

VIBHUTI GLASS WORKS

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COMMISSIONER OF INCOME TAX, LUCKNOW

APRIL 28, 1989

[R.S. PATHAK, CJ AND RANGANATH MISRA, J.]

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Income Tax Act, 1961: Section 28—Income—Accrual of—Factory owned by assessee—State Government allowed to manage for 20 years as condition for grant of loan—Profits earned—Applied by managing State Government for paying assessee's debts—Whether assessee assessable.

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The assessee Company had a glass factory besides other business. Since the glass factory business had been suffering losses for several years, resulting in increasing debt, the assessee took loans from the State Government and mortgaged the land, buildings and machinery. Later, under a deed executed by it the assessee allowed the State Government to take over running of the glass factory for a period of 20 years and permitted it to have a share of the business, if and when they exceeded a prescribed limit, as conditions for guaranteeing repayment of a loan of Rs.20 lakhs granted by the Industrial Finance Corporation.

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During assessment proceedings for the assessment year 1962-63, the assessee contended that the profits earned by the glass factory business during that period were not assessable in its hands, but in the hands of the State Government, which had taken over the factory and was running the business, and that, in any event, only half of the profit could be included in its assessment as the State Government was entitled to 50 per cent of profits under the deed. Rejecting the contentions, the Income-tax officer held that the assessee was liable to be assessed in respect of the entire profits earned by the glass factory.

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The assessee's appeals were dismissed by both the Appellate Assistant Commissioner and the Appellate Tribunal. On a reference made at assessee's instance, the High Court affirmed the Tribunal's finding that the entire profits of the factory, and not half of them accrued to the assessee. It also rejected assessee's contention that the income was diverted through an overriding title before it reached the assessee.

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Dismissing the appeal of the assessee, this Court,

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A HELD: The present case is one where the income accrued to the assessee directly and was merely, upon such accrual, applied to discharge an obligation of the assessee. [801B]

B Although the Deed executed by the assessee is described as a lease-deed and provides that the glass factory is demised to the State Government, in substance possession of the factory was transferred to the State Government only for the purpose of enabling it to manage and run the business. [800F]

C The entire income earned during the year under consideration was the income of the assessee and was merely applied by the managing State Government for the payment of the assessee's debt, and there was no over-riding title. The profits earned during the year under consideration were not sufficient for the State Government to enjoy a share in the profits in accordance with the terms of the Deed, and therefore, no part of the profits could be regarded as assessable in the hands of the State Government. In point of fact, no part of the profits was actually taken by the State Government. [801C-D]

Commissioner of Income-tax, Bombay City II v. Sitaldas Tirathdas, [1961] 41 ITR 367, relied on.

E CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1442 (NT) of 1975.

From the Judgment and Order dated 14.3.1974 of the Allahabad High Court in I.T.R. No. 437 of 1971.

E.C. Agarwala for the Appellant.

F S.C. Manchanda, Ms. A Subhashini and M.B. Rao for the Respondent.

The Judgment of the Court was delivered by

G PATHAK, CJ. This appeal by certificate granted by the Allahabad High Court is directed against a judgment of the High Court answering the following questions in favour of the Revenue and against the assessee in an income tax reference:

H "(1) Whether on the facts and in the circumstances of the case, and on a correct interpretation of the leasedeed

dated 22.8.1960, the Tribunal was right in holding the profits of the Glass factory during the relevant accounting year accrued to the assessee-company? A

(2) If the answer to the question no. 1 is in the affirmative, whether the Tribunal was right in holding that the entire profits and not one half of the profits of the glass factory during the relevant accounting year accrued to the assessee-company?" B

The assessee, Messrs. Vibhuti Glass Works is a public limited company. It has a glass factory and also carries on other business. The accounts of the glass factory are closed on 31 March each year, while the assessee closes its accounts on 30 September each year. We are concerned with the assessment year 1962-63. C

For several years the glass factory business had been suffering losses resulting in increasing debt. It took heavy loans from the Banaras State Bank, Varanasi, for which purpose its stocks and stores were hypothecated to the Bank. It also took loans from the Uttar Pradesh Government and the land, buildings and machinery were mortgaged accordingly. The assessee found it difficult to emerge out of its financial embarrassment. It discovered also that it needed certain equipment in order to produce better quality goods and also required funds for its working capital and for repaying loans to other creditors. It approached the Industrial Finance Corporation, New Delhi, and the State Finance Corporation for financial assistance and the Industrial Finance Corporation agreed to grant a loan of Rs.20 lakhs on condition (a) that the State Government guaranteed repayment and (b) that the State Government postponed their charge under the mortgage deeds and the Industrial Financial Corporation was allowed to have the first charge. The State Government agreed to those conditions provided the assessee allowed the State Government to take over the running of the glass factory for a period of 20 years. The State Government also stipulated that if and when the profits of the business exceeded a prescribed limit, a share of those profits would go to the State Government. The assessee agreed to this arrangement and executed a document dated 22 August, 1960 incorporating the requisite conditions. D
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For the relevant accounting period the glass factory business disclosed a profit of Rs.92,960 while the assessee suffered a loss of Rs.3,47,656 according to its separate profit and loss account. During H

A assessment proceedings for the assessment year 1962-63 it was contended by the assessee before the Income Tax Officer that the profit of Rs.92,960 earned by the glass factory business was not assessable in the hands of the assessee but in the hands of the Uttar Pradesh Government which had taken over the factory and was running the business. It was contended that in any event only half of the profits could be included in the assessment of the assessee, the remaining profit being assessable in the hands of the State Government which was entitled to 50 per cent of the profits under the Deed dated 22 August, 1960. Both contentions were rejected by the Income Tax Officer, who held that the assessee was liable to be assessed in respect of the entire profits earned by the glass factory. He set off the profit against the loss declared by the assessee and computed a net loss of Rs.2,54,785.

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The assessee appealed to the Appellate Assistant Commissioner of Income Tax, but without success. A second appeal by the assessee filed before the Income Tax Appellate Tribunal was also dismissed. At the instance of the assessee the Appellate Tribunal referred the two questions of law set forth earlier to the High Court of Allahabad. The High Court considered the various provisions of the Deed dated 22 August, 1960 and answered both the questions in favour of the Revenue and against the assessee.

It is apparent that this appeal must be disposed of on a consideration of the terms of the Deed dated 22 August, 1960. A perusal of the conditions set forth in that document discloses that the State Government was given the power to manage the glass factory business for a period of 20 years from the date it assumed possession. Although the Deed is described as a lease-deed and it provides that the glass factory is demised to the State Government, in substance possession of the glass factory was transferred to the State Government only for the purpose of enabling it to manage and run the business. The High Court has given good reason for reaching that conclusion.

Clause (c) of paragraph 7 of the Deed provides "that if upon the expiration or sooner determination of this demise it is found that the working of the factory has shown profits after meeting the entire liabilities of the company the balance profits, after accounting for all charges and expenses incurred by the State Government, shall be divided between the company and the Governor in equal proportion."

It was contended by the assessee before the High Court that the

income was diverted through an overriding title before it reached the assessee. The High Court, in our opinion, has rightly rejected the contention, holding that there was no overriding title and in fact it was a case of mere application of the income. The proper test to be applied in such a case has been laid down by this Court in *Commissioner of Income-tax, Bombay City II v. Sitaldas Tirathdas*, [1961] 41 ITR 367 and we are satisfied that the present case is one where the income accrued to the assessee directly and was merely applied upon such accrual to discharge an obligation of the assessee. The entire income earned during the year under consideration was the income of the assessee and was merely applied by the managing State Government for the payment of the assessee's debts.

We are also in agreement with the High Court that the profits earned during the year under consideration were not sufficient for the State Government to enjoy a share in the profits in accordance with the terms of the Deed, and no question, therefore, arises of any part of the profits being regarded as assessable in the hands of the State Government. In point of fact, it appears that no part of the profits was actually taken by the State Government.

In the result, the appeal fails and is dismissed but in the circumstances there is no order as to costs.

N.P.V.

Appeal dismissed.

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