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COMMISSIONER OF INCOME-TAX U.P. LUCKNOW

v.

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THE MAHESHWARI DEVI JUTE MILLS LTD. KANPUR

April 15, 1965

[K. SUBBA RAO, J. C. SHAH AND S. M. SIKRI, JJ.]

Income-tax—Sale of asset—Capital receipt or income.

C To protect the interests of its members against loss resulting from over-production, the Jute Mills Association provided that the members shall work their looms for a fixed number of hours and gave to its members facility of transferring "loom-hours", that is, the number of hours for which the members were entitled to work their factories. A member of the Association was thereby permitted, in addition to the "loom hours" allotted to that member, to work D its factory for such "loom hours" as were transferred to it by another member. The respondent-assessee had transferred its surplus "loom hours" which it could not utilize during the assessment years, and received certain sums of money as consideration, which the Income-tax Officer included in the respondent's total income liable for payment of income-tax. That order was confirmed by the Appellate Assistant Commissioner and the Tribunal, but the High Court on a re- E ference, held in favour of the assessee.

In his appeal to this Court, the Commissioner contended that: The right to work for the allotted number of hours was an asset of the assessee capable of being transferred, and where it was a part of the normal activity of the assessee's business to earn profit by making use of its asset by either employing it in its own manufacturing concern or by letting it out to others, the consideration received for F allowing the transferee to use that asset was income received from business and chargeable to income tax.

HELD: The High Court was right in holding that the receipts from sale of "loom-hours" were in the nature of capital receipts and were not taxable. [770 E]

G Distinction between revenue and capital in the law of income-tax is fundamental. Tax is ordinarily not levied on capital profits: it is levied on income. Sale of stock-in-trade or circulating capital or rendering service in the course of trading results in a trading receipt; sale of assets which the assessee uses as fixed capital to enable him to carry on his business results in capital receipt. The "loom-hours" were the asset of the respondent, but their temporary user could not be granted. The transaction was therefore a sale of "loom- H hours", and when a businessman disposes of his capital for whatever reason, unless it is a part of his circulating capital, the receipt is capital and not income which is taxable. [769 E, F]

Commissioner of Excess Profits Tax, Bombay City v. *Sri Lakshmi Silk Mills*, [1952] S.C.R. 1, distinguished.

Maheshwari Devi Jute Mills v. *Commissioner of Income-tax U.P.* I.T. Misc. Case. decided on 13th September 1962, overruled.

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 66 and 67 of 1964. A

Appeals from the judgment and decree March 28, 1961 of the Allahabad High Court in Income-tax Reference No. 165 of 1954.

S.V. Gupte, Solicitor-General, R. Ganapathy Iyer and R. N. Sachthey, for the appellant (in both the appeals). B

A. V. Viswanatha Sastri, S. Murthy and *B. P. Maheshwari*, for the respondent (in both the appeals).

The Judgment of the Court was delivered by

Shah, J. The Maheshwari Devi Jute Mills Ltd. carries on the business of manufacturing jute goods and is a member of the Jute Mills Association. To protect the members against loss resulting C from overproduction, members of the Association entered into an agreement dated January 9, 1932 called "the First Working Time Agreement" restricting hours of work. That agreement was to expire on December 11, 1944. With a view to continue the arrangement, a fresh agreement was executed on June 12, 1944. The preamble of the agreement was: D

> "Whereas the signatories generally as a consequence of over-production having been put to considerable losses and in general interests of the Members and their employees and of the association and the jute industry and trade in general etc.....have determined E that provisions similar to those contained in the Working Time Agreement should be entered into and continued in manner hereinafter appearing".

By cl. 4 of the agreement, the association imposed restrictions upon the hours of work of its members. The number of hours for which the members were entitled to work their factories were called F "loom-hours". Allotment of "loom-hours" depended upon the number of looms installed in the factory of each member. By cl. 5 it was provided that the number of working hours per week set out in the agreement represented the total number of hours for which a member was entitled to work its registered complement of looms. Clause 10 prescribed the maximum number of "loom- G hours" for a mill with a complement of looms exceeding 220. Clause 13 provided for registration of "loom-hours" of each member of the association. Clause 6 of the agreement enabled members to be grouped if they happened to be under the control of the same managing agents or who were combined by any arrangement or agreement for registration as "Group Mills". It was open to a mem- H ber of the Group Mills so registered to utilise the allotment of hours of work per week of other members in the same group who were not fully utilising the hours of work allowed to them. By sub-cl. (b) a member was also entitled to transfer his surplus "loom-hours" to another member and upon such transfer being duly effected and registered with the Association, the transferee was entitled, subject to certain conditions, to utilise "loom-hours" so transferred.

A The respondent was under the agreement allotted 220 x 72 hours per week. In the account year corresponding to the assessment year 1949-50, the preparatory section of the factory of the respondent was unable to work the looms for more than 48 hours a week, and with the sanction of the Association the respondent sold 220 x 24 "loom-hours" to the Naskarpara Jute Mills and as
B consideration of the sale received Rs. 53,460/-. In the account year corresponding to the assessment year 1950-51 the respondent received from the Birla Jute Mills and Hanuman Jute Mills a total amount of Rs. 1,85,230/- for sale of surplus loom-hours. In proceedings for assessment for the assessment years 1949-50 and 1950-51 the Income-tax Officer included in the total income
C of the respondent the amounts received by sale of "loom-hours" as revenue receipts liable to tax. The order of the Income-tax Officer was confirmed by the Appellate Assistant Commissioner and the Income-tax Appellate Tribunal. At the instance of the respondent, the Tribunal referred the following question to the High Court of Judicature at Allahabad:

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> "Whether on the facts and in the circumstances of the case the receipts of the assessee by the sale of loom-hours amounting to Rs. 53,460/- and Rs. 1,85,230/- in the assessment years 1949-50 and 1950-51 respectively were revenue receipts liable to tax under the Indian
E Income-tax Act?"

The High Court answered the question in the negative. The Commissioner of Income-tax has preferred these appeals with certificate granted by the High Court under s. 66-A (2) of the Indian Income-tax Act.

F The Tribunal held that the receipts in question were not capital receipts, nor were they of a casual or non-recurring nature. The plea of the respondent that the receipts for sale of loom-hours are not chargeable to tax because they are, within the meaning of s. 4(3) (vii), casual and non-recurring, has no substance. By cl. (3) (vii) of s. 4 receipts which are not capital gains chargeable accord-
G ing to the provisions of s. 12B and which are not arising from business or the exercise of a profession, vocation or occupation or by way of addition to the remuneration of an employee are exempt from tax, if they are of a casual and non-recurring nature. But a receipt in the ordinary course of the assessee's business, even though it is casual or non-recurring, is by the express words used
H by the Legislature, taxable.

It is not the case of the Department that a business in "loom-hours" was carried on by the respondent. It is also common ground that for imposing restrictions upon the number of working hours, no compensation was paid to the . abers by the association or by any other body: if it were, such compensation being paid for agreeing to restraint on trade would be capital. To protect the

interests of its members the Association provided that the members shall work their looms for a fixed number of hours and gave to its members facility of transferring the number of "loom-hours". But by transferring "loom-hours" no interest in the looms or the machinery of the factory was being transferred: thereby merely a member of the Association was permitted in addition to the "loom-hours" allotted to that member to work its factory for such "loom-hours" as were transferred to it by another member of the Association. In the proceedings before the Income-tax authorities, the Tribunal and the High Court, these "loom-hours" have been regarded as an asset belong to each member and in considering these appeals we do not think we would be justified in allowing counsel to raise a contention (as was sought to be done) that "loom-hours" were in the nature of a privilege and were not an asset at all. The case has at all earlier stages been considered on the footing that by virtue of the covenant incorporated in the agreement between the members of the Association, the right to work for the allotted number of hours was an asset capable of being transferred, subject to the sanction of the Association.

The respondent was unable, on account of inefficiency of its preparatory section, to supply the requisite material for running the factory for 72 hours per week which it was entitled to do. It therefore transferred a fraction of the "loom-hours" allotted to it to other members of the Association and in consideration of the transfer received in the two years in question substantial sums of money. The Solicitor-General submitted that where it is a part of the normal activity of the assessee's business to earn profit by making use of its asset by either employing it in its own manufacturing concern or by letting it out to others, consideration received for allowing the transferee to use that asset is income received from business and chargeable to income-tax. In support of his contention counsel relied upon the judgement of this Court in *Commissioner of Excess Profits, Bombay City* v. *Shri Lakshmi Silk Mills Ltd.*(1). *In Shri Lakshmi Silk Mills Ltd. case* the assessee Company was a manufacturing concern and had for the purpose of its business installed a plant for dyeing silk yarn. For a part of the chargeable period the Company could not secure silk yarn and its plant remained idle. The Company then let out the plant and the question arose whether rent received by the Company was chargeable to excess profits tax as profit of the business or was income from other sources and therefore not chargeable to excess profits tax. It was held by this Court that if a commercial asset is incapable of being used as such, rent received by letting it out to others is not income of the business. But an asset acquired and used for the purpose of the business does not cease to be a commercial asset of that business as soon as it is

(1) [1952] S.C.R. 1: 20 I.T.R. 451.

A temporarily put out of use or is let out to another person for use in his business or trade. Receipt by the exploitation of a commercial asset is the profit of the business, irrespective of the manner in which the asset is exploited by the owner of the business, for the owner is entitled to exploit it to his best advantage either by using it himself personally or by letting it out to somebody else. B What was let out in *Lakshmi Silk Mills' case*(1) was the dyeing plant which continued to remain the property of the Company and it was temporarily let out when the assessee was unable to use it. Receipt from a commercial asset when it is capable of being used by the assessee but is not so used because of circumstances which necessitate cesser of its use would undoubtedly be income, C where the asset remains the property of the assessee and user of the asset is given to another person. If in the present case, for the hours which the respondent was unable to use its looms the respondent had permitted some other person to work the looms, profits received for permitting such user would be income. But the distinction between that case and the present case arises from the pecu- D liar nature of the transaction in "loom-hours". "Loom-hours" cannot from their very nature be let out while retaining property in them, for there can be no grant of a temporary right to use "loom-hours". "Loom-hours" are the asset of the respondent, but temporary user of the "loom-hours" cannot be granted. The transaction in this case is of sale of "loom-hours". There is no E doubt that when a businessman disposes of his capital for whatever reason, unless it is a part of his circulating capital, the receipt is capital and not income which is taxable.

Distinction between revenue and capital in the law of income-tax is fundamental. Tax is ordinarily not levied on capital profits: F it is levied on income. It is well-settled that sale of stock-in-trade or circulating capital or rendering service in the course of trading results in a trading receipt: sale of assets which the assessee uses as fixed capital to enable him to carry on his business results in capital receipt.

G Our attention was invited to a judgment of the Allahabad High Court in *Maheshwari Devi Jute Mills* v. *Commissioner of Income-tax, U.P., Lucknow*(2) in which a Division Bench of the Allahabad High Court answered a similar question relating to taxability of payments received for sale of "loom-hours" by the respondent in an assessment year with which we are not concerned in H these appeals. The Court in that case ignoring the view in the judgments under appeal held that "loom-hours" did not form the fixed profit-making structure of the respondent and it was not correct to say that the capital structure of the business was 220 looms multiplied by the number of hours per week for which the machinery

(1) [1952] S.C.R. 1; 20 I.T.R. 451.

(2) I.T. Misc. Case No. 177 of 1960 decided on September 13, 1962.

was entitled to work. The "loom-hours" had in the view of the Court nothing to do with the capital structure of the business and there was nothing to show that the defect in the preparatory section which rendered the "loom-hours" unutilisable was permanent. It was always open to the respondent to acquire the necessary yarn from outside and thereby utilise the remaining quota of "loom-hours" in manufacturing jute, and if the respondent preferred not to procure yarn and chose to sell the surplus "loom-hours" and thus ensure profit for itself without incurring any risk, the receipt by disposal of a commercial asset was profit of the business irrespective of the manner in which that asset was exploited by the owner of the business. In the view of the High Court the respondent was entitled to exploit the asset to its best advantage: it may do so either by utilising it personally or by letting it out to somebody else, and the sale of a part of its quota of "loom-hours" amounted to exploitation of its capital asset and the receipt obtained therefrom was income. We are unable to agree with this view. The surplus "loom-hours" were disposed of and no interest remained therein with the respondent: there was no exploitation of the "loom-hours" by permitting user while retaining ownership. Receipt by sale of "loom-hours" must therefore be regarded in this case as a capital receipt and not income.

In our judgment the High Court was right in holding that the receipts from sale of "loom-hours" were in the nature of capital receipts and were not taxable. The appeals fail and are dismissed with costs.

Appeals dismissed.