Commissioner of Income Tax Vs George Williamson (Assam) Ltd.

Court: Gauhati High Court

Date of Decision: Dec. 4, 2003

Acts Referred: Income Tax Act, 1961 â€" Section 37

Citation: (2004) 187 CTR 499 : (2004) 2 GLR 707 : (2004) 265 ITR 626

Hon'ble Judges: P.P. Naolekar, C.J; I.A. Ansari, J

Bench: Division Bench

Advocate: K.P. Sarma and U.C. Bhuyan, for the Appellant; A.K. Saraf, S. Saikia, P. Bathra, K. Jain, S.K. Agarwal and Nitu Agarwal, for the Respondent

Final Decision: Dismissed

Judgement

P.P. Naolekar C.J.

1. The facts giving rise to the filing of these appeals and the questions of law raised are similar, we propose to dispose of these appeals by a

common judgment and order.

2. All these appeals have been preferred by the Revenue against the respondent companies for the relevant assessment years 1988-89 to 1991-

92. The relevant facts necessary for disposal of these appeals are that the respondent-companies carry on business and follow the mercantile

system of accounting and close their accounts on June 30 each year. The respondent-companies filed their returns and claimed deduction of lease

rent paid in respect of the plant and machinery taken on lease, which had earlier been shown as sold in the previous years relevant to the

assessment years. After the sale of plant and machinery, the assessee-companies took them back immediately on lease from the respective buyers

for use in the business run by the company and they were being used as before. During the previous year, the assessee-companies paid lease rent

for plant and machinery so taken back on lease and used by the companies for the purposes of their business during the relevant previous years.

The company claimed lease rent paid as admissible deduction in respect of the plant and machinery taken on lease. The assessing authority

disallowed the deduction to the company on the ground that the sale of the plant and machinery and taking them back immediately on lease were

not bona fide transactions. The transaction is a device adopted by the company solely for reduction of taxable profit and tax thereon and as per the

dictum laid down in McDowell and Co. Ltd. Vs. Commercial Tax Officer, the assessee is not entitled to claim deduction for such transactions.

According to the assessing authority, the rent paid cannot be said to be an expenditure incurred wholly and exclusively for the purpose of the tea

manufacturing business of the assessee within the meaning of Section 37 of the Income Tax Act, 1961. On this count, the deductions claimed by

the respondent-companies were refused. For arriving on this conclusion, the assessing authority relied on certain facts, viz., that even after transfer

of the property by sale possession of the relevant assets was not delivered to the buyer ; that the assets were sold by the company at a price much

above the market value ; that these assets were in use after taking back the assets on lease in the same function and manner and that the transaction

entered into, was only a device adopted by the company solely for claiming deduction from taxable profit.

3. Being aggrieved, the assessee-company preferred appeals before the Commissioner of Income Tax (Appeals) challenging the orders of the

assessing authority disallowing the deductions of lease rent paid in respect of the plant and machinery. The appellate authority on appreciation of

materials placed on record has held that it is not correct to say that the plant and machinery has not been delivered to the buyer. The delivery of

goods to the buyer is proved by documents on record. The transactions of transfer of plant and machinery are entered into between the companies

and the third parties, the seller and buyer had no inter se interest in each other, that is, the transactions of sale took place between the parties at

arms'' length. The sale price of the plant and machinery was determined on the basis of valuation by an independent valuer and there was nothing

on record to indicate that such valuation was doubtful and an exaggerated value has been put for sale transactions. Although the delivery of

possession is an essential ingredient of sale of movable property, actual delivery of possession does not mean that the buyer should take away the

assets after delivery and the acknowledgment by the buyer of taking delivery would suffice the requirement of taking delivery of goods for the paid

price. The entire sale price was invested for capital gains in units of the Unit Trust of India and could be used later on by the company. The

transactions of sale of plant and machinery and taking back on lease have not been disputed by the authority. The plant and machinery has been

sold by the company to the lessor and thereafter leased back to the lessee but the lease payment was made from the yearly profit and not out of

the capital realised from the sale of the plant and machinery. On the aforesaid findings, the appellate authority reached the conclusion that the

transactions had not been effected as a colourable device, but were a genuine business arrangement entered into for the business purpose purely

on business considerations. The first appellate authority allowed the deduction of the lease rent by the company. Aggrieved by the said order, the

Revenue preferred appeals before the Income Tax Appellate Tribunal. The Appellate Tribunal has upheld the findings arrived at by the first

appellate authority and held that the transactions entered into by the assessees were genuine and validly entered into and there was no motive on

the part of the assessees to defraud the Revenue. The only object of such transaction was to augment the fund which was invested by the

assessees in the Unit Trust of India and that the decision of McDowell and Co. Ltd. Vs. Commercial Tax Officer, has no application in the case.

From the orders passed by the first appellate authority as well as by the Tribunal it is apparent that the findings arrived at by the appellate authority

were based on materials placed on record and it has been held that the transactions of sale of plant and machinery and taking them back on lease

were genuine and bona fide transactions. The Revenue filed these appeals before this court against the orders passed by the Tribunal.

4. It is contended by learned counsel for the Revenue, Mr. U. Bhuyan, that the transactions entered into by the company in selling the plant and

machinery and thereafter immediately taking back the same on lease would not have been held to be bona fide transactions by the authorities had

the approach of the authorities in appreciating the facts found on record had been, as per the decision of McDowell and Co. Ltd. Vs. Commercial

Tax Officer, wherein it is said that any device adopted by the company solely for the reduction of taxable profit, would not be permissible, the

courts and the Tribunals should see and consider that the fiscal jurisprudence of this country has been changed and extended to hold that any tax

planning which is intended in avoidance of tax must be struck down by the court and the principle laid down in Duke of Westminster [1936] AC 1

would not be applicable.

5. We have heard learned counsel appearing for the respective parties at length. To deal with the point raise in these appeals, it is necessary to

refer to some important cases. In the case of IRC v. Fisher''s Executors [1926] AC 395 , Lord Sumner observed thus :

My Lords, the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the

Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any expressed terms or of any omissions that he

can find in his favour in taxing Acts. In so doing/ he neither comes under liability nor incurs blame.

6. In the matter of IRC v. Duke of Westminster [1936] AC 1; [1935] 19 TC 490, similar view was expressed by Lord Tomlin, which runs thus

(page 520 of [1935] 19 TC) :

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he

succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers

may be of his ingenuity, he cannot be compelled to pay an increased tax.

7. In the case of McDowell and Co. Ltd. Vs. Commercial Tax Officer, , O. Chinnappa Reddy J., while dismissing the observation of J. C. Shah

J., in Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, based on Westminster [1936] AC 1 and Fisher"s Executors [1926]

AC 395 said that (page 160) : ""We think that the time has come for us to depart from the Westminster principle as emphatically as the British

courts have done and to dissociate ourselves from the observations of Shah J., and similar observations made elsewhere."" Chinnappa Reddy J.,

further stated that (page 160) :

In our view, the proper way to construe a taxing statute, while considering a device to avoid tax, is not to ask whether the provisions should be

construed literally or literally, nor whether the transaction is not unreal and not prohibited by the statute, but whether the transaction is a device to

avoid tax, and whether the transaction is such that the judicial process may accord its approval to it.

8. The decision rendered by the Chinnappa Reddy J., in McDowell and Co. Ltd. Vs. Commercial Tax Officer, came for consideration and the

question arose whether the principle in Duke of Westminster [1936] AC 1 , has been departed from, subsequently, by the House of Lords in

England. These decisions have been considered in Union of India and Another Vs. Azadi Bachao Andolan and Another, and the court said that the

majority view in McDowell and Co. Ltd. Vs. Commercial Tax Officer, does not take the view expressed by the learned judge O. Chinnappa

Reddy. Speaking for the majority, Ranganath Misra J. (as he then was) has observed thus (page 171) :

Tax planning may be legitimate, provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to

encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every

citizen to pay the taxes honestly without resorting to subterfuges.

9. The court has considered the decision in Craven v. White [1990] 183 ITR 216, ; [1988] 3 All ER 495, where the House of Lords pointedly

considered the impact of Furniss v. Dawson [1984] 1 All ER 530 and IRC v. Burmah Oil Co. Ltd. [1982] STC 30 (HL) and W.T. Ramsay Ltd.

v. IRC [1982] AC 300, where Lord Keith of Kinkel observed thus (see [2003] 263 ITR 755 :

''My Lords, in my opinion the nature of the principle to be derived from the three cases is this : the court must first construe the relevant

enactment in order to ascertain its meaning ; it must then analyse the series of transactions in question, regarded as a whole, so as to ascertain its

true effect in law ; and finally it must apply the enactment as construed to the true effect of the series of transactions and so decide whether or not

the enactment was intended to cover it. The most important feature of the principle is that the series of transactions is to be regarded as a whole. In

ascertaining the true legal effect of the series it is relevant to take into account, if it be the case, that all the steps in it were contractually agreed in

advance or had been determined on in advance by a guiding will which was in a position, for all practical purposes, to secure that all of them were

carried through to completion. It is also relevant to take into account, if it be the case, that one or more of the steps was introduced into the series

with no business purpose other than the avoidance of tax.

The principle does not involve, in my opinion, that it is part of the judicial function to treat as nugatory any step whatever which a taxpayer may

take with a view to the avoidance or mitigation of tax. It remains true in general that the taxpayer, where he is in a position to carry through a

transaction in two alternative ways, one of which will result in liability to tax and the other of which will not, is at liberty to choose the latter and to

do so effectively in the absence of any specific tax avoidance provision such as Section 460 of the Income and Corporation Taxes Act, 1970.''...

Lord Oliver (at pages 518-519) said that (page 756 of [2003] 263 ITR) :

''It is equally important to bear in mind what the case did not decide. It did not decide that a transaction entered into with the motive of minimising

the subject''s burden of tax is, for that reason, to be ignored or struck down. Lord Wilberforce was at pains to stress that the fact that the motive

for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides (see [1981] 1 All ER 865; [1982] AC 300).

Nor did it decide that the court is entitled, because of the subject''s motive in entering into a genuine transaction, to attribute to it a legal effect

which it did not have ... Thus, we see that even in the year 1988 the House of Lords emphasised the continued validity and application of the

principle in Duke of Westminster [1936] AC 1 .

10. In MacNiven (H.M. Inspector of Taxes) v. Westmorland Investments Ltd. [2001] 1 All ER 865; [2002] 255 ITR 612 Lord Hoffmann

observes (see [2003] 263 ITR 757) :

In the Ramsay case [1982] AC 300 both Lord Wilberforce and Lord Fraser of Tullybelton, who gave the other principal speech, were careful to

stress that the House was not departing from the principle in IRC v. Duke of Westminster [1936] AC 1 ; [1935] All ER Rep 259. There has

nevertheless been a good deal of discussion about how the two cases are to be reconciled. How, if the various juristically discrete acquisitions and

disposals which made up the scheme were genuine, could the house collapse them into a composite self-cancelling transaction without being guilty

of ignoring the legal position and looking at the substance of the matter ?

My Lords, I venture to suggest that some of the difficulty which may have been felt in reconciling the Ramsay case with the Duke of Westminster''s

case arises out of an ambiguity in Lord Tomlin''s statement that the courts cannot ignore ''the legal position'' and have regard to ''the substance of

the matter''. If ''the legal position'' is that the tax is imposed by reference to a legally defined concept, such as stamp duty payable on a document

which constitutes a conveyance on sale, the court cannot tax a transaction which uses no such document on the ground that it achieves the same

economic effect. On the other hand, if the legal position is that tax is imposed by reference to a commercial concept, then to have regard to the

business ''substance'' of the matter is not to ignore the legal position but to give effect to it.

The speeches in the Ramsay case [1982] AC 300 and subsequent cases contain numerous references to the ''real'' nature of the transaction and to

what happens in ''the real world''. These expressions are illuminating in their context, but you have to be careful about the sense in which they are

being used. Otherwise you land in all kinds of unnecessary philosophical difficulties about the nature of reality and, in particular, about how a

transaction can be said not to be a ''sham'' and yet be ''disregarded'' for the purpose of deciding what happened in ''the real world''. The point to

hold on to is that something may be real for one purpose but not for another. When people speak of something being a ''real'' something, they

mean that it falls within some concept which they have in mind, by contrast with something else which might have been thought to do so, but does

not. When an economist says that real incomes have fallen, he is not intending to contrast real incomes with imaginary incomes. The contrast is

specifically between incomes which have been adjusted for inflation and those which have not. In order to know what he means by ''real'', one

must first identify the concept (inflation adjustment) by reference to which he is using the word.

Thus in saying that the transactions in the Ramsay case were not sham transactions, one is accepting the juristic categorisation of the transactions as

individual and discrete and saying that each of them involved no pretence. They were intended to do precisely what they purported to do. They

had a legal reality. But in saying that they did not constitute a ''real'' disposal giving rise to a ''real'' loss, one is rejecting the juristic categorisation as

not being necessarily determinative for the purposes of the statutory concepts of ''disposal'' and ''loss'' as properly interpreted. The contrast here is

with a commercial meaning of these concepts. And in saying that the Income Tax legislation was intended to operate ''in the real world'', one is

again referring to the commercial context which should influence the construction of the concepts used by Parliament.

11. The Supreme Court, after noticing these cases at page 758 of [2003] 263 ITR has held thus :

With respect, therefore, we are unable to agree with the view that Duke of Westminster''s case [1936J AC 1; 19 TC 490 is dead, or that its

ghost has been exorcised in England. The House of Lords does not seem to think so, and we agree, with respect. In our view, the principle in

Duke of Westminster''s case [1936] AC 1; 19 TC 490 is very much alive and kicking in the country of its birth. And as far as this country is

concerned, the observations of Shah J. in Commissioner of Income Tax, Gujarat Vs. A. Raman and Company, are very much relevant even

today.

12. The Supreme Court has approved a decision of the Madras High Court in M.V. Valliappan and Others Vs. Income Tax Officer and Others, ,

where the Madras High Court has held that (page 758 of [2003] 263 ITR): ''''The decision in McDowell and Co. Ltd. Vs. Commercial Tax

Officer, cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or

arrangement which is perfectly permissible under law, which has the effect of reducing the tax burden of the assessee, must be looked upon with

disfavour.

13. In view of the aforesaid legal principles laid down by the Supreme Court, it is clear that the principles laid down by Westminister [1936] AC 1

are still applicable in this country and it is open for assessees to arrange their affairs in such a manner that it would not attract the tax liabilities, so

far, it can be managed within the permissible limit of law. The assessees can very well manage their tax affairs so that the tax attracted in the

transaction is less and would not fall outside the four corners of the law applicable at the relevant time. The tax management is permissible, if the

law authorises so.

14. In the present case, the first appellate authority and the Tribunal have held that the transactions were genuine and validly entered into and that

the assets were sold and leased back purely on business considerations and there is no question of any colourable device because in the said

transaction, the assessee-company has got a substantial benefit by selling its plant and machinery to the leasing company and the advantage, which

the assessee-company has acquired, cannot be considered to be artificial or dubious and there was no motive on the part of the assessees to

defraud the Revenue. The object of the transaction was to augment funds which were invested by the assessees in the Unit Trust of India. From the

aforesaid finding it is apparent to us that the assessees entered into transactions with the parties to sell and lease back the assets, on the sale price

which was determined by an independent valuer. This has been done to minimise the tax liability, which in our opinion, is permissible under the law.

In the aforesaid view, we do not find any infirmity or illegality in the impugned orders passed by the Appellate Tribunal and the appeals are

dismissed.