SPECIAL BENCH.

Before Sir Murray Coutts Trotter, Chief Justice, Mr. Justice Krishnan and Mr. Justice Beasley.

THE COMMISSIONER OF INCOME-TAX, MADRAS, PETITIONER,

1926, April 23.

v.

MANGALAGIRI SRI UMAMAHESWARA GIN AND RICE FACTORY, LTD., GUNTUR, RESPONDENT IN REFERRED CASE No. 4 OF 1925

AND

GUNTUR MERCHANTS GIN AND RICE FACTORY, LTD., GUNTUR, RESPONDENT IN REFERRED CASE No. 6 OF 1925.*

Indian Income-tax Act (XI of 1922), sec. 10 (2) (vi)—Assessee leasing his machinery and plant to another for rent, himself undertaking to bear loss due to depreciation—Assessee entitled to deduction on account of depreciation.

If *A* leases to *B*, his buildings, machinery and plant for a certain rent and undertakes himself to bear the loss arising from depreciation on account of *B* working the machinery, etc., the lessor *A*, if assessed to income-tax on his rent is entitled to a deduction allowable under section 10 (2) (vi) in respect of loss caused by such depreciation. In order to claim this deduction it is not necessary that the assessee himself should use the machinery and cause the wear and tear, the assessee's business of leasing his machinery being also a business, within the meaning of the section, in which the depreciation ensues.

CASE stated under section 66 (2) of the Indian Income-tax Act (XI of 1922) by the Commissioner of Income-tax, Madras, in the matter of assessment on the respondents abovenamed, the question referred being "Whether the allowance provided in section 10 (2) (vi) of the Act is admissible in computing the income of an assessee who has leased out his plant, machinery and buildings?"

* Referred Cases Nos. 4 and 6 of 1925.

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The necessary facts are found in the judgment of BEASLEY, J.

Ch. Raghava Rao (with *A. Sundaram Ayyar*) for the assessee.—The articles of the company empower it to lease the mill to others; hence leasing is its business. The depreciation to its plant and machinery having arisen in the course of that business and the company having under the lease deed, itself undertaken to make the necessary repairs due to depreciation, it is entitled to the deduction allowable under section 10 (2) (vi). Without paying for the repairs it cannot earn the rent income as lessor; *Smith* v. *Anderson*(1), *Inland Revenue Commissioners* v. *Korean Syndicate, Ltd.*(2).

M. Patanjali Sastri for the Crown.—The depreciation mentioned in section 10 (2) (vi) of the Act is in respect of "such buildings, machinery and plant" as are mentioned in clause (iv) of the same section, *i.e.*, the depreciation must be due to their use in the business of the assessee. Here the depreciation does not arise from the letting by the assessee. It is due to their working by the lessee who is not the assessee; hence the deduction on account of depreciation is not allowable; *Union Cold Storage Company, Ltd.* v *Jones*(3), and on appeal *Union Cold Storage Company, Ltd.* v. *Jones*(4), and *Usher's Wiltshire Brewery, Ltd.* v. *Bruce*(5). The company's normal business is direct milling, and not letting. It temporarily abandoned milling and let the mill to others. Such letting cannot be termed its business.

Ch. Raghava Rao in reply.—In this case, leasing was authorized by the articles. In *Union Cold Storage Company, Ltd.* v. *Jones*( ), it was not so. Section 10 (2) (vi) does not say that the depreciation must directly arise from the user.

JUDGMENT.

COUTTS TROTTER, C.J.

COUTTS TROTTER, C.J.—The assessees in this case are a limited company registered on the 11th January 1921 which is the owner of a mill equipped with machinery for the milling of rice. The company elected not to work its mill on its own account but leased it out to another firm in consideration of Rs. 1,500 per annum

(1) (1880) 15 Ch. D., 247 at 258, 260.
(2) [1921] 3 K.B., 258.
(3) (1923) 8 Tax Cases, 725.
(4) (1924) 8 Tax Cases, 757 at 742.
(5) [1915] A.C., 433 at 463 and 464.

which it is entitled to do under the provisions of its memorandum and articles of association. I think it is clear that the assessees cannot come to Court and ask for deductions on the footing that they are carrying on a business of rice milling. The business they are carrying on is that of lessors of a building which derives its lettable value from the fact that it is equipped with certain machinery which is available for the purpose of milling rice. And of course it is on that lettable value that the lessors have been assessed. It seems to me that this is not the infrequent case of the same building and its contents being taxable both in the case of the lessors and the lessees. Different deductions will be allowable in the case of the lessors and the lessees. The lessors as carrying on the business of letting a rice mill can justly deduct from their assessment any sum which is due to depreciation of the lettable value of the property by reason of wear and tear of machinery which falls upon them under the contract of lease. Similarly the lessees being taxable as carrying on the business of rice milling will be entitled to a deduction of such repairs as fall upon them under the lease. The Crown does not suffer from the fact that the parties can distribute the incidence of the liability for repairs as they choose, because only one total sum can be allowed as deduction. If that principle be right, it answers the question raised by the case and it is not our function to apportion which deduction can be rightly claimed by the lessors and which by the lessees which is a matter for the Commissioner to work out as a question of fact.

KRISHNAN, J.—This is a reference under section 66 (2) of the Indian Income-tax Act XI of 1922; the question referred for our decision is

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"whether the allowance provided in section 10 (2) (vi) of the Act is admissible in computing the income of an assessee who has leased out his plant machinery and buildings."

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The Commissioner has answered the question in the negative.

Section 10 (2) (vi) is as follows :—

"In respect of depreciation of such buildings, machinery, plant or furniture being the property of the assessee a sum equivalent to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed."

The assessee here is a limited company formed primarily for the purpose of milling rice; and to carry out that object the company had acquired buildings, mill machinery and plant. They did not however carry on that business. There is a provision in the memorandum of association authorizing the directors to lease out the mill to third parties for rent if it is beneficial to the company to do so; acting under this authority the mill was leased out to certain lessees for a fixed annual rent for a period of three years. The arrangement was that the lessees were to work the mill and take the profits, and do the necessary repairs to it and hand it back at the end of the period to the lessors in proper working order; the lessors were however to bear the loss by depreciation by wear and tear caused by the working of the mill. The company is assessed on the rent received by them. It is clear from the facts that the company was carrying on the business of letting the mill for purpose of being worked by the lessees.

As very correctly observed by the learned Commissioner of Income-tax, two conditions must be fulfilled by the assessees before they become entitled to the deduction claimed for depreciation, under section 10 (2) (vi); the property depreciated must belong to the assessees and must be "used for the purpose of the business." The first condition is admittedly fulfilled. But the Commissioner thinks the second is not. I am inclined to think he is not right in that view. The business here is the business of leasing the buildings

and mill machinery for being worked as a mill. The rent received is not only for the use of the mill but also to cover the necessary wear and tear. A portion of that rent represents the loss by wear and tear. The lease being of the mill as a working concern it is not straining the language of clause (vi) to hold that the machinery and buildings are used for the purpose of the lease and that the depreciation caused to them by wear and tear arises, so far as the assessees are concerned, from that user. Though the direct cause of the wear and tear may be the working of the mill by the lessees, such working is authorized by the lease and is part of the business of the lease; that part of the rent which represents the loss due to depreciation is not really income to the lessors but is meant to make good the loss on capital value of the machinery. I agree with the learned Chief Justice in holding that the assessees here are entitled to a deduction for depreciation of their buildings, machinery and plant which under the lease they have to bear. What that amount properly is for the year of assessment is for the taxing authorities to find. My answer to the reference on the facts of this case is as stated above.

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BEASLEY, J.—The only point upon which I had any doubt was whether it could be said that the assessees were themselves carrying on business, because it is not only necessary for an assessee before becoming entitled to the deduction for depreciation under section 10 (2) (vi) of the Act to be the owners of the property in respect of the property depreciated but that also that property must be used for the purpose of the business. There is no doubt of course that the assessees are the owners of the property; but is the property used for the purpose of the business? This is a case of a limited company formed for the purpose of milling rice

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and in pursuance of that object the company acquired buildings, mill, machinery and plant. The company did not carry on the business of milling rice; it availed itself of the authority given to it of leasing out the mill for a fixed annual rental. The lessees worked the mill and took the profits and under the lease had to do the necessary repairs to the mill. They had not however to bear loss by depreciation by wear and tear and it is in respect of the latter loss that the company claims the deduction under section 10 (2) (vi). The Commissioner of Income-tax has held that the property is not used by the assessee for the purpose of the business, but I agree with the learned Chief Justice and with my brother KRISHNAN, J., that the view he has taken is incorrect. The company could either work the mill itself or could let it out to others to do so. One is the business of milling and the other is the business letting out the mill for others to do so. Both, in my view, are equally a business, and my answer, therefore, to the reference would be that the company is entitled to a deduction for depreciation of the buildings, machinery and plant.

Government will pay the assessees in each case Rs. 100 for their costs.

N.R.