch and protect the building. The company also provided certain service - such as heating and cleaning - for the tenants, if required, at an additional charge. For four years the company was assessed under Schedule A to income-tax on the gross value of the building as appearing in the valuation list. The company admitted its liability to be assessed in respect of profits from the services supplied to the tenants under Schedule D, but the Crown claimed in making the assessment under Schedule D, to include the rents of the offices as part of the receipts of trade, making allowance for tax assessed under Schedule A. It may be mentioned that the scheme of the English Income Tax Acts to provide for the taxation of specific properties under schedules appropriate to them and under a general Schedule D, to provide for taxation of income not dealt with specifically. Schedule A provides for

the taxation of income derived from property in land, B for income derived from occupation of land, C for income derived from Government securities and E for income form employment in the public service. The house of Lords held in the above cited case that the rents were profits arising from the ownership of land in respect of which the assessment under Schedule A was exhaustive and that they, therefore, could not be included in the assessment under Schedule D, as trade receipts of the company. The assessee-company, in the cited case, was the owner of the Salisbury House, and the decision of the House of Lords rested in the view that Schedule A was exhaustive in respect of profits arising from ownership of land. The above decision is not of much help to the respondent because the assessee in the present case is not the owner but only a lessee of the property in question, and section 9, which is analogous to schedule a of the English Act, applies to income from property consisting of buildings or lands appurtenant thereto of which the assessee is the owner.

The respondent can also have not much support from the decision of East India Housing and Land Development Trust v. Commissioner of Income-tax, because what was decided therein was that in the case of income from landed property by the owner-company, the income would fall under the specific head described in section 9 and not under section 10 even though the company had been incorporated with the object of buying and developing landed property and promoting a market thereon. Section 9, as mentioned earlier, does not apply to the present case because the appellant is not the owner of the property in question. As such, there arises no question in this case of the exclusion of section 10 on the ground that section 9 is the specific head. In the instant case, the revenue relies not upon the specific head given in section 9 but upon the residuary head given in section 12 of the Act. It is plain that the considerations which would weigh for applying section 9 on the ground of being a specific head would not hold good for invoking section 12 which can come into the picture only if all the preceding heads of income, including business income as given in section 10, are ruled out. Where, as in the present case, the income can appropriately fall under section 10 as being business income, no resort can be made to section 12 of the Act.

As a result of the above, we accept the appeal and set aside the judgment of the High Court. The answer to the question referred by the Tribunal is that the income in question was assessable under section 10 and not under section 12 of the Act. The appellant shall be entitled to the costs of this court as well as those of the High Court. One hearing fee.

Appeals allowed.

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