

Karnataka High Court

Addl. Commissioner Of ... vs Hindustan Machine Tools Ltd. on 15 June, 1979

Equivalent citations: 1980 121 ITR 798 KAR, 1980 121 ITR 798 Karn

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Bench: M S Iyengar, M R Jois

JUDGMENT Srinivasa Iyengar, J.

1. The Income-tax Appellate Tribunal, Bangalore Bench, has referred the following question for the opinion of this court :

"Whether, on the facts and in the circumstances of the case, the income derived by the assessee by leasing out the premises in its industrial estate is assessable as income under the head 'Income from business' ?"

2. The question arises in relation to the assessment for the assessment year 1966-67, the previous year being the one ended with March 31, 1966. The assessee is the Hindustan Machine Tools Ltd. It constructed an Industrial estate with the object of having ancillary units which would manufacture components required for the purposes of the machines in the manufacture of which it was engaged. It had constructed 50 sheds. These had been leased out to several persons on a rental basis. The question arose as to whether the income from those sheds should be treated as income from property under s. 22 of the Income-tax Act, 1961 (hereinafter referred to as "the Act"), or as business income under s. 28 of the Act. The ITO held that as the assessee was the owner of the sheds, the income therefrom should be brought to tax under s. 22 of the Act. On appeal, the AAC disagreed with him and held that the income should be computed under the head "business" under s. 28 of the Act. On a further appeal the Tribunal upheld the view taken by the AAC. At the instance of the CIT, the above question has been referred to this court.

3. There is no dispute that the assessee was the owner of the sheds and they had been let out on rent. The view of the Tribunal was that the dominant object in construction of the sheds and letting them out to several entrepreneurs was to have a ready source of supply of components which the assessee itself might have found it inconvenient to manufacture and which it preferred the ancillary units to manufacture for it, and the leasing out of the premises in the industrial estate, therefore, was incidental to and for the purposes of the assessee's business of manufacture of various machines and the income by leasing out premises was part of its income from business.

4. The Tribunal relied upon the pamphlet which had been issued by the assessee at the time of the inauguration of the industrial estate and also the contents of the lease deeds entered into between the assessee and the third party. The object as had been stated in this pamphlet which has been annexed as annex. "A" was :

"In the manufacture of machine tools, Hindustan Machine Tools with its present capacity of 1,000 machines per annum has to manufacture over 2 million component parts of various types every year. Instead of manufacturing all these components in the main factory of HMT as at present, it is intended to set up a large number of small-scale ancillary feeder industries in the Industrial Estate

owned and managed by small-scale entrepreneurs mainly of the worker-proprietor type and to sub-contract to them the simpler components which do not require heavy equipment or very high degree of skill and technique. The Hindustan Machine Tools factory will thereafter limit itself to the manufacture of the more complicated and heavy components requiring heavy equipment and a high degree of skill and technique and leave the simpler components to be manufactured by the ancillary feeder industries and supplied to HMT thereby passing on to the small-scale entrepreneurs the ownership of the means of production and part of the profits which HMT would have otherwise made."

5. It is also stated :

"The entrepreneurs for the units are selected by HMT having regard to the candidate's experience in the particular line, his technical competence and his genuine enthusiasm to build up competitive small-scale industrial units."

6. Several facilities were accorded to the ancillary units by the HMT which included free technical advice for the setting up of the units and for the manufacture of the components required by the HMT, training of workers for the units on a nominal charge, technical inspection and other services of HMT to the fullest extent possible to the units at cost and supply of raw material and stores to be drawn by the units from HMT at cost including overheads. The lessee agreed among other things to permit Hindustan's agents, security staff and workmen to enter the premises at any time to view the condition thereof. The lessee also entered into a specific declaration to the following effect :

"I, Shri.....entrepreneur of Ancillary Unit No.....in the HMT Industrial Estate do hereby solemnly declare that the drawings, layouts and other documents received by me from HMT for the products planned on my unit, will be used exclusively for the manufacture and supply of these products to HMT only and will not be made known, passed on/used for manufacture and supply of these products to any third party, firm or corporation without the prior approval of HMT in writing."

7. Having regard to these facts the Tribunal came to the conclusion that the letting out of the sheds was not merely for the purposes of letting out the property in the capacity of an owner, but was an integral part of the activity of the assessee, viz., in securing component parts for the purposes of its own business of manufacture of machine tools.

8. In spite of the assessee himself engaging in the manufacture of these components through its own labourers, the ancillary units were required to manufacture them for its purposes. In effect the assessee was getting the components manufactured by the ancillary units and with a view to have this manufacture done, the sheds had been permitted to be occupied by the ancillary units and it is in this process that the assessee received some amount by way of rent. The intention was not to earn income from property as such.

9. The question as to whether a particular income falls under one head or the other has to be decided having regard to the facts and circumstances of a case. In *Nalinikant Ambalal Mody v.*

S.A.L. Narayan Row, CIT [1966] 61 ITR 428, the Supreme Court observed :

"Whether an income falls under one head or another has to be decided according to the common notions of practical men, for the Act does not provide any guidance in the matter."

10. Section 22 of the I.T. Act reads thus :

"The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head 'Income from house property'."

11. The section itself indicates that merely because a person is the owner of the property it does not follow that the income therefrom should be assessed under the heading "Income from house property". It excepts portions of such property as may be occupied for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax. The guidance to be sought is to find out the user of the property and the character in which that property is used. The distinction was brought forth in decision of the Supreme Court in *Karanpura Development Co. Ltd. v. CIT* [1962] 44 ITR 362, 377 :

"Ownership of property and leasing it out may be done as a part of business, or it may be done as landowner. Whether it is the one or the other must necessarily depend upon the object with which the act is done. It is not that no company can own property and enjoy it as property, whether by itself or by giving the use of it to another on rent. Where this happens, the appropriate head to apply is 'Income from property' (section 9 of the Income-tax Act, 1961), even though the company may be doing extensive business otherwise. But a company formed with the specific object of acquiring properties not with the view to leasing them as property but to selling them or turning them to account even by way of leasing them out as an integral part of its business, cannot be said to treat them as landowner but as trader. The case which have been cited in this case both for the against the assessee-company must be applied with this distinction properly borne in mind. In deciding whether a company dealt with its properties as owner, one must see not to the form which it gave to the transaction but to the substance of the matter."

12. This view was again reiterated in the case of *S.G. Mercantile Corporation P. Ltd. v. CIT* . In that case an earlier decision of the Supreme Court in the case of *East India Housing and Land Development Trust Ltd. v. CIT* was referred to but was distinguished. In *Karanpura Development Company's case* [1962] 44 ITR 362 the Supreme Court did not specifically refer to the *East India Housing and Land Development Trust Ltd.'s case*, but referred to the decision in the case of *Commercial Properties Ltd., In re* [1928] ILR 55 Cal 1057; AIR 1928 Cal 456, which had been followed in *East India Housing case* and observed [1962] 44 ITR at p. 376) :

"There, the object of the registered company was to acquire land, build houses and let premises to tenants in Calcutta and elsewhere. The sole assets were three properties which were let out and all that the registered company did was the management and collection of rents. Rankin C.J. held that

the receipts were income from property within section 9 of the Income-tax Act, that letting out such property and collecting rents was not doing business, and that profits and gains from business were very different from income from property."

13. It is, therefore, seen that the activities in the case of Commercial Properties Ltd. and East India Housing case were very restricted and consisted of only in owning property and collecting of rent. There was no exploitation of the property for commercial or business purposes in those cases. The Supreme Court considered the question in the case of CIT v. National Storage Pvt. Ltd. . In that case the assessee after purchasing a plot of land constructed 13 units thereon, 12 units meant for the members of the Indian Motion Picture Distributors' Association, who had floated the company, and one unit for Foreign Film Distributors in Bombay, who were not members of the association. Each unit was divided into four vaults, having a ground floor for rewinding of films and an upper floor for storage of films. The assessee entered into agreements with the film distributors who are permitted to use these vaults. There were other facilities also provided to the vault-holder. The persons who had taken the vaults were described as licensees and they were paying certain charges. The question arose as to whether the vaults were used for the purposes of business and income arising was assessable under s. 10 of the Act. The Supreme Court observed (p. 601) :

"The question which really arises in the present case is whether the assessee is carrying on any business, i.e., is it carrying on any adventure or concern in the nature of trade, commerce or manufacture ? If it is carrying on any adventure or concern in the nature of trade, then section 9 specifically excludes the income derived from property from computation under section 9, if the property is occupied for the purpose of adventure or concern."

14. The High Court had held that the income had to be computed under s. 10 of the Act. The Supreme court observed (pp. 602, 603) :

"The assessee not only constructed vaults of special design and special doors and electric fittings, but it also rendered other services to the vault-holders...These vaults could only be used for the specific purposes of storing of films and other activities connected with the examination, repairs, cleaning, waxing and rewinding of the films."

15. It was argued before the Supreme Court that s. 10 could not be applied as the assessee could not be said to be in occupation of the premises for the purposes of any concern of its own, but it was observed (p. 603) :

"The assessee was thus in occupation of all the premises for the purpose of its own concern, the concern being the hiring out of specially built vaults and providing special services to the licensees. As observed by Viscount Finlay in *Governors of the Rothunda Hospital, Dublin v. Coman* [1920] 7 TC 517 (HL), 'the subject which is hired out is a complex one' and the return received by the assessee is not the income derived from carrying on an adventure or concern in the nature of trade."

16. The provisions of ss. 9 and 10 of the Indian I.T.Act, 1922, correspond to ss. 22 and 28 of the Act, 1961, the latter being in almost identical terms with the earlier enactment.

17. The High court of Patna in the cases of Rohtas Industries Ltd. v. CIT [1961] 41 ITR 524 and Jamshedpur Engineering and Machine Manufacturing Co. Ltd. v. CIT [1957] 32 ITR 41 and the High Court of Punjab in the case of CIT v. Delhi Cloth and General Mills Co. Ltd. [1966] 59 ITR 152 held that the income derived by the assessee from leasing out of house property to its employees for efficient conduct of its own business was to be treated as 'business income' and not 'income from house property'. The Madhya Pradesh High Court has considered a similar question in the case of CIT v. National Newsprint and Paper Mills Ltd. [1978] 114 ITR 388. The company was engaged in the business of manufacture and sale of newsprint having a huge industrial complex and also for the purposes of locating a bank, post office, police station and other offices. Its contention was that the receipts from such letting out had to be assessed under the head "Income from business". The department had accepted that the income derived from quarters let out to its employees would come under the head "Business income", but not in respect of receipts from portions let out to others. The High Court held that the dominant purpose of letting out of accommodation was to carry on its business more efficiently and smoothly and the activity of letting out had a definite nexus with the business that the assessee was carrying on and letting out of the accommodation to the persons other than the employees was incidental, and the assessee's income was to be taxed under s. 10 of the Indian I.T. Act, 1922, or s. 28 of the I.T Act, 1961, and not as income from property under s. 9 of the Indian I.T. Act, 1922, or s. 22 of the 1961 Act. The High Court followed the principle enunciated by the Supreme Court in National Storage Pvt. Ltd.'s case [1967] 66 ITR 596.

18. In our opinion, the facts in the instant case are much stronger than in the cases where letting out accommodation to the employees or housing post office and other amenities were concerned. In the instant case, the benefit the assessee derives is almost direct, namely, continuous supply of components to keep up its own production and manufacturing of components under its own guidance and scrutiny. The assessee is rendering service to the ancillary units by furnishing raw materials, technical know how and supervision. In the language used by the Supreme Court in National Storage Pvt. Ltd.'s case [1967] 66 ITR 596, it can be said that the assessee was in occupation of the premises so let out for the purposes of its own concern, i.e., by hiring out the sheds with a view to manufacture of component parts to be used by the assessee itself in the manufacture of the machine tools and the income derived is not the income derived from the exercise of property rights only, but is income derived from carrying on its own business.

19. The view taken by the Tribunal that the income was to be assessed under the head "Income from business" is correct, and the question referred is answered accordingly.