Supreme Court of India
The Fazilka Electric Supply Co. ... vs The Commissioner Of Income-Tax, ... on 1 March, 1962
Equivalent citations: 1963 AIR 464, 1962 SCR Supl. (3) 496
Author: S Das
Bench: Das, S.K.

PETITIONER:
THE FAZILKA ELECTRIC SUPPLY CO. LTD.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME-TAX, DELHI

DATE OF JUDGMENT:
01/03/1962

BENCH:
DAS, S.K.
BENCH:
DAS, S.K.
SHAH, J.C.

CITATION:
1963 AIR 464 1962 SCR Supl. (3) 496
CITATOR INFO :
E 1969 SC 239 (12,13)
R 1990 SC 123 (31)
E 1990 SC 153 (17)

ACT:
Income Tax-- Assessment of Excess amount realiesd over written down value--Electric Supply Company--Term of license--Option for Government or local bodies to purchase the Company--Sale by Company, if sale or compulsory acquisition--India Electricity Act 1910(IX of 1910), ss. 3.7 Indian Income Tax Act 1922 (11 of 1922), s. 10(2) (vii).

HEADNOTE:
The appellant carried on the business of generating and supplying electricity in the town of Fazilka in accordance with the terms of a license for fifteen years. Clause 9(a) of the license gave the Government an option to acquire the undertaking on expiration of fifteen years from the date of the license. The said option was in accordance to sub. s. (1) of s. 7 of the Electricity Act, 1910. The Government of Punjab exercised its option and acquired the undertaking on a payment which was in excess of the written down value of the building, machinery and plant of the undertaking. For the assessment of the appellant for the relevant year, the

Income-Tax Officer computed such excess realisation over the written down value as did not exceed the difference between the original cost and the written down value and held the said sum as taxable in the hands of the appellant by reason of the provisions in s. 10(2) (vii) of the Income Tax Act .

The appellant contended that no part of the excess was taxable since the undertaking had not been voluntarily sold, but had been compulsorily acquired by the Government ; and on a proper construction of the Electricity Act and the rules made thereunder, this so-called sale was really a compulsory acquisition of property and not a sale as legally understood.

Held, that from the provisions of the Electricity Act, 1910, read alongwith the rules made thereunder, it is manifest that the condition as to the option of purchase either by the local authority or Government. is the result of an agreement between the applicant who had applied for license and the Government who granted the license.

The true scope and effect of s. 7 of the Electricity Act is that it is an enabling section and merely provides for the option of purchase to be exercised on the expiration of a certain period agreed to between the parties, and s. 10 of the Act

497

further provides that in an appropriate case Government may even forego the option. The scheme of the Electricity Act as indicated by the relevant provisions thereof and the rules made thereunder, shows beyond any doubt that the option of purchase is the result of a mutual agreement between the parties, the applicant for the license on one hand and the Government on the other.

Held, further, that s. 7 does not provide for a compulsory purchase or compulsory acquisition without reference to and independent of any agreement by the licensee. The expression "compulsory purchase" in the second proviso to sub-s. (1) of s. 7 is another enabling provision which enables a part to specify in the license such percentage as should be added to the value of the building, plant and machinery etc. when the option is exercised, notwithstanding the use of the expression "compulsory purchase" in the said second proviso, there is no compulsory purchase or compulsory acquisition in the sense in which that expression is ordinarily understood.

Sakataguna Nayudu v. Chinna Mununami Na (1928) L. R. 55 I.A. 243, Calcutta Electric Supply Corporation v. Commissioner of Income-tax, West Bengal, (1951) 19 I.T.R. 406.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 183 of 1961. Appeal from the judgment and order dated, April 24, 1959. of the Punjab High Court in I.T.R. No. 18 of 1954. S. K. Kapur,

Bishambar Das and K.K. Jain, for the appellant.

K. N. Rajagopal Sastri and D. Gupta, for the respondent. 1962, March 1. The Judgment of the Court was delivered by S. K. DAS, J.-On July 23, 1934. the then Government of the Punjab granted a license under s. 3 of Indian Electricity Act, 1910 (IX of 1910) (hereinafter called the Electricity Act) to two persons named Harbhagwan Nanda and Harcharan Dass for the generation and supply of electric energy in the town of Fazilka. The licence, which is marked annexure ,A' and forms part of the statement of the case, contained a clause, viz. el. 9(1) of which read as follows :

> "9. (1) The option, of purchase given by sub- section (1) of section 7 of the (Electricity) Act shall first be exercisable on the expiration of 15 years from the date of the notification of this licence and on the expiration of every subsequent period of 10 years. The percentage of the value to be determined in accordance with and for the purpose of sub-section (1) of section 7 of the (Electricity) Act of lands, buildings, works, materials and plant of the licensee therein mentioned to be added under the second proviso of that sub-section to such value on account of compulsory purchase shall be 20 percent."

Under this clause, read with a. 7 of Electricity Act, the Government bad an option of purchasing the undertaking on the expiration of 15 years from the date of the license and on the expiration of every subsequent period of ten years. In 1935, about a year after the grant of the license, a public limited company under the name and style of the Fazilka Electric Supply Co. Ltd.. which is the appellant herein, was incorporated, and it acquired the rights and privileges of the license known as the Fazilka Electric License, 1934. The appellant carried on the business of generating and supplying electricity in the town of Fazilka in accordance with the terms of the license for 15 years. On the expiration of 15 years from the date of license, the Government of the Punjab exercised its option and acquired the undertaking on July 23, 1949 on a total payment of Rs. 374,000/-, which was in excess of the written down value of the building machinery and plant of the undertaking. In connection with the assessment of the appellant for the year 1950-51, the Income-tax Officer computed such excess realisation over the written down value as did not exceed the difference between the original cost and the written down value, at Rs. 77,700/- and held that this sum of Rs. 77,700/- was taxable in the hands of the appellant by reason of the provisions in s. 10(2)(vii) of the Indian Income-tax Act, 1922. The appellant contended that no part of the excess over the written down value, was taxable since the undertaking had not been voluntarily sold, but had been compulsorily acquired by the Government ; therefore, the transaction was. not a sale within the meaning of the provisions in s. 10 (2)

(vii) of the Income-tax Act.

Both the Income-tax Officer and the Appellate Assistant Commissioner repelled this contention of the appellant. On an appeal to the Income-tax Appellate Tribunal, the Tribunal also held against the appellant and came to the conclusion that there was a sale of the building machinery and plant of the undertaking within the meaning of s. 10(2)(vii) of the Income-tax Act. The appellant then moved the Tribunal for a reference of the following question of law which it said arose out of the Tribunal's

order ;

> "Whether on the facts and in the circumstances of this case, and on a true interpretation of section 7(1) of the Indian Electricity Act and clause 9 of the Fazilka Electric License, 1934, the transaction, by which the Government acquired the undertaking, could be regarded as a sale within the meaning of section 10(2)
>
> (vii) of the Income-tax Act ?"

The Tribunal referred the question to the High Court. The High Court answered the question against the appellant. The appellant then asked for a certificate under s. 66A(2) of the Income-tax Act and having obtained such a certificate, has preferred the present appeal to this Court.

Section 10(1) of the Income-tax Act states that Income-tax shall be payable by an assessee under the head "Profits and gains of business, profession or vocation" in respect of the profit or gains of any business, profession or vocation carried on by the assessee. Sub-section (2) of the said section states that such profits or gains shall be computed after making certain allowances referred to in cls. (i) to

(xv). Clause (vii) relates to an allowance in respect of any building, machinery or plant which has been sold or discarded or demolished or destroyed, the allowance being the amount by which the written down value thereof exceeds the amount for which the building, machinery or plant, as the case may be, is actually sold or its scrap value ; the second proviso to the clause states that where the amount for which any such building, machinery or plant is sold, whether during the continuance of the business or after the cessation thereof, exceeds the written down value, so much of the excess as does not exceed the difference between the original cost and the written down value shall be deemed to be profits of the previous year in which the sale took place. It is not disputed before us that if what took place on July, 23, 1949 in exercise of the option given to the Government under cl. 9 of the license read with s. 7 and other provisions of the Electricity Act, was a sale within the meaning of clause (vii), then the amount which the Income-tax, Officer determined to be Rs. 77,700/- would be taxable in the hands of the appellant as profits within the meaning of the said clause. Therefore, the answer to the question which was referred to the High Court depends on whether there was a sale of the building, machinery and plant of the undertaking in question.

The learned Advocate for the appellant has contented before us that the High Court was in error in holding that there was a sale of the building, machinery and plant of the appellants undertaking. He has submitted that a sale involves mutual agreement and a contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price. He has argued that on a proper construction of the provisions of the Electricity Act and the rules made thereunder, the so-called sale in the present case was really a compulsory acquisition of property and not a sale as legally understood ; therefore, s. 10(2) (vii) of the Income-tax Act was not attracted to the transaction in question and the excess over the written down value could not be deemed to be profits in the hands of the appellant.

It is necessary to read here some of the provisions of the Electricity Act and rules made thereunder. Section 3 of the Electricity Act states in effect that the State Government may, on application made in the prescribed form and on payment of the prescribed fee, grant to. any person a license to supply (electric) energy in any specified area. Sub-section (2) of s. 3 states that in respect of every such license and the grant thereof certain provisions shall have effect : one of these provisions is that any person applying for a license shall publish a notice of his application in the prescribed manner and with the prescribed particulars and no license shall be granted until all objections received by the State Government with reference thereto have been considered by it ; another provision is that the provisions contained in the Schedule to to the Electricity Act shall be deemed to be incorporated with and to form part of every license granted save in so far as they are expressly added to, varied or exempted by the license. Sections 5 and 7 deal with the purchase of the undertaking in certain circumstances and a. 10 empowers the State Government to vary the terms of purchase. Notwithstanding ss. 5, 7 and 8, the State Government may, in any license to be granted under the Electricity Act, vary the terms and conditions upon which, and the periods on the expiration of which, the licensee shall be bound to sell his undertaking, or direct that subject to such conditions and restrictions, if any, as it may think fit to impose, the provisions of the said sections or any of them shall not apply. Now, we may read s. 7 so far as it is relevant for our purpose.

> " 7. (1) Where a license has been granted to any person not being a local authority, and the whole of the area of supply is included in the area for which a single local authority is constituted, the local authority shall, on the expiration of such period, not exceeding fifty years, and of every such subsequent period not exceeding twenty years, as shall be specifie d in this behalf in the license, have the option of purchasing the undertaking, and if the local authority, with the previous sanction of the State Government, elects to purchase, the licensee shall sell the undertaking to the local authority on payment of the value of all lands, buildings, works, materials and plant of the licensee suitable to, and used by him for, the purposes of the undertaking, other than a generating station declared by the license not to form part of the undertaking for the purpose of purchase, such value to be, in case of difference of dispute, determined by arbitration :

Provided that the value of such lands, buildings, works, materials and plant shall be deemed to be their fair market- value at the time of purchase, due regard being had to the nature and condition for the time being of such lands, buildings, works, materials and plant, and to the state of repair thereof, and to the circumstance that they are in such a position as to be ready for immediate working and to the suitability of the same for the purposes of the undertaking :

Provided also that there shall be added to such value as aforesaid such percentage, if any, not exceeding twenty per centum on that value as may be specified in the license, on account of compulsory purchase.

(2) Where-

(a) the local authority does. not elect to purchase under subsection (1), or

(b) the whole of the area of supply is not included in the area for which a single local authority is constituted ; or

(c) a license supplies energy from the same generating station to two or more areas of supply, each controlled by its own local authority, and has been granted a license in respect of each area of supply, the State Government shall have the like option upon the like terms and conditions.

(3) x x x
(4) x x x
(5) x x x

The section gives to the local authority and if the local authority does not elect to purchase, to the State Government, an option to purchase the undertaking. If neither is willing to exercise the option on the expiry of period@ referred to therein then the license may be revoked on an application or by consent of the licensee. In that case s. 8 lays down that the licensee has the option to dispose of his undertaking to any other person within six months. If the licensee fails to do this, then the Government may remove the works at the cost of the licensee as laid down in s. 5 of the Electricity Act.

We may now turn to the rules in so far as they are relevant to the point under consideration. The rules lay down that every application for a license shall be accompanied by copies of a draft license as proposed by the applicant, and the draft license shall contain, among other particulars, the proposed periods after which the right to purchase is to take effect and a statement of any special terms of purchase or orders proposed to be made under s. 10 and any proposed modification of the Schedule to be made under s. 3, sub- s.(2), el. (f). The applicant shall then publish a notice of his application by public advertisement, and such advertisement shall include inter alia the draft license. Where any person desires to have any amendment made in the draft license, he shall deliver a statement of the same. The rules further provide for a local enquiry if any person locally interested objects to the grant ; if and when Government has approved of a draft license, either in its original form or in a modified form, a duty is cast on Government to inform the applicant of such approval and of the form in which it is proposed to grant the license and if the applicant is willing to accept the license in the form proposed, then Government shall on receipt of an intimation in writing of such acceptance publish the license and notify that it has been granted.

If, therefore, the provisions of the Electricity Act are read along with the rules made thereunder, it becomes manifest that the condition as to the option of purchase, either by the local authority or Government, is the result of an agreement between the applicant who has applied for the license and Government who grants the license. Section 7 of the Electricity Act is merely an enabling provision which allows the parties to specify in the license the periods on the expiration of which the right of option shall be exercised, subject to the maximum ,periods mentioned therein. The true scope and effect of s. 7 is not what the appellant suggests.

It merely provides for an option of purchase to be exercised on the expiration of certain periods agreed to between the parties, and s. 10 further provides that in an appropriate case Government may even forego the option. This section does not provide for a compulsory purchase or compulsory

acquisition without reference to and independent of any agreement by the licensee. Our attention has been drawn to the use of the expression "compulsory purchase" in the second proviso to sub-s. (1) of a. 7 and it has been argued that the use of that expression indicates the intention of the Legislature. The second proviso is another enabling provision which enables the parties to specify in the license such percentage,it any,not exceeding twenty per centum, asshould be added to the value of the building, plant, machinery etc. when the option of purchase is exercised. No doubt, the expression used in the proviso is "compulsory purchase" ; but in substance what it provides for is that the parties may agree to increase the market value of the building, plant etc. by a certain percentage when the option of purchase is exercised and the price has to, be paid. The use of the expression "if any" after the word ,,Percentage" shows that the parties may agree not to increase the market value at all. If the whole scheme of the' Electricity Act and the rules made thereunder, is kept in mind, it becomes obvious that notwithstanding the use of the expression "compulsory purchase" in the second proviso to sub-s. (1) of s. 7, there is no compulsory purchase or compulsory acquisition in the sense in which that expression is ordinarily understood. The High Court has rightly pointed out that the scheme of the Electricity Act as indicated by the relevant provisions thereof and the rules made thereunder, shows beyond any doubt that the option of purchase is the result of a mutual agreement between the parties, the applicant for the license on one hand and Government on the other. The High Court rightly observed :

> " The rules show that a draft license has to be sent by an applicant for license containing definite and specific terms on which the license is sought. This amounts to an offer. The Government accepts it or rejects it. If it modifies it in any way, then the applicant or offerer must accept the modification. If the Government accepts the offer with or without modification, then it grants a license. In my view a license granted by the Government in such circumstances amounts to a contract between the parties."

On behalf of the appellant it hag been contended, somewhat faintly, that all the elements necessary to constitute a contract are, not present here. We are unable to agree. There was an undertaking on the part of the applicant for the license to sell the undertaking to the local authority or Government upon certain terms set out in the license, and the time at which the option was to be exercised and the price which was to be paid for the property were specified. There was consideration for the contract as the license was granted on those terms. Therefore, all elements necessary for a contract were present, and the sale in pursuance thereof was not a compulsory purchaser acquisition. v.Chhinna Munnuswamy Nayakar(1) We are, therefore, of the opinion that the High Court correctly answered the question referred to it. There was a sale in the present case of the building, machinery and plant within the meaning (1) (1928) L. R. 55 I.A. 243.

of cl. (vii) of a. 10(2) of the Income-tax Act.In view of this conclusion it is unnecessary todeal with a somewhat larger question which wascanvassed before us on behalf of the respondentthat s. 10(2)(vii) of the income-tax Act is attracted even to a compulsory sale. Nor do we consider it necessary to examine the decisions bearing upon the question whether a compulsory transfer to and vesting of property in Government, constitute a sale within the meaning of the relevant provisions of the Indian or English Statute. It is sufficient to point out that Calcutta Electric Supply Corporation v. Commissioner of Income-tax, West Bengal (1) related to a transaction by which Government

acquired the plant etc. and it was held that such acquisition could not be regarded is a sale within the meaning of s. 10(2)(vii) of the Income-tax Act.

In the result, the appeal fails and is dismissed with costs. Appeal dismissed.

(1) [1951] 19 I.T.R. 406.