

IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

INCOME TAX APPEAL No.581 of 2008 (O&M)

DATE OF DECISION: 16.09.2016

M/s Maltex Malsters Ltd.

....Appellant

versus

Commissioner of Income Tax, Patiala and another

.....Respondents

CORAM: - HON'BLE MR. JUSTICE S.J. VAZIFDAR, CHIEF JUSTICE
HON'BLE MR. JUSTICE DEEPAK SIBAL

Present: Mr. Akshay Bhan, Senior Advocate with
Mr. Abhishek Sanghi, Advocate for the appellant
Mr. Zora Singh Klar, Advocate for the respondents

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S.J. VAZIFDAR, CHIEF JUSTICE:

This is an appeal against the order of the Tribunal allowing the Department's appeal against the order of the Commissioner of Income Tax (Appeals). The matter pertains to the Assessment Year 2004-05.

2. The appeal was admitted on the following substantial question of law:-

Whether in the facts and circumstances of the case, the income arising out of the leasing out of the business assets is business income or income from other sources?

The other questions that are sought to be raised by the appellant relate to this question.

3. The appellant/assessee filed a return declaring a loss of about Rs.48.46 crores. The return was processed under Section 143(3). The question is whether the amount of Rs.30 lakhs per annum received by the assessee from M/s United Breweries Limited (hereinafter to be referred to as "UB Ltd.") as lease rent is assessable under the head "Profits and gains from business" or under the head "Income from other sources".

4. The assessee is the owner of plant and machinery, fixtures and fittings and equipment and apparatus installed in a building constructed on land admeasuring about 10 acres also owned by it. The assessee had been manufacturing its products from this property and with its equipment for about 20 to 30 years.

5. To determine the question, it is necessary to refer to two lease agreements entered into between the assessee and UB Ltd. in detail.

6. The assessee and UB Ltd. entered into a Lease Deed dated 01.04.1998 (hereinafter referred to as "the first lease deed") wherein the assessee and UB Ltd. are referred to as the lessor and the lessee, respectively. The recitals in the lease deed inter alia state that UB Ltd. required large quantities

of malt for brewing its products; that it had been purchasing the malt from various suppliers; that it was facing difficulty in procuring the right quality and quantity of malt and that it was facing difficulties. Clause-1 stated that the lease was for a period of five years commencing from 1st April, 1998 and at an annual consideration of Rs.25 lakhs for the first two years and thereafter of Rs.30 lakhs. Under clause-2, the assessee undertook to make available the entire malting facility capable of producing 12,000 MT of malt per month along with the entire plant and machinery and storage spaces of the requisite capacity. Routine minor repairs were to the account of UB Ltd. and major repairs and replacement of assets which had become obsolete, redundant and irreparable were on the assessee's account. Clause-7 of the agreement read as under:-

- "7. The LESSEE shall utilise the services of such employees on the rolls of the LESSOR as on 31.3.1998 during the term of this Agreement. These employees shall continue to be on the rolls of the LESSOR and in no manner shall it be construed or deemed that such employees have been taken or transferred to LESSEE's rolls. The LESSEE shall reimburse the LESSOR all the costs in connection with the salaries and other costs including all statutory dues under all statutes/laws including inter alia Provident Fund, ESI, Bonus and such other laws as are applicable, on behalf of the employees of the LESSOR on a monthly basis irrespective of variation in level of production. The LESSOR undertakes to pay all statutory dues in respect of their employees under all Statutes/laws including inter alia, labour laws, Provident Fund, ESI and such other laws as are applicable. The LESSOR shall keep the LESSEE indemnified at all times in the event of any action taken or

prosecution initiated against the LESSEE in connection with any of the LESSOR's employees. However, additional expenses incurred on festival occasions on its employees and others on whose rolls the employees are working shall be borne by the LESSOR."

7. The lease rental received pursuant to the first lease deed dated 01.04.1998 was assessed as business income. It is not open to challenge the same today. Indeed, the Department fairly did not challenge the same either.

8. The first lease was to expire on 31.03.2003. Two months prior thereto, UB Ltd. and the assessee entered into another Lease Deed dated 29.01.2003 (hereinafter to be referred to as "the second lease deed"). The parties terminated the first lease deed dated 01.04.1998. The recitals were similar to those under the first lease deed. The Department relied upon the fact that the recitals do not indicate the business expediency or reason for the assessee's having entered the second lease deed. Mr. Abhishek Sanghi, the learned counsel appearing on behalf of the appellant/assessee, rightly relied upon clauses-1, 2, 3, 4 and 7 of the second lease deed which read as under:-

"1. LESSOR doth hereby grant to the LESSEE and the LESSEE doth hereby accepts the lease (more particularly the entire Malting Facility on the land admeasuring 10 acres for a period of Ten years commencing from the date of this Deed at a annual consideration of Rs.30,00,000 (Rupees Thirty lacs only) payable in quarterly instalments at the end of each quarter. All taxes and levies on the said amount shall be to the account of the LESSOR.

It is agreed between the Parties that after the completion of two years from the date of this Lease Deed, the parties shall discuss on the revision of annual consideration mentioned above payable by the LESSEE to the LESSOR for the years 2005-2006 and thereafter.

2. The LESSOR further undertakes to take necessary steps to expand the installed capacity from the present level of 12,000 MT to 18,500 MT during the year 2003 along with the upgradation of the existing environmental facility as well as technological upgradation in the kilning system and other facilities as deemed necessary by the LESSEE and the said malting facility. The financial arrangement as regards the financial requirement, repayment of interest cost of such capital expenditure shall be borne by the LESSOR.

The LESSOR herein undertakes to make available to the LESSEE the entire Malting Facility capable of producing 18,500 MT of malt per annum along with all plant & machinery, including utilities in good working condition along with all covered storage spaces including godowns and such other sheds and storehouses exclusively for the period of this Agreement.

3. It has been agreed between LESSOR and the LESSEE that a technical audit will be jointly carried out of the Plant & Machinery. The LESSOR undertakes to handover the Malting operations to the LESSEE which is fully operational at present. The LESSEE shall be responsible for carrying out routine minor repairs, renewals and maintenance of plant and machinery at its cost. However, it is agreed between the parties that in case of major repairs, replacement of asset, which has become obsolete or redundant and irreparable, the cost shall be borne by the LESSOR.
4. The LESSOR herein agrees that in the event any capital expenditure for the purpose of upgradation of technology and upgradation of facilities to meet changes in environmental laws is deemed necessary by the LESSEE at the said malting facility, the financial arrangements relating to funding repayment and interest costs of such capital expenditure shall be mutually decided between the LESSEE and the LESSOR before finalisation.

...

7. The LESSEE shall utilise the services of such employees on the rolls of the LESSOR as on the date of this Lease Deed during the term of this Agreement. These employees shall continue to be on the rolls of the LESSOR and in no manner shall it be construed or deemed that such employees have been taken or transferred to LESSEE's rolls. The LESSEE shall reimburse the LESSOR all the costs in connection with the salaries and other costs including all statutory dues under all statutes/laws including inter alia Provident Fund, ESI, Bonus and such other laws as are applicable, on behalf of the employees of the LESSOR on a monthly basis irrespective of variation in level of production. The LESSOR undertakes to pay all statutory dues in respect of their employees under all Statutes/laws including inter alia, labour laws, Provident Fund, ESI and such other laws as are applicable. The LESSOR shall keep the LESSEE indemnified at all times in the event of any action taken or prosecution initiated against the LESSEE in connection with any of the LESSOR's employees. However, additional expenses incurred on festival occasions on its employees and others on whose rolls the employees are working shall be borne by the LESSOR."

We will construe the lease deed later.

9. The Assessing Officer noted that no operation had to be carried out by the assessee and that it was merely to hand over possession of the assets to UB Ltd. and that the working expenses were to be paid by UB Ltd. That, however, does not justify the Assessing Officer's conclusion that the income from the lease agreement cannot be said to be business income.

The Assessing Officer referred to the judgment of the Supreme Court in Sultan Bros (P) Ltd. vs. CIT, [1964] 51 ITR 353 (SC) and held that in the present case, the assessee and UB Ltd. had entered into a composite agreement and, therefore, the income is taxable under the head "Income from

other sources". That, however, is not sufficient to decide the issue. It is necessary to construe the entire lease deed and the other facts.

10. The Assessing Officer, however, rightly rejected the assessee's contention based on the fact that its case for the Assessment Year 2000-01 was completed under scrutiny and its income from the first lease deed was held to be business income. On the other hand, the CIT (A) held in the assessee's favour only on the ground that in the past the income under the lease deed was considered under the head "Profits and gains from business". Referring to the judgment of this Court in CIT vs. Dalmia Dadri Cement Ltd. [1970] 77 ITR 410, the CIT (A) held that considering the past practice of the assessee and the consistent stand taken by the Department over the years, the assessee rightly treated the income as business income. The Tribunal, however, rightly upheld the Assessing Officer's finding in this regard.

11. The Assessment Year 2000-01 pertained to the period covered by the first lease deed and not the second lease deed. It was rightly held that merely because the income under the first lease deed during Assessment Year 2000-01 was considered to be business income, it does not necessarily follow that the income under the second lease deed also constitutes business income.

12. In a case such as this, it is imperative to ascertain whether the income under a fresh lease deed ought to be computed under the head "Income from other sources" or under the head "Profits and gains from business". It is necessary to consider the very nature of the transactions. If, for instance, it was decided to permanently lease out the property, it would of necessity be considered to be income from other sources. If, as in the present case, it is contended that the decision to lease out the property is only for the purpose of meeting the business requirements of the assessee for a limited period of time to tide over a difficult period, it would be required to be computed under the head "Profits and gains from business". The stand taken by the Department/Revenue in respect of the earlier lease deed cannot, therefore, be binding on the Department/Revenue in respect of the subsequent lease deed. The principle of consistency cannot be applied for the fact situation under each lease deed is fundamentally different. If, however, the fact situation including as to the intention of the assessee in leasing its assets remains unchanged, the Assessing Officer must continue to assess the income as business income. Whether this is so or not must, however, be examined and the Assessing Officer cannot blindly assume it to be so.

We have, however, upheld the decision to treat the income as business income and not under the head "Income from other sources" for different reasons which we will come to while dealing with the order of the Tribunal.

13. The Tribunal, after setting out the clauses, held as under:-

"22. It is evident from the terms and conditions of the fresh lease deed executed during the previous year that the assessee company does not have any intention of carrying on the business of its own with the help of plant and machinery owned by it. The mere fact that the employees shall continue to be in employment of the assessee may not cloud the fact that the assessee has leased plant and machinery for a period of 10 years in addition to its earlier period of 5 years. It has to be borne in mind that the agreement is between the two sister concerns. Therefore, continuing the employees on its roll by the assessee company subject to reimbursement by the lessee company would not affect the real purpose if the assessee of leasing out the plant and machinery without the intention of restarting the business in so far as it could be a conscious decision to avoid legal hassles and financial losses involved for termination of the employment and reappointment by the lessee company.

23. Viewing the terms and conditions of the lease deed with reference to the decision of the Hon'ble Supreme Court referred to earlier in para Nos.9 to 12, we do not have any doubt in our mind that there does not appear to be any intention of the assessee to restart the business of its own. The termination of earlier lease agreement, and execution of fresh agreement for a period of 10 years was not under any compelling circumstances, financial or otherwise. As per the terms of the agreement, it is evident that the assessee has allowed the lessee to use all the plant and machinery and its employees and the facts and circumstances do not project the intention of the assessee of temporary suspension of business constrained by compelling circumstances and therefore, carrying on its business by itself. The facts that the assessee is receiving the interest of more than Rs.40 lacs from the lessee on out

standings with them establishes the fact that the assessee is not financially handicapped.

24. Taking the totality of the facts and circumstances of the case into consideration, we are of the view that the income from letting out of the plant and machinery to the sister concern falls under the head "income from other sources."

14. A duration of 10 to 15 years of a lease of this nature does not indicate an intention on the part of the lessor to part with its business assets permanently or for an inordinate period of time indicating that its intention is to discontinue its business activities. By its very nature, such a lease agreement is bound to be for a longer duration. Running an industry is capital intensive. It requires the lessee to deploy considerable resources tangible and intangible, movable and immovable. This, in turn, requires a large expenditure. The lease deed itself requires the lessee i.e. UB Ltd. to pay the costs of certain repairs and maintenance. A lessee in a contract of this nature, therefore, would not find it financially feasible to accept a lease for a short period. The return of investment would not be adequate if the lease is for a short duration.

15. In Universal Plast Ltd. vs. Commissioner of Income Tax, Calcutta, (1999) 5 Supreme Court Cases 189, the Supreme Court considered the following questions:-

"Whether on the facts and in the circumstances of the case, the Tribunal was correct in law that the income received by the assessee by leasing out the factory was business income?

Whether on the facts and in the circumstances of the case, the Appellate Tribunal was justified in holding that the letting of godowns at Guntur and Narsaraopet and the letting of the factory with machinery at Narsaraopet and at Guntur did not constitute business of the assessee?"

After reviewing several judgments of the Supreme Court, it was held:-

"18. In the light of the above discussion, the propositions may be summarised as follows:

(1) no precise test can be laid down to ascertain whether income (referred to by whatever nomenclature, lease amount, rents, licence fee) received by an assessee from leasing or letting out of assets would fall under the head "profits and gains of business or profession";

(2) it is a mixed question of law and fact and has to be determined from the point of view of a business in that business on the facts and in the circumstances of each case including true interpretation of the agreement under which the assets are let out;

(3) where all the assets of the business are let out, the period for which the assets are let out is a relevant factor to find out whether the intention of the assessee is to go out of business altogether or to come back and restart the same.

(4) if only or a few of the business assets are let out temporarily while the assessee is carrying out his other business activities then it is a case of exploiting the business assets otherwise than employing them for his own use for making profit for that business; but if the business never started or has started but ceased with no intention to be resumed, the assets also will cease to be business assets and the transaction will only be exploitation of property by an owner thereof, but not exploitation of business assets."

16. No precise test can obviously be laid down, even where some of the clauses in two lease deeds are the same. Their importance and weightage may differ in each of the lease deeds. Moreover, it will be necessary to construe the

documents as a whole and not individual clauses thereof. Decided cases, are, therefore, important only to determine the basis on which such cases are to be decided, rather than for the facts obtaining in those cases. Take for instance, the case of Sultan Bros (P) Ltd. vs. CIT, [1964] 51 ITR 353 (SC), which is also referred to by the Assessing Officer. In that case, the assessee never carried on any business of a hotel in the premises let out or otherwise at all and there was nothing to show that it intended to carry on a hotel business in the same building. It was, therefore, held that letting out the building did not amount to carrying on the business and, therefore, the income under the lease could not be assessed as income from business. As held by the Supreme Court in that case:-

"Whether a particular letting is business, has to be decided in the circumstances of each case. Each case has to be looked at from a business man's point of view to find out whether the letting was the doing of a business or the exploitation of his property by an owner."

17. Then again in New Savan Sugar and Gur Refining Co. Ltd. vs. Commissioner of Income-tax Calcutta, [1969] 74 ITR 7 (SC), the assessee had leased its building, machinery and plant for a period of five years with three options to the lessee to renew the same for similar periods. The lessee never exercised its options to terminate the lease after the first two years. The Supreme Court interpreted the terms of the

lease deed to come to the conclusion that the assessee desired parting with the machinery, the factory and the premises with the obvious purpose of earning rental income and not to treat the factory and the machinery as a commercial asset during the subsistence of the lease. It was found, as a matter of fact, that the intention of the appellant was to go out of business altogether. It was, therefore, held that the income was not assessable as business. In Universal Plast Ltd. (supra) itself, it was found, as a matter of fact, that the lease was a veiled agreement for a lease-cum-sale.

18. Applying these tests, it is necessary to construe the two lease deeds.

19. It is evident that one of the main reasons for the Tribunal's decision in paragraph-22 which we set out earlier is that the Tribunal assumed that UB Ltd. and the assessee are sister concerns. They are not. The Tribunal's interpretation of Clause-7 and the construction thereof is obviously based on this presumption. This presumption is, however, erroneous and without any basis. Our attention has not been invited to anything that indicates that they are sister concerns. The Tribunal's interpretation of clause-7 is, therefore, based on a fundamentally erroneous factual basis.

20. Clause-7 clearly indicates that the assessee did not intend the lease arrangement to continue for an indefinite

period of time. That as a matter of fact the lease is now terminated is a different matter. We cannot base our decision on that fact for it has not been brought on record. However, even otherwise, clause-7 is in favour of the assessee. The Tribunal has merely speculated that the clause could be a conscious decision to avoid legal difficulties and financial loss on account of the termination of the employment and re-employment by UB Ltd. If it was the assessee's intention to make this a permanent arrangement or an arrangement for an indefinite period, there was no reason for it to insist upon UB Ltd. continuing with its employees. Indeed, if UB Ltd. terminated the services of the employees in accordance with law, it would not have affected the assessee's rights or interest in its property in any manner whatsoever if the assessee intended continuing with the system indefinitely. The fact that the assessee insisted upon its employees being retained is a strong indication that it intended coming back into the business using the same assets and properties. This was an important term of the contract.

21. There are other factors also which together with clause-7 support the assessee's case. For instance, the second paragraph of clause-1 provides that after completion of two years the parties would discuss the revision of the annual consideration of Rs.30 lakhs for the year 2005-06 onwards. If

the parties had not agreed to the revised consideration, the agreement would have come to an end. In the normal course of events, a party intending to continue such an arrangement for an indefinite period of time, would have finalized the consideration payable and not have left such a crucial aspect open-ended.

The second paragraph of clause-1 read with clause-4 makes this clearer. Clause-4 requires the parties to mutually decide regarding the capital expenditure for upgrading the technologies and the facilities.

22. Clause-2 also indicates that the assessee retained an interest in the plant and machinery and the property for otherwise it would not have agreed to expand the installed capacity at its costs.

23. It was contended on behalf of the Revenue that clause-2 indicates that there was no necessity on account of financial hardship for the assessee leasing the property. However, as Mr. Abhishek Sanghi, the learned counsel appearing on behalf of the appellant pointed out, the financial difficulties faced by the assessee would have been alleviated on account of the lease rentals that it was to receive under the agreement.

24. The construction of a term in an agreement is a question of law. Moreover, as we indicated, the Tribunal

proceeded on an erroneous presumption, namely, that UB Ltd. and the assessee are sister concerns. In any event, the Tribunal ought to have considered the agreement as a whole.

25. The findings of the Tribunal, therefore, are perverse. We, however, confirm the finding of the Tribunal that the decision of the Department to treat the income for the previous years in respect of the first lease deed as business income does not bind the Department with respect to the income received under the second lease deed.

26. In the circumstances, the question of law is answered in favour of the assessee and against the Revenue. The appeal is accordingly allowed.

(S.J. VAZIFDAR)
CHIEF JUSTICE

16.09.2016
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(DEEPAK SIBAL)
JUDGE

Note:- Whether non-speaking/reasoned : Yes/
Whether to be referred to Reporters - YES/