

Income from leasing out business assets for a limited period to carry out production activity is business income

Summary – The High Court of Punjab & Haryana in a recent case of Maltex Malsters Ltd., (the Assessee) held that Income earned by assessee-company from leasing out its business assets for manufacturing malt for a period of ten years was to be taxed as business income and not as income from other sources

Facts

- The assessee was the owner of plant and machinery, fixtures and fittings and equipment and apparatus installed in a building also owned by it. It had been manufacturing its products, *i.e.*, malt from said property and with its equipment for about 20 to 30 years.
- The assessee entered into lease agreement with UB in terms of which assessee undertook to make available the entire malting facility capable of producing 12,000 MT of malt per month along with the entire plant and machinery and storage spaces of the requisite capacity. Routine minor repairs were to be carried out by UB Ltd. and major repairs and replacement of assets which had become obsolete, redundant and irreparable were on the assessee's account. The lease agreement was for a period of five years. The income from said agreement was assessed as business income.
- Two months prior to expiry of said lease agreement, the parties entered into another lease agreement for a period of ten years on more or less similar terms as agreed in first agreement.
- The Assessing Officer opined that it appeared from subsequent agreement that no operation had to be carried out by the assessee and that it was merely to hand over possession of the assets to UB Ltd. He thus held that rental income earned from subsequent agreement was taxable as 'income from other sources'.
- The Tribunal upheld the order of the Assessing Officer.
- On appeal:

Held

- In a case such as this, it is imperative to ascertain whether the income under a fresh lease deed ought to be computed under the head 'income from other sources' or under the head 'Profits and gains from business'. It is necessary to consider the very nature of the transactions. If, for instance, it was decided to permanently lease out the property, it would be of necessity to consider income from other sources. If, as in the present case, it is contended that the decision to lease out the property is only for the purpose of meeting the business requirements of the assessee for a limited period of time to tide over a difficult period, it would be required to be computed under the head 'Profits and gains from business'.

- The stand taken by the revenue in respect of the earlier lease deed cannot, therefore, be binding on the department/revenue in respect of the subsequent lease deed. The principle of consistency cannot be applied because each lease deed is fundamentally different. If, however, the fact situation including as to the intention of the assessee in leasing its assets remains unchanged, the Assessing officer must continue to assess the income as business income. Whether this is so or not must, however, be examined and the Assessing Officer cannot blindly assume it to be so.
- A duration of 10 to 15 years of a lease of this nature does not indicate an intention on the part of the lessor to part with its business assets permanently or for an inordinate period of time indicating that its intention is to discontinue its business activities. By its very nature, such a lease agreement is bound to be for a longer duration. Running an industry is capital intensive. It requires the lessee to deploy considerable resources tangible and intangible, movable and immovable. This, in turn, requires a large expenditure. The lease deed itself requires the lessee, *i.e.*, UB Ltd. to pay the costs of certain repairs and maintenance. A lessee in a contract of this nature, therefore, would not find it financially feasible to accept a lease for a short period. The return of investment would not be adequate if the lease is for a short duration.
- It is evident that one of the main reasons for the Tribunal's decision is that the Tribunal assumed that UB Ltd. and the assessee are sister concerns. They are not. The Tribunal's interpretation of clause of lease deed is, erroneous and without any basis.
- Another clause of subsequent lease deed clearly indicates that the assessee did not intend the lease arrangement to continue for an indefinite period of time. That as a matter of fact the lease is now terminated is a different matter.
- If it was the assessee's intention to make this a permanent arrangement or an arrangement for an indefinite period, there was no reason for it to insist upon UB Ltd. continuing with its employees. Indeed, if UB Ltd. terminated the services of the employees in accordance with law, it would not have affected the assessee's rights or interest in its property in any manner whatsoever if the assessee intended continuing with the system indefinitely. The fact that the assessee insisted upon its employees being retained by 'UB' was a strong indication that it intended to come back in the business using the same assets and properties. This was an important term of the contract.
- There are other factors also which together support the assessee's case. For instance, the second paragraph of clause -1 provides that after completion of two years the parties would discuss the revision of the annual consideration of Rs. 30 lakhs for the year 2005-06 onwards. If the parties had not agreed to the revised consideration, the agreement would have come to an end. In the normal course of events, a party intending to continue such an arrangement for an indefinite period of time, would have finalized the consideration payable and not have left such a crucial aspect open-ended.
- Further, the assessee retained an interest in the plant and machinery and the property for otherwise it would not have agreed to expand the installed capacity at its costs.
- In view of above, it is held that the income arising out of the leasing out of the business assets is business income of the assessee.