(1986) 07 GUJ CK 0011

In the Gujarat High Court

Case No : IT Reference No. 135 of 1978

Commissioner of Income Tax	APPELLANT
Vs	
Bhavnagar Bone and Fertiliser Co. Ltd.	RESPONDENT

Date of Decision : 22-07-1986

Acts Referred:
Finance (No. 2) Act, 1971 — Section 2, 2(6)(c)
Income Tax Act, 1961 — Section 2(24)(va), 256(1), 260(1), 28(iv)

Citation : (1986) 07 GUJ CK 0011

Hon'ble Judges : S.A. Shah, J;R.C. Mankad, J

Bench : Division Bench

Advocate : S.N. Shelat and G.N. Shah, for the Appellant; K.C. Patel, D.A. Mehta and R.K. Pstel, for the Respondent

Judgement

Mankad, J.—The Tribunal has referred to us for our opinion the following three questions u/s 256(1) of the income tax Act, 1961 (''the Act"): 1. Whether, on the facts and in the circumstances of the case, the income tax Appellate Tribunal was right In law in holding that the assessee was an ''industrial company'' within the meaning of clause (c) of sub-section (6) of section 2 of the Finance (No. 2) Act, 1971 ?

2. Whether, on the facts and in the circumstances of the case, the Income- tax Appellate Tribunal was justified in law in holding that the amount of Rs. 3,82,905 could not be subjected to tax under the provisions of section 28(iv) of the income tax Act, 1961 ?

3. Whether, on the facts and in the circumstances of the case, the income tax Appellate Tribunal was right in law in holding that the amount of Rs. 89,888 which formed part of the total sum of Rs. 3,82,905 and which was written off by the assessee could not be said to be the benefit, reward or bounty arising out of the business ?

We will first take up for consideration, the second question relating to amount of

Rs. 3,82,905. If our answer to this question is in the affirmative, the third question will not survive because that question is in regard to an amount of Rs. 89,888 which forms part of the aforesaid amount of Rs. 3,82,905 and which is alleged to have been written off by the assessee. If it is held that amount of Rs. 3,82,905 could not be subject to tax under the provisions of section 28(iv) of the Act, it is immaterial whether or not Rs. 89,888 could be said to be value of any benefit or perquisite arising from the business of the assessee. 2. Facts relevant to question No. 2 may be briefly stated as under. One Jodhpur Bone & Fertiliser Co. partnership firm (the firm) carried on business at Jodhpur. The partners of the firm are directors of the assessee-company, which is a private limited company. The firm was having a current account with the assessee-company. The firm sold its entire plant, machinery, furniture, etc., to P. Lenier & Sons Ltd., London on 20-3-1950. As a result of the sale, the firm had to wind up its business activities and the only activity which it carried on thereafter was realisation of debts and payments of various expenses. On 31-3-1957, there was a credit balance of Rs. 3,82,905 in the firm''s account in the books of the assessee-company. Initially it was decided to issue shares of the assessee-company to the partners of the firm in lieu of the said credit balance as per the resolution of the board of directors of the assessee-company passed on 21-4-1954. However, the shares were not issued and on 22-6-1970, the board of directors of the assessee-company resolved that the aforesaid credit balance be transferred to the profit and loss appropriation account. Later on the advice of the auditors of the assessee-company by another resolution, the board of directors of the assessee-company resolved that the aforesaid credit balance which was transferred to the profit and loss appropriation account be transferred to capital reserve account. The question which arose before the ITO in the course of the assessment proceedings for the assessment year 1971-72, the year under consideration, was whether the amount of Rs. 3,82,905 which was transferred to capital reserve account was a revenue receipt in the hands of the assessee-company. The contention of the assessee-company was that the amount represented the outstanding credit balance in the current account of the firm and was not a revenue receipt. The ITO, however, rejected the assessee''s contention and held that the amount was income of the assessee- company u/s 28(iv). In the result, the ITO included the amount of Rs. 3,82,905 in the total income of the assessee. In the appeal preferred by the assessee-company before the AAC, the assessee-company reiterated its contention and urged that the provisions of section 28(iv) were not applicable inasmuch as there was no benefit or perquisite arising out of the business and, consequently, addition of the aforesaid amount as business income was not justified. This contention found favour with the AAC who held that there was no business transaction between the firm and the assessee-company and, therefore, the aforesaid amount could not be treated as a revenue receipt. In the result, the AAC deleted the addition made by the ITO. Being aggrieved by the decision of the AAC the revenue carried the matter in appeal before the Tribunal. The Tribunal dealing with the above controversy observed : "Monetary benefit did not partake of the character of income under fundamental concept of income (sic) have been now made taxable by extended definition of income u/s 2(24)(va) of the income tax Act, 1961, as a corollary by treating the said income taxable under the head ''Profits and gains of business or profession'', the essential prerequisite of taxability of such benefit or perquisite is that it must arise from the business of the assesses." In other words, observed the Tribunal, there must be nexus between the business of the assessee and the benefit which the assessee has derived. After referring to various decisions, the Tribunal observed, "these decisions make it abundantly clear that the benefit received or receivable by a person must be one which has intimate connection with business and even if such benefit is received by way of bounty, nonetheless it would be taxable, if it accrues to it is received by it in course of business or employment of office". The Tribunal observed that the facts on record disclosed that the firm was maintaining current account with the assessee-company as its business activity had come to an end, and in order to recover outstanding from third parties or to make payment of outstanding dues of third parties. The relationship between the firm and the assessee-company was that of creditor and debtor and the transactions from 4-7-1950 onwards showed that the transactions had no connection ''with inter se business of the assessee-company and the said firm''. The amount standing to the credit of the firm was adjusted in the aforesaid manner since the partners of the firm were directors of the assessee-company. This, however, did not indicate that the assessee-company had received benefit which could be said to have accrued to it from the business carried on by it. The Tribunal held that there was no nexus which is essential prerequisite to bring to charge the benefit between the aforesaid transactions and the business of the assessee. The mere fact that current account was maintained for adjusting liabilities of the firm would not establish nexus. In the result, the Tribunal held that the amount of Rs. 3,82,905 did not fall within the mischief of section 28(iv).

3. We do not find any infirmity in the reasoning of the Tribunal. The amount of Rs. 3,82,905 which stood to the credit of the firm in the books of account of the assessee-company was first transferred to the profit and loss appropriation account of the assessee-company and later on it was transferred to capital reserve of the company. The amount of Rs. 3,82,905 was not received by the assessee-as a result of any business transaction or transaction with the firm. As rightly observed by the Tribunal, this amount had no connection or nexus with the business of the assessee-company. It did not represent value of any benefit or perquisite arising from the business of the assessee-company. This amount, therefore, would not partake of the character of the income. We broadly agree with the reasoning and conclusion reached by the Tribunal and confirm its view that amount of Rs. 3,82,905 was not includible in the total income of the assessee-company u/s 28(iv). We, therefore, answer question No. 2 referred to us in the affirmative and against the revenue. In view of our answer to question No. 2, as already observed above, question No. 3 does not survive and, therefore, we need not answer the said question.

4. This takes us to question No. 1. Facts which are relevant so far as this question is concerned, briefly stated, are as follows. As pointed out above, the assessee-company is a private limited company. It carried on business of manufacture, sale and export of bones, crushed bone meals, horns, hoofs, etc., up to the assessment year 1955-56. After the said assessment year, it entered into an agreement with Gujarat Bone Crushing Co., Bhavnagar (''Bhavnagar firm'') under which, it allowed Bhavnagar firm to run its factory in consideration of a lump sum of Rs. 30,000 per year and Bhavnagar firm was under an obligation either to sell entire goods manufactured by It to the assessee-company or to effect sales thereof through the assessee-company. Agreements containing identical terms were executed from time to time. A copy of one of such agreements dated 20-12-1963, is placed on record. According to the assessee-company, the terms of the agreements and other evidence led by it clearly establish that it was engaged in the manufacture of goods. The assessee-company, therefore, in the course of assessment proceedings for the assessment year under consideration that is assessment year 1971-72, claimed that it was an ''industrial company'' within the meaning of clause (c) of sub-section (6) of section 2 of the Finance (No. 2) Act, 1971. The ITO, however, following his decision of the earlier years rejected the claim of the assessee-company. The AAC before whom the assessee went in appeal, held that the assessee-company was ''industrial company'' as claimed by it and directed the ITO to treat the assessee-company as such. The revenue being aggrieved by the decision of the AAO carried the matter in appeal before the Tribunal. The Tribunal, however, upheld the view taken by the AAC. It is in the background of these facts that question No. 1, set out above is referred to us for our opinion.

5. We do not consider it necessary to examine in detail the Question which is referred to us, since in our opinion, the Tribunal has not properly construed the provisions of the Finance (No. 2) Act, defining ''industrial company'' and it has also failed to appreciate the evidence led by the assessee-company in the light of the said provision.

6. Section 2(6)(c) which defines ''industrial company'' reads as follows:

(6)(c) ''industrial company'' means a company which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining.

Explanation : For the purposes of this clause, a company shall be deemed to be mainly engaged in the business of generation or distribution of electricity or any other form of power or in the construction of ships or in the manufacture or processing of goods or in mining, if the income attributable to any one or more of the aforesaid activities included in its total income of the previous year (as computed before making any deduction under Chapter VI-A of the income tax Act) is not less than fifty-one per cent of such total income;

The assessee-company claimed that it is an ''industrial company'' within the meaning of the aforesaid provision on the ground that it is mainly engaged in the manufacture or processing of goods. Now, before proceeding to examine the claim of the assessee-company on merits, it was necessary for the Tribunal to interpret the expression ''engaged in manufacture or processing of goods''. Unless the meaning to be attributed to this expression was clearly understood, exercise of examining the evidence would prove to be futile. The Tribunal, however, besides reproducing the aforesaid provision, made no attempt to interpret the above expression, and, consequently, the exercise which it did of referring to various clauses of the agreement, decisions of various Courts, etc., was meaningless. The Tribunal has also not discussed in detail as to how the principles laid down by various decisions referred to by it helped in interpreting the expression ''engaged in manufacture or processing of goods''. The decisions to which reference is made, lay down that if an asset is used as commercial asset, it would not cease to be commercial asset, even if it is leased and the income derived from exploitation of this commercial asset would not lose its character as business income. The Tribunal has not explained as to how this view taken in the various decisions helps in reaching the conclusion that the assessee-company was an industrial company within the meaning of the aforesaid provisions of the Finance (No. 2) Act. The Tribunal has also not properly appreciated various clauses of the agreement entered into between the assessee-company and Bhavnagar firm. Prima facie, the conclusion reached by it on the basis of various clauses of the agreement that the assessee-company was intimately connected with the activities of Bhavnagar firm, and that it could not be inferred that the assessee-company had decided to stop its activities altogether and leased out the factory at a fixed rent to the Bhavnagar firm, does not seem to be Justified. It was urged on behalf of the assessee-company that the assessee-company had placed on record voluminous evidence in support of its claim to establish that it was engaged in the manufacture or processing of goods; but we do not find any discussion about this evidence in the order of the Tribunal. We do not know what evidence weighed with the Tribunal when it held : "On facts, therefore, we would come to the conclusion that the manufacturing activity carried on by the firm could be said to be carried out by the assessee-company and as a corollary it must follow that the assessee-company has been rightly held as an ''industrial company'' within the meaning of the aforesaid provisions of the Finance Act so as to qualify for lower rate of tax as stipulated under the said Finance Act." It was the duty of the Tribunal to discuss evidence which was led by the assessee-company and reach conclusion on appreciation of such evidence in the light of the definition of ''industrial company''. Since the Tribunal has not recorded findings on proper appreciation of evidence on record keeping in mind the aforesaid provisions of law, we are unable to answer question No. 1 on the materials placed before us. In the view which we are taking, we have refrained from expressing any opinion on the questions of facts as well as law on which both the learned counsels addressed us. As observed by the Supreme Court in COMMISSIONER OF Income Tax, WEST BENGAL I Vs.

INDIAN MOLASSES CO. P. LTD., , two courses are open to us : to call for supplementary statement of the case from the Tribunal, or to decline to answer the question raised by the Tribunal and to leave the Tribunal to take appropriate steps to adjust its decision u/s 260(1) of the Act in the light of the answer of this Court. If we direct the Tribunal to submit a supplementary statement of the case, the Tribunal will, according to the decisions of the Supreme Court in New Jehangir Vakil Mills Ltd. Vs. Commissioner of Income Tax, North, Kutch and Saurashtra, , PETLAD TURKEY RED DYE WORKS CO. LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY NORTH., and The Keshav Mills Co. Ltd. Vs. Commissioner of Income Tax, Bombay North, , be restricted to the evidence on the record and may not be entitled to take additional evidence. That may result in injustice. In the circumstances, as held by the Supreme Court in Indian Molasses Co. (P.) Ltd.''s case (supra), we think it appropriate to decline to answer the question on the ground that the Tribunal has failed to consider and decide the question whether the assessee-company is ''industrial company'' within the meaning of section 2(6)(c). It will be open to the Tribunal to dispose of the appeal u/s 260(1) in the light of the observations made by this Court after determining the question which ought to have been decided. Reference answered accordingly with no order as to costs.

