Universal Plast Limited Etc vs Commissioner Of Income Tax, Calcutta on 23 March, 1999

Equivalent citations: AIR 1999 SUPREME COURT 1641, 1999 (5) SCC 189, 1999 AIR SCW 1255, 1999 TAX. L. R. 480, 1999 (2) SCALE 243, 1999 (3) ADSC 182, 1999 (4) SRJ 385, (1999) 103 TAXMAN 493, (1999) 2 JT 377 (SC), (1999) 237 ITR 454, (1999) 149 TAXATION 645, (1999) 3 SUPREME 257, (1999) 153 CURTAXREP 95, (1999) 2 SCALE 243

Bench: Syed Shah Mohammed Quadri, S.P.Bharucha

PETITIONER:
UNIVERSAL PLAST LIMITED ETC.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME TAX, CALCUTTA

DATE OF JUDGMENT: 23/03/1999

BENCH:
Syed Shah Mohammed Quadri, S.P.Bharucha

JUDGMENT:

QUADRI,J.

Civil Appeal No.207 of 1995 is filed by the assessee - Universal Plast Limited - from the judgment and order of a Division Bench of the Calcutta High Court in Income Tax Reference No. 17 of 1991 under Section 256(2) of the Income Tax Act, 1961 [for short, `the Act'] passed on February 6, 1992 [hereinafter referred to as `UPL Case']. Civil Appeals Nos._____ of 1999 @ Special Leave Petition c Nos. 10912-14 and 10984 of 1986, in which leave is granted, are preferred by the assessee - The Guntur Merchants Cotton Press Company Limited, Guntur - aggrieved by the judgment and order of a Division Bench of the Andhra Pradesh High Court in Case Referred No.22 of 1979, under Section 256(1) of the Act dated August 9, 1984 [hereinafter referred to as `Guntur Merchants' case']. The points for consideration in these appeals are similar. In UPL case, the question of law referred to the Calcutta High Court, at the instance of the revenue, reads : "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law that the income received by the assessee by leasing out the factory was business income?"

> The following is one of the questions of law referred to the Andhra Pradesh High Court, at the instance of the assessee in Guntur Merchants' case : "Whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the letting of Godowns at Guntur and Narsaraopet and the letting of the factory with machinery at Narsaraopet and at Guntur did not constitute business of the assessee?"

Both the Calcutta High Court as well as the Andhra Pradesh High Court answered the said questions in the negative, in favour of the Revenue and against the assessee. The assessees are thus in appeal before us. To resolve the controversy in these cases, we refer to the facts in the UPL case. The appellant-assessee set up a factory styled as "UPL Factory" for carrying on the business of manufacturing PVC sheets and allied products. It appears that from the venture the assessee suffered losses for two years. It then entered into an agreement styled as `leave and licence' agreement with M/s. Leatherite Industries Limited [hereinafter referred to as `the licensee'] for a period of 7 years on March 13, 1977. The agreement contains renewal clause giving option to the licensee to renew it for a further period of three years. The licensee was to pay licence fee of Rupees twenty four lakhs and twenty per cent of the net profit of the factory in question with effect from April 1, 1977. For the first three months which fell in the accounting year relevant to the assessment year 1977-78, the assessee received only licence fee of Rupees six lakhs as no profit was earned by the licensee during the said period. That amount was shown by the assessee as part of the business income. The Income Tax Officer did not accept that it was business income and assessed the same as income from other sources. However, the Commissioner of Income Tax (Appeal) accepted the plea of the appellant-assessee that it was its business income and allowed the appeal on April 27, 1985. The Revenue unsuccessfully appealed against the order of the Appellate Authority before the Income Tax Appellate Tribunal. On an application filed by the Revenue under Section 256(2) of the Act, the High Court directed the Tribunal to draw up statement of case and refer the aforementioned question to it. On February 6, 1992 the High Court answered the question in the negative, in favour of the Revenue and against the assessee, as noted above. Mr. M.L.Verma, learned senior counsel appearing for the assessee, has contended that under the `leave and licence' agreement, the assessee exploited the business assets; the intention in receiving a share in the profit of the business as part of the consideration and in ensuring that the amounts due by the Company to the creditors are paid regularly was to keep the business running so that it might continue the business after the expiry of the lease period. He invited our attention to various clauses of the Agreement and pointed out that the High Court has not considered Clauses 15 and 16 which unmistakably point out that the Agreement was only a temporary measure and the intention of the assessee was to go back to the factory. Therefore, submitted the learned counsel, the High Court had erred in not treating the amount in question as business income. Mr. K.N. Shukla, learned senior counsel for the Revenue, supported the judgments under appeal in these cases. The question whether the amount earned by an assessee by leasing out the assets of the business would be an income from business carried on by it, has been the subject matter of consideration by this Court as well as by various High Courts and it would be useful to refer to the judgments of this Court bearing on the issue. In Commissioner of Excess Profits Tax, Bombay City Vs. Shri Lakshmi Silk Mills Limited [1951(20) I.T.R. 451], the assessee-company was carrying on the business of manufacturing silk cloth and dyeing silk yarn. Due to lack of supply of silk yarn during the relevant period while keeping idle other plant and

machinery, it let out dyeing plant for five months. The question which came up for consideration before this Court was whether the rent received from letting out the dyeing plant would fall under the head "Income from business" or "income from other sources". If it was "Income from business", it would have been chargeable to excess profits tax; if not, the liability would not arise. Mahajan,J., speaking for the Court, observed that no general principle could be laid down which was applicable to all cases and each case had to be decided on its own circumstances. It was held that it was part of the normal activities of the assessee's business to earn money by making use of its machinery by either employing it in its own manufacturing concern or temporarily letting it to others for making profit for that business when for the time being it could not itself run it and for that reason the dyeing plant had not ceased to be a commercial asset of the assessee, so the sum representing the rent for five months received from the lessee by the assessee was income from business and was chargeable to excess profits tax. In Narain Swadeshi Weaving Mills Vs. Commissioner of Excess Profits Tax [1954 (26) I.T.R. 765], a Constitution Bench of this Court considered a similar question which also arose under the Excess Profits Tax Act, 1940. In that case, the assessee-firm was carrying on manufacturing business. A Public Limited Company was incorporated to take over the business from the assessee-firm. The company purchased the building of the assessee-firm and took over from it the plant and machinery on lease at an annual rent. One of the questions that fell for consideration there was whether the lease money obtained by the assessee from the company could be legally treated as business profit liable to excess profits tax. Distinguishing Shri Lakshmi Silk Mills case (supra), it was pointed out that only a part of the business of the assessee therein, namely dyeing silk yarn, was temporarily stopped owing to difficulty in obtaining silk yarn on account of war so that part of the assets did not cease to be commercial asset of that business and accordingly, the income from the assets would be the profit of the business irrespective of the manner in which that asset was exploited by the company. Noticing the facts in the case before the Court that the assessee had already sold land and building to the Company; it was not having any manufacturing, trading or commercial activity; and let out the plant and machinery on an annual rent of Rupees forty thousand and applying the common sense principle to the facts, this Court found that the transaction of lease was quite apart from the ordinary business activity of the company, so it was impossible to hold that the letting out of the plant and machinery etc. was at all a business operation when its normal business activity had come to a close. In Commissioner of Income Tax, West Bengal Vs. Calcutta National Bank Limited [1959 (37) I.T.R. 171], the case arose under the Excess Profits Tax Act. The assessee was a banking company. It owned a six-storeyed building of which only a part was under its occupation and the rest was let out to tenants. The question was whether the rent received from the tenants of the building was the business income of the company. The majority opinion was that realisation of rental income of the assessee was in the course of its business being in prosecution of one of its objects in its memorandum and was liable to be included in its business profits and was assessable to excess profits tax. That conclusion was reached on the premise that the term `business' as defined in that Act was wider than the definition of that term under the Income Tax Act. The minority, however, took a contrary view. In Sultan Brothers Private Ltd. vs. Commissioner of Income Tax, Bombay City-II [1964 (51 I.T.R.353)], the assessee constructed a building, fitted it up with furniture and fixtures and let it out on lease fully equipped and furnished for the purpose of running a hotel. The lease amount provided separately for running of the building and hire charges for furniture and fixtures. The question that fell for consideration was whether the rent income was business income taxable under the Income Tax Act, 1922? It was held that as the

assessee never carried on any business of a hotel in the premises let out or otherwise at all and there was nothing to show that it intended to carry on a hotel business itself in the same building, the letting of the building did not amount to the carrying on of a business, so the income under the lease could not be assessed as income from business. The Constitution Bench formulated the principle thus : "Whether a particular letting is business, has to be decided in the circumstances of each case. Each case has to be looked at from the businessman's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner..".

In New Sevan Sugar and Gur Refining Co.Ltd. vs. Commissioner of Income Tax, Calcutta [1969 (74) I.T.R.7], the appellant-company was carrying on business of crushing sugarcane and gur refining. The building, machinery and plant of the factory mill were leased out initially for a period of five years with three options to renew for similar periods on the part of the lessee. The assessee had, however, the option to terminate the lease after first two years which option was not exercised. The question was whether the income which arose to the assessee for the Assessment Year 1955-56 from the lease was assessable as income from business or income from other sources? It was held, on interpretation of the terms of the lease deed, that the intention of the appellant-assessee was to part with the machinery of the factory and the premises with the obvious purpose of earning rental income and not to treat the factory and the machinery as commercial asset during the subsistence of the lease; the intention of the appellant was found to go out of business altogether, therefore the income was not assessable as business income. Commissioner of Income Tax, Lucknow vs. Vikram Cotton Mills Ltd. [1988 (169) I.T.R.597] is again a case arising under the Income Tax Act, 1922. One of the creditors filed a petition in the High Court for winding up. The Industrial Financial Corporation took possession of fixed assets under an English mortgage of those assets. The assessee company had gone into losses and had stopped its manufacturing activity. Under the scheme evolved by the High Court under the Companies Act, the business assets were let out for ten years with an option for renewal for another ten years. The management of the company was transferred to a Board of Trustees approved by the High Court. The question which fell for determination was whether the rental income was assessable in the relevant assessment years as business income? The findings of the Tribunal were that on account of financial crisis, the company found it advantageous to let out the machinery on hire for a temporary period and the company was able to liquidate its liability at the end of the lease period and regained possession of its assets; the company did not sell or otherwise dispose of its assets; there was nothing on record to show that the company was formed to let out plant and machinery on hire. The Tribunal came to the conclusion that the maintenance of the assets meant that the Company had an intention to re-start the business and that the intention of the Company in letting out its assets was to exploit the commercial assets for the purpose of its business and therefore the rental income was assessable as business income. On reference, that conclusion was upheld by the High Court. On appeal to this Court, while affirming the decision of the High Court, it was noted that all relevant facts were correctly considered from the standpoint of an ordinary prudent businessman by the Tribunal and it was also pointed out that the stoppage of the business by the company was a temporary suspension of business for a temporary period with the object of tiding over the crisis condition and there was never any act indicating that the company intended to carry on the business in future. In the light of the above discussion, the propositions may be summarised as follows: (1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, lease amount, rents licence fee) received by an assessee from

leasing or letting out of assets would fall under the head `Profits and Gains of business or profession'; (2) it is a mixed question of law and fact and has to be determined from the point of view of a businessman in that business on the facts and in the circumstances of each case including true interpretation of the agreement under which the assets are let out; (3) where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business altogether or to come back and restart the same. (4) if only or a few of the business assets are let out temporarily while the assessee is carrying out his other business activities then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets. Now adverting to the facts of UPL case, the High Court referred to the findings of the Tribunal that the leasing out of the factory was not a sequel to the assesee's decision to go out of the business in respect of the subject factory and that it was just a make-shift transient alternative means of commercial exploitation of the commercial assets, so income from such letting could not be treated as the fruits of ownership simplicitor of the asset. The High Court also referred to various clauses in the Agreement, particularly Clauses 1,2, 4,7,19,20,21 and 22 and concluded that "licensee exercising its vested right of option to purchase the licenced premises, the assessee stands completely out in the cold". The High Court recorded the following findings :

> "Therefore, it can very well be presumed that at the time the licence agreement was entered into, the intention of the ultimate outright sell out was already there. The assessee was already committed to the licensee for such a sell-out at licensee's pleasure and there is no means of the assessee falling back from that commitment. Therefore, it can very reasonably be inferred that the assessee in the case decided to go out of business as far as this particular factory was concerned..
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> The lease agreement is in fact a veiled agreement for lease-cum-sale....We are of the opinion that the licensing is not meant to be a temporary stop gap exploitation of commercial assets. It could not be in the contemplation of the assessee at the time it entered into the licence agreement, to retain the assets any more as a commercial asset."

It was contended by Mr. Verma that the High Court did not consider Clauses 2(ii)c, 3(v), 4, 7 15 and 16 of the Agreement. The clauses read thus: "2(ii)c. The 25% of the net profit, if any, within 60 days of the accounts of licensee being adopted and passed by the Shareholders.

3. The licensee hereby agrees and covenants: (v) to permit the licensor on reasonable previous notice in writing to enter the UPL factory premises and inspect the premises, plants, machinery etc. with or without their agent, inspector, engineer and other personnel and provide all necessary facilities to them;

4. The Licensee shall use the said UPL factory for the purpose of business of manufacturing; provided always that the Licensor shall not in any way be responsible for any debt or responsibility

incurred by the Licensee during the subsistence of this Agreement including that in respect of expenses, such as working expenses, rates and taxes in respect of property, except of capital nature insurance premia, interest on all advances, depreciation on newly acquired assets, bonus and gratuity to employees nor for any liability in respect of Sales Tax or tax on incomes, profits and gains made by the Licensee so far as they relate to the Licensee's part of the income from the UPL factory and the Licensee hereby indemnified the Licensor against all such debts, liabilities, costs, charges and expenses in respect thereof.

7.The Licensee shall be liable for payment of retrenchment/retirement compensation, if any, to the workmen in case such workmen are retrenched or retired by the Licensee. However, the Licensor shall be liable for payment of retrenchment/retirement compensation, if any, in case of workmen retrenched or retired after the termination of the licence.

PROVIDED, however, that on the termination of the licence, the Licensee shall be liable for any retrenchment compensation payable to workmen on account of removal by them of any plant and machinery acquired and installed by the Licensee.

15.In the event of the Licensee committing a breach of any of the terms of this Agreement or making default in payment as provided in clause 2(ii) of any two quarterly instalments, the Licensor shall be entitled to terminate this agreement upon the expiry of the period of one month from the service of notice in writing by the Licensor to the Licensee to remove the breach or to make payment, as the case may be, if the Licensee fail to remove the breach or to make payment, as the case may be, within the said period.

16. If the Licensee pass a resolution for winding up or are ordered to be wound up (except for the purpose of amalgamation or reconstruction) or if the Licensee shall do or cause to be done or permit or suffer any act or thing whereby the Licensor's right in the UPL factory and in the building, plant, machinery and equipment therein may be prejudiced or put in jeopardy, the Licensor may without any notice determine this Agreement and the licence and it shall thereupon be lawful for the Licensor to enter upon and retake possession of the UPL factory.

From a plain reading of the clauses noted above, what is clear is that they deal with a situation arising out of the breach of the terms of the Agreement entitling the Licensor to terminate the Agreement on the expiry of the period of one month from the service of the notice to the Licensee. Clause 16 deals with a situation of the Licensee being wound up in which situation the Licensor reserved his right to determine the Agreement and retake the possession of the factory. These clauses do not whittle down the conclusion arrived at by the High Court with reference to the rights of the assessee-lessor coming to an end on the exercise of option by the lessee under clause 19 of the Agreement. Applying the afore-mentioned tests, we are clear in our mind that the High Court has reached the correct conclusion which does not warrant interference. So far as Guntur Merchants' case is concerned, the Agreement of Lease is not placed on record and there is no challenge that in recording its findings the Tribunal and in answering the question the High Court has ignored any vital clause of the Agreement. The Tribunal recorded the findings as follows :

> "The assessee stopped its business of ginning cotton in 1964 for the sole reason of non- availability of cotton and that it did not start the same even in 1977; there was nothing to show that the non-availability of cotton continued or could continue for such a long period; the godowns of the assessee were let out to a tobacco merchant and the assessee could not be said to be carrying on the business of cotton with godowns so let out; the assessee could be said to have only exercised his right as an owner of the property in the leasing out its properties; the machinery remained idle for a very long period and the assessee had separated the machinery from the godown and let out the pressing factory to a metal pressing factory; the assessee did not continue its business for an unusual long time and give out its godown to different business than the one which the assessee was carrying on; the conduct of the assessee did not support that it was using the godown and machinery as business asset and not as the owner of the property."

On considering these findings, the High Court answered the question referred to it in favour of the Revenue. On the face of these findings, it cannot but be concluded that the assessee had dismantled its business never to return back to it. Applying the aforesaid principles, it has to be held that the answer recorded by the High Court to the question referred to it is correct in law. In the result, we hold that both the High Courts were right in answering the questions referred to them, in favour of the Revenue and against the assessee. These appeals are, therefore, dismissed with costs.