SUPREME COURT OF INDIA

Adityapur Industrial Area Development Authority

Vs

Union of India and Others

Appeal (Civil) 6382 of 2003

(B. P. Singh and S. H. Kapadia, JJ)

03.05.2006

JUDGMENT

B. P. SINGH, J.

Adityapur Industrial Area Development Authority - the appellant herein challenged, by a writ petition, the notice issued by the Deputy Commissioner of Income Tax, TDS Circle, Jamshedpur dated February 14, 2003 to the Manager of the Central Bank of India, Jamshedpur bringing to the notice of the Manager of the Bank that the Finance Act, 2002 had brought about changes in the Income Tax Act and while Section 10(20A) had been omitted, an Explanation was added to Section 10(20) of the Act. The provisions of the Income Tax Act, 1961 as they stood after the amendment obliged the Bank to deduct income tax at source from the interest accrued on fixed deposit receipts of the appellant/Authority. The Manager of the Bank was required to comply with the provisions and deduct tax at source and report compliance. The High Court of Jharkhand at Ranchi in the aforesaid writ petition pronounced its judgment on May 8, 2003 dismissing the writ petition holding that in view of the amended provisions of the Income Tax Act, the notice was valid and legal. The appellant/ Authority has impugned the judgment and order of the High Court in this appeal by special leave.

The appellant/Authority has been constituted under the Bihar Industrial Areas Development Authority Act, 1974 to provide for planned development of industrial area, for promotion of industries and matters appurtenant thereto. The appellant/Authority is a body corporate having

perpetual succession and a common seal with power to acquire, hold and dispose of properties, both moveable and immovable, to contract, and by the said name sue or be sued. The Authority consists of a Chairman, a Managing Director and five other Directors appointed by the State Government. The Authority is responsible for the planned development of the industrial area including preparation of the master plan of the area and promotion of industries in the area and other amenities incidental thereto. The Authority has its own establishment for which it is authorized to frame regulations with prior approval of the State Government. The State Government is authorized to entrust the Authority from time to time with any work connected with planned development, or maintenance of the industrial area and its amenities and matters connected thereto. Section 7 of the Act obliges the Authority to maintain its own fund to which shall be credited moneys received by the Authority from the State Government by way of grants, loans, advances or otherwise, all fees, rents, charges, levies and fines received by the Authority under the Act, all moneys received by the Authority from disposal of its moveable or immovable assets and all moneys received by the Authority by way of loan from financial and other institutions and debentures floated for the execution of a scheme or schemes of the Authority duly approved by the State Government. Unless the State Government otherwise, directs, all moneys received by the Authority shall be credited to its funds which shall be kept with the State Bank of India and/ or one or more of the Nationalized Banks and drawn as and when required by the Authority.

Article 289 of the Constitution of India provides as follows:-

"289. Exemption of property and income of a State from Union taxation. - (1) The property and income of a State shall be exempt from Union taxation.

(2) Nothing in clause (1) shall prevent the Union from imposing, or authorising the imposition of, any tax to such extent, if any, as Parliament may by law provide in respect of a trade or business of any kind carried on by, or on behalf of, the Government of a State, or any operations connected therewith, or any property used or occupied for the purposes of such trade or business, or any income accruing or arising in connection therewith.

(3) Nothing in clause (2) shall apply to any trade or business, or to any class of trade of business which Parliament may by law declare to be incidental to the ordinary functions of Government."

It is also necessary to notice the relevant provisions of the Income Tax Act, 1961. Chapter III of the Income Tax Act relates to incomes which do not form part of total income. The relevant part of Section 10 as it stood before its amendment by the Finance Act of 2002 read as follows:-

"10. In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included:-

(20) the income of a local authority which is chargeable under the head "Income from house property", "Capital gains" or "Income from other sources" or from a trade or business carried on by

it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its own jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area ;

(20A) any income of an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both."

By the Finance Act, 2002 with effect from April 1, 2003 an Explanation was added to Section 10(20) and Section 10(20A) was omitted. The Explanation added to Section 10(20) is as follows:-

"Explanation. - For the purposes of this clause, the expression "local authority" means –

(i) Panchayat as referred to in clause (d) of article 243 of the Constitution ; or

(ii) Municipality as referred to in clause (e) of article 243P of the Constitution; or

(iii) Municipal Committee and District Board, legally entitled to, or entrusted by the Government with, the control or management of a Municipal or local fund; or

(iv) Cantonment Board as defined in section 3 of the Cantonments Act, 1924 (2 of 1924). "

It would thus be seen that the income of a local authority chargeable under the head "Income from house property", "Capital gains" or "Income from other sources" or from a trade or business carried on by it was earlier excluded in computing the total income of the Authority of a previous year. However, in view of the amendment, with effect from April 1, 2003, the Explanation "local authority" was defined to include only the authorities enumerated in the Explanation, which does not include an authority such as the appellant. At the same time Section 10 (20A) which related to income of an authority constituted in India by or under any law enacted for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, which before the amendment was not included in computing the total income, was omitted. Consequently, the benefit conferred by (20A) on such an authority was taken away.

The High Court by its impugned judgment and order held that in view of the fact that Section 10(20A) was omitted and an Explanation was added to Section 10(20) enumerating the "local authorities" contemplated by Section 10(20), the appellant/Authority could not claim any benefit under those provisions after April 1, 2003. It further held that the exemption under Article 289(1) was also not available to the appellant/Authority as it was a distinct legal entity, and its income could not be said to be the income of the State so as to be exempt from Union taxation. The said decision of the High Court is impugned in this appeal.

Shri K.K. Venugoal, learned Senior Advocate appearing on behalf of the appellant submitted that having regard to Section 3(3) of the General Clauses Act and the provisions of Section 7 of the Bihar Industrial Areas Development Authority Act, 1974, it must be held that the appellant is a local Authority. According to him the appellant/Authority must be held to be a local Authority within the meaning of Section 10(20) of the Income Tax Act. He further submitted that Article 289 (1) exempted from Union taxation, the properties and income of a State. Referring to Clause (2) of Article 289, he submitted that it contemplates a trade or business being carried on by or on behalf of the Government of a State. That brings in the concept of agency under the Contract Act. Therefore, by necessary implication, an agency of the State, not carrying on trade or business, is not covered by Clause (2) of Article 289 and, therefore, the exemption must extend to such an agency of the State Government. He also relied on some decisions of this Court. He also submitted that the amendment referred to above in Section 10 of the Income Tax Act is not made by reference to Article 289 of the Constitution of India and that was perhaps not present to the mind of the Legislature. He commended a public policy approach in such matters.

Mr. T.S. Doabia, learned senior counsel appearing on behalf of the Union of India, repelled the submissions urged on behalf of the appellants by contending that unless the income generated by an agency or instrumentality of the State went to the coffers of the State directly and remained the income of the State, the agency, whether Corporation, Company or an Authority, could not claim the exemption from Union taxation under Article 289 (1). The true test to be applied in the context of Article 289 (1) of the Constitution was whether the income accruing is the income of the State. What is exempted under Article 289 (1) from Union taxation is the income of the State and not the income of any authority under the State. In the facts of this case he submitted that the appellant/ Authority being a distinct legal entity, earning income and managing its own funds, cannot claim that its income is the income of the State. In particular, he laid emphasis on Section 17 of the Bihar Industrial Area Development Authority Act, 1974 which reads as follows:-

"When the State Government is satisfied that the purpose for which the Authority was established under this Act has been substantially achieved so as to render the continuance of the Authority unnecessary, the Government may by notification in the official Gazette, declare that the Authority shall be dissolved with effect from such date as may be specified in the notification and the authority shall be deemed to be dissolved accordingly from the said date and all the properties, funds and dues realizable by the authority alongwith its liabilities shall devolve upon the State Government."

He submitted that the Government has powers to dissolve the appellant/ Authority with effect from such date as it may specify in the Notification. With effect from that date the properties, funds and dues realizable by the Authority along with its liabilities devolve upon the State Government. It, therefore follows as a necessary corollary that till such time as the Authority is not dissolved, its properties, funds and dues are those of the Authority itself and not of the State. If it were otherwise there was no need for Section 17 to prescribe that as from the date of dissolution of the Authority, properties, funds and dues realizable by the Authority along with its liabilities shall devolve upon the State Government.

A mere perusal of Article 289(1) discloses that a claim of exemption under it must proceed on the foundation that the exemption is claimed in respect of property and income of a State. Once it is held that the property and income is that of the State, a question may well arise whether it is still taxable in view of the provision of Clause (2) of Article 289 which dominantly is in the nature of a proviso. Clause (2) empowers the Union to impose any tax to such extent as Parliament may by law provide, in respect of a trade or business of any kind carried on by, or on behalf of, the Government of a State, or any operation connected therewith. Thus, even the income of the State within the meaning of Clause (1) of Article 289 may be taxed by law made by the Parliament, if such income is derived from a trade or business of any kind carried on by or on behalf of the Government of a State or any operations connected therewith. Clause (1) of Article 289, therefore empowers Parliament to frame law imposing a tax on income of a State which is earned by means of trade or business of any kind carried by or on behalf of the State Government.

It is true, as submitted by Sri Venugopal, that Clause (2) of Article 289 empowers the Parliament to make a law imposing a tax on income earned only from trade or business of any kind carried by or on behalf of the State. It does not authorize the Parliament to impose a tax on the income of a State if such income is not earned in the manner contemplated by Clause (2) of Article 289. This, to our mind, does not answer the question which arises for our consideration in this appeal. Clause (2) of Article 289 pre- supposes that the income sought to be taxed by the Union is the income of the State, but the question to be answered at the threshold is whether in terms of Clause (1) of Article 289, the income of the appellant/ Authority is the income of the State. Having regard to the provisions of the Bihar Industrial Areas Development Authority Act, 1974, particularly Section 17 thereof, we have no manner of doubt that the income of the appellant/ Authority constituted under the said Act is its own income and that the appellant/ Authority manages its own funds. It has its own assets and liabilities. It can sue or be sued in its own name. Even though, it does not carry on any trade or business within the contemplation of Clause (2) of Article 289, it still is an Authority constituted under an Act of the Legislature of the State having a distinct legal personality, being a body corporate, as distinct from the State. Section 17 of the Act further clarifies that only upon its dissolution its assets, funds and liabilities devolve upon the State Government. Necessarily therefore, before its dissolution, its assets, funds and liabilities are its own. It is, therefore, futile to contend that the income of the appellant/ Authority is the income of State Government, even though the Authority is constituted under an Act enacted by the State Legislature by issuance of a Notification by the Government thereunder.

According to Basu's Commentary on the Constitution of India (Sixth Edition, page 50, volume 'L') Articles 285 and 289 are analogous to each other inasmuch as while Article 285 exempts Union property from State taxation, Article 289 exempts the State property from taxation. While clause (1) of Article 289 exempts from Union taxation any income of a State, derived from governmental or non-governmental activities, clause (2) provides an exception, namely, that income derived by a State from trade or business will be taxable, provided a law is made by Parliament in that behalf. Clause (3) of Article 289 is an exception of the exception prescribed by clause (2) of Article 289 and it provides that income derived from particular trade or business may be made immune from Union taxation if Parliament declares such trade or business as incidental to the ordinary functions of Government (emphases supplied). The reason is obvious. Under the constitution, the State has no power to tax any income other than agricultural income. Under the Constitution, power to tax "income" is vested only in the Union. Therefore, while any property of the Union is immune from State taxation under Article 285(1), income derived by the State from business, as distinguished

from governmental purposes, shall not have exemption from Union taxation unless the Parliament declares such trade or business as incidental to the ordinary functions of Government of the State [See Article 289(3)] (emphasis supplied).

Applying the above test to the facts of the present case it is clear that the benefit, conferred by Section 10(20A) of the Income Tax Act, 1961 on the assessee herein, has been expressly taken away. Moreover, the explanation added to Section 10(20) enumerates the "local authorities" which do not cover the assessee herein. Therefore, we do not find any merit in the submission advanced on behalf of the assessee.

In : Andhra Pradesh State Road Transport Corporation vs. Income Tax Officer and Anr., the question arose as to whether the income derived from trading activity by the Andhra Pradesh Road Transport Corporation established under the Road Transport Corporation Act, 1950 was not the income of the State of Andhra Pradesh within the meaning of Article 289 (1) of the Constitution and hence exempted from Union taxation. This Court considered the scheme of Article 289 and observed as follows:-

"The scheme of Art. 289 appears to be that ordinarily the income derived by a State both from governmental and non- governmental or commercial activities shall be immune from income-tax levied by the Union, provided, of course, the income in question can be said to be the income of the State. This general proposition flows from cl. (1).

Clause (2) then provides an exception and authorities the Union to impose a tax in respect of the income derived by the Government of a State from trade or business carried on by it, or on its behalf; that is to say, the income from trade or business carried on by the Government of a State or on its behalf which would not have been taxable under cl. (1), can be taxed, provided a law is made by Parliament in that behalf. If clause (1) had stood by itself, it may not have been easy to include within its purview income derived by a State from commercial activities, but since cl. (2), in terms, empowers the Parliament to make a law levying a tax on commercial activities carried on by or on behalf of a State, the conclusion in inescapable that these activities were deemed to have been included in cl. (1) and that alone can be the justification for the words in which cl. (2) has been adopted by the Constitution. It is plain that cl. (2) proceeds on the basis that but for its provision, the trading activity which is covered by it would have claimed exemption from Union taxation under cl. (1). That is the result of reading cls. (1) and (2) together.

Clause (3) then empowers the Parliament to declare by law that any trade or business would be taken out of the purview of cl. (2) and restored to the area covered by cl. (1) by declaring that the said trade or business is incidental to the ordinary functions of government. In other words, cl. (3) is an exception to the exception prescribed by cl. (2). Whatever trade or business is declared to be incidental to the ordinary functions of government would cease to be governed by cl. (2) and would then be exempt from Union taxation. That, broadly stated, appears to be the result of the scheme adopted by the three clauses of Art. 289".

Reading these three Clauses together this Court held that the property as well as the income in

respect of which exemption is claimed under Clause (1) must be the property and income of the State, and thus the crucial question to be answered is: "Is the income derived by the State from its transport activities the income of the State"? It was observed that if a trade or business is carried on by a State departmentally or through its agents appointed exclusively for that purpose, there would be no difficulty in holding that the income made from such trade or business is the income of the State. Difficulties arise when one is dealing with trade or business carried on by a Corporation established by a State by issuing a Notification under the relevant provisions of the Act. In this context, the Court observed:

".....The corporation, though statutory, has a personality of its own and this personality is distinct from that of the State or other shareholders. It cannot be said that a shareholder owns the property of the corporation or carries on the business with which the corporation is concerned. The doctrine that a corporation has a separate legal entity of its own is so firmly rooted in our notions derived from common law that it is hardly necessary to deal with it elaborately; and so, prima facie, the income derived by the appellant from its trading activity cannot be claimed by the State which is one of the shareholders of the corporation".

This Court considered the scheme of the Act under which the State Corporation was constituted and held:-

".....The main point which we are examining at this stage is: is the income derived by the appellant from its trading activity, income of the Stage under Art. 289 (1)? In our opinion, the answer to this question must be in the negative. Far from making any provision which would make the income of the Corporation the income of the State, all the relevant provisions emphatically bring out the separate personality of the Corporation and proceed on the basis that the trading activity is run by the Corporation and the profit and loss of the Corporation. There is no provision in the Act which has attempted to lift the veil from the face of the Corporation and thereby enable the shareholders to claim that despite the form which the organization has taken, it is the shareholders who run the trade and who can claim the income coming from it as their own. Section 28 which provides for the payment of interest clearly brings out the duality between the Corporation on the one hand and the State and Central Governments on the other. Take for instance the case of supersession of the Corporation authorized by S. 38. Section 38 (2) (c) emphatically brings out the fact that the property really vests in the corporation, because it provides that during the period of supersession, it shall vest in the State Government .....

.....Therefore, we are satisfied that the income derived by the appellant from its trading activity cannot be said to be the income of the State under Art. 289 (1), and if that is so, the facts that the trading activity carried on by the appellant may be covered by Art. 289 (2), does not really assist the appellant's case. Even if a trading activity falls under cl. (2) of Art. 289, it can sustain a claim for exemption from Union taxation only if it is shown that the income derived from the said trading activity is the income of the State. That is how ultimately, the crux of the problem is to determine whether the income in question is the income of the State and on this vital test, the appellant fails".

Considerable reliance was placed on the principles laid down in the aforesaid decision by learned counsel appearing for the Union of India. He submitted that having regard to the provisions of the Act under which the appellant/Authority is established, the same conclusion may be reached. In particular, emphasizing the fact that as in Andhra Pradesh Road Transport Corporation case, so in the instant case as well, Section 17 of the Act provides that upon dissolution of the appellant/Authority, the properties, funds and dues realizable by the Authority along with its liabilities shall devolve upon the State Government. Impliedly, therefore, such properties, funds and dues vest in the Authority till its dissolution, and only thereafter it vests in the State Government. He also referred to various other provisions of the Act and submitted that there was nothing in the Act which attempted to lift the veil from the face of the Corporation. Even though the Authority was created under an Act of the Legislature, it was still an Authority which had a distinct personality of its own, having perpetual succession and a common seal, with powers to acquire, hold and dispose of property, and to contract, and could sue and be sued in its own name. Shri Venugopal, on the other hand, tried to distinguish the judgment on the ground that the Andhra Pradesh Road Transport Corporation is being run on business lines, and a Corporation that runs on business lines is distinguishable and different from a Corporation which is not run on those lines. Even if such a distinction is drawn, that will not have the effect of making the income of the Corporation the income of the State Government having regard to the other features noticed above.

Shri Venugopal then relied upon two decisions of this Court reported in Shri Ramtanu Co-operative Housing Society Ltd. and Anr. vs. State of Maharashtra and Ors. and 2 New Delhi Municipal Council vs. State of Punjab and Ors.. In Shri Ramtanu Co- operative Housing Society; the question which arises for consideration in the instant appeal did not arise at all. The question was whether the State of Maharashtra was competent to enact the Maharashtra Industrial Development Act, 1961 and whether the impugned Legislation fell within Entry 43 List I of the Seventh Schedule of the Constitution, so that only the Parliament was empowered to enact such Legislation and not the State of Maharashtra. In that context, this Court considered the true character scope and intent of the Act by reference to the purposes and the provisions of the Act. Having considered the various provisions of the Act including those relating to the functions and powers of the Corporation, this Court concluded that in pith and substance the Act was meant for the establishment, growth and organization of industries, acquisition of land in that behalf and carrying out the purposes of the Act by setting up the Corporation as one of the limbs or agencies of the Government. It held that even though the Corporation received moneys from disposal of lands, buildings and other properties and also received rents and profits, such receipts arose not out of any business or trade but out of sole purpose of establishment, growth and development of industries. The Corporation was not a trading Corporation, as it was not involved in buying or selling activity. The true character of the Corporation was to act as an architectural agent of the development and growth of industrial towns by establishing and developing industrial estates and industrial areas. It, therefore, negative the argument that the Corporation being a trading one, the impugned Legislation fell within Entry 43 of List I of the Seventh Schedule.

This decision does not help the appellant because even if it is held that the appellant/ Authority is not a trading Authority, yet that does not answer the question whether the income of the Authority is the income of the State so as to attract Clause (1) of Article 289.

Similarly, the decision in New Delhi Municipal Council vs. State of Punjab and Ors. (supra) does

not advance the case of the appellant. It was held that the property/ municipal taxes levied by the New Delhi Municipal Council under the relevant Act constituted Union taxation within the meaning of Clause (1) of Article 289 of the Constitution of India. The levy of property taxes under the aforesaid enactments on lands or buildings belonging to the State Government was invalid and incompetent by virtue of the mandate contained in Clause (1) of Article 289. However, if any land or building is used or occupied for the purpose of any trade or business, meaning thereby a trade or business carried on with profit motive, by or on behalf of the State Government, such land or building shall be subject to the levy of the property taxes levied by the said enactments. In other words, State property exempted under Clause (1) means such property as is used for the purpose of the Government and not for the purpose of trade or business. That was a case where the question arose in relation to the levy of property tax on lands and buildings owned by the State Governments which was "property of the State Government". In the instant case, we are concerned with the income of the appellant/ Authority and the same principles apply. The exemption can be claimed only if the income can be said to be the income of the State Government. In the facts of this case, it is not possible to hold that the income of the appellant/ Authority is the income of the State Government.

Learned counsel for the Union of India also relied upon two decisions reported in Food Corporation of India vs. Municipal Committee, Jalalabad and Anr. and Board of Trustees for the Visakhapatnam Port Trust vs. State of A.P. and Ors. and submitted that this Court has consistently taken the view that a Corporation having the attributes of a Company must be held to be distinct from the Central Government, and not eligible for exemption from taxation under Article 285. The High Court also in its impugned judgment and order has referred to several decisions of this Court wherein this Court dealing with cases arising under Article 285 of the Constitution of India, which exempts properties of the Union from State taxation, took a similar view. We may usefully refer to the cases reported in: Food Corporation of India vs. Municipal Committee, Jalalabad and Anr., Municipal Commissioner of Dum Dum Municipality and Ors. vs. Indian Tourism Development Corporation and Ors., 3 Central Warehousing Corporation vs. Municipal Corporation and Western Coalfields Ltd. vs. Special Area Development Authority, Korba and Anr. and Bharat Aluminium Company Ltd. vs. Special Area Development Authority, Korba and Ors.

Having considered all aspects of the matter we hold that the High Court is right in concluding that the appellant/ Authority could not claim exemption from Union taxation under Article 289 (1) of the Constitution of India. The impugned notice issued by the Income Tax Authorities was, therefore, valid and legal and could not be successfully challenged in the writ petition. Accordingly, this appeal is dismissed but without any order as to costs.

J