

Deputy Commissioner of Vs. A.P. State Textiles Development

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Court : Income Tax Appellate Tribunal ITAT Hyderabad

Decided On : Oct-31-1994

Reported in : (1995)53ITD142(Hyd.)

Judge : R Garg, M Ramakrishna

Appellant : Deputy Commissioner of

Respondent : A.P. State Textiles Development

Judgement :

1. The appeals and cross-objection are against the orders of the Commissioner of Income-tax (Appeals) for the assessment years 1987-88, 1988-89 and 1990-91. As they involve common grounds they are being disposed of for the sake of convenience by this common order.

2. The common dispute in all the appeals is about the exemption claimed by the assessee under Section 11 of the Income-tax Act. For the assessment year 1987-88, the claim was rejected by the Income-tax Officer by observing as under : As regards the claim of exemption under Section 11 of the Act, the assessee relied on the decision of the Supreme Court in the case of Andhra Pradesh Road Transport Corporation. The Supreme Court in the case of A.P.S.R.T.C. have held that the income is exempt under Section 11 of the Act, 1961 on the ground that the entire capital has been provided by the Government and that the provisions of Road Transport Corporation Act, provides that the balance of income left after utilisation of the net profits for the purposes of set off under Section 30 of the R.T.C. Act was

to be made over to the State Government for purpose of road development and are to be utilised for financing the expansion programmes of the Corporation. In the instant case, similar circumstances are not prevailing and the claim of the assessee for exemption under Section 11 cannot be allowable.

3. In appeal, the assessee's claim for exemption was accepted by the Commissioner (Appeals) by observing in para 5(ii) as under : The purpose of the establishment of the Corporation is evident in the G.O. Ms. No. 498, cited above. It is clearly to help the weavers of the State. The appellant Corporation buy yarn from the Spinning Mills and supplies it to weavers and gets the cloth woven by them by payment of wages to them at specified rates. The cloth is sold to the public through its own outlets and other Government agencies.

The promotion of the welfare of the weavers and the rehabilitation of the handloom industry are clearly objects of the general public utility and to the extent, the appellant corpn. aims at the advancement of these objects and so, it is entitled for the exemption under Section 11. As already mentioned, prima facie, the dividend clauses militates against the Corporation being a charity.

However, excessive reliance on the clauses on paper may be misplaced. The clauses may have to be read in the context of the actual performance. As no dividends were declared so far and as there is also a commitment that there would be no declaration of dividends, I am inclined to agree with the remarks of the Tribunal in the case of the Infrastructure Corpn. cited above and hold that the appellant corpn. is a charity. Even the provisions of Section 11(4A) are not applicable in the present case because the work relating to the appellant corpn. is carried on mainly by the beneficiaries of the institution who are the weavers themselves. In this context, I agree with the contention made out by the learned representative in the note reproduced above. In these circumstances, I have to hold that the appellant corpn. is entitled for the grant of exemption under Section 11. I am also fortified in this view by the decision of the A.P. High Court in the case of Girijan Cooperative Corpn. Ltd. v. CIT 4. In assessment year 1988-89, the matter was re-examined by the ITO and concluded in paras 6, 7, 8 & 9 as follows : It is a fact that the assessee supplies yarn and other inputs to the Weavers for the

manufacture of handloom cloth. The Weavers are to contribute their labour, manufacture the handloom cloth and return the finished products to the assessee. In turn, the assessee pays them wages on piece basis. Apart from this, the assessee also purchases mill-made cloth and supply them to the various Mahila Mandals and get them stitched into ready-made garments. Here also, the stitching charges are paid at the piece rate. The assessee has also got handloom cloth dyed by paying dyeing charges to the various persons/concerns. The handloom cloth is sold through the retail out-lets and the ready-made garments were sold in accordance with the directions of the Government of Andhra Pradesh.

A scrutiny of the records reveal that the assessee was incurring losses from its inception up to and including the assessment year 1977-78. The assessee has not filed the returns for the assessment years 1978-79 to 1985-86. Therefore, nothing can be said about the trading results achieved by the assessee during these accounting years. The position for the other years is as under :Asst. year 1986-87 Loss returned Rs. 11.05 lakhs -do- 1987-88 Net profit as -do- 1988-89 -do- Rs. 81.05 " -do- 1989-90 -do- Rs. 23.61 " From the details given above, it may be seen that right from the assessment years 1987-88 onwards, the assessee-Corporation has earned substantial profits although no dividends have been declared so far. With regard to the assessee's contention that it has been formed for the advancement of an object of general public utility as laid down under Section 2(15) of the Income-tax Act, it may be mentioned that all the activities of the assessee as detailed above are commercial in nature and with a view to earn profit. In fact, it has earned substantial profits for the 3 assessment years as mentioned above. With regard to the welfare/rehabilitation of Weavers it may be mentioned that the assessee is doing nothing special other than a commercial firm which also provides yarn and other inputs to the Weavers for the manufacture of handloom cloth and pay them at piece rate for the work done. Apart from this, the assessee does no other welfare work for the work done by them. For all these reasons it has to be held that the assessee is not carrying on any object of general public utility which can fall within the ambit of Section 2(15) of the Income-tax Act. The assessee's contention that the income of the assessee is exempt under Section 11 of the Act even after the introduction of Sub-section 4A is not tenable because the activities of the assessee is providing yarn and other inputs to the Weavers for the

manufacture of handloom cloth and paying them at piece rate is purely a commercial proposition. Apart from this the assessee does no other service/welfare work for the Weavers. Further the weavers are not the shareholders of the assessee-company and no dividends/surplus has been passed on to them. Also It is noticed that apart from the manufacture of handloom cloth, the assessee is also engaged in the purchase of mill-made cloth and getting them stitched into readymade garments through the Mahila Mandals by paying them wages at piece rates and selling them readymade garments through the retail outlets. It is also noticed that the assessee has got the cloth dyed by paying dyeing charges to the various persons/concerns. All these activities would go to prove that the assessee concern is engaged in the outright commercial activities and earning substantial profits, although the same have been accumulated till to date without declaration of dividends. As pointed out above, the Weavers are the Artisans from whom the assessee gets its work done but they are not the shareholders in the assessee corporation and derive no other benefit except the wages for the work done by them. The assessee placed reliance on the decision of the A.P. High Court in the case of Girijan Co-op.

Society v. CIT [1989] 178 ITR 359 and contended that the assessee is entitled for exemption under Section 11. The facts of the assessee's case are different from the facts existed in the case of Girijan Co-op. Society, as enumerated hereunder :

(i) In the case of Girijan Co-op. Corporation Ltd., the shareholders are co-op. Stores, which are in turn constituted by the persons belonging to Scheduled Tribes as its members. Thus, the persons belonging to S. Ts are the members/shareholders/beneficiaries of the Corporation through their co-op. Societies.

(ii) The Corporation purchases products/articles from the members through its Societies and provide assistance to the members. Thus, the beneficiaries under the corporation are the persons belonging to the S.T., who are actually involved in carrying on the assessee's business.

(iii) Also there is a provision for the declaration of dividends and the dividends are paid to the member Societies which serve their constituents, i.e., to say the

members or the beneficiaries are entitled to receive/share the profits of the assessee's corporation.

In the assessee's case, though the assessee corporation claims to have formed for the up-liftment of Weavers community, the entire capital was contributed by the A.P. State Government. That is, the weavers are not the shareholders or members and they are not entitled to dividends/surplus. Secondly, the weavers are paid remuneration by piece rate for their services similar to other job workers who were doing stitching and dyeing jobs. Although there is a provision for declaration of dividends, they have to be paid only to the Government of Andhra Pradesh, because it is the sole shareholder of the assessee. Thus the Weavers get nothing except their wages for the work done along with other workers who are doing other jobs. For these reasons they cannot be treated as the beneficiaries who are doing the assessee's business.

From the facts given above, it is clear that the Weavers who are claimed as the beneficiaries of the assessee are not doing the business of the assessee entirely and are not entitled to the profits of the Corporation. For all these reasons, the case of assessee is hit by the provisions of Section 11(4A) of the Act. As such, the assessee cannot get the exemption under Section 11.

5. This order of the ITO was upheld by the Commissioner (Appeals) disagreeing with his predecessor. The reasons given are that (a) though the G.O. Ms. No. 498 dated 6-5-1975 might have given birth to the appellant-corporation, the nature of activities carried out by it has to be appraised only with reference to its own Memorandum and Articles of Association and with reference to what has been achieved by way of results; (b) it is not correct to say that some of the ancillary objects were in the nature of power given to the management of the appellant corporation Ltd., a similar controversy arose for assessment year 1985-86, wherein it was held by the Judicial Member that each object whether described as main, ancillary or residuary object, was first and foremost an object itself independent of each other. Thus all the clauses figuring under Part B of Memorandum of Association would be independent objects of the appellant-corporation and the cumulative effect of the same cannot be ignored; (c) the

clauses relating to distribution of dividends and distribution of assets on winding up cannot be conjured away by the assurance given by the appellant-corporation in the letter dated 4-9-1990 unless the appellant-corporation goes through an F.G.M. to pass a resolution for deleting the said offending clauses and secures necessary confirmation from the Company Law Board. Without such a formal amendment of Articles of Association, Clause 92 of Articles of Association cannot be wished away by any pious assurance given by the appellant-corporation. In that view of the matter, the existence of Clauses 92 and 131 of Articles of Association needs to be taken note of with all its concomitant effect and that if some of the clauses offend the charitable objects, the performance dictated by such clauses cannot be any better.

6. Observing that his predecessor-in-office opined that the provisions of Section 11(4A) were not applicable to the appellant's case because the work relating to the appellant corporation was carried on mainly by the beneficiaries, viz., the weavers. He has distinguished the assessee's case from that of Girijan Co-operative Corporation Ltd. 's case (supra) and held that the weavers who are the necessary adjuncts to the appellant's business cannot be equated to the Girijans who are the beneficiaries of the Girijan Cooperative Corporation Ltd. 's case (supra). As per the charter of the appellant corporation evidenced by the Articles and Memorandum of Association and in terms of the appellant's actual case history over the period right from inception, the weavers, he held, have no active participatory role in the conduct of the appellant's business. The disbursement of the wages to weavers cannot, he observed, be construed as a benefit to them, since it was in recognition of services rendered by them, the weavers cannot be said to be carrying on the business by contributing their labour for wages, that the employment for wages in the course of carrying on of business cannot be construed as an advancement of any other object of general public utility and that even the Government undertakings and public sector enterprises which are cast in the mould of model employer do not enjoy any such privileged position. He further observed that the industries operating in rural/backward areas enjoy only certain tax concessions and not exemption under Section 11 and in that view of the matter, the appellant corporation which makes use of the services of the weavers for parrying on its business cannot claim to be an institution as envisaged in Section 11(4A)(b).

Section 11(4A) was introduced as a check against the misuse of tax concessions by persons connected with the affairs of the trust. The intention was to bring to tax the business profits of such errant trusts. Obviously, the idea was to grant exemption under Section 11(4A)(b) only to institutions such as blind schools, craft guilds, etc. and not to regular business such as that of the appellant. The weavers are not in the same position as Girijans as in the case of Girijan Co-operative Corporation Ltd. (supra). The fact that the weavers are required by way of wages would not make them the beneficiaries. Section 11(4A)(b) visualises an identity of purpose, a commonality of interest and total involvement and participation of the beneficiaries in the activities of the institution. In other words, the institution solely exists for the beneficiaries and the beneficiaries make the institution. Can it be said that such a vinculum and association exist in the given context of the case? The answer is an emphatic 'No'. The weavers have no control over the appellant's business activities and the benefits accruing to them by way of wages is just a compensation for the services rendered.

According to him, it is possible that the appellant might have provided an opportunity to the weavers to earn wages. That in his opinion, by itself would not place them in the same position as is mandated by Section 11(4A)(b). Stating that he had already highlighted the role of weavers as an input of the appellant's business and also pointed out earlier in his order that the appellant has absolute discretion to deploy the profit and reserve fund in the manner it deems fit and such an unbridled discretion has a potential mischief, he took the view that the Articles of Association did not refer to the weavers as the beneficiaries of the reserve fund or of the dividends declared. In such a context, what is the benefit accruing to the weavers. In his view Section 11(4A)(b) contemplates a situation where there would be a total anastomosis of thought and deed between the institution and the beneficiaries. In the instant case, the weavers are totally distanced from the assessee-corporation. Thus in his opinion Section 11(4A)(b) which was visualised for a totally different purpose cannot be transplanted into the assessee's case, which has nothing in common with the institutions referred to in that Section. He then referred to the decision of the case of Auroboutique Trustv. ITO [IT Appeal Nos. 421 & 437 (Mad.) of 1987] and reproduced in his order the relevant portion which is as follows: The main part of Sub-section 4A is that nothing in the

provisions of Section 11 to exempt the income from tax shall apply to profits and gains of business. The embargo is on every kind of profits and gains from business irrespective of how it is derived who derives it. It is only the exception to the embargo which talks of two cases that of an income derived by religious trust from the business of painting and publication of books and that of an institution for charity where the business is carried on by the beneficiaries. These exceptions actually prove the rule that if the income does not fall within the scope of these exceptions from general embargo it will not be eligible for the exemption under Section 11. The alternative contention of the assessee was that it should be taken to have satisfied the conditions in Sub-clause (b) that the business is being entrusted to St. Aurobindo Ashram which is the beneficiary.

This contention also is not acceptable because the condition in Sub-clause (b) applied only to an institution and not the trust.

Obviously the idea was to grant the exemption only to institutions such as blind schools or craft guilds and not a regular business such as that of the assessee. The ITO was thus justified in disallowing exemption to the assessee under Section 11.

In view of the above finding of the ITAT, Madras Bench 'D' he held that the idea was not to grant exemption to a regular business such as that of the appellant. Thus when the weavers are not the beneficiaries and do not carry on the business, the appellant's case does not fit into the requirements of Section 11(4A)(b). In view of the foregoing, he held that the D.C. (Assts.) was justified in denying exemption under Section 11 of the Act.

7. For assessment year 1990-91, the ITO and the Commissioner (Appeals) mainly followed their earlier orders for assessment year 1988-89 and disallowed the claim of the assessee.

8. The learned counsel of the assessee Shri K. Satyanarayana referred to the Government order requiring formation of the Corporation, its objectives and certain clauses of Articles of Association. He then referred to certain decisions reported in Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1 (SC),

Girijan Co-op.

Corporation Ltd.'s case (supra), CIT v. Federation of Indian Chambers of Commerce & Industry [1981] 130 ITR 186 (SC), CIT v. Gayathri Women Welfare Association [1993] 203 ITR 389 (Kar.), CIT v. Andhra Pradesh State Road Transport Corporation [1986] 159 ITR 1 (SC), the decision of the Tribunal in the case of A.P. State Civil Supplies Corporation [IT Appeal No. 2574 (Hyd.) of 1988 dated 28-8-1990] the decision of the Bombay High Court in the case of CIT v. Western India Chamber of Commerce Ltd. [1982] 136 ITR 67 (Bom.) and the decision of the Rajasthan High Court in the case of CITv. Maharana of Mewar Charitable Foundation [1987] 164 ITR 439 (Raj.). On the basis of the aforesaid decisions, the learned counsel for the assessee submitted that the entire capital of the assessee corporation is owned by the Government of Andhra Pradesh. Though there is a provision for declaration of dividend, no dividend has been declared so far because of absence of profits and in any case even if the dividend was to be declared it would go to the A.P. Government and would not be a fetter against charitable nature of the Corporation. He further submitted that the funds have been utilised for making up the losses and therefore, that was an application for charitable purposes. He also referred to the audit certificate incorporating the application of income at 'Nil' because the entire amount was spent by the assessee for charitable purposes. He then referred to registration granted under Section 12A of the Income-tax Act by the Commissioner of Income-tax and stated that the charitable nature of the society has been recognised by the Commissioner himself. Referring to Sub-section (4A) of Section 11, he submitted that weavers helped in carrying on the activities of the assessee and in fact activities were carried on by the weavers only for whose benefit the corporation was set up. He further submitted that the fact that the assessee has not claimed exemption in the earlier year should not be considered as a factor against the assessee. He, therefore, submitted that the order of the Commissioner of Income-tax (Appeals) in the appeal for the assessment year 1987-88 should be upheld and the orders in appeal for the assessment years 1988-89 and 1990-91 deserve to be reversed.

9. The learned Departmental Representative Shri K. Vasantha Kumar on the other hand, submitted that the assessee corporation was set up somewhere in 1975 and

no claim for exemption under Section 11 of the Income-tax Act was made right up to assessment year 1986-87. On the contrary returns were filed for some of the years offering some income as if the Corporation was doing business. This according to him shows that the assessee was not a charitable institution but was a Corporation carrying on business activities. He further submitted that if it was all charitable institution, it should have been registered under Section 25 of the Companies Act, 1956. Referring to the decision of the Supreme Court in CIT v. Indian Sugar Mills Association [1974] 97 ITR 486, he submitted that distribution of dividend clause is inconsistent with the objects of general public utility. In the decision of the Supreme Court in the case of Surat Art Silk Cloth Manufacturers Association (supra), the surplus was to be utilised for the members' benefit only which is not there in the present case.

Referring to the Government order, setting up the Corporation, he submitted that the said order authorised export activity to the Corporation, which could not be in the nature of the charity. Referring to the clause of Articles of Association regarding dividend, reserve fund and winding up, he submitted that the very existence of those clauses is inconsistent with the main object of the Corporation. He further submitted that the Corporation, offends the provisions of Section 11(4A) as it is not run by the weavers. Weavers were paid simply wages for the work done by them and apart from that they have no interest in the activity of the Corporation. Referring to the decision of the Supreme Court in the case of Gangabai Charities v. CIT [1992] 197 ITR 416, he submitted that the articles contained in the Articles of Association are contrary to the Government's order intending to set up the corporation. Referring to the decision of the A.P. High Court in the case of Girijan Co-operative Corporation Ltd. (supra), he submitted that it was a co-op, society set up and the benefit under its bye-laws was reserved only for Girijans. The decision of the Tribunal in the case of A.P. Essential Commodities Corporation, he submitted, is distinguishable. In that case, the trade was not for the purpose of profit but to help the general public. The clause authorising declaration of dividend was omitted and these factors were the main consideration before the Tribunal to decide the issue in favour of that assessee. On the contrary, he submitted that the decision of this Tribunal in the case of A.P. State Warehousing Corporation is squarely applicable wherein it was held that the object

of the society as in this case was to earn profit. He then referred to and relied upon various decisions referred to by the Commissioner (Appeals) and also the decision of the A.P. High Court in the case of A.P. State Civil Supplies Corporation Ltd. v. CIT [1984] 148 ITR 497 and in the case of CIT v. Hyderabad Secunderabad Foodgrains Association Ltd. [1989] 175 ITR 574. He submitted that the order of the Commissioner (Appeals) for the assessment years 1988-89 and 1990-91 are the correct orders on the issue and should be upheld and the contrary order rendered in the appeal for assessment year 1987-88 deserves to be reversed.

10. We have heard the parties and considered the rival submissions. The 1st issue made out by the revenue is that trust has been treating itself non-charitable and was filing return as if carrying on business, that it failed to file loss returns for assessment years 1979-80 to 1985-86, that for assessment year 1986-87 loss return was accepted and therefore to get over the lapse of the assessee in claiming losses for the assessment years 1978-79 to 1985-86 for which no return was filed, the provisions of Section 11 are called in aid as an escape hatch and that it is incredible that it took about 14 years for the assessee to espy the charitable disposition in its activities and, therefore, Section 11 cannot be invoked as a matter of expediency nor can it be used for bailing out the assessee from tax implication. We do not think that the assessee's failure to claim exemption in the earlier year has any impact on the issue to be decided in the years under consideration.

We have to consider the case on merits of the case and not on the assessee's attitude or the position obtaining in the earlier year/years. We do not find any bar in assessee's putting up a claim in a year if it was not put up in the earlier year/years. We, therefore, hold that the assessee's claim even made after 14 years is not an impediment by itself. For whatever purpose or benefit the claim is made in the year under consideration or that it was not made in the earlier year(s) for those reasons, it has to be considered on merits in the year under consideration.

11. The provisions of the Income-tax Act on which the assessee's case rests for claiming exemption is Section 11 which provides that certain income enumerated in Clauses (a) to (d) shall not be included in the total income of the previous year

of the person in respect of the income. Clause (a) which is material for the purposes of deciding this appeal is as under : (a) income derived from property held under trust wholly for charitable or religious purposes to the extent to which such income is applied to such purposes in India; and where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of twenty-five per cent of the income from such property; Sub-section (4) of Section 11 provides that for the purposes of this section 'property held under trust' includes a business undertaking so held. The term 'trust' has been defined in Explanation 1 to section 13 of the Act that for the purposes of Section 11 etc., 'trust' includes any other legal obligations. The word 'charitable purpose' is defined in Section 2(15) to include relief of the poor, education, medical relief and the advancement of any other object of general public utility. The assessee is admittedly holding a business undertaking which is to be treated as a property held under trust if there is any.

The dispute in this appeal is as to whether the assessee corporation is a trust within the meaning of the Explanation 1 to Section 13 read with Section 11(1)(a). It would be a trust if it falls within the phrase "any other legal obligation" appearing in Explanation 1 to Section 13.

The assessee is incorporated under the Companies Act as a Private Limited Company. Its legal obligations are contained in its memorandum of association and articles of association. If therefore, any legal obligation is there in its memorandum of association or articles of association which is wholly for charitable purpose, it would enjoy the exemption under Section 11 of the Act.

12. The AP State Textile Corporation Ltd., the assessee, was incorporated on 31st May, 1975. As per its memorandum of association, the objects clauses are divided into three parts as follows : (b) Objects ancillary or incidental to the attainment of the objects mentioned at (a) above, and 13. The main object is stated in Clause (1) of part (A) of Article III of the Memorandum of Association and reads as under : To promote, own, establish, aid and assist rehabilitation, growth and development of the Handloom (cotton, wool and silk), powerloom, all types of including leather garment manufacturing and Sericulture Industries, both within and outside the Co-

operative fold.14. There are as many as 37 ancillary and incidental objects appearing in Clauses (2) to (38) of Part (B) in the said Article III of the Memorandum of Association for the attainment of and/or with a view to aid main object of promoting and development of Handloom and Powerloom, garments manufacturers and Sericulture units. Other objects are stated in Part (C) of Article III to be nil. Article IV of the Memorandum of Association provides that liability of the Corporation is limited and as per Article 2 of the Articles of Association, the Corporation is to be a private company within the meaning of Section 3(1)(iii) of the Companies Act, 1956 and accordingly, (a) restricts the right to transfer its shares in the manner provided in the Articles of Association; (b) limits the number of its members to fifty not including (i) persons who are in the employment of the company and, (ii) persons who, having been formerly in the employment of the company were members of the company while in the employment and have continued to be members after the employment ceased and (c) prohibits any invitation to the public to subscribe for any shares in or debenture of the company provided that where two or more persons hold one or more shares in the company jointly, they shall for the purposes of this definition, be treated as a single member. Article V of the Memorandum of Association provides for the capital of the company. It states that 'the authorised share capital of the Company is Rs. 5,00,00,000 (Rupees Five Crores) divided into 5,00,000 (Rupees five lakhs) equity shares of Rs. 100 (Rupees one hundred) each, with power to increase, reduce the capital for the time being into several cases and to attach thereto respectively, such preferential, guaranteed, qualified or special rights, privileges and conditions as may be determined by or in accordance with the Articles of Association of the company and to vary, modify, amalgamate or abrogate any such rights, privileges or conditions in such manner as may for the time being be provided by the Articles of Association. Parts II, III, IV, V and VI of Articles of Association containing Articles 6 to 33 deal with various aspects of the issue, allotment, lien, transfer of shares and alteration of capital. In none of the clauses of Memorandum of Association and Articles of Association, there is obligation that the shares are to be subscribed, issued or allotted to A.P. Government only and none else.

Certain rights are however reserved for the A.P. Government in Articles 76 and 121 of the Articles of Association.

15. Assessee's claim is that it was incorporated in pursuance of G.O. Order 498 dated 6-5-1975 of A.P. for promoting the welfare of weavers and its objects should be considered in the light of the said G.O. The G.O. provides that in spite of the appreciable investment made by the Government under the plan schemes for the development of Handloom Industry, there is still a preponderant majority of weavers outside the co-operative fold and the benefit of various development programmes are not accruing to them. Even among the existing weavers co-operatives, quite a number of them are languishing and are not able to provide full and sufficient employment to their members resulting in many of these weavers taking up independent weaving or working for master weavers.

The order further states that in regard to export of handloom goods, in spite of the vast potential and opportunities existing in Andhra Pradesh, the performance of the State has been anything but satisfactory. Similarly, powerloom weavers, workers engaged in the manufacture of readymade garments, sericulturists, wool weavers and other concerned with Textile Industries have to be adequately provided their much needed technical guidance as well as financial assistance for improving their production with a view to help them to produce exportable varieties and thus earn export incentive. In order to achieve this object, the Government of Andhra Pradesh directed the establishment of the assessee-corporation, under the Companies Act, 1956 with an authorised capital of Rs. 1.00 crore divided into 1 lakh shares of Rs. 100 each and that it shall be a fully Government owned corporation. A sum of the Rs. 25 lakhs was immediately sanctioned and the Director, Handloom Textiles was authorised to draw and invest in equity shares of the intended Corporation.

16. The Commissioner of Income-tax (Appeals) in the appeal for assessment year 1988-89 held that though the G.O. of the A.P. Government lays down the intention of the Govt. which might be charitable, it was not translated into reality through the instrumentality of the assessee corporation. It being a Company, under the Companies Act, is governed by its Memorandum of Association and Articles of Association which nowhere binds it, to the avowed objects contained in the Memorandum of Association. He referred to the Supreme Court decision in the case of Heavy Engineering Mazdoor Union v. State of Bihar 3 SCR 995, wherein

the Heavy Engineering Corporation was held to be acting on its own under the authority of its Memorandum of Association and Articles of Association and not as a servant or an agent of the Central Government and, therefore, the reference to the Industrial Disputes under Section 10 of the Industrial Disputes Act, 1947 was held not to be made to the Govt. Reliance was also placed by the Commissioner (Appeals) on the decision of the Supreme Court in Praga Tools Corporation v. C.A. Immanuel 3 SCR 773 wherein it was held that a Corporation incorporated under the Companies Act did not have a statutory or public duty imposed upon it. He also referred to the decision of the Supreme Court in the case of S.L. Agarwal v. General Manager, Hindustan Steel Ltd. 3 SCR 363 wherein it was held that a Company incorporated under the Companies Act is not a Department of the Govt. inasmuch as it has a separate and distinct legal entity. He, therefore, held that the character of the Company is to be determined only with reference to various clauses of the memorandum of association and Articles of Association.

17. We are in agreement with the Commissioner (Appeals) on this issue, namely, that the character of the Corporation is to be determined with reference to its memorandum and Articles of Association. A company incorporated under the Companies Act has a separate legal entity, than its shareholders. The premier case on this issue is the case of Solomon v. Solomon & Co. Ltd. wherein the entire shareholding except one share belonged to Solomon and it was held that the Company has a separate existence independent of Solomon, that the law recognises a company as a juristic person separate and distinct from its members and that the rights and obligations of a Company are distinct from those of its shareholders. Therefore, the legal status of the Government Company is not affected merely because the share capital of the company is contributed by the Central Government and all its shares are held by the President of India or the Governor of a State and certain nominated officers of the Govt. The reference to the observations of Justice P.L.

Mukherjee, as he then was in *Re River Steam Navigation Co. Ltd.* [1967] 2 Comp. Law Journal 106 are apt to the situation: 'Government today is a competitor with public/private companies and corporations and doing trade or business or commerce. In doing so, the Government is not doing it qua Government. It joins

the field of competition in these diverse spheres and fields as Government companies, as State Trading Corporations and in many other forms under particular Statutes'.

Therefore, it is clear that when the Government engages itself in trading ventures, particularly as Government companies under the Company Law, it does not do so as a political State or political Government, but it does so in the garb and essence as a company. Again the observations of Mr. Justice Chandrachud, the then Chief Justice of India in the case of *Western Coalfields Ltd. v. Special Area Development Authority* AIR 1982 SC 697 are worth noting. They are: "Even though the entire share capital of the appellant-companies has been subscribed by the Government of India, it cannot be predicated that the companies themselves are owned by the Govt. of India. The companies which are incorporated under the Companies Act, have a corporate personality of their own, distinct from that of the Govt. of India. The land and buildings are vested in and owned by the Companies, the Govt.

of India only owns the share capital". We find, therefore, ourselves in agreement with the Commissioner (Appeals) for the proposition that the Government and the Corporation owned by the Govt. are two distinct and separate legal entities and the Corporation owned by the Government is not Government itself nor a wing/department of the Government.

Therefore, unless the memorandum of association and Articles of Association of the Company depicts a character of the Company to be that of a charitable nature, it cannot be held to be so. In other words, the 'legal obligation' of the assessee-company to call it a trust wholly for charitable purposes Under Section 11 has to be seen from its Memorandum of Association/Articles of Association.

18. Examining various clauses of the memorandum of association, the Commissioner of Income-tax (Appeals) further held in assessment year 1988-89 that there is no mention whatsoever to the upliftment of weavers per se either in the main object or in the ancillary objects in Part B, that if the object was to promote the interest of the weavers in the handloom/powerloom sector, the same should have been spelt out in no uncertain terms in the memorandum of

association; that if the weavers were to be benefited incidentally as a result of the assessee's activities it would not mean that the welfare of the weavers was the sole concern of the assessee, that if the assessee corporation was the one meant for the upliftment of the weavers, the objects both main and ancillary should speak of ways and means of providing various facilities, financial, infrastructural and marketing to the weavers, that various clauses in the Memorandum of Association are of a piece with what is normally seen in the case of a company engaged in the business of manufacture and trading and there is nothing in those clauses to elevate the assessee corporation as a purveyor of charity by providing support to the weavers perse, that the clauses independently or collectively do not exude any discernible concern for the weavers, while orchestrating in unison about developing the assessee's business in the chosen sectors, that the outgo on any one of their account, namely, land, capital, labour and organisation cannot be considered as an object of general public utility promoting the lot of weavers in a larger canvass as it were, unless the said input can transcend beyond its normal connotations to a laudable objective setting the pace and standard, dominating the thoughts, quickening the impulses, giving the impetus and staring the course of action unswervingly for its fulfilment; and that to achieve the same, he stated, the model should be that of Girijan Co-operative Corporation Ltd. These observations, in our opinion, are not fully correct.

19. It is no doubt true that the Corporation and the Government are two separate legal entities and the Corporation cannot be equated with the Government or a Wing/Department of the Government but, in this case, a mandate has been imposed upon the assessee-company by Articles 76 and 121 of the Articles of Association extracted below clearly showing that a right is reserved to the A.P. Govt. for conducting the affairs of the Corporation which ensured its Control within the parameters of G.O.: Art. 76. Specific powers of Board to make rules.- Without prejudice to the generality of the above provisions, the Board shall reserve for decision of the State Government :- (1) Rules of the Company governing the conditions of service of the employees, provident fund and other rules creation of Reserve and Special Fund; (2) Sale, lease or disposal otherwise of the whole or substantially the whole of the undertaking of the Company; Art 121. Rights of the Government.- Notwithstanding anything contained in any of these Articles, the

Government may from time to time, issue such directives it may consider necessary in regard to the conduct of the business of the Company or Directors thereof and in like manner may vary and annul such directive. The Board shall give immediate effect to the directives so issued.

The entire capital of the assessee-company is to be owned by the A.P.Govt. as depicted in the G.O. dated 6-5-1975 and even as a matter of fact, the entire capital owned by the A.P. Govt. No further capital can be issued or existing shares could be transferred without the concurrence or knowledge of the A.P. Govt., it being a private limited company restricting the right of the transferability of its shares and prohibiting any invitation to public for subscribing to its shares. The Govt. of A.P. is bound by its G.O. and could not allow the violation thereof. At least nothing of that sort can be assumed or presumed.

20. Quoting the decision in the case of Sashikant Laxman Kale v. Union of India [1990] 185 ITR 104 (SC) and in the case of R.D. Shetty v. International Airport Authority of India 3 SCR 1014, the Commissioner of Income-tax (Appeals) held that the profit earned by a public sector undertaking enures for the benefit of public, that the same is not exempt from the incidence of income- tax despite the fact that such profit enriches the public coffer and not the private coffer and that their survival very much depends upon the budgetary provision of the Govt. and not upon private resources, which are available to the industries in the private sector. He particularly quoted the observation of the Supreme Court which according to him is the key to the issue, viz., that a point of view emerging currently is that the Income-tax Department should confer exemption under Section 10 to the undertakings of the Government or public sector from tax liability by suitable amendment to Section 10 of the I.T. Act as is given to local authorities/housing boards and the support for such a view was sought to be on the ground that the exemption from tax liability of public sector undertakings would ultimately benefit the consumer and the public at large. From this he concluded that the Supreme Court has acknowledged the fact that the Government or Public Sector Undertakings are otherwise liable to tax under the Income-tax Act in respect of profits earned by them and that being so, how the assessee-company, cast in the same mould as the genre of Government or Public Sector

undertakings, could claim exemption in respect of the income earned by it under Section 11 of the IT Act by claiming that its objects are charitable in nature and its income enures for the Government and in turn for the public. We do not subscribe to this view: firstly, because Section 11 was not a subject-matter of consideration before their Lordships in either of the cases; secondly, the definition of 'charitable purposes' as appearing in Section 2(15), as it stood then, prohibited the carrying on an activity for profit by a charitable institution. This was because of the existence of words in the definition 'not involving carrying on of any activity for profit' immediately after the stated 'object of general public utility' were deleted only with effect from 1-4-1984. If a Government company or a public sector undertaking or, as stated by the CIT (Appeals), all such companies, are established with the object of general public utility and are engaged in pursuing that object, every such company would be charitable institution for the purposes of Section 11.

21. With this background, let us examine whether the assessee-corporation is established with a legal obligation so as to be a 'trust wholly for charitable purposes'. The main object of the assessee is to promote, own, establish, aid and assist rehabilitation, growth and development of the Handloom (cotton, wool and silk), Powerloom, all types of including leather garment manufacturing and Sericulture Industries, both within and outside the Co-operative fold. This is the dominant and primary purpose of the assessee-corporation.

Other objects appearing in Clauses (2) to (38) in the Objects clause of the memorandum of Association of the company are merely powers incidental to the carrying out of the dominant and primary purpose.

This is also evident from the caption given in Part B of the Objects clause, viz., 'the objects ancillary or incidental to the attainment of the main object mentioned at (A) above'. It is held by the majority decision of the Supreme Court in the case of Surat Art Silk Cloth Manufacturing Association (supra) that where the main or primary objects are distributive, each and every one of the objects must be charitable in order that the trust or institution may be upheld as a valid charity. But if the primary or dominant purpose of a trust or institution is charitable, another

object which by itself may not be charitable but which is merely ancillary or incidental to the primary or dominant purpose would not prevent the trust or institution from being a valid charity. In this case, only one cause is designated as main object which is the primary and dominant object. The assessee's is not a case of having distributive main or dominant object. Therefore, even if the objects enumerated in Clauses (2) to (38) are not charitable, that would not prevent the assessee from being held charitable if its main object in Clause (1) is its primary and dominant purpose. We, therefore, have to determine whether the main object of the assessee which is primary and dominant is charitable or not.

22. In *Surat Art Silk Cloth Manufacturing Association* (supra), the Supreme Court noted with approval its earlier decision in the case of *CIT v. Andhra Chamber of Commerce* [1965] 55 ITR 722 wherein without any doubt it was held that the dominant or primary purpose to promote commerce and trade in art silk yarn, raw silk, cotton yarn, art silk cloth, woollen cloth and cotton cloth fell within the category of advancement of an object of general public utility. With the same logic, the object of the assessee-corporation, "To promote, own, establish, aid and assist rehabilitation, growth and development of the Handloom (cotton, wool and silk), Powerloom, all types of including leather garment manufacturing and Sericulture Industries, both within and outside the Co-operative fold", would be an object of general public utility. Furthermore, it is directed towards the welfare of the weavers as stated and depicted in G.O. No. 498 which is issued by the Government of Andhra Pradesh.

23. Another issue made by the Revenue is that the assessee is a private limited company and not registered under Section 25 of the Companies Act, that it has the provision for declaring dividend, creating reserves for equalisation of dividend and distribution of assets to shareholders which are of private gains and contrary to the basic character of charity. The assessee has full discretion to deploy the profit in the manner it wants and, therefore, as decided in *Indian Sugar Mills Associations's case* (supra), *Surat Art Silk Cloth Manufacturer's case* (supra) and *Dharmadeeptiv. CIT* [1978] 114 ITR 454 (SC), where the relevant rules and regulations permitted distribution of profit, it would be inconsistent with the object of public utility.

The registration of the assessee-company as private limited company, of course, gives an impression that it is for private gains or purposes, but, as aforesaid, its objects are charitable purposes within Section 2(15) of the IT Act, to pursue the object of general public utility.

There is no bar in law or a legal disability for a private company to engage in charitable activities. For being a charitable institution, it is not necessary that it should be registered under Section 25 of the Companies Act. This section provides : 25(1) Where it is proved to the satisfaction of the Central Government that an association - (a) is about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object, and (b) intends to apply its profits, if any, or other income in promoting its objects and to prohibit the payment of any dividend to its members, the Central Government may, by licence, direct that the association may be registered as a company with limited liability, without the addition to its name of the word 'Limited' or the words 'Private Limited'....

This section also recognises that a company registered under this section could be a private limited company also. This section gives a power or discretion that if an association intends to be formed for promoting commerce, art, science, religion, charity or any other useful object or intends to apply its profits for such objects prohibiting the distribution of dividends to its members, such an association may be directed to be registered without the addition to its name of the words 'Limited' or 'Private Limited'. This section neither lays down nor can, in our opinion, be interpreted to mean that a company registered shall necessarily be a charitable institution nor to mean that if a company is directed to be registered with the addition of the words 'Limited' or 'Private Limited', shall not be a charity. Furthermore, the assessee-company's primary and dominant purpose as stated in its main object satisfies fully the conditions prescribed in Clause (a) of Section 25(1) of the Companies Act, it being formed for promoting charity. It could not be registered under Section 25 because of the existing clauses for declaration of dividend. These clauses are:- 91. Reserve Fund.- Subject to such directions as may, from time to time be issued by the Government in this behalf, the Board may, before recommending any dividend, set aside out of the profits of the Company

such sums as it thinks proper as a reserve fund, to meet contingencies or for equalising dividends or for special dividends or for repairing, improving and maintaining any of the property of the Company and for amortisation of capital and for such other purposes as the Board shall in its absolute discretion think conducive to the interests of the Company; and may invest the several sums so set aside upon such investments (other than shares of the Company), as it thinks fit from time to time deal with and vary such investments and dispose of all or any part thereof for the benefit of the Company and may divide the reserve funds or any part thereof in the business of the Company; and without being bound to keep the same separate from the other assets.

92. Dividends.- The profits of the Company available for payment of dividend subject to any special rights relating thereto created or authorised to be created by these presents and subject to the provisions of these presents as to the reserve funds and amortisation of capital shall, with the approval of the Government be divisible among the members in proportion to the amount of capital held by them respectively : Provided always that (subject as aforesaid) any capital paid up on a share during the period in respect of which a dividend is declared shall only entitle the holder of such share to an apportioned amount of such dividend as from the date of payment.

93. Declaration of Dividends.- The Company in annual general meeting may declare dividend to be paid to the members according to their rights and interests in the profits and may fix the time for payment but no dividend shall exceed the amount recommended by the Board.

94. Dividend out of profits only and not to carry interest.- No dividend shall be payable otherwise than out of the profits of the year or other period or any other undistributed profits of the Company and no dividend shall carry interest as against the company.

95. When to be deemed net profits.- The declaration of the Board as to the amount of the net profits of the Company shall be conclusive.

96. Interim dividend.- The Board may, from time to time, pay to the members such interim dividends as in their judgment the position of the Company justified.
97. Debts may be deducted.- The Board may retain any dividends on which the Company has a lien and may apply the same in or towards satisfaction of the debts, liabilities or engagements in respect of which the lien exists.
98. Dividends or bonus payable in specific assets.- Subject to the provisions of the Act, any general meeting declaring a dividend may resolve that such dividend be paid wholly or in part by the distribution of specific assets and in particular of paid-up shares, debenture or debenture stock of the Company or paid up shares, debenture-stock of any other Company or in any one or more of such ways; any general meeting may resolve that any moneys, investments, or other assets forming part of the undivided profits of the Company standing to the credit of the Reserve Fund, or in the hands of the Company and available for dividend or representing premia received on the issue of shares and standing to the credit of the share premium account be capitalised and distributed amongst the shareholders in accordance with their rights on the footing that they become entitled thereto as capital and that all or any part of such capitalised fund be applied on behalf of the shareholders in paying up in full any unissued shares of the Company and that such unissued shares so fully paid be distributed accordingly amongst the share-holders in the proportion in which they are entitled to receive dividends and shall be accepted by them in full satisfaction of their interest in the said capitalised sum. For the purpose of giving effect to any resolution under this Article, the Board may settle any difficulty which may arise in regard to the distribution as it thinks expedient and in particular may issue fractional certificates and may fix the value for distribution of any specific assets and may determine that cash payments shall be made to any members upon the footing of the value so fixed or that fractions of less than Re. 1 may be disregarded in order to adjust the rights of all parties and may vest any such cases of specific assets in trustees upon such trusts for the persons entitled to the dividend or capitalised fund as may seem expedient to the Board. Whether requisite, a proper contract shall be filed in accordance with Section 75 of the Act and the Board may appoint any person to sign such contract on behalf of the person entitled to the

dividend or capitalised fund and such appointment shall be effective.

99. Effect of transfer.- A transfer of shares, shall not pass the right to any dividend declared thereon after such transfer and before registration of the transfer.

100. Retention in certain cases.- The Board may retain the dividends payable upon shares in respect of which any person is under the transmission clause (Article 25) entitled to become a member or which any person under that clause is entitled to transfer until such person shall become a member in respect of such shares or shall duly transfer the same.

101. Dividend to joint holders.- Any one of the several persons who are registered as the joint holders of any share, may give effectual receipts for all payments on account of dividends in respect of such shares.

102. Dividend to be in cash.- Except as otherwise provided in Article 97 no dividend shall be payable except in cash and shall be paid within forty-two days of its declaration.

103. Payment by post.- Unless otherwise directed, any dividend may be paid by cheque or warrant sent through the post to the registered address of the member or persons entitled or in the case of joint holders to the registered address of that, one whose name stands first on the register in respect of the joint holding; or to such person and to such address as the share-holder or joint holder may in writing direct and every cheque or warrant so sent shall be made payable to the order or the person to whom it is sent.

104. Notice of Dividends.- Notice of the declaration of any dividend, whether interim or otherwise, shall be given to the holders of registered shares in the manner hereinafter provided.

105. Unclaimed dividend.- All dividends unpaid or unclaimed shall be dealt with in accordance with Section 205A of the Companies Act, 1956.

131. Distribution of assets on winding up.- If the Company shall be wound up and the assets available for distribution among the members as such shall be

insufficient to repay the whole of the paid-up capital such assets shall be distributed so that, as nearly as may be, the losses shall be borne by the members in proportion to the capital paid up, or which ought to have been paid-up at the commencement of the winding up on the shares held by them respectively. And if in a winding up, the assets available for distribution among the members shall be more than sufficient to repay the whole of the capital paid up at the commencement of the winding up, the excess shall be distributed among the members in proportion to the capital paid up at the commencement of the winding up or which ought to have been paid up on the shares held by them respectively. But this clause is to be without prejudice to the rights of the holders of shares issued upon special terms and conditions.

24. The existence of these clauses also, in our opinion, does not invalidate the charity. Almost similar clauses were there in A.P. State Civil Supplies Corporation's case (*supra*) dealt with the issue to resolve the difference between the Accountant Member and the Judicial Member. It noted a Supreme Court decision in this regard in the case of CIT v. A.P. State Road Transport Corporation [1986] 159 ITR 1, wherein the amount left over after utilisation for the purposes set out in Section 30 of the Road Transport Corporations Act was to be made over to the State Government for the purposes of road development and it did not form part of the general revenue of the State. The said provision of the Act did not spell out details of how the road development was to be done etc. That was left to the discretion of the State Government.

Applying that logic, the Special Bench held that in the case of APSCSC also, under Article 6 the income of the company had been declared to belong to Price Equalisation/Stabilisation Fund, Department of Civil Supplies, Government of Andhra Pradesh, that, therefore, a legal liability had been created by Article 6 whereby all income vested in the said Fund, that ownership vested in the Fund as such and the amount did not go into the coffers of the State Government, that the manner in which the amount which might be in the Fund had to be utilised had not been spelt out and that was left to the discretion of the Government, that it necessarily had to be so in view of very rapidly changing economic factors, that holding the price line was essential to counteract inflation and in its view it could

not be disputed that it was an object of general public utility and that they saw no difference. The assessee-corporation is established with the object of upliftment of weavers and the dividend received by it, if any, has to be utilised for their welfare in terms of G.O. Ms No. 498 dated 6-5-1975. Here also we see no difference.

25. As regards carrying on of the activity on business lines resulting in profit, we may quote the following from the decision of the Supreme Court in the case of APSRTC:- The submission founded upon Section 22 is based upon a misunderstanding of what that section provides. A road transport corporation cannot be expected or be required to run at a loss. It is not established for the purpose of subsidising the public in matters of transportation of passengers and goods. The objects for establishing a road transport corporation are those set out in Section 3 of the RTC Act which we have already reproduced above.

Section 18 shows that it is the duty of a road transport corporation to provide, secure and promote the provision of an efficient, adequate, economical and properly co-ordinated system of road transport services in the State. No activity can be carried on efficiently, properly, adequately or economically unless it is carried on on business principles. If an activity is carried on on business principles, it would usually result in profit, but, as pointed out by this court in Surat Art Silk Cloth Manufacturers Association's case [1980] 120 ITR 1 (SC), it is not possible so to carry on a charitable activity in such a way that the expenditure balances the income and there is no resultant profit, for, to achieve this, would not only be difficult of practical realisation but would reflect unsound principles of management. What Section 22, therefore, does when it states that it shall be the general principle of a road transport corporation that in carrying on its undertakings it shall act on business principles is to emphasise the objects set out in Section 3 for which a road transport corporation is established and to prescribe the manner in which the general duty of the corporation set out in Section 18 is to be performed. It is now firmly established by the decisions of this court in Surat Art Silk Cloth Manufacturers Association's case [1980] 121 ITR 1 (SC) and Bar Council of Maharashtra's case [1981] 130 ITR 28(SC) that the test is 'What is the predominant object of the activity - whether it is to carry out a charitable purpose or to earn profit' If the predominant object is to carry out a charitable purpose and

not to earn profit, the purpose would not lose its charitable character merely because some profit arise from the activity.

26. Furthermore, the mere fact that the assessee carries on an activity for profit or is engaged in carrying on a business is of no consequence after 1-4-1984 with effect from which date such an activity no more remains as a prohibition as the prohibition stands deleted from the definition of 'charitable purpose' defined in Section 2(15) of the IT Act. As regards the private gain also, the decision in the case of Girijan Co-op. Corporation Ltd. (supra) is an authority applying which the Special Bench held in para 29 as under: We are also unable to agree that the surplus enures for private gain. According to Article 5 of the Articles of Association which was in force in the previous year, the total share capital is to be contributed and in fact was contributed by the State Government.

Therefore, even assuming that any declaration of dividends permissible under Clause 28 of the Memorandum of Association as it stood before amendment, the dividend would go in its entirety to the Government, i.e., it goes to the public and consequently there would be no chance of any element of private gain, if by private gain it is meant that the gain enures for individuals other than 'State'. In our view, the decision of the Andhra Pradesh High Court in the case of Girijan Co-op. Corporation Ltd. v. Commissioner of Income-tax [178 ITR 359]. supports this conclusion, in which it was held, that even if dividends are to be declared, if its utilisation is for public purpose, the entity does not lose its character of charitable nature.

27. Similarly, for distribution of assets clause, we endorse and adopt the finding of the Special Bench in the case of APSCSC, wherein also there was an article, Article 132, similar to the assessee's Article 131. The Special Bench, after referred to G.O.Ms No. 701 dated 26-7-1974, held in paragraph 31 as under:- It is only in the fitness of things that in the event of the assessee-company being wound up, whatever assets are left out of those which are received on transfer initially together with accretion thereto should revert to the Government which had transferred its own assets to the assessee-company for setting it up. Therefore, on the facts the distribution of assets in the present case is only a return of the assets

to the Government with whose assets the assessee came into being. On the facts, therefore, we consider that Article 132 also does not militate against the conclusion that the assessee is a charitable entity.

28. We, therefore, hold that the assessee-corporation is an institution created wholly for charitable purposes. But, that is not the end of the matter. To claim exemption under Section 11, the assessee has to comply with various conditions contained in Sections 11 to 13 of the Act.

Various objections raised by the Revenue and accepted by the CIT (Appeals) in the appeal for assessment year 1988-89 are discussed below.

29. One of the objections raised by the Revenue is that the assessee was not registered under Section 12A of the Act. This section provides that the provisions of Section 11 and Section 12 shall not apply in relation to the income of any trust or institution unless the following conditions are fulfilled, namely:- (a) the person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and in the prescribed manner to the Chief Commissioner or Commissioner before the 1st day of July, 1973, or before the expiry of a period of one year' from the date of the creation of the trust or the establishment of the institution, whichever is later: Provided that the Chief Commissioner or Commissioner may, in his discretion, admit an application for the registration of any trust or institution after the expiry of the period aforesaid; (b) where the total income of the trust or institution as computed under this Act without giving effect to the provisions of Section 11 and Section 12 exceeds twenty-five thousand rupees in any previous year, the accounts of the trust or institution for that year have been audited by an accountant as defined in the Explanation below Sub-section (2) of Section 288 and the person in receipt of the income furnishes along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

The assessee made an application for registration on 11-9-1989 in Form No. 10A. The CIT (Appeals) commented a lot on the late filing of the application but the Commissioner of Income-tax, A.P.-I, who was to deal with the issue under Section

12A, has condoned the delay by holding that the assessee was prevented by sufficient cause and allowed the assessee's application at H.Qrs. No. I/12A/32/89-90 in the register maintained for applications under Section 12A, on 7-2-1992. The assessee has also filed the audit report required under Section 12A. Therefore, it remains no impediment, though we agree with the CIT (Appeals) that it is a necessary condition for granting the exemption under Section 11.

30. Another provision which is said not to have been complied with by the assessee is Sub-section (2) of Section 11. This Sub-section reads as under:- Where seventy-five per cent of the income referred to in Clause (a) or Clause (b) of Sub-section (1) read with the Explanation to that Sub-section is not applied, or is not deemed to have been applied, to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied with, namely:- (a) such person specifies, by notice in writing given to the Assessing Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart and, the period for which the income is to be accumulated or set apart, which shall in no case exceed ten years; (b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in Sub-section (5).

As per the provisions of Sub-section (1), only that income is exempt which is applied for charitable purposes. Sub-section (2), however, relaxes that condition and gives an option to an assessee who has not spent 75 per cent of its income of a year, to accumulate or, set apart for such purpose for a period not exceeding 10 years. The income to the extent of accumulation is not included in the total income of that year if deposited in the forms or modes specified in Sub-section (5) of Section 11. In a case where such accumulated income is utilised for any purpose other than charity or ceases to remain accumulated for application or deposited as per Section 11(5) or is not utilised for the stated purposes within a period of 10 years, the income to that extent will be included in the total income of that year in which it is so applied, ceases to be so accumulated or invested or as the case may

be immediately after the expiry of the period of account. Such investment of accumulated income is to be made within 6 months as per rules. The objection of the Revenue in the words of the CIT (Appeals) is: As a matter of fact, the annexure in Form No. 1 OB does not specify how the profit of Rs. 81.85.357 is sought to be employed. The entire annexure is interspersed with the observations like 'nil' and 'not applicable'. This coupled with the unbridled discretion the appellant enjoys by virtue of Articles of Association, would not entitle the appellant to any exemption under Section 11. In such a case, when the appellant had flagrantly contravened the requirements of Section 11 (2) in toto, it is not open to it to raise the plea that the accumulations were applied for charitable purposes.

Reliance was placed on the decision of the Madras Bench of the Tribunal in the case of Sri Rafeeq Trustv. ITO [IT Appeal No. 1771 (Mad.) of 1979 dated 30-8-1980]. We do not see any merit in this objection of the Revenue. Form No. 10B shows that the amount of Rs. 81,85,357 was applied for charitable purposes as can be seen from the following extract from the Annexure:- The Form nowhere requires to state as to how the amount was utilised or sought to be applied. Therefore, the CIT (Appeals) is not right in making the observation quoted above. As submitted by the assessee, it was utilised for meeting the losses of earlier year and such an adjustment is an application for the purposes of the trust in view of the decision of the Rajasthan High Court in Maharana of Mewar Charitable Foundation's case (supra). There was nothing to be accumulated or for which a request could be made belatedly, which could be rejected on the strength of the decision of the Madras Bench (supra).

31. Next complaint of the Revenue is the violation of the provisions of Section 11(4A) of the IT Act. At the relevant time, the provision stood as under :- (4A) Sub-section (1) or Sub-section (2) or Sub-section (3) or Sub-section (3A) shall not apply in relation to any income, being profits and gains of business, unless- (a) the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or publication of books or is of a kind notified by the Central Government in this behalf in the Official Gazette; or (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the

beneficiaries of the institution, and separate books of account are maintained by the trust or institution in respect of such business.

The CIT (Appeals), in the appeal for assessment year 1984-85, held that there was no violation as the work relating to the assessee-corporation was done by its beneficiaries, i.e., weavers, whereas the CIT (Appeals) in the subsequent year held that they were paid only wages for their work and they have no active participatory role in the conduct of the assessee's business; that the disbursement of wages to weavers cannot be construed as a benefit to them, since it was in recognition of services rendered by them; that the weavers cannot be said to be carrying on the business by contributing their labour for wages; that the employment for wages in the course of carrying on of business cannot be construed as an advancement of any other object of general public utility; that the weavers are not in the same position as Girijans as in the case of Girijan Co-operative Corporation Ltd. (supra); that the fact that the weavers are required by way of wages would not make them the beneficiaries; that Section 11(4A)(b) contemplates a situation where there would be a total anastomosis of thought and deed between the institution and the beneficiaries; that in the instant case, the weavers are totally distanced from the appellant-corporation; and that thus, Section 11(4A)(b) which was visualised for a totally different purpose cannot be transplanted into the assessee's case, which has nothing in common with the institutions referred to in that Section. He referred to the decision of the Madras Bench of the Tribunal in the case of Auroboutique Trust (supra), wherein it was held that Clause (b) of Sub-section (4A) of Section 11 applied only to institutions such as blind schools or craft guilds and not a regular business. The learned departmental representative stated that it was only a part of the work, even if so considered, which was done by the weavers and the corporation got its work, a major one, from others who were not beneficiaries. The assessee's reliance is on the order of the CIT (Appeals) for assessment year 1984-85. On this point, we agree with the order of the CIT (Appeals) for assessment years 1988-89 and 1990-91. Weavers do the work of the assessee-corporation not as beneficiaries but on 'work contract' basis. They are paid wages for their work and not as beneficiaries of the assessee-corporation. We agree with the CIT (Appeals) in his observation that the weavers cannot be said to be carrying on the business by

contributing their labour for wages. Even then, we have the figures before us for assessment year 1988-89 from the final accounts as drawn on 31-3-1988. From Schedule 'N' of the final accounts, we find that the manufacturing expenditure is Rs. 11,28,10,729.90. Out of this, only a sum of Rs. 1,60,25,648.86 accounts for the wages paid. Even if the entire wages are considered to be paid to weavers, it is hardly a little over 14 per cent of the manufacturing expenses. As stated by the Assessing Officer, the assessee supplies yarn and other inputs to the weavers for manufacture of handloom cloth, gets back the finished products and effects sale; the assessee also purchases mill-made cloth and gets it stitched into ready-made garments and sells the same to Government of Andhra Pradesh.

Stitching charges paid by the assessee are Rs. 1,13,74,430, a figure almost matching the wages paid to weavers. We are not considering the other figures of expenses of the corporation as the manufacturing expenditure is sufficient to hold that benefit to the weavers by payment of wages is a small part of manufacturing expenses themselves.

We also find ourselves in agreement with the finding of the CIT (Appeals) in assessment year 1988-89 that the position of Girijans in the case of Girijan Co-op, corporation was different. In that case, the provisions of Sub-section (4A) of Section 11 were not the subject-matter of consideration. We, therefore, hold that the assessee-corporation violated the provisions of Section 11(4A) of the IT Act and, therefore, its business would not be exempt under Section 11 of the Act.

32. To conclude, we hold that (i) the assessee-corporation is a charitable institution as envisaged in Section 11 and (ii) its income from business does not enjoy the exemption under Section 11 because it does not satisfy the conditions laid down in Sub-section (4A) thereof.

33. The cross-objection by the assessee for assessment year 1987-88 is only to support the order of the CIT (Appeals). For the reasons stated in setting aside the order of the CIT (Appeals), the cross-objection is dismissed.

34. In the result, the appeal of the Revenue for assessment year 1986-87 is allowed while the cross-objection for assessment year 1987-88 and the appeals

for assessment years 1988-89 and 1990-91 by the assessee are dismissed.

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