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**(1973) 05 AHC CK 0033**

**In the Allahabad High Court**

**Case No : Income-tax Reference No. 453 of 1971**

Commissioner of Income Tax

APPELLANT

Vs

Vikram Cotton Mills Ltd.

RESPONDENT

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**Date of Decision : 08-05-1973**

**Acts Referred:**

Companies Act, 1913 — Section 153

Income Tax Act, 1922 — Section 10, 12, 24(2)

**Citation : (1977) 106 ITR 829**

**Hon'ble Judges : Satish Chandra, J;N.D. Ojha, J**

**Bench : Division Bench**

**Advocate : Deokinandan, for the Appellant; V.B. Singh and Gopal Behari, for the Respondent**

**Final Decision : Disposed Off**

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## **Judgement**

Satish Chandra, J.—The Income Tax Appellate Tribunal, Bombay Bench, has referred the following question of law for the opinion of this court :

"Whether, on the facts and in the circumstances of the case, the income derived by the assessee-company by way of lease-rent from the letting out of its assets during the years ended December 31, 1959, December 31, 1960, December 31, 1961, and December 31, 1962, is assessable to tax under the head "profits and gains of business" or under the head "income from other sources" ?"

2. The question relates to the assessment years 1960-61, 1961-62, 1962-63 and 1963-64.

3. The assessee-company was a limited company. It carried on the business of manufacture of textiles. From 1949 the assessee-company started running into losses. At the end of December, 1953, the position was that as against the capital of Rs. 11,00,000 the accumulated liabilities of the assessee-company amounted to Rs. 26,00,000. Because of this the assessee-company stopped its manufacturing activity from December, 1953. This state of affairs continued till

May 21, 1956, when one of the creditors of the company filed a winding-up petition in the High Court. M/s. Industrial Finance Corporation, who was one of the major creditors of the company, had in exercise of its powers under an English mortgage of the fixed assets of the company taken actual physical possession of the immovable properties hypothecated to them. u/s 153 of the Indian Companies Act, 1913, the High Court with the approval of the assessee-company and the creditors evolved a scheme whereunder the business assets of the assessee-company were let out to M/s. Fibres Dealers (Pvt.) Ltd., Calcutta, on Rs. 2,50,000 per year rent. The lease was for 10 years with an option of renewal for another ten years. The intention was that the various creditors will be paid out of the lease money. The management of the assessee-company was transferred to a board of trustees appointed by the High Court,

4. The lease money realised by the assessee-company for the assessment years 1957-58 to 1959-60 was assessed by the department u/s 10 of the Indian Income Tax Act, 1922, under the head "profits and gains of business". But in subsequent assessment years the Income Tax Officer held that the income from the lease rent was liable to be taxed under the head "income from other sources" under Section 12 of the Act.

5. The assessee-company took the matter in appeal. It was urged before the Commissioner that the assets of the company were exploited and there was no intention for the assessee to discontinue the business activities. The assets of the company were let to the lessee with the principal object of liquidating a colossal liability and extricating itself from financial crisis. The Commissioner, however, upheld the finding of the Income Tax Officer. The assessee-company then took the matter to the Tribunal. The Tribunal found:

(1) There was nothing on record to indicate that the assessee-company was formed to let out its plant and machinery on hire.

(2) On account of financial crises, the assessee-company found it advantageous to let out the machinery for a temporary period of ten years to the lessee.

(3) The assessee-company was able to liquidate its liabilities at the end of such period and regain the physical possession of its assets.

(4) The assessee-company was able to persuade its creditors not to make any distress sale of the machinery taken over by the Industrial Finance Corporation, with a view to salvage the company from its total extinguishment.

(5) At the end of the lease period, the assessee-company did not dismantle the assets and did not sell away or otherwise dispose of the assets.

6. Maintenance of the assets by the company meant that the company had intention to restart manufacturing of textiles. The Tribunal inferred that the intention of the company in letting out its assets was to exploit the commercial assets for the purposes of its business. The Income Tax Officer was directed to treat the income arising out of the letting out of the assets as business income.

7. At the instance of the Commissioner of Income Tax, Lucknow, the Tribunal has referred the question mentioned above for the opinion of this court.

8. The assessee's case is that the income received by it from the lease of the plant and machinery was business income and was liable to be adjusted against the unabsorbed loss of the preceding year. Section 24 of the Indian Income Tax Act, 1922, deals with set-off and carry-forward of losses. Under Sub-section (1) where an assessee sustains a loss of profits or gains in any year under any of the heads mentioned in Section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year. Sub-section (2) provides that where an assessee suffers a loss in any business and the loss cannot be wholly set off under Sub-section (1), the unabsorbed loss shall be carried forward to the succeeding year and shall be set off against the income from the same business. Before the loss can be carried forward, two conditions must be fulfilled. Firstly, the income against which the loss has to be set off should be income from business and, secondly, the business must be the same in which the loss was suffered.

9. Learned counsel for the assessee submitted that the plant and machinery of the factory were commercial assets and any income derived from the letting out of such an asset would be business income. In support, reliance was placed upon several decisions of the Supreme Court.

10. In Commissioner of Excess Profit Tax, Bombay City Vs. Sri Lakshmi Silk Mills Ltd., the Supreme Court held that the yield of income by a commercial asset was the profit of the business irrespective of the manner in which that asset was exploited by the owner of the business. He was entitled to exploit it to his best advantage and he might do so either by using it himself personally or by letting it out to somebody else. The view that in order to constitute business income the commercial asset must at the time it was let out be in a condition to be used as a commercial asset by the assessee himself was not correct. In that case the company was the manufacturer of silk cloth and as a part of its business it installed a plant for dyeing silk yarn. Owing to difficulty in obtaining silk yarn between January to December, 1943, the company could not make use of this plant. In August, 1943, it was let out to a person on a monthly rent. It was held that it was a 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 that the dyeing plant had not ceased to be a commercial asset of the assessee and the sum representing the rent for five months received from the lease by the assessee was, therefore, income from business. It is true that in this case the principal business of the company, namely, of manufacturing of silk cloth was not stopped, none the less, owing to business exigencies the company found it more advantageous to use its dyeing plant in a different manner, that is, by letting it out to another person instead of using it itself. Since there was no intention to

permanently suspend the use of the dyeing plant it was held that the plant continued to bear the character of a business asset and its use according to the advantage of the moment was for business purposes.

11. In *Narain Swadeshi Weaving Mills Vs. The Commissioner of Excess Profits Tax*, the assessee was a firm. It carried on manufacturing business. In April, 1940, the partners of this firm formed a limited company. The company purchased the building and leasehold rights in land from the firm. It took over plant and machinery on lease from the firm. The assessee-firm did not thereafter manufacture anything and it had no further trading or commercial activity. On these facts it was held by the Supreme Court that the letting out of the plant and the machinery by the assessee-firm to the company was not part of its business activity and hence it could not be held that the assessee-firm was carrying on any business. It will be seen here that the intention of the firm was to permanently discontinue its manufacturing business by giving it over to the company. The company was a distinct entity and was itself carrying on the business. This case has no application to a situation where the business activity is discontinued because of exigencies of the business, where the company finds it advantageous to do so temporarily without intending to permanently discontinue its business activity. When an assessee diverts the user of its business assets, the assets continue to retain the character of commercial assets. They do not become capital assets so that yield of income therefore may lose the character of profits and gains of business.

12. The decision of the Bombay High Court in *COMMISSIONER OF Income Tax, BOMBAY NORTH, KUTCH AND SAURASHTRA Vs. NATIONAL MILLS CO. LTD. (IN LIQUIDATION)*., has material bearing on the point. There the assessee-company was carrying on the business of manufacturing textiles. It got into financial difficulties. It was wound up. The liquidator let out the plant and the machinery of the company on a monthly rent for three years. It was held that in order that the income of the assessee should be business income, it was not necessary that the income should be produced by the assessee, utilising the business assets itself. So long as those assets were used as business assets, it was irrelevant whether the business assets were exploited and used by the assessee itself or some one else. Where, instead of carrying on the business itself the assessee permitted someone else to use the assets and to carry on the identical business, then the activity of the assessee was a business activity. If the assessee stopped doing business altogether, those assets might cease to have the character of business or commercial assets. Then, they take on an entirely different character and become capital assets and qua those assets the assessee was not carrying on any business but qua those assets the assessee had become their owner. As an owner the assessee might also exploit those assets and receive income. But the income which it received was no longer business income because no business was being carried on and the assets were not business assets. In such a case, the income would be an income derived by the owner from his capital assets and the head of income under which such income would fail for the purpose of the

Income Tax Act would be Section 12 and not Section 10. Whether a business was carried on or not and whether assets of an assessee were business assets or not are questions of fact.

13. In the present case the Tribunal has pointed out that the company had no intention to permanently discontinue its business. It adopted the method of using its business assets through another company by way of a lease in order to resolve its very serious financial difficulties. Since the liabilities were liquidated the assessee-company was able to regain possession of its business assets with an intention to utilise them for carrying on its manufacturing business. In our opinion there was sufficient material to justify the finding of the Tribunal that the income derived from the lease of the plant and machinery was income from business and that the income so derived could be set off against losses of the company from the business of the manufacture of textiles brought forward from the preceding year u/s 24(2) of the Income Tax Act.

14. In the present case the lessee utilised the business assets of the assessee-company to carry on the same kind of business as was being carried on by the assessee, namely, manufacture of textiles. So it cannot be said that the business in which the losses occurred was not continued to be carried on in the assessment years in question within the meaning of Clause (2) of Section 24 of the Indian Income Tax Act, 1922. That being the position, the income from the lease was taxable u/s 10 under the head "profits and gains of business."

15. For the revenue reliance was placed upon Seth Banarsi Das Gupta Vs. Commissioner of Income Tax and Others, . In that case Seth Banarsi Das Gupta along with his five brothers formed a partnership and carried on a business of manufacturing sugar at its factory at Bijnor. In 1944, litigation started between the parties when one of them filed a suit. During the pendency of the litigation the factory remained under the management of a receiver appointed by the court. The receiver let out the sugar mills to one of its partners who gave the highest bid, Each partner was given his share of the lease money. The assessee, which was a Hindu undivided family of which Seth Banarsi Das was the karta, suffered some losses in the business of sugar in the previous year. The assessee claimed that unabsorbed losses of the preceding year be brought forward and adjusted against the share of lease money. It was found that the partnership to which the sugar mills belonged had stopped carrying on business since 1944. Since then the sugar mills was in the custody of a receiver. The receiver was not permitted to carry on the business of running the sugar mills. He was letting it out in order to keep it in serviceable condition so that it may bring a proper price when sold. On these facts it was held that the income received from letting out the mills was not business income. The case is distinguishable because there the firm had stopped doing the business altogether and so the assets ceased to have the character of commercial assets. They became capital assets and the firm became its owner. It realised income from the assets as owner and, as such, such income was liable to be taxed u/s 12. Section 12 when it speaks of income

from letting of the building or plant refers to the letting of assets which are in law the properties of the assessee as capital assets. Those provisions are not attracted where the assessee finds it advantageous to divert temporarily the user of its assets to some other person without intending to permanently suspend its business activity.

16. For those reasons our answer to the question referred to us is that the income derived by the assessee-company by way of lease-rent from the letting out of its assets during the years ended December 31, 1959, December 31, 1960, December 31, 1961, and December 31, 1962, is assessable to tax under the head "profits and gains of business".

17. The assessee will be entitled to its costs which is assessed at Rs. 200. Fee of the learned counsel for the department is assessed at the same figure.