THE COMMISSIONER OF INCOME TAX, PUNJAB

v.

THE LAHORE ELECTRIC SUPPLY CO.

November 25, 1965

[A. K. SARKAR, J. R. MUDHOLKAR AND R. S. BACHAWAT, JJ.]

Income Tax Act 1922—*s.* 10(2)(*xv*)—*Whether company carried on business—Therefore whether entitled to deduction of expenses.*

The assessee company carried on the business of supplying electricity to various cities under licences from the Government. All the licences, except one for the supply of electricity to the city of Lahore, were terminated or disposed of by 1942. Soon after that, the Provincial Government acquired the company's undertaking for the supply of electricity in Lahore and part of the value for the acquisition remained due to be paid to the company after the listing and valuation of the assets. The company also possessed considerable assets not appertaining to the Lahore Electric Supply Undertaking and all its funds were invested in securities and shares, the income from which was the sole income after September 5, 1946.

In its assessment to income-tax for the years 1948-49 and 1949-50, the company claimed deduction of various amounts under s. 10(2)(xv) of the Income-tax Act, 1922, on the basis that it had been carrying on business in the accounting years concerned and the expenses had been incurred solely for the purpose of that business. Their contention was rejected by the Income-tax Officer and his stand was confirmed by the Appellate Assistant Commissioner. However, the Tribunal held in appeal, that the question depended on what the intentions of the company were and on the facts took the view that the assessee company had not ceased to carry on business. The High Court, upon a reference, also answered the question in the assessee's favour. In arriving at this conclusion, the Tribunal and the High Court relied on, *inter alia,* the following facts :—

(1) the company did not sell its undertaking as a going concern;

(2) it continued in possession of all assets of its undertakings other than those appertaining to the Lahore Electric Supply Undertaking;

(3) it continued to hold deposits from consumers of electricity which had to be returned with interest;

(4) it had no intention of going into liquidation;

(5) the Directors had indicated in their report that they were considering purchasing some manufacturing concern to have an additional source of profit; etc.

HELD : (*Per* Sarkar and Mudholkar JJ.)—

None of the grounds set out by the Tribunal and the High Court led to the conclusion that the company intended to carry on business.

The facts found made it clear that since 1942 the only business of the company was to work the Lahore Electric Supply licence. It stopped that business when the undertaking was taken over by the Goevrnment. Thereafter, during the accounting years concerned, namely 1947-48 and 1948-49 it had not started any other business. [723 F]

A *The Commissioners of Inland Revenue* v. *The Anglo Brewing Co. Ltd.* 12 T.C. 803, referred.

The Commissioners of Inland Revenue v. *The South Behar Railway Co.* 12 T.C. 657, 712 distinguished.

(*Per* Bachawat, J., dissenting)

(i) The Memorandum of the assessee company showed that one of its subsidiary objects was to invest in stocks, shares, securities, etc. and to sell, exchange or otherwise deal with them from time to time. The main business of generating and supplying electricity having stopped, the company invested its funds in deposits and stocks and shares. The activity of investment and getting a return for its capital was a part of its legitimate business activities [728 H-729 B]

The Commissioners of Inland Revenue v. *The Korean Syndicate Ltd.* 12 T.C. 181; *Karanpura Development Co. Ltd.* v. *C.I.T. West Bengal,* (1962) 3 S.C.R. 368, 378; *Laxminarayan Ram Gopal & Sons* v. *Govt. of Hyderabad* (1955)I S.C.R. 393, 405-407; *The Commissioners of Inland Revenue* v. *Dale Steamship Co. Ltd.* 12 T.C. 712; referred to.

(ii) On the facts of the case, the Tribunal had rightly come to the conclusion that the company had not ceased to carry on its business.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 813 D and 814 of 1963.

Appeals by Special Leave from the Judgment and Order dated the December 30, 1960 of the Punjab High Court in Income Tax Reference No. 10 of 1959.

Niren De, Additional Solicitor-General, Gopal Singh and E *R. N. Sachthey,* for the appellant.

G. C. Sharma, Uma Mehta, B. S. Pachauri and *K. K. Jain,* for the respondent.

The Judgment of Sarkar and Mudholkar, JJ. was delivered by Sarkar J. Bachawat, J. delivered a dissenting Opinion. F

Sarkar J. The respondent is a company incorporated in 1912. The immediate object of the Company was to acquire from the People's Bank of India Ltd. the licence it had obtained from the Government for the supply of electricity to Lahore city. The Company acquired that licence in 1913 and the necessary G plants and machinery for the generation and supply of electricity. Between 1923 and 1939 it acquired licences for similar purposes in regard to various other places in different parts of India. All these licences were however either terminated or disposed of one by one and in 1942 the only licence which the Company possessed was that in respect of the city of Lahore. About the end of 1942 H or beginning of 1943, the Government of the then Province of Punjab acquired the Company's undertaking in regard to the supply of electricity to the city of Lahore and on September 5,

1946, the Company delivered its aforesaid undertaking with all assets to the Government. It was agreed that the Company would pay to the Government half of the net profits of the Lahore electric supply undertaking arising between November 27, 1942 and September 5, 1946. On September 5, 1946, the Company received from the Government a part of the moneys payable to it in respect of the Lahore electric supply undertaking leaving a large amount due which was to be paid after the listing and valuation of its assets. Besides this sum the Company also possessed considerable assets not appertaining to the Lahore electric supply undertaking. All these funds were invested by the Company in government and other securities and shares and the income from these investments appears to have been the sole income of the Company after September 5, 1946.

In its assessment to income-tax for the years 1948-1949 and 1949-1950 the Company claimed deduction of various amounts under s. 10(2)(xv) of the Income-tax Act, 1922, on the basis that it had been carrying on business in the accounting years concerned and the expenses had been incurred solely for the purpose of that business. This contention was rejected by the Income-tax Officer. On appeal by the Company to the Appellate Assistant Commissioner, certain deductions were allowed but that authority did not accept the contention that the Company was carrying on business so as to come within s. 10 of the Act. The Company then took the matter up in further appeal to the Income-tax Appellate Tribunal. The Tribunal accepted the Company's contention and granted it large deductions under s. 10(2)(xv) of the Income-tax Act. The appellate Commissioner of Income-tax requested the Tribunal to state a case to the High Court but that request was rejected. The appellant Commissioner thereafter on August 20, 1958 obtained an order from the High Court of Punjab directing the Tribunal to refer the following two questions to the High Court for its opinion :

1. Whether on the facts and in the circumstances of the case the conclusion of the Appellate Tribunal that the assessee company had not ceased to carry on business during the relevant accounting period, is, in law, correct.

2. If the answer to the first question be in the affirmative, whether all the expenses which the Tribunal has allowed are admissible under section 10(2) of the Income-tax Act ?

A Accordingly the Tribunal stated a case to the High Court in regard to these two questions. The High Court answered both the questions in the affirmative. Hence the present appeals by the Commissioner of Income-tax.

In this Court the learned Additional Solicitor General appear-
B ing for the appellant abandoned the second question. The only point, therefore, that arises for decision in this appeal is whether on the facts found it could be said that the Company had been carrying on business in the two accounting years.

As we have earlier stated, the Tribunal took the view that the
C Company had not ceased to carry on business. The Tribunal observed that the question would depend on what the intentions of the Company were. The High Court was of the same opinion. We also think that that is the correct view. This postulates that the Company was not in fact carrying on any business for if it was, it would be superfluous to enquire whether the Company
D intended to carry on a business. The Courts below thought that the facts showed that the Company intended to carry on business. The facts on which they relied were—(1) the Company did not sell its undertaking as a going concern; (2) it continued in possession of all assets of its undertakings other than those appertaining to the Lahore electric supply undertaking; (3) it continued to hold depo-
E sits made by consumers of electricity supplied by the Lahore electric supply undertaking which had to be returned to them with interest; (4) it had no intention of going into liquidation; (5) the Directors' report showed that the Directors were "considering if they could possibly purchase some manufacturing concern which might become an additional source of profit to the shareholders"; and (6) there
F was nothing to show that there was permanent discontinuance of the business of the Company. So far as the High Court is concerned, it appears to have held that the Company was carrying on business because there was nothing to show that it intended to go into liquidation and because by keeping its staff and establishment it indicated that it would resume business, for otherwise it would not have re-
G tained them. The High Court also took into account the fact that during the larger part of the accounting periods the situation in the country was abnormal as a result of the partition of India and that explained why the Company had not commenced any fresh business.

H In our opinion, none of the grounds mentioned in the preceding paragraph leads to the conclusion that the Company intended to carry on business. The facts found make it abundantly clear that since 1942 the only business of the Company was to work the

Lahore electric supply licence. It stopped that business on September 5, 1946 when the undertaking was taken over by the Government. Thereafter, during the accounting years concerned, namely, 1947-48 and 1948-49 it had not started any other business. The mere fact that the Company had not gone into liquidation would not establish that it had the intention to do business. If it were not so, then in the case of all trading companies it had to be held that they were always doing business. There is neither authority nor principle to support such a proposition. There was further no question of the Company's going into liquidation in the accounting years, for during that time it had not received from the Government the entire amount due to it as compensation for the acquisition of its Lahore electric supply undertaking. At the relevant time the Company was not possessed of any commercial undertaking. What we have quoted earlier from the Directors' report would show that what was in the contemplation of the Directors was the purchase of a new concern. The Directors however had not stated that they did intend to do so. What they said was that they were considering whether they would do so or not. That does not express an intention to resume business. It is unnecessary to go into the question whether an expression of an intention to resume business in vacuo would amount to carrying on business. It is sufficient for the purpose of this case to state that even an intention to resume business has not been established.

A B C D E

It would, therefore, appear that the business was closed and the Company had not established an intention to resume it. That would be enough to show that no business was carried on and it would be irrelevant to enquire whether the business was permanently closed. We may add that we do not understand what was meant by saying that the Company did not sell its undertaking as a going concern. The only going trading concern that it possessed was the Lahore electric supply undertaking and that it sold; it had no other commercial undertaking. After the sale of the Lahore electric supply concern all it did was to invest its moneys and the Tribunal has not found this activity to be a business.

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The facts that the Company had to pay the Government half share of the profits between November 27, 1942 and September 5, 1946 and that it had to return the consumers the deposits made by them would not indicate that it was carrying on a business. It would be laying down strange law to hold that where a business has in fact ceased to be run, it must be deemed as continuing because the outstanding liabilities of that business had not been liquidated. The question whether the Company was carrying on business arises

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A only because if it was, it would be entitled under s. 10 to deductions from its business income in regard to certain expenses incurred by it for the purpose of that business. Business as contemplated by that section is an activity capable of producing a profit which can be taxed. Payment of outstanding liabilities is not an activity which can ever produce such a result. It cannot be said, therefore, that
B because liabilities of a closed business were outstanding, it has to be held that either the business was continuing or that an intention to resume business must be inferred : see *Commissioners of Inland Revenue* v. *The Anglo Brewing Co. Ltd.*(1).

C Some reliance was placed in this connection on an observation of Lord Sumner in *The Commissioners of Inland Revenue* v. *The South Behar Railway Co.*(2). There Lord Sumner observed, "If, as was held in re Dagnall, (1896)2 Q.B. 407, a married woman continues to carry on business for the purpose of 45 & 46 Vict., c. 75, s. 1(5), as long as her trade debts remain undischarged, there would
D seem to be a presumption that a company continues to carry on business as long as it is engaged in collecting debts periodically falling due to it in the course of its former business." We are unable to hold that Lord Sumner intended to lay down that a business which is closed down is deemed to be carried on so long as its outstandings are being collected. *South Behar Railway's case*(2) was concerned
E with a financing company whose only activity after the finances had been furnished was to receive from the Government by way of profits of the financing activity, earlier a certain proportion of the net earnings of the undertaking financed which was being managed by the government and later a fixed sum and to receive from the Government the finance supplied when the Government acquired the
F undertaking as it intended to do. All that Lord Sumner intended to say was that the receipt of the moneys was the business of the company and its only business after the financing had been completed. He was not concerned with the case of a closed business whose outstandings were being collected.

G The Tribunal did not hold that the Company was in fact doing business or that anything that it did amounted to carrying on business. The onus of showing this was clearly on the Company. All that it did was to refer to the sale of its Lahore electric supply undertaking to the Government and the listing of the assets of that undertaking and valuing it as the carrying on of business. This
H contention was rightly rejected by the Tribunal on the ground that the sale of the undertaking though within its memorandum was not

(1) 12 T.C. 803, 813.
(2) 12 T.C. 657, 712.

its business which was really the working of that undertaking. It also seems to us that the condition of the country immediately following the partition is by itself irrelevant for deciding whether the Company was doing business.

Learned counsel for the respondent contended that the Income-tax Officer's order showed that in one of the assessment years the Company had received a certain amount as a result of a business of dealing in investments. The Tribunal however did not find this as a fact. Neither does it seem to us that the Income-tax Officer considered this income as business income though it described it as such, for he held that the Company was not doing any business at all.

In our opinion, it must, therefore, be held that the Company had ceased to carry on business and we would answer the first question in the negative. The appeals must be allowed with costs here and below and we order accordingly.

Bachawat, J. These appeals by special leave raise the question whether the respondent-Company was carrying on business during the according years 1947-48 and 1948-49 corresponding to the assessment years, 1948-49 and 1949-50, and, therefore, entitled to deduction of expenses for carrying on the business under s. 10(2)(xv) of the Indian Income-tax Act, 1922. The company was incorporated in 1912. In 1913, it acquired the license to supply electric energy in Lahore and thereafter it acquired other licenses for supply of electric energy at various other places. Before 1942, it disposed of all the licenses other than the Lahore license. The Punjab Government took steps for the acquisition of the undertaking relating to Lahore license under the Defence of India Act and Rules, and there were disputes and litigations between it and the company. The disputes were compromised by an agreement dated June 2, 1945, whereby the company sold the undertaking to the Government at a price to be settled by valuation and also agreed to pay to the Government half the net profits of the undertaking less taxes from November 27, 1942 till the date of the delivery of the undertaking to the Government. Pending the compilation of the lists and the making of the valuation of the assets of the undertaking, the company and the Punjab Government entered into a supplementary agreement dated September 2, 1946 under which the Company received a sum of rupees one crore towards part payment of the price, and on September 5, 1946 the company delivered the undertaking to the Punjab Government.

A It is common case that until September 5, 1946 the company was carrying on the business. The dispute is whether the company had ceased to carry on business thereafter and more particularly during the accounting years 1947-48 and 1948-49. During this period, the company was not generating or supplying electricity at Lahore or at any other place, and it carried on its activities with a B reduced staff. It devoted a part of its activities for the making of the lists and the valuation of the assets sold to the Punjab Government. It had considerable undisposed of assets. The deposits of its old customers were outstanding and it was liable to repay the same with interest. It invested the cash received from the Government and other sources in stocks and shares and bank deposits and C received by way of income, large sums of money from interest on deposits and dividends. During the accounting year 1947-48, it was in receipt of some business income from the sale of its investments. It utilised its income to pay dividends to the shareholders and to meet its expenses. It had no intention of going into liquidation and successfully opposed a winding-up petition. In the direc- D tors' report for the accounting year, 1946-47 dated November 25, 1948, the directors stated :

> "In the meanwhile, however, your Directors are considering if they could possibly purchase some manufacturing concern which might become an additional source of E profit to the shareholders."

For the assessment years, 1948-49 and 1949-50, the company claimed deduction of expenses for carrying on its business during the accounting years 1947-48 and 1948-49 under s. 10(2)(xv) of the Indian Income-tax Act, 1922. The Income-tax Officer held F that the company was not carrying on any business and totally disallowed contribution to employees' provident fund, pension and gratuity to old staff, valuer's remuneration, legal expenses, depreciation and income-tax provision, but he allowed a part of the salary paid to certain employees, rent, office expenses, interest, auditor's and directors' fees. On appeal, the Appellate Assistant Commis- G sioner held that though there was some little business income, there was practically no business and he allowed in full the audit charges, directors' fees and payment for interest, but he reduced the rent and establishment charges allowed by the Income-tax Officer. On further appeal by the company, the Appellate Tribunal recorded the H following finding :

> "Keeping in mind the entire facts and circumstances of this case, we have come to the clear conclusion that

the assessee Company had not ceased to carry on its business."

On this finding, the Tribunal held that in addition to the expenses allowed by the Appellate Assistant Commissioner the whole of the contribution to provident fund, pension, gratuity, rent, depreciation, establishment charges and office expenses and the legal expenses for resisting the winding-up should be allowed. Under the orders of the Punjab High Court, the Tribunal referred the following questions of law for the decision of the High Court :

"(1) Whether on the facts and in the circumstances of the case the conclusion of the Appellate Tribunal that the assessee company had not ceased to carry on business during the relevant accounting period is, in law correct ?

(2) If the answer to the first question be in the affirmative, whether all the expenses which the Tribunal has allowed are admissible under section 10(2) of the Income-tax Act ?"

The Punjab High Court answered both the questions in the affirmative, and the Commissioner of Income-tax now appeals to this Court by special leave. Counsel for the appellant conceded that if the first question is answered in the affirmative, the second question must also be answered in the affirmative. The sole question before us is, therefore, whether on the facts found the company had ceased to carry on business during the accounting years 1947-48 and 1948-49.

The memorandum of the company discloses the objects for which the company was constituted. If a question arises whether a particular activity of the company is a business activity, it is pertinent and relevant to enquire whether it is so regarded in its memorandum. See *The Commissioners of Inland Revenue* v. *The Korean Syndicate Ltd.*(1), *Karanpura Development Co. Ltd.*, v. *The Commissioner of Income-tax, West Bengal*(2), *Laxminarain Ram Gopal & Sons* v. *Government of Hyderabad*(3). In the instant case, the memorandum of the company discloses that its main purpose is to carry on the business of electric light and power company in all its branches, including generating and supplying electricity. Clause 4 of the memorandum shows that one of its subsidiary objects is to invest in stocks, shares, investments or securities of all classes and descriptions and to hold, sell,

(1) [1921] 12 T.C. 181. (2) [1962] 3 S.C.R. 368, 378.
(3) [1955] 1 S.C.R. 393, 405-407.

A exchange or otherwise dispose of, deal with them from time to time. A company may of course own shares and make investments, and still not carry on any business; but in this case there is nothing to show that its investments are not to be regarded as part of its business activities. The main business of generating and supplying electricity had stopped and the company, therefore, invested its B funds in deposits and stocks and shares. The activity of investment and getting a return for its capital is a part of its legitimate business activities. In *The Commissioners of Inland Revenue* v. *Dale Steamship Co. Ltd.*(1), the objects of the company were, *inter alia*, to acquire steamships and other vessels, to build, charter, let out on hire and trade with ships, to carry on business as shipowners, C merchants, etc., and to invest and deal with the moneys not immediately required. At the outbreak of the war, the company owned and traded with five ships. Of these, one was detained by the enemy at Hamburg, one was sold and the remaining three (all insured) were sunk during the war. The proceeds of sale and the insurance moneys received were all placed on deposit or invested in easily D realisable investments in order to facilitate the resumption of trading or winding up. In an assessment of the company to Corporation Profits Tax, it was held on the authority of *The Commissioners of Inland Revenue* v. *The South Behar Railway Company Limited*(2) that the company was carrying on a trade or business, and that it was liable to assessment to Corporation Profits Tax. The wording E of s. 52 of the Finance Act, 1920 made no difference, for as pointed out by Viscount Cave, L.C in the *South Behar Railway Company's case*(2) at p. 705, the words "including the holding of investments" in the statute referred not to all cases in which the company had money invested, but to cases where the holding of investments F was the business or part of the business of the company. The activity of investment of its available funds may be regarded as a business activity of the company even though the company for the time being may not be carrying on its main business. The company's main business may be quiescent, but, nevertheless, it may still carry on business.

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It has been specifically found that the company was dealing in investments during the accounting year, 1947-48 and that a surplus of Rs. 2,447/- realised by the company from sale of its investments during the year was a business income of the assessee. See paragraph 6 of the statement of case dated March 6, 1959, paragraph 4 H of the order of the Appellate Assistant Commissioner dated April 18, 1951 and the last part of the order of the Income-tax Officer for

(1) 12 T.C. 712. (2) 12 T.C. 657.

the assessment year, 1948-49, dated August 21, 1949. The order of the Income-tax Officer specifically stated that even the balance-sheet for the period ending March 31, 1947 showed that the difference on realisation of assets stood at Rs. 1,25,783/, and it thus appeared that the company was dealing in securities. The Revenue thus claimed to assess the surplus on the realisation of the investments as the profits of a business under s. 10, and its claim has been upheld. I fail to see how the Revenue can take an inconsistent stand and claim that the activity of investment was not a business activity of the company.

The Tribunal also found that the entire business of the company was not sold to the Punjab Government as a going concern and the company continued to own and hold considerable assets not appertaining to the Lahore licence. The company sold and disposed of only its undertaking relating to the Lahore license, on September 5, 1946. Even then, the Punjab Government did not take up all the business debts and liabilities of the undertaking. The company continued to remain liable to the old consumers in respect of their deposits. The company continued to pay interest on these deposits to the consumers. In paragraph 12 of its order dated December 8, 1951, the Tribunal observed, and, in my opinion, rightly :

> "If payment of interest on consumers deposits was a proper business expense in the preceding years, we do not see why or how its character changed in the years under review."

The Tribunal rightly pointed out that the activity of making lists and valuing the assets of the company for the purpose of ascertaining the price of the Lahore undertaking from the Punjab Government is not a business activity of the company. But, looking at the other facts and circumstances of the case and the relevant authorities on the point, the Tribunal came to the clear conclusion that the company had not ceased to carry on its business. There is enough material on the record to support this finding.

There is no set formula for determining whether in a given case a company is carrying on business. For the right understanding of the matter, one must import a little common sense. From the shareholders' and the directors' point of view, the company was undoubtedly carrying on business during the relevant accounting periods. From the popular point of view, what the company did during these years was a business activity. Again, if the question arose whether the company was carrying on business during these

A years for the purpose of s. 20 of the Code of Civil Procedure, I have no doubt in my mind that the answer would be in the affirmative. From whatever point of view the matter is looked at, the conclusion is irresistible that the company was carrying on business during the relevant accounting years. There is ample material on which the Tribunal could come to this finding, and I see no reason
B for disturbing its finding.

In the result, the appeals are dismissed with costs.

ORDER

In accordance with the majority Judgments, the Appeals are
C allowed with costs here and below.