Bombay High Court Commissioner Of Income Tax vs Shri Chhatrapati Sahakari Kakhar ... on 4 May, 2000 Equivalent citations: 2000 111 TAXMAN 176 Bom Author: Kapadia JUDGMENT Kapadia, J. The above reference No. 449 of 1995 is a reference under section 256(1) of the Income Tax Act, 1961 by the Tribunal, Special Bench, Pune, relating to the assessment years 1984-85 to 1988-89, at the instance of the department, for seeking opinion of this court on 15 questions which are as follows: 1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that by reconciling the two views expressed by the Supreme Court in the cases of CIT v. Biffi Cotton Mills (P.) Ltd. (i979) 116 ITR 60, on one hand, and Chowringhee Sales Bureau (P.) Ltd. v. CIT(I973) 87 ITR 542 and Sinclair Murray & Co. (P.) Ltd. v. CIT(I974) 97 ITR 615, on the other, the principle that emerges is that it is not the point at which or the method by which a receipt was collected by a trader that would determine the taxability of the trading receipt as income, but nature, object and obligation of the receipt'; on the facts of the decision in CIT v. Bazpur Co-operative Sugar Factory Ltd. (1988) 172 ITR 321/38 Taxman 195 (SC) and Punjab Distilling Industries Ltd v. CIT (1959) 35 ITR 519 (SC) in such reconciliation ? 2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that 'what is relevant to see is not how the amount was collected and when it was collected, but with what obligation it was collected'. (In total disregard of the Supreme Court's decisions in Bazpur Co-operative Sugar Factory Ltd's case (supra) and Punjab Distilling Industries Ltd.s case (supra) and CIT v. Punjab Distilling Industries Ltd. (1964) 53 ITR 75 ?) 3. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the purpose of collecting the deposit, i.e., deduction is to issue shares (but not immediately but after certain time, i.e., the time taken to repay the loans); when the Tribunal itself held in para 7 of its order that the main purpose of collecting the deposits from the cane-growers by way of deduction from the cane price was to secure funds to repay the loans taken from the financial institutions, to repay the capital provided by the State Government and then to convert the deposit into share capital ? 4. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law incoming to a conclusion that there is total difference and dissimilarity in the Bye-law (unamended) of Bazpur Co-operative Sugar Factory and the Bye-law No. 61A reproduced in para 7of its order ? 5. Whether, on the facts and in the circumstances of the case, the Tribunal correctly interpreted the Bye-law No. 6 1 A of the assessee-factory ? 6. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in coming to the conclusion that only when there is adjustment of the deposit or part thereof towards losses, then the amount of the deposit will belong to the assessee and if not, it does not belong to the assessee ? 7. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that during the period the deposits remained with the assessee, they are not regarded as assessee's own money but as only a liability ? 8. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in coming to the conclusion that the depositors as the lenders of the money are the owners of

the money, while the assessee is not the owner of the money and only entitled to use of the money ? 9. Whether, on the facts and in the circumstances of the case, and in law, the Tribunal was justified in interpreting the Supreme Court decision in the case of Bazpur Co-operative Sugar Factory Ltd. (supra) in comnig to the conclusion that only those deposits which get consumed amount to trading receipts ? Question No. 10 (reframed by this Court) as follows: 10. Whether, in view of the decision of the Supreme Court in the case of Bazpur Co-operative Sugar Factory Ltd. (supra), the Tribunal was justified in coming to the conclusion that no collections were involved except money retention and that the trading operation was only an occasion for retention of money and not consideration for supply of cane ? 11. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the fact, the interest was be in paid on the deposits brings out the relationship of a creditor and debtor ? 12. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in rejecting the argument that the provision in the Bye-law No. 61A was only a make-belief affair, in spite of the I-act that loans and other liabilities were nil and the State Government's share capital was insignificant and could have been easily redeemed ? 13. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in treating the non-refundable and refundable deposits as loans, and not as income ? 14. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding, in respect of various funds like Chief Minister's Fund, Hutment Fund, Small Savings Scheme, Y.B. Chavan Memorial Fund, etc. (a) that the assessee acted as an agent and collections were made as per the directions of the State Government, (b) for spending them on the purposes specified by the State Government, and (c) that the collections were made by way of retaining amount of cane-price payable to the sugarcane growers and, hence, are not trading receipt liable to tax ? 15. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in not following the Madhya Pradesh High Court's decision in the case of Jiwajirao Sugar Co. Ltd. v. CIT (1989) 176 ITR 182, in respect of the Area Development Fund and Cane Development Fund ?" 2. The above questions also form part of various appeals referred to above, preferred by the department under section 260A of the Act. 2. The above questions also form part of various appeals referred to above, preferred by the department under section 260A of the Act. 3. Since a common substantial question of law arises in all the above matters, they are disposed of by this common judgment. 3. Since a common substantial question of law arises in all the above matters, they are disposed of by this common judgment. 4. For the sake of brevity, although the questions referred to this court by the Tribunal are numerous, the basic substantial question of law is : whether, on the facts and in the circumstances of the case, the various funds/deposits collected by the assessee-Karkhana out of the sugarcane price payable to the cane-growers, are trading receipts of the assessee as held by the Supreme Court in the case of CIT v. Bazar Co-operate Sugar Factory Ltd. (1988) 172 ITR 321/38 Taxman 195 ? 4. For the sake of brevity, although the questions referred to this court by the Tribunal are numerous, the basic substantial question of law is : whether,

on the facts and in the circumstances of the case, the various funds/deposits collected by the assessee-Karkhana out of the sugarcane price payable to the cane-growers, are trading receipts of the assessee as held by the Supreme Court in the case of CIT v. Bazar Co-operate Sugar Factory Ltd. (1988) 172 ITR 321/38 Taxman 195 ? 5. For the sake of convenience, we refer to the facts of the referred case being the subject-matter of IT Reference No. 449 of 1095 which are as follows. 5. For the sake of convenience, we refer to the facts of the referred case being the subject-matter of IT Reference No. 449 of 1095 which are as follows. 6. Shri Chhatrapati Sahakari Sakhar Karkhana, Bhawaninagar, Pune, is the Co-operative Sugar-Factory which is owned by a Co-operative Society. The said society is engaged in the business of manufacture and sale of sugar. The working of the society is governed by its bye-laws. Under section 4 of the Maharashtra Co-operative Societies Act, 140, the Government is empowered to issue directions to the society regarding its working by virtue of the powers available to the Government. In view of the bye-laws of the Karkhana, sugarcane price of a crushing season is fixed by the Government from time to time for each Karkhana in the State. A Karkliana has a specific area. of operation and the lands of the cane-growers which fall within that area come within the authority of the Karkhana. The cane price is decided by the Government. The cane grower using land for taking crops within the Karkhana area is obliged to become the member of the society. He is obliged to sell his harvest only to the Karkhana within whose authority his land falls. Such a member cannot sell sugarcane to any other Karkhana. It is for this reason that the sugarcane price is fixed by the Government Karkhana-wise. While determining the cane price to be given by the Karkhana, the Government is required to consider the amount of actual sugar sold during the sugar year which is, generally, between October of a particular year to next September. The Committee is also required to take into account the value of the closing stock of controlled sugar and free sugar prevailing on the last date of the previous sugar year, viz., 30th September. A sugar year is also declared by the Commissioner of Co-operation and Registrar of Co-operative Societies. It is generally for the period Ist October to 30th September. Under the bye-laws, the Karkhana is required to make deductions from the cane price mentioned in the sale memo (bill). These deductions are as under: 6. Shri Chhatrapati Sahakari Sakhar Karkhana, Bhawaninagar, Pune, is the Co-operative Sugar-Factory which is owned by a Co-operative Society. The said society is engaged in the business of manufacture and sale of sugar. The working of the society is governed by its bye-laws. Under section 4 of the Maharashtra Co-operative Societies Act, 140, the Government is empowered to issue directions to the society regarding its working by virtue of the powers available to the Government. In view of the bye-laws of the Karkhana, sugarcane price of a crushing season is fixed by the Government from time to time for each Karkhana in the State. A Karkliana has a specific area. of operation and the lands of the cane-growers which fall within that area come within the authority of the Karkhana. The cane price is decided by the Government. The cane grower using land for taking crops within the Karkhana area is obliged to become the member of the society. He is obliged to sell his harvest only to

the Karkhana within whose authority his land falls. Such a member cannot sell sugarcane to any other Karkhana. It is for this reason that the sugarcane price is fixed by the Government Karkhana-wise. While determining the cane price to be given by the Karkhana, the Government is required to consider the amount of actual sugar sold during the sugar year which is, generally, between October of a particular year to next September. The Committee is also required to take into account the value of the closing stock of controlled sugar and free sugar prevailing on the last date of the previous sugar year, viz., 30th September. A sugar year is also declared by the Commissioner of Co-operation and Registrar of Co-operative Societies. It is generally for the period Ist October to 30th September. Under the bye-laws, the Karkhana is required to make deductions from the cane price mentioned in the sale memo (bill). These deductions are as under: (i) Area Development Fund, (ii) Cane Development Fund, (iii) Huts-ments Fund, (iv) Chief Minister's Relief Fund, (v) Members Small Savings Fund, (vi) Late Y.B. Chavan Memorial Fund, (vii) Memers 'Non-refundable Deposits, (viii) Members' Refundable Deposits, (ix) Non-members Refundable Deposits, and (x) Voluntary Deposits of Members Fund. Accordingly, various amounts are collected by the Karkhana from the cane-growers out of the cane purchase price payable to the cane-growers at various rates fixed by the Government. 7. The short point, therefore, which arises for consideration is: whether, the above deposits are taxable as income of the assessee-Karkhana (Society) ? 7. The short point, therefore, which arises for consideration is: whether, the above deposits are taxable as income of the assessee-Karkhana (Society) ? 8. For the sake of convenience and clarity, we have discussed each of the deductions, i.e., deposits separately to facilitate giving answers to the questions referred to us: 8. For the sake of convenience and clarity, we have discussed each of the deductions, i.e., deposits separately to facilitate giving answers to the questions referred to us: (A) Members' Non-refundable Deposits and Members' Refundable Deposits - Before coming to the arguments, it would be relevant to quote the concerned bye-laws regarding fixation of cane-price and deductions to be made by the Karkhana from the cane-price towards Non-refundable Deposits and Refundable Deposits (hereinafter referred to, for the sake of brevity, as 'Deposits'). Bye-law No. 60: Regarding fixation of cane-price: "The rate of sugarcane supplied by members will be fixed each year by the board of directors. The same will be of ex gate cane. It will be the same for all the members. The Karkhana will also reimburse to the members their expenses of harvesting and transporting the cane up to the factory gate at the rate fixed by the board of directors. Such transporting expenses will differ in the case of every member depending upon the distance of his field from the factory gate. Such expenditure reimbursed by the Karkhana will be treated as a part of cost of sugarcane. The board of directors will, each year, fix the rate of sugarcane to be paid to the members considering the constitution, objects and bye-laws of the Karkhana and the financial results of each year. However, so long as the Karkhana has not fully repaid the share capital contributed by the State Government and/or the loans taken on block capital account from WC and other Central Financing institutions, the board of directors will pay the price as fixed

by the State Government. The rate of cane supplied by the non-members at the gate will be fixed by the board of directors. It will not be more than the rate fixed for the members' cane. If, however, rate of cane for the non-members has to exceed the members, the approval of the State Government is necessary." Bye-law No. 61A "(1) Every year the society shall collect from the members non-refundable deposit at the rate not less than Re. 1 per ton of sugarcane supplied by them. However, in determining such rate, the Board shall consider the amount required for the repayment of loan of I.F.C.I., repayment of bank loan on Block Capital Account and the repayment of time-deposit received from the members. The rate of interest on such deposit shall not exceed 121k) until, the Government share capital, the loan of I.F.C.I. Maharashtra State Co-op. Bank on long-term loan advanced for capital expenditure and by any other financial agencies has been refunded. The NRD collected as above shall not be refunded to the member till the repayment of Government share capital and term loans taken from 1M and other financial institutions are repaid fully. (2) The deposits collected as above shall not be. refundable to members. However, the Board may convert Such deposits into shares after repayment of loans taken from IM, loan from Maharashtra State Co-op. Bank, Government share capital and long-term loans taken from other banks for capital expenditure. The amount of fixed deposits collected by the Society from a member shall not exceed three times, the shares held by the members. Thereafter such fixed deposits shall not be accepted by the Karkhana. The Karkhana has to collect the deposits until it holds Government share capital and has other loans outstanding, (3) On a member ceasing to be a member as provided in bye-law No. 22, the amount standing to the credit of his account as a non-refundable deposits may be transferred to any other member's account at his option deposits may be transfer and approval of the board of directors or shall be refunded to such member or his legal heirs with the approval of the board of directors after the lapse of one year from ceasing to be members, on recovery of all amounts due from him, if any, and after considering the financial Position of the Society. However, the total amount of such refund in any year shall not exceed 1/10th of the total non-refundable deposit standing at the beginning of the year. (4) The amount of deposits so collected shall be utilised for the repayment of term loans taken for the capital expenditure as rnentioned in sub-clause two above. (5) The amount of deposits so collected of the members or part thereof call be transferred to name of any other member on an application by tile member. However, consent of both members in writing shall be Bye-law No. 6 1 B:"In addition to the non - refund able deposit from member as mentioned in bye-law No. 6 1A above, if the board of directors find it necessary, the 'y shall have a right to collect the time deposits for a period not exceeding five years, out of the cane-price payable to the cane supplier, it a prescribed rate per ton of sugarcane supplied as may, be decided by them every year. This deposits will be used by society only for the purpose of expansion programme and capital expenditure and interest paid on these deposits will not exceed 12%." Mr. Desai, the learned senior counsel appearing on behalf of the department, contended that the above deductions from the price paid by the assessee to the farmers were on account Of Purchase

of sugarcane. It was contended that the business of the assessee is to manufacture and sell sugar from the cane purchased by it and, therefore, the above deductions were made in the course of the assessee's trading operations and, therefore, the said deductions constituted trading receipts in the hands of the assessee and is, therefore, liable to be included in the assessee's taxable income. The learned counsel for the department further contended that on reading of the bye-laws, it is clear that the primary purpose for which the above deductions are made is to discharge the assessee's liabilities to the financial institutions and to the State Government. He placed heavy reliance on the judgment of the Supreme Court in the above case of Bazpur Co-operative Sugar Factory Ltd. (supra). He further contended that the word 'deposit' is a misnomer. He contended that there was no relationship of creditor and debtor. He contended that the amounts were not refundable. He contended that the society was free to appropriate the amounts to reduce its trading losses. He contended that the amount.,; could be used by the society for trading operations. He contended that the cane-grower had no option but to sell sugar-cane to the Karkhana wit hill whose area the land of the grower fell. He contended that none of the criteria to constitute such deductions as deposit is fulfilled in this case. He contended that the deposits, so-called, are collected from the cane price paid to the cane-grower in the course of trading operations and, therefore, such deposits constituted trading receipts. He contended that the Tribunal erred in coming to the conclusion that there was substitution of one set of creditors by another set of creditors. He contended that the Tribunal erred in holding that the primary purpose of the above deductions was to repay the loans in the form of shares to the cane-growers. He contended that no time-limit was fixed to repay the loans. He contended that there was no obligation imposed by the bye-laws on the assessee to repay the amount. He further pointed out that, under the bye-laws, the cane-grower is not entitled to return of the alleged deposits till the liability of the assessee to the financial institutions and to the State Government is discharged. He contended that, therefore, it was open to the assessee to use the funds without any hindrance till the assessee discharges its liabilities to the financial institutions and the State Government. He contended that during all these years, the assessee has not discharged its liabilities to the financial institutions and the State Government so that it could go on receiving the alleged deposits particularly in view of the fact that it was obliged to repay only after discharging its liabilities to the Government and the financial institutions. He contended that even on the death of a member or on a cane-grower ceasing to be a member the deposit became repayable subject to the discretion of the board of directors. Hence, he contended that the above deductions were a part of trading operations and, therefore, they were in the nature of trading receipts. On the other hand, Mr. Inamdar, the learned counsel appearing on behalf of the assessee, contended that all receipts by an assessee cannot be deemed to be income of the assessee. He contended that the burden of proof was on the department to prove whether a particular receipt is income or not. He further contended that the court is required to ascertain as to whether, at the time of accrual, the receipt could be said to be income of the assessee. He contended that it is not

an income at the time of accrual, then the manner in which subsequently it is applied is of no consequence. He contended that the department cannot assess all receipts as income. That the department can assess only those receipts that amount to income. He contended that the taxability of an amount, as income, would depend on the nature and character of receipt at the initial stage. That if the amount initially received partakes of the character of a trading receipt then it would be taxable as income; however, if the amounts are initially not taxable as income, they cannot be taxed on the ground of their appropriation by the assessee to his own credit subsequently. He contended that the proposition is well-settled, namely, that an amount which is not initially received as a trading receipt cannot become a trading receipt on account of subsequent appropriation by the assessee or by subsequent application thereof by the assessee. Applying the above test, he contended that the court is required to examine the true nature and character of the transaction. He contended that for the last several years, the department accepted the deductions as deposit. He contended that it is only after the judgment of the Apex court in the case of Bazpur Co-operative Sugar Factory Ltd. (supra) that the department has now sought to reverse its stand by contending that the said deposit is a trading receipt. He contended that the judgment of the Supreme Court in Bazar Co-operative Sugar Factory Ltd.'s case (supra) has no application to the facts of this case as the bye-laws of Bazpur Co-operative Sugar Factory case (supra) are different from the bye-laws in the present case. He contended that in the case of Bazpur Co-operative Sugar Factory Ltd. (supra), the assessee had established a fund called 'Loss Equalization and Capital Redemption Reserve Fund'. That on the opening date of the year of account, namely, 1-7-1959, an amount of Rs. 1,30,196 stood to the credit of the said fund. That during the relevant accounting year 1-7-1959 to 30-6-1960, the Society added Rs. 5,15,863 to the above fund by deduction from the price payable by the society to the cane-growers/members. That the concerned bye-law 50 of the society permitted the society to appropriate such deposits towards the losses incurred by the society/ Karkhana in its working and after adjusting the losses, if any, the deposits were to accumulate and utilise for repayment of loans to financial institutions and thereafter the balance, if any, was to be used to redeem Government share. That during the accounting year, the society in that matter, debited Rs. 2,34,354 to the Loss Equalization Fund by adjusting the said amount against the loss brought forward from the previous year, with the result that at the close of the year on 30-6-1960 the account showed a credit balance of Rs. 4,11,705. In the circumstances, Mr. Inamdar pointed out that on a bare reading of the judgment of the Supreme Court, it is clear that the amounts deducted were used by the society as permitted under the bye-laws of that society to be used towards deduction of losses and, therefore, it amounted to a contribution from the member. Hence, he contended that the judgment of the Supreme Court in the case of Bazpur Co-operative Sugar Factory Ltd. (supra) has no application to the facts of this case. He further pointed out that, in the present matter, the assessee has undertaken an obligation to pay interest to the cane-growers/members. He pointed out that, in the present matter, the society had no right to appropriate the deduction towards

any other purpose except to discharge the liabilities of financial institutions and the Government and, therefore, return the deposits in the form of shares to the producer member which was not the case in Bazpur Co-operative Sugar Pactory Ltd.'s case (supra). He contended that the reliance placed by the department on the judgment of the Supreme Court in the case of Punjab Distilling Industries Ltd. v. CIT (1959) 35 ITR 519 is also not correct. He contended that, in that matter, the assessee carried on business as a distiller of country liquor and sold the produce of its Distillery to wholesalers. In that matter, the Government devised a scheme whereby the distiller was entitled to charge the wholesalers a price for the bottles in which the liquor was supplied, at rates fixed by the Government, which the distiller (assessee) was bound to repay as and when the bottles came to be returned. However, in addition to the price fixed under the Government Scheme, the distiller-assessee took from the wholesalers certain further amounts, described as security deposits without the Government's sanction and as a condition imposed by the assessee itself for the sale of its liquor. This additional amount imposed by the assessee itself was not a condition prescribed by the Government. The moneys described as security deposits were also returned when the bottles were returned but the entire sum was refunded only when 90 per cent of the bottles were returned. In other words, the assessee was free to use the additional amount till such time as 90 per cent of the bottles came to be returned. It was under these set of circumstances that the Supreme Court held that the additional amount described as security deposit was really an extra price for the bottles and the additional amount was actually a part of the consideration for the sale of liquor and, therefore, it was a trading receipt. In the Circumstances, it was contended by Mr. Inamdar that the judgment of the Supreme Court in the case of Punjab Distilling Industries Ltd. (supra) has no application to the facts of this case. He further pointed out that in Punjab Distilling Industries Ltd.s case (supra), the additional amount recovered as security deposit was a receipt which arose as a result of a condition imposed by the assessee and it was not as a result of condition imposed by the Government whereas, in the present case, the assessee was duty bound to deduct the deposits from the cane bill pursuant to the directions given by the State Government. He contended that cases in which there is appropriation of profits by the assessee, stand on a different footing from the case on hand. He submitted that in case of trading receipts, there is an element of profit making which is absent in the present case. He contended that this profit making element was very much there in Punjab Distilling Industries Ltd.'s case (supra) and, therefore, the said judgment has no application to "s case. He further contended that in the case of Chowringhee Sales Bureau (P) Ltd. v. CIT (1973) 87 ITR 542 (SC) on which reliance has been placed by the department has also no application to this case. In that matter, the assessee, a private company, dealing in furniture, also acted as an auctioneer. As an auctioneer, the assessee realised Rs. 32,000 as sales tax. This amount was credited separately under (lie head 'Sales tax collection amount'. The assessee did not pay the amount of sales tax to the actual owner of the goods. The assessee did not deposit the amount in the State exchequer as the assessee challenged the validity of Bengal Finance (Sales Tax) Act, 1941. It

was held by the Supreme Court that sale by an auction is a sale under- Sale of Goods Act, 1930. That under section 64- of the Sale of Goods Act, in the case of sale by auction where the goods are put up for sale in lots, each lot is deemed to be the subject of a separate contract of sale. Therefore, the assessee was held to be a seller. Even in the cash memos issued by the assessee to the auction purchasers, the assessee was shown as the saler and the amount realised from the purchasers included sales tax which the assessee did not pay, to the actual owner of the goods auctioned because the statutory liability for payment of that sale was that of the assessee. At this stage, Mr. Inamdar pointed out that in the case of Punjab Distilling Industries Ltd. (supra), it was the statutory liability of the assessee to pay the sales tax collected. Under the circumstances, on facts of that case, the Supreme Court held that as the amount of sales tax was received by the assessee, as an auctioneer, the amount form part of its trading or business receipt. Mr. Inamdar, accordingly, contended that the judgment in the case of Chowringhee Sales Bureau (P.) Ltd. (supra) has no application to this case. He contended that in the case of Chowringhee Sales Bureau (P.) Ltd. (supra), it was found on facts that the sum of sales tax collected by the auctioneer was, in reality, a portion of the sale price itself because the sales tax was not the liability of the purchaser of the goods but was the liability of the saler of the goods and that the owners of the goods who had sent them to the assessee for being auctioned had received only their sale price less the amount charged by the assessee as sales tax from the purchasers. He, accordingly, contended that once there is a statutory liability to pay sales tax collected from the purchasers 011 the salers then the amounts collected constituted a portion of sale price and, therefore, such amounts were trading receipts. He contended that this was also one of the points taken into account by (lie Supreme Court in the case of Punjab Distilling Industries Ltd. (supra). Hence, the judgment of the Supreme Court in Chowringhee Sales Bureau (P) Ltd.'s case (supra) (i) has no application to the facts of this case. He further contended that the impugned judgment of the Tribunal is correct. He contended that in the present matter, on examination of bye-laws, the Tribunal has found that the primary purpose of the deposit was to issue shares to the producer members and not to adjust the losses and, therefore, these deposits did not partake of the character of trading receipts. He contended that, in the present matter, the Tribunal on facts and on examination of bye-laws, found that the deducted amount constituted deposits from the creditors. That the society had agreed to repay the deposits with interest and, therefore, in the present case. there was substitution of' one set of creditors by, another set of creditors which was not the case in Bazpur Co-operative Sugar Factory Ltd. (supra). Further, the Tribunal found that, in the present case, the bye-laws provide for payment of interest which, according to the learned counsel, is one of the key distinguishing features of this case. In the circumstances, he contended that essentially, the Tribunal has recorded finding of fact. Hence, no interference is called for in the above appeals /references. Reasons : Bye-law Nos. 60,6 IA and 61B deal with fixation of cane price. Under bye law No. 60, it is, inter alia, provided that so long as the Karkhana has not fully repaid the share capital contributed by the Government and/or the loans taken on block

capital amount from financial institutions, the board of directors will pay the price as fixed by the State Government. In other words, on discharging the above liabilities, the board of directors are free to fix the price. 1n the present case, the above liabilities of- the financial institutions and Government have not been discharged and, therefore, the cane-price is being fixed by the Government. Bye-law No. 61A provides, inter alia, that every year the society shall collect from the members non refundable deposits at the rate not less than Re. 1 per ton of sugarcane supplied by them. However, in deciding such rate, the shall consider the amount required for repayment of loans of financial institutions. Bye-law No. 61A further provides for rate of interest on non refundable deposits which shall riot exceed 12 per cent until redemption of the Government share capital by the society and repayments of the loans of the financial institutions fully. Clause 2 of bye-law No. 61A categorically states that the deposits shall not be refunded to members. These are non-refundable deposits covered by bye-law No. 61A. However, under clause 2, the Board is given discretion to convert such deposits into shares only after repayment of loans taken from the financial institutions. Under the said clause, it is further provided that the amount of fixed deposits collected by the society from a member shall not exceed three times the shares held by the members. Under the said clause, it is provided that the Karkhana shall collect the deposits until the Karkhana holds Government share capital and other loans outstanding. In other words, till all liabilities are discharged, the Karkhana shall collect deposits from the members. Under clause 3 of bye-law No. 61A, it is provided that on a member ceasing to be a member, the amounts standing to the credit of his account as a non-refundable deposit may be transferred to any other member's account at his option but subject to approval of the board of' directors or shall be refunded to such member or his legal heirs subject to approval of the board of directors and after considering the financial position of the society. Under clause 4 of bye-law No. 61A, the amount of deposits so collected shall be utilised for the repayment of term loans taken for capital expenditure. Bye-law No. 61B lays down that in addition to the non-refundable deposits mentioned in bye-law No. 6 1 A, the board of directors may, if they find it necessary, have a right to collect time deposits for a period not exceeding five years out of the cane-price payable to the cane-supplier at a prescribed rate which deposit will be used by the society only for the purposes of expansion programme and capital expenditure and the interest paid on these deposits will not exceed 12 per cent. In other words, bye-law No. 61B deals with refundable deposits referred to above. On detailed examination of the above byelaws, it is clear that till the loans taken by the society are repaid and till the share capital contributed by the Government is fully repaid, the Karkhana will pay the price of sugarcane as fixed by the State Government. However, on repayment, the Karkhana would be free to fix the price to be paid to the cane-grower. This clause shows that the right to fix cane price is given to the Government only till the repayment of the loans to the financial institutions and till the Government share capital is redeemed and not thereafter. It is not in dispute that till today the loans have remained outstanding. It is not in dispute that, till today the Government share capital has not been redeemed.

However, the purport of bye-law No. 60 is very clear that the society has a right to fix the price of sugar-cane on the above contingency being fulfilled. In fact, till share capital is repaid, the Government is authorised by society to fix price - (See Orders of Director of Sugar dated 13-3-1984 and 24-3-1986 to Karkhana). Therefore, fixation and payment of the price of sugarcane certainly forms part of the trading operations of the assessee. The directions of the Government to deduct certain amounts from the cane bill would not come into picture on the repayment of loans to the financial institutions and on repayment of Government share capital by the society. Under bye-law No. 61A, the society is given the discretion to determine the rate at which the deductions would be made from the price payable to the growers after considering certain parameters mentioned in the said bye-law. Clause 1 of bye-law No. 6 1 A prescribes that the rate of interest shall not exceed 12 per cent. The said clause clearly mentions, once again, that the non-refundable deposits shall not be refunded till repayment of Government share capital and till repayment of loans taken from financial institutions. However, under clause 2 of bye-law No. 61A, it is provided that the Karkhana shall collect the deposits until it holds the Government share capital and other loans outstanding. In other words, the right to collect the deposits has been given to the assessee till the assessee discharges its liabilities to the Government and financial institutions. Therefore, the assessee is empowered to hold on to the deposits till repayment of Government share capital and the loans to financial institutions. As stated above, the rate of deduction shall be decided by the Board. This aspect clearly indicates that the right to collect the deposits, the rate of which is determined by the board of directors, has been given to the society. The rate of deposit is not decided by the Government. The period to repay the share capital to the Government is not prescribed. The period to repay loans to the financial institutions is not prescribed. The only embargo placed on the society, under the bye-laws is that the deposits shall not exceed three times the shares held by the members. This is only to maintain the debt-equity ratio. Therefore, a reading of the bye-laws clearly indicates that the deposits are trading receipts made available to the society to carry on trading operations. Clause 2 of bye-law No. 61 A categorically mandates that the deposits shall not be refundable to members. It further provides that the board of directors may convert such deposits into shares. In other words, they may not convert such deposits into shares. This clause also indicates clearly that the deductions from the cane price constitute a source of income to the society. The provision for debt-equity ratio in the bye-laws, as stated above, is only to see that servicing of the loans do not become cumbersome and to protect the company from liquidation. It has nothing to do with deduction which is a trading receipt as stated above. Under clause 3 of bye-law No. 61A also, one finds that the amounts shall not be refunded without the approval of the board of directors. In the case of a deposit on maturity, the depositor has a right to repayment. In the present case, no such right has been given. In the present case, the board of directors may refuse to repay the deposit on the ground of weak financial position of the society. Further, in the case of a deposit in the real sense a fixed maturity period is prescribed. Generally, deposits are

invited by the companies to meet working capital requirements. Therefore, the said deposits are for a fixed period. In the present matter, no such period is prescribed except for deposit covered under bye-law No. 61 B. Reading of the above bye-laws, therefore, clearly shows that the primary purpose of the said deposits is to provide an important source of return on periodical basis to the Karkhana to carry out trading operations of manufacture and sale of sugar. In a matter of this type, there cannot be any strait-jacket formula. It will depend on facts of each case. It will depend on bye-laws of society. There is one more aspect which needs to be mentioned. A cane-grower whose lands fall within the area of the Karkhana has no option but to sell the sugar-cane to that Karkhana. He has no bargaining power in the matter of price fixation. The price is fixed by the Government. The grower cannot sell his produce to any other Karkhana. The Karkhana pays the price of the sugar-cane fixed by the Government under the above bye-laws. As stated above, the Government is empowered by the society to fix the price of sugar-cane till redemption of the Government share capital. Therefore, price fixation is also a matter of trading operations. This clearly shows that the above deposits have been recovered by the society as a part of trading operations and, therefore, it constitutes part of trading receipts. None of the above facts have been considered by the Tribunal in the impugned judgment. The Tribunal has erred in coming to the conclusion that the primary purpose of collecting the deposits, i.e., deductions is to issue shares not immediately but after the time taken to repay the loans. On the contrary, the above bye-laws clearly indicate that the primary purpose of collecting the deposits, i.e., deductions was to discharge the liabilities of the Society. We do not find merit in the contention of the assessee that, in the present matter, there is substitution of one set of creditors by another set of creditors which argument found favour with the Tribunal. The deposits form part of the price paid to the cane-grower. Fixation and payment of the price of sugar-cane constituted an integral part of the trading operations of the society. The business of the society was to manufacture and sell sugar. There was no separate contract of fixed deposits between the society and the member. Nothing prevented the society from inviting fixed deposits from its members de hors the price. No separate fund came to be created. In the circumstances, it cannot be said that there was substitution of one set of creditors by -another set of creditors. The deductions were from the price. It provided a periodical return. Therefore, the deposits were trading receipts in substance. In our opinion, in a matter of this type, the true test to be applied is whether the amounts sought to be deducted reached the assessee as his income. If the amounts sought to be deducted reached the assessee as his income, then it would constitute a trading receipt. The above discussion clearly shows, on facts of this case, that the amount reached the assessee as its income. Ultimately, there is no dispute regarding the principle of law. The question is only regarding application of law to the facts of this case. We have examined the bye-laws de hors the judgment of the Supreme Court in the case of Bazpur Co-operalive Sugar Factory Ltd. (supra). However, since detailed arguments have been advanced on both sides, we may point out that in the said judgment, the Supreme Court has laid down on examination of the

bye-laws in that case that the primary purpose for which the deposits was liable to be used were not to issue shares to the members for discharging liabilities of the society. In the present case, we have examined the bye-laws which, as stated above, clearly provided that the price fixation is with the society; that the society empowered the Government to fix the price of the sugarcane under its bye-laws till redemption of the Government share capital; that the deductions were made from the price paid to the growers which constituted the part of the trading operations: that by this mode the society got the benefit of periodical return and, lastly, the said deductions constitute consideration for the supply of sugar-cane. As stated hereinabove, in each case, the court has to examine the nature of the receipt. Therefore, we have examined this matter oil the bye-laws of the Karkhana. However, it has been urged that, in the present matter, the society has agreed to pay interest to the cane-grower which was not the fact in the case of Bazpur Co-operalive Sugar Factory Ltd. (supra). In the case of Shree Nirmal Commercial Ltd, v. CIT(I 992) 193 ITR 694 (Born.) the facts were as follows : The assessee was originally registered as a private limited company which was latter converted into a public limited company. Its objects were to build and construct houses. The company obtained a lease of land belonging to the Government of Maharashtra. After securing possession of the land, the company devised a scheme for raising finances by incorporation of article 4A in its articles of association. Under the scheme, the shareholders were to enter into a standard form of agreement with the assessee which conferred on them the right of occupation of specified floor space. In consideration of the agreements, the members who purchased the shares were also required to make a deposit on which the company agreed to pay interest to the shareholders. Accordingly, those members who purchased the shares and made the deposits were allotted specified floor area in the building on a proportionate basis. The assessing officer found the deposits to be non-refundable deposits. The assessing officer found that the interest payable on Such deposits was to be fixed by the company and not by the depositors. Hence, he contended on above facts that the deposit was the absolute property of the company and the provisions for payment of interest was only a devise for showing the amount received in the course of trade as deposit. The appellate authority agreed with the assessing officer and came to the conclusion that notwithstanding the nomenclature of deposit and the apparent grant of interest the so-called deposit partook of the character of the trading receipt. The Tribunal also agreed with the view of the department. Accordingly, the matter came by way of reference to This Court. Considering the transaction in its entirety this court agreed with the view of the Tribunal that the above transaction was a business transaction and the deposits received by the builder, therefore, ought to be treated as revenue receipts in the hands of the assessee. This was in view of the following facts, namely, that the deposits were to be held by the assessee-company as long as the member continued to occupy the floor area allotted to him and in the event of the member transferring his occupancy right to another with the approval of the board of directors the amount standing to the credit of the member was to be transferred in the books to the credit of the new transferee. The court found that there was no contingency or event

contemplated in which the shareholder could demand repayment of the deposit. Therefore, this court concluded that even if the amount is shown as liability in the balance sheet of the company, it did not partake of the character of a loan. Mr. Inamdar, however, submitted that in the above case, the court found that in consideration of the agreements the members who made the requisite deposits were allotted a specified floor area in the building and, therefore, he contended that it was a business transaction and the amount received by the builders constituted trading receipts. He, therefore, contended that the said judgment did not apply to the facts of this case. We do not find any merit in the said contention. This judgment lays down that if a deposit in question partook of the character of trading receipt, then merely because interest is paid to the deposit holder will not change the nature and the character/quality of the receipt. In the present case also, under the byelaw the rate of deposit was fixed by the society and not by the canegrower. In the present case also, under the bye-law no event or contingency has been contemplated under which the shareholder could demand repayment of the deposit. Hence, merely because the Karkhana has agreed to pay interest will not be a conclusive test to come to the conclusion that a liability has accrued to the society on deduction. Accordingly, we hold that the said deductions, ie., deposits mentioned in clause (A) above constitute trading receipts. To the above extent, we hold that the Tribunal erred in holding that the said deductions did not constitute trading receipts. (B) Deductions from the cane-price in respect of Area Development Fund, Hutment Fund, Cane Development Fund - It is contended on behalf of Karkhana that funds under above heads are collected by way of deductions to enable the sugar Karkhana to spend within their area of operation expenditure on amenities such as, running of schools, colleges, maintenance of roads, irrigation, supply of fertilizers and to provide huts to homeless families. It is urged that the assessee acts as an agent on behalf of the Government. It is contended that the above deductions are made pursuant to the instructions given by the Government. These contentions were rejected by the assessing officer on the ground that they stood on the same footing as non-refundable deposits and since these deductions were also made in the course of trading operations and since they were used for meeting the assessee's own liabilities, they constituted trading receipt. On the other hand, it has been urged on behalf of Karkhana that under the various directions issued by State Government from time to time, the Karkhana was required to make the above deductions. A trading receipt means assessee's own money which can be put to any use. In our view as regards the deposits towards Area Development, Cane Development and Hutment Fund are concerned, the principle of diversion of income by overriding title would squarely apply. The various directions given by the State Government show that the Karkhana is required to deduct from the cane-price the above amounts towards the said funds. It is a clear case of diversion of income at source by overriding title. As stated above, in every matter, the court has to examine the nature and the quality of the receipt. As stated hereinabove, the court has to see the facts of each case. There is a difference between an amount which a person is obliged to apply out of his income and an amount which by the nature of the obligation cannot be

said to be a part of the income of the assessee. Where, by obligation, income is diverted before it reaches the assessee, it is deductible; but where the income is required to be applied to discharge an obligation which is self-imposed, after such income reaches the assessee, then, such income is taxable. Diversion of income by overriding title can be created by a contract between two parties before the income reaches the hands of the assessee. These are the basic principles which are required to be kept in mind, In the case of CIT v. Madras Race Club (1996) 219 ITR 39 (Mad.), the assessee was a company carrying on the business of horse racing. At the instance of the Government, the assessee was asked to conduct races for two days on behalf of Chief Minister's Relief Fund and for one day on behalf of Beggars' Rehabilitation Fund. The assessee claimed that the net collections for the above three days were not assessable as income in its hands as the assessee had no power to deal with the said collections. The department did not accept the claim of the assessee. The matter came by way of reference to the High Court which took the view that obligations are there in every case but it is the nature of the obligation which is the decisive fact. Where by, the obligation, income is diverted before it reaches the assessee, it is deductible but where the income is required to be applied to discharge an obligation, after such income reaches the assessee, then, it is taxable. On facts, looking to the nature of the obligations, the Madras High Court came to the conclusion that the collections for charitable purpose effected during three days under instructions of the Government were not taxable as it was a case of diversion of income by overriding title. Therefore, the real question in all the above matters is: whether the income has accrued to the assessee and whether the profits on the scheme form the income of the assessee. Applying the above test to the facts of this case, we hold that the deductions, ie., deposits made by the Karkhana on account of Area Development Fund, Cane Development Fund and Hutment Fund do not constitute trading receipt. We are of the view that as regards these funds the Karkhana acted as an agent and collections were made as per the directions of the Government to be spent on the purposes specified by the State Government and that the collections were made by way of retention of money from the cane-price payable and, hence, they are not trading receipts. To that extent, we agree with the view of the Tribunal. However, the department has heavily relied upon the judgment of the Madhya Pradesh High Court in the case of Jiwajirao Sugar Co. Ltd. v. CIT (1989) 176 ITR 182 /(1988) 40 Taxman 434, in which it has been held on facts that there was no diversion of income by overriding title when part of price of molasses is set apart under the Molasses Control order to be utilised for erection of storage facilities, particularly as the assessee did not loose title to the fund. As stated by us earlier, the basic test to be applied in such cases is the nature of the obligations. No one particular test could be said to be conclusive in such cases. In that matter, on facts, the Madhya Pradesh High Court found that there was no material on record to show that the title to the fund was separately kept by the assessee as enjoined by the Control Order. Further, the above judgment of the Madhya Pradesh High Court has been expressly dissented from by this court in the case of Somaiya Orgeno-Chemicals Ltd. v. CIT (1995) 216 ITR 291/(1994) 74

Taxman 206, in which this court has laid down that what was necessary was to see whether there was diversion at source and whether the assessee had lost domain and control over the amount so diverted. Hence, the judgment of the Madhya Pradesh High Court was expressly dissented from by this court in Somaiya Orgeno Chemicals Ltd.'s case (supra). In the present case, the test laid down by this court in Somalia Orgeno Chemicals Ltd.'s case (supra) is applicable with regard to Cane Development Fund, Area Development Fund and Hutment Fund as there is diversion of income at source and on deduction of the amount towards the said funds. The assessee lost domain and control over the amounts so diverted. (C) Late Shri Y.B. Chavan Memorial Fund, Chief Minister's Relief Fund and Education Fund - For reasons given hereinabove while dealing with question of deductions, ie., deposits on account of Area Development Fund, Cane Development Fund and Hutment Fund, we hold that all deductions made from the cane price on account of Chief Minister's Relief Fund, late Shri Y.B. Chavan Memorial Fund and Education Fund cannotconstitulc trading receipt of the Karkhana. The items falling under these heads also amount to diversion of income by overriding title. The judgment of the Madras High Court in the case of Madras Race Club (supra) is squarely applicable. Hence, we are of the view that the Karkhana acted as an agent on behalf of the Government/Authorities and the said deductions, therefore, did not constitute the part of the income of the Karkhana. These collections never reached the hands of the Karkhana as income. This is in view of the facts of this case and the bye-laws of the Karkhana. (D) Small Saving Scheme Certificate - In the assessment order dated 27-3-1989, for the assessment year 1986-87, the department has concluded that Small Saving Scheme Certificates are not trading receipts of the Karkhana. That they are purchased in the names of the members and are handed over to the members for personal benefits. In the light of the above discussion, we also hold that Small Saving Scheme Certificate does not constitute trading receipts. 9. Accordingly, we answer the following questions referred to us in the above reference/ appeals : 9. Accordingly, we answer the following questions referred to us in the above reference/ appeals : Question No. 1 in the reference - In the affirmative. Question No. 2 in the reference - In the affirmative excluding the bracketed portion. Question No. 3 in the reference - In the negative. Question No. 4 in the reference - In the negative. Question No. 5 in the reference - In the negative. Question No. 6 in the reference - In the negative. Question No. 7 in the reference - In the negative. Question No. 8 in the reference - In the negative. Question No. 9 in the reference - In the negative. Question No. 10 of the reference as recasted by us. - In the negative. Question No. 11 in the reference - In the negative. Question No. 12 in the reference - Answered hereinbelow: One of the arguments advanced on behalf of the department on facts was that loans did not exist and that the share capital of the Government was insignificant. On examination of the balance sheet, the Tribunal was right in rejecting the contention of the department. However, answer to this question has no relevance to the points which arise for determination in the above references/appeals. Question No. 13 in the reference - In the negative. Question No. 14 in the reference - In the affirmative. Question No. 15 in the reference - In

the affirmative. 10. The question referred to us in Income-tax Appeal No. 208 of 1999 and others and the answer given is as follows: 10. The question referred to us in Income-tax Appeal No. 208 of 1999 and others and the answer given is as follows: Question : Whether, on the facts and in the circumstances of the case, the Tribunal was right in deleting the following additions by holding that various funds/deposits collected by the assessee out of the cane-price are not trading receipts ? Answer: As stated above, the non-refundable and refundable deposits are trading receipts whereas deposits on account of Education Fund, Area Development Fund, Hutment Fund, late Y.B. Chavan Memorial Fund, the Chief Minister's Relief Fund, Cane Development Fund and Small Saving Scheme Certificate are not trading receipts. 11. Before concluding we may once again mention that before the Tribunal it was contended on behalf of the department that the deposit fund was Rs. 5 crores while the Karkhana's own capital was much less and, therefore, the deposits were collected for business. To this extent, we have examined the balance sheet. The Tribunal has right in rejecting the said contention on facts. However, in the present references and appeals under section 260A, we are only concerned with substantial question of law. Moreover, we are not concerned with the manner in which the accounts are maintained by the assessee. Suffice it to say that on examination of the balance sheet, we do riot find merit in the contentions advanced by the department on this point and, accordingly, we have answered question No. 12 as mentioned hereinabove. 11. Before concluding we may once again mention that before the Tribunal it was contended on behalf of the department that the deposit fund was Rs. 5 crores while the Karkhana's own capital was much less and, therefore, the deposits were collected for business. To this extent, we have examined the balance sheet. The Tribunal has right in rejecting the said contention on facts. However, in the present references and appeals under section 260A, we are only concerned with substantial question of law. Moreover, we are not concerned with the manner in which the accounts are maintained by the assessee. Suffice it to say that on examination of the balance sheet, we do riot find merit in the contentions advanced by the department on this point and, accordingly, we have answered question No. 12 as mentioned hereinabove. 12. Accordingly, the above references and appeals stand disposed of with no order as to costs. 12. Accordingly, the above references and appeals stand disposed of with no order as to costs.