aside, but, in the circumstances of these cases, there is not order in regard to costs.

Sarla Sharma
v.
Shakuntla
and another

Mehar Singh, J.

R.S.

INCOME-TAX REFERENCE

Before Inder Dev Dua and R. S. Narula, J.J.

M/S SONEPAT LIGHT POWER AND GENERAL MILLS LTD., (IN LIQUIDATION),—*Appellants*

versus

THE COMMISSIONER OF INCOME-TAX, PUNJAB—*Respondent*

Income-Tax Reference No: 31 of 1962.

1965

April, 8th.

Income-Tax Act (XI of 1922), as amended by Act (VIII of 1946)—S. 10(2)(vii)—Scheme of—Indian Electricity Act (IX of 1910)—Section 7(i)—Amount payable under—Nature of—Amount paid by government under second proviso to section 7—Whether taxable.

Held, that the scheme of the deeming provisions of section 10(2)(vii) of the Income-tax Act, 1922, is based on the fact that an assessee recovers the value of the capital investment of plant, machinery, etc., by earning an income-tax rebate on account of depreciation and that it is presumed in law that at the end of a certain period the written-down value of the machinery, etc., as a result of depreciation would be reduced to nil. By this process of allowing a rebate on the original capital costs written-down value is obained every year after deducting the depreciation allowed till that time. If then the assessee sells or disposes of the machinery, etc., at a price higher than the written-down value on his books, he is justly deemed to have earned a profit to the extent of the difference between the amount he actually receives against the sale of machinery and the written-down value thereof in his books. But for the legal fiction created by the deeming provision in section 10(2)(vii) of the Incem-tax Act, such surplus earned by an assessee would certainly not be 'profit' and would not be taxable under section 10(1) as it was not the business of the assessee to sell away his profit-making apparatus.

Held, that the provisions of section 7 of the Indian Electricity Act, 1910, are not of a confiscatory nature but have been made to

help the assessee for whom the electric undertaking would be wholly useless after the termination of his licence for generating and supplying electricity under the Act. The relevant part of section 7(1) of the Act merely provides a mode and furnishes the criteria on the basis of which the sale price for the machinery, etc., payable by the government to the assessee has to be determined.

Held, that it is not correct to call the amount paid by the Government to the assessee under the second proviso to sub-section (1) of section 7 of the Indian Electricity Act, 1910, as 'Solatium'. In fact the amount which may become payable under that provision is a part of the amount paid for the sale of the undertaking. The word "amount" used in section 10(2)(vii) of the Income-tax Act includes the total amount paid by the Government to the assessee by virtue of para 9 of the licence and in pursuance of section 7 of the Electricity Act including what is called "their fair market value" under the first proviso and the added value up to 20 per cent by virtue of the second proviso to sub-section (1) of section 7 of the Electricity Act. The entire amount is taxable.

Reference under section 66(1) *of the Income-Tax Act,* 1922, *by the Income-Tax Appellate Tribunal (Delhi bench), dated* 28*th August,* 1961, *for decision of the below noted question of law referred to this court:—*

(1) *Whether the surplus realised by the assessee has been correctly assessed under section* 10(2)(*viii*) ?"

(2) *Whether the solatium paid has been rightly included as part of the sale price* ?"

(3) *Whether the loss on the service lines has been rightly ignored in the computation of profits and losses under section* 10(2) (vii) ?"

H. R. Sodhi and Man Mohan Singh, Advocates, for the Petitioner.

D. N. Awasthy, Hem Raj Mahajan and K. C. Sood, Advocates, for the Respondent.

JUDGMENT.

The following judgment of the Court was delivered by—

Narula, J.

Narula, J.—This case raises the question of interpretation of section 10(2) (vii) of the Indian Income-tax Act, 1922 as amended by Central Act VIII of 1946 (hereinafter referred to as the Income Tax Act).

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The Sonepat Light Power and General Mills Ltd., Sonepat (hereinafter referred to as the assessee), now in liquidation, started its business in 1941 under a licence, dated 23rd April, 1935 under the Indian Electricity Act No. 9 of 1910 (hereinafter called the Electricity Act). Section 7(1) of the Electricity Act reads as follows:—

"7. (1) Where a license has been granted to any person not being a local authority, and the whole of the area of supply is included in the area for which a single local authority is constituted, the local authority shall, on the expiration of such period not exceeding fifty years, and of every such subsequent period, not exceeding twenty years, as shall be specified in this behalf in the license, have the option of purchasing the undertaking and, if the local authority, with the previous sanction of the State Government, elects to purchase, the licensee shall sell the undertaking to the local authority on a payment of the value of all lands, buildings, works, materials and plant of the licensee suitable to, and used by him for, the purposes of the undertaking, other than a generating station declared by the license not to form part of the undertaking for the purpose of purchase, such value to be, in case of difference or dispute, determined by arbitration:

Provided that the value of such lands, buildings, works, materials and plant shall be deemed to be their fair market value at the time of purchase, due regard being had to the nature and condition for the time being of such lands, buildings, works, materials and plant, and to the state of repair thereof and to the circumstance that they are in such a position as to be ready for immediate working and to the suitability of the same for the purposes of the undertaking;

Provided also that there shall be added to such value as aforesaid such percentage, if any, not exceeding twenty per centum on that value as may be specified in the license, on account of compulsory purchase,"

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Clause (a) of sub-section (3) of section 7 is also relevant in the context of this case and is reproduced below:—

"(3) Where a purchase has been effected under sub-section (1) or sub-section (2) :—

(a) the undertaking shall vest in the purchasers free from any debts, mortgages or similar obligations of the licensee or attaching to the undertaking:

Provided that any such debts, mortgages or similar obligations shall attach to the purchase money in substitution for the undertakings:"

In accordance with the requirements of section 7(1) of the Electricity Act the following provision was made in para 9 of the license granted to the assessee which was called "the Sonepat Electric License, 1935":—

"9(1) The option of purchase given by sub-section (1) of section 7 of the Act shall first be exercisable on the expiration of twenty years from the date of the notification of this license and on the expiration of every subsequent period of ten years.

The percentage of the value to be determined in accordance with and for the purpose of sub-section (1) of Section 7 of the Act of the lands, buildings, works, materials and plant of the licensee therein mentioned to be added under the second proviso of that sub-section to such value on account of compulsory purchase shall be twenty per cent."

In pursuance of the agreement contained in the license, the Punjab Government exercised its option to purchase the undertaking of the assessee during the financial year ending 31st March, 1956 i.e., during the assessment year 1956-57.

In making the Income-Tax assessment for the aforesaid year, the Income-Tax Officer held that the provisions of section 10(2) (vii) of the Income-Tax Act were attracted and determined the taxable profits on the sale of the machinery etc. at Rs. 98,415. This figure has ultimately been reduced by the order of the Income-Tax Appellate Tribunal

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(Delhi Branch), dated 22nd April, 1961 to Rs. 44,580. If the provisions of section 10(2) (vii) of the Income-Tax Act are applicable to the amount paid by the Punjab Government to the assessee in consideration of the purchase of the machinery etc. of the undertaking of the assessee, the total amount of profit determined, as stated above, to be Rs. 44,580 is not disputed.

Against the above-said order of the Income-Tax Officer, dated 31st December, 1957 an appeal was preferred by the assessee. This appeal was dismissed by the orders of the Appellate Assistant Commissioner of Income-tax, dated 8th April, 1958. The appellate authority rejected the contention of the assessee that the sale in question amounted to compulsory acquisition and not to a sale as contemplated by section 10(2) (vii) of the Income-tax Act. The second contention raised by the assessee before the Appellate Assistant Commissioner was, in any case to exclude a sum of 20 per cent of the value of the Machinery, etc., which had been computed in the sale price on account of the agreement contained in the second half of para 9 of the license and which had to be paid in pursuance of the second proviso to subsection (1) of section 7 of the Electricity Act. It was argued before the appellate authority that this amount of 20 per cent was in the nature of a solatium and was not taxable because it was not paid in consideration of the sale but as compensation for cessation or sterlisation of the business of the assessee.

A further appeal preferred by the assessee against the order of the Appellate Assistant Commissioner dated 4th August, 1958 was dismissed by the orders of the Income-Tax Appellate Tribunal, dated 19th January, 1960. Thereupon the assessee made a petition to the Income-Tax Appellate Tribunal under section 66(1) of the Income-Tax Act to make a reference to this Court. It is in pursuance of the said application of the assessee that the Income-Tax Appellate Tribunal (Delhi Branch 'B') has made this reference by order, dated 28th August, 1961. The questions of law referred to this Court are enumerated in para 7 of the statement of the case drawn by the Income-Tax Appellate Tribunal and those questions are reproduced below :—

> "(1) Whether the surplus realised by the assessee has been correctly assessed under section 10(2) (vii)".

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(2) "Whether the solatium paid has been rightly included as part of the sale price?"

(3) "Whether the loss on the service lines has been rightly ignored in the computation of profits and losses under section 10(2) (vii)".

At the hearing of this case before us Shri Hans Raj Sodhi, the learned advocate for the assessee, frankly conceded that in view of the judgment of the Supreme Court of India in *Fazilka Electric Supply Co. Ltd.* v. *Commissioner of Income-Tax, Delhi* (1), affirming on appeal the judgment of a Division Bench of this Court (Bhandari, C.J., and Bishan Narain J.) this question is no more open. The Punjab judgment is reported as *Fazilka Electric Supply Co. Ltd.*, v. *Commissioner of Income-Tax, Delhi* (2). The relevant facts of the Fazilka Electric Supply Company's case and of the instant case in so far as they relate to question No. 1 reproduced above are identical. S. K. Das J., who wrote the judgment of the Supreme Court in the *Fazilka Electric Supply Company's case* held in this connection as follows :—

> "If the whole scheme of the Electricity Act and the rules made thereunder is kept in mind, it becomes obvious that notwithstanding the use of the expression "compulsory purchase" in the second proviso to sub-section (1) of section 7; there is no compulsory purchase or compulsory acquisition in the sense in which that expression is ordinarily understood. The High Court has rightly pointed out that the scheme of the Electricity Act as indicated by the relevant provisions thereof and the rules made thereunder, shows beyond any doubt that the option of purchase is the result of a mutual agreement between the parties, the applicant for the licence on one hand and Government on the other. The High Court rightly observed;
>
> "The rules show that a draft license has to be sent by an applicant for licence containing definite

(1) A.I.R. 1963 S.C. 464.
(2) A.I.R. 1959 Punj. 483=1959 P.L.R. 555.

and specific terms on which the licence is sought. This amounts to an offer. The Government accepts it or rejects it. If it modifies it in any way, then the applicant or offerer must accept the modification. If the Government accepts the offer with or without modification, then it grants a licence. In my view a licence granted by the Government in such circumstances amounts to a contract between the parties."

"(8) On behalf of the appellant, it has been contended, somewhat faintly, that all the elements necessary to constitute a contract are not present here. We are unable to agree. There was an undertaking on the part of the applicant for the license to sell the undertaking to the local authority or Government upon certain terms set cut in the license, and the time at which the option was to be exercised and the price which was to be paid for the property were specified. There was consideration for the contract as the license was granted on those terms. Therefore, all the elements necessary for a contract were present, and the sale in pursuance thereof was not a compulsory purchase or acquisition. (See *Sakalaguna Nayudu* v. *Chinna Munuswamy Nayakar* (3)."

Question No. 1 referred to us by the Tribunal is, therefore, answered in the affirmative, i.e. in favour of the Revenue. The learned counsel for the assessee has not pressed before us question No. 3 reproduced above, Question No. 3 is, therefore, also answered in favour of the Revenue, i.e. in the affirmative.

Great stress has been laid by Mr. Hans Raj Sodhi on the dispute involved in question No. 2. His argument is that in view of the judgment of the Supreme Court, it is no doubt true that the machinery, etc., has not been compulsorily acquired by the Punjab Government but has been purchased by it. Even so, says Mr. Sodhi, it is only the fair market value of the machinery etc., referred to in the first proviso to section 7(1) of the Electricity Act which should

(3) 55 Ind. App. 243=A.I.R. 1928 P.C. 174.

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be treated as "the amount" for which the machinery has been "actually sold" within the meaning of section 10(2) (vii) of the Income-Tax Act and that the additional stipulated amount paid by virtue of the agreement contained in para 9 of the licence in pursuance of the second proviso to sub-section (1) of section 7 of the Electricity Act is in the nature of a solatium for the cessation of the business of the assessee and cannot be computed as part of the sale price and is, therefore, not taxable under the deeming provisions of clause (vii) of sub-section (2) of section 10 of the Income-Tax Act. Reliance has been placed by Mr. Sodhi in support of this argument on the observations of their Lordships of the Privy Council in *Commissioner of Income-Tax, Bengal* v. *Shaw Wallace and Company* (4), which are to the following effect :—

> "Sum received from a principal by an agent "as full compensation for cessation of the agency" or as "compensation for the loss of office" are not sums received for carrying on business, but are as some sort of solatium for the compulsory winding up of an agency and, therefore, are not assessable as income, profits and gains within the meaning of Income-Tax Act.".

Though the Privy Council judgment was given before the amendment of section 10(2) (vii) of the Income-Tax Act by Act VIII of 1946 we do not think the difference between the unamended provision and the amended provision is material for the purposes of the question before us. In the case of *Shaw Wallace and Company,* however, there was no question of any sale, nor was any question of the interpretation or application of clause (vii) of sub-section (2) of section 10 of the Income-Tax Act involved therein. On the other hand it was a voluntary agreement between the two companies in that case by which certain amount was paid "as full compensation for the cessation of the agency" of the other company. Under the Electricity Act, the situation seems to be very different. The provisions of section 7 are not of a confiscatory nature but appear to have been made to help the assessee for whom the electric undertaking would be wholly useless after the termination of his license for generating and supplying electricity under the

(4) A.I.R. 1932 P.C. 138.

Electricity Act. The scheme of the deeming provisions of section 10(2) (vii) of the Income-Tax Act is based on the fact that an assessee recovers the value of the capital investment of plant, machinery etc. by earning an income-tax rebate on account of depreciation and that it is presumed in law that at the end of a certain period the written down value of the machinery, etc., as a result of depreciation would be reduced to nil. By this process of allowing a rebate on the original capital costs, written down value is obtained every year after deducting the depreciation allowed till that time. If then the assessee sells or disposes of the machinery, etc. at a price higher than the written down value in his books, he is justly deemed to have earned a profit to the extent of the difference between the amount he actually receives against the sale of the machinery and the written down value thereof in his books. But for the legal fiction created by the deeming provision in section 10(2) (vii) of the Income-Tax Act, such surplus earned by an assessee would certainly not be 'profit' and would not be taxable under section 10(1), as it was not the business of the assessee to sell away his profit-making apparatus.

The next case relied upon by the learned counsel for the assessee is of "*Commissioner of Income-Tax, Hyderabad* v. *M/s Vazir Sultan and Sons*" (5). The following observations in the majority judgment of Their Lordships of the Supreme Court in that case have been relied upon by Mr. Sodhi:—

> ".....the agency agreements in fact formed a capital asset of the assessee's business worked or exploited by the assessee by entering into contracts for the sale of the cigarettes manufactured by the Company to the various customers and dealers in the respective territories. This asset really formed part of the fixed capital of the assessee's business. It did not constitute the business of the assessee but was the means by which the assessee entered into the business transactions by way of distributing those cigarettes within the respective territories. It really formed the profit making apparatus of the assessee's business of distribution of the cigarettes manufactured by the Company. As it was "thus neither circulating capital nor stock-in-trade of the business

(5) A.I.R. 1959 S.C. 814.

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carried on by the assessee, it could certainly not be any thing but a capital asset of its business and any payment made by the Company as and by way of compensation for terminating or cancelling the same would only be a capital receipt in the hands of the assessee."

While making the above observation Their Lordships of the Supreme Court relied on the Privy Council judgment in the case of *Shaw Wallace and Company.*

For the reasons given above neither the Privy Council judgment nor the above-said judgment of Their Lordships of the Supreme Court is relevant for the purpose of deciding the question before us.

Mr. Sodhi then relied on judgment of the Nagpur High Court reported in *Rai Bahadur Jairam Valji*, v. *Commissioner of Income-Tax, C. P. and Berar* (6). In that case also the question that arose was regarding the liability of Income-Tax of an amount received by the assessee as damages or compensation for the "premature" termination of a contract between two parties. No such question arises in the instant case. This judgment of the Nagpur High Court is, therefore, of no assistance to us in deciding question No. 2 referred to us by the Commissioner of Income-Tax.

The learned counsel for the assessee then referred to the dictionary meaning of the word "solatium". But it is significant that the word "solatium" has not been used in this case either in the second proviso to section 7(1) of the Electricity Act or in para 9 of the licence granted to the assessee under the Electricity Act. No charm, therefore, attaches to the use of the word "solatium" by the learned counsel for the assessee.

Mr. D. N. Awasthy, the senior counsel appearing for the Commissioner of Income-Tax invited our attention to the scheme of section 10(2) (vii) of the Income-Tax Act, to the wording of section 7 of the Electricity Act and to the stipulation contained in para 9 of the licence of the assessee and argued that the Income-Tax Department has to take into account the substance of the transaction and not to go by mere words.

(6) (1951) 19 I.T.R. 361.

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It appears to us that the relevant part of the section 7(1) of the Electricity Act merely provides a mode and furnishes the criteria on the basis of which the sale price for the machinery, etc. payable by the Government to the assessee has to be determined. It was admitted before us by the learned counsel for both the sides that the sale price of the respective parts of the undertaking, i.e. Power House, buildings, sub-station, etc., is inclusive of the fair market value and the 20 per cent thereof and that the break-up of the figures is not available with them. Even the statement of depreciable assets and profit under section 10(2) (vii) of the Income-Tax Act for the assessment year in question signed by the Voluntary Liquidator of the assessee and accepted by the Income-Tax Appellate Tribunal, Delhi, shows that the total amount has been shown as sale price and the so-called solatium has not been calculated or provided separately. The relevant words used in sub-section 10(2) (vii) of the Income-Tax Act are :—

> "In respect of any such building, machinery or plant which has been sold, the amount by which the written down value thereof exceeds the amount for which the building, etc. is actually sold."

After the judgment of the Supreme Court in the *Fazilka Electric Supply Company's case* it is settled that the machinery, plant, etc., were sold by the assessee to the Government. The question which then arises is what is the amount for which those things were actually sold. We think that to ask that question is to answer it. It is the total amount which the assessee received from the Government on account of the sale which is the amount for which the sale took place. It is nobody's case that the so-called solatium was payable independently of or without the sale of the property in question in any circumstances whatsoever.

In the judgment of the Supreme Court in the *Fazilka Electric Supply Company's* case the following observations appear to be not only relevant but significant :—

> "The second proviso is another enabling provision which enables the parties to specify in the licence such percentage, if any, not exceeding twenty per centum, as should be added to the value of

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the building, plant, machinery, etc. when the option of purchase is exercised. No doubt, the expression used in the proviso is "compulsory purchase", but in substance what it provides for is that parties may agree *to increase the market value of the building, plant, etc. by a certain percentage* when the option of purchase is exercised and the "price has to be paid. The use of the expression "if any" after the word "percentage" shows that the parties may agree not to *increase the market value at all*". (*italics* by us).

The sentences *in italics* in the above-said observations of Their Lordships of the Supreme Court further indicate:—

(i) that the result of addition of the stipulated amount upto 20 per cent is to fix a higher market value of the property sold; and

(ii) that the payment of the so-called solatium is also not compulsory under the statute as in the case of compulsory acquisition under the Land Acquisition Act but is subject to an agreement between the parties and the statute only lays down the maximum outside limit of 20 per cent within which the Government and the licencee may agree to the payment of any amount or no such amount at all.

The Supreme Court judgment further shows that the licence under the Electricity Act is in the nature of a contract between the parties and that there is, in fact no compulsory purchase in the sense in which that expression is ordinarily understood. This would show that the total amount paid by the Government to the assessee in pursuance of section 7 of the Electricity Act and Para 9 of the 'Agreement' is the sale price.

It may also be noticed in this connection that in case of difference between the parties as to the value to be paid to the licensee under section 7(1) it has to be decided by statutory arbitration. The additional sum of 20 per cent over and above the normal market value is part of the consideration for the agreed sale provided in the licence itself and the assessee can compel its payment in appropriate proceedings, it is not in the nature of an *ex gratia* payment.

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"Purchase Money" in section 7(3) of the Electricity Act would include each of the amounts mentioned in the first and second proviso to section 7(1) of that Act. It cannot be argued that the creditors of the assessee can reach that part of the amount which is paid under the first proviso but not the sum of 20 per cent thereon paid in pursuance of an agreement under the second proviso. This also strengthens the view we are taking.

We think that it is not correct to call the amount paid by the Government to the assessee under the second proviso to sub-section (1) of section 7 of the Electricity Act as 'Solatium' and that in fact the amount which may become payable and did in this case become payable under that provision is a part of the amount paid for the sale of the undertaking.

We, therefore, hold that the word "amount" used in section 10(2) (vii) of the Income-Tax Act includes the total amount paid by the Government to the assessee by virtue of para 9 of the licence and in pursuance of section 7 of the Electricity Act including what is called "their fair market value" under the first proviso and the added value upto 20 per cent by virtue of the second proviso to sub-section (1) of section 7 of the Electricity Act. In these circumstances we answer question No. 2 also in the affirmative, i.e., in favour of the Revenue.

All the three questions referred to us are, therefore, answered in favour of the Commissioner of Income-Tax. The parties are, however, left to bear their own costs in this case.

K. S. K.

APPELLATE CIVIL

Before Prem Chand Pandit, J.

BHAGAT SINGH,—*Appellant*

versus

PUNJAB STATE,—*Respondent*

F.A.O. No. 106 of 1963.

1965

April, 19th.

Workmen's Compensation Act (VIII of 1923)—S. 4(1)(c) and Schedule IV— Workman, suffering permanent partial disablement declared to be 20 per cent, discharged from service—Whether entitled to compensation as in the case of total disablement or proportionate to the permanent disability caused—Compensation payable— How to be determined.