

Case Note: Case involving the issue whether the selling of bulk water at profit by the Municipal Board to the Cantonment Board would constitute “trade or business” under the Income Tax Act and would thus be taxable under the Income Tax Act.

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AIR1951All582

IN THE HIGH COURT OF ALLAHABAD

Decided On: 26.09.1950

Appellants: **The Municipal Board**

v.

Respondent: **The Commissioner of Income-tax, C.P. and Berar**

Hon'ble Judges:

Malik, C.J. and V. Bhargava, J.

JUDGMENT

Malik, C.J.

1. This is a reference under Section 66 (1), Income-tax Act, and the two questions that have been referred to us are as follows :

"(1) Whether on the facts of the case the arrangement for supply of water to Agra Cantonment constituted any trade or business on the part of the Agra Municipality ?

(2) Whether the Agra Cantonment was not within the jurisdictional area of the Agra Municipality ?"

2. The Cantonment area of Agra is surrounded on all sides by land within the municipal limits of Agra. From 1894 the Municipal Board used to provide water for the Cantonment including the Fort. This continued upto 1906 and in that year the Cantonment Board became a share-holder in the Municipal Water Supply Works by paying a lump sum amount representing the Cantonment Board's share on the capital costs. After 1906 water was supplied from the Water Works Agra both to the Cantonment area as well as to the Municipal area. In the year 1932, however, there was a fresh agreement the terms of which are important. According to this the complete ownership of the Water Works was vested in the Municipal Board and the Agra Cantonment agreed to buy water in bulk at three places: (1) H. L. Reservoir at Rakabganj, (2) Reservoir in Fort and (3) 2" main to old Ordinance Quarters at Chipitola. This agreement was for a period of five years and provided for a minimum and maximum supply of water at a particular rate. The Municipal Board had nothing to do with the distribution of the water supply to the residents within the Cantonment. It was only concerned with the bulk supply and was

entitled to deal only with the Garrison Engineer, Agra Division, or such other officer as the Cantonment Board might nominate for the purpose. The agreement also provided that

"the Cantonment Board shall, at its own cost and expense, provide and maintain, to the satisfaction of the Municipal Board, all distribution, pumping and plant beyond the taking over points mentioned above and shall be responsible for the maintenance and upkeep of the same."

In accordance with this agreement water was supplied in bulk by the Municipal Board to the Cantonment at the reservoir in Rakabganj, at the reservoir in Fort and at the 2" main to old Ordinance Quarters at Chipitola. The Income-tax Officer considered the income derived by the Board by sale of the water to the Cantonment Board as income, profits and gains which was taxable under the Income-tax Act.

3. On behalf of the Board, however, reliance is placed on Section 4 (3) (iii) which is as follows :

"4 (3) Any income, profits or gains falling within , the following classes shall not be included in the total income of the person receiving them :

* * * *

(iii) The income of local authorities (except income from a trade or business carried on by the authority so far as that income is not income arising from the supply of a commodity or service within its own jurisdictional area.)"

Mr. Banerji, on behalf of the Municipal Board of Agra, has contended that it was not income from trade or business and was not taxable at all; and, secondly, that, even if it was income from trade or business, it was income arising from the supply of commodity or service within the jurisdictional area of the Municipal Board.

4. Under the Municipalities Act provisions are made for certain amenities to be supplied to the residents of the municipality. Those are statutory obligations which the municipality must perform. Section 7 sets out the obligatory duties and the relevant portion of it is as follows :

"(7) It shall be the duty of every board to take reasonable provision within the municipality for --

* * * *

(j) providing a sufficient supply of pure and wholesome water where the health of the inhabitants is endangered by the inefficiency or unwholesomeness of the existing supply, guarding from pollution water used for human consumption and preventing polluted water from being so used."

Section 128, Municipalities Act, gives the Municipal Board a right to collect water tax on the annual value of buildings or land or of both where the municipality has made arrangement for the supply of water to the residents living within the municipal limits. How this water supply is to be regulated is provided for in a number of sections beginning from Section 224, Municipalities Act. Section 233 of the Act provides for rules to be framed relating to the supply of water from the municipal or public water works. Besides these statutory duties there are certain discretionary powers imposed under Section 8, Municipalities Act. In Sub-section (2) of Section 8, a Board may make provision for the extension beyond the limits of the municipality of the benefit of any municipal undertaking. The extension of the benefit of water supply to a Cantonment area must, however, be subject to tax previous sanction of the Central Government. Mr. Banerji has urged that the contract relating to the sale of water to the Cantonment Board must be deemed to be an extension beyond the limits of the municipality of the municipal undertaking regarding the supply of water and it is, therefore, not a trade or business.

5. We have carefully looked into the agreement. In our view the extension of a benefit under Section 8 (2) can only cover a case where a municipal board undertakes to supply water to the residents of a locality directly and is entitled to control the supply and make rules and regulations for the same. It cannot cover the case, like the present, where the Municipal Board sells water in bulk to the Cantonment Board and has nothing to do with the distribution of that water to the residents of the Cantonment area. The agreement makes it clear that the Municipal Board had entered into a contract to sell water to the Cantonment Board at a profit and it, therefore, clearly came within the definition of the words "trade or business". There was no statutory obligation to sell any water to the Cantonment Board and if the Municipal Board entered into a contract to sell water at a profit, to such a contract none of the provisions relating to taxation regulations of framing of rules etc., quoted above could apply. Our attention has been drawn to a passage from Hannan on Principles of Income Taxation, p. 25, where the author points out that if a municipal corporation is empowered not only to provide a water service for its rate-payers but also to supply water beyond the municipal boundaries, and to sell water by contract for trade and other purposes (within the area of compulsory supply) these additional services are trading activities. We agree that the transaction in question was in the nature of a trade and the profits are taxable unless they come under the exceptions given in Section 4 (3) (iii), Income-tax Act. Section 4 (3) (iii) exempts the income from a trade or business carried on by a municipal board if such income arises from the supply of a commodity or service within its own jurisdictional area. So far as the Hakabganj reservoir is concerned, it is admitted that it is within the municipal limits. So far as the other points of supply are concerned they are outside the municipal limits.

6. Mr. Banerji has urged that jurisdictional area need not be the same as the limits of a municipal board under Section 3, Municipalities Act. Section 3 gives the Provincial Government the right to define the limits of any municipality and Section 5 provides that where a notification has been made by the State Government under Section 3 relating to a particular area, such area will thereafter be subject to all the notifications, rules, regulations, bye-laws, orders, directions, etc. of the municipal board. Ordinarily the jurisdictional area of a municipal board must be the same as its limits under Section 3 and

the rules, regulations, byelaws, orders passed by the Board can apply within that area and not outside. The fact that the Cantonment area is enclosed on all sides by Municipal area will not make it within the jurisdictional area of the Municipal Board. The Cantonment area must be deemed to have been cut out of the Municipal area and cannot be said to be within it.

7. Mr. Banerji has urged that, where the benefit of a municipal undertaking is extended; beyond its municipal limits under Section 3 (2), the jurisdictional area must be deemed to have been extended to the area to which the benefit of any municipal undertaking has been extended at least for the purposes of that undertaking. The question does not really arise in this case as in our view the benefit of the undertaking to supply water to the residents of the Municipal Board has not been extended beyond the limits of the municipality and the municipality has not undertaken to supply water to the residents of the Cantonment Board. It is not, therefore, necessary to express any final opinion on the point. It may be possible for a Municipal Board to extend the benefit of any municipal undertaking beyond its municipal area in such a way that the rules and regulations framed by it relating to that undertaking become applicable to that area also. In that, case it may be possible to urge that the jurisdictional area of the Municipal Board has been extended, but as we have already said there is nothing to show in the statement of the case that the jurisdictional area of the board has been extended for the purposes of water supply to the Cantonment.

8. Our answer to the two questions is : (1) The supply of water to Agra Cantonment constituted trade or business on the part of the Municipal Board, and (2) The Agra Cantonment is not within the jurisdictional area of the municipality.

9. It was pointed out to us at this stage that the real point in the case is not covered by the two questions framed by the Tribunal. In an objection to the statement of the case the Executive Officer of the Municipal Board clearly brought out the fact that the Rakabganj Reservoir was within the municipal limits and wanted the question to be referred to this Court "whether the income derived by supply of water to the Rakabganj Reservoir was liable to Income-tax ?." The Commissioner of Income-tax had suggested that one comprehensive question should be referred and it was as follows :

"(a) Whether in the circumstances of the case, the income derived by the applicant -Board for the supply of water to the Cantonment Board, Agra, is exempt from liability to tax under Section 4 (3) (iii), Income-tax Act as not being income from a trade or business carried on by it and (b) if the answer to question (a) is in the negative, whether the entire income or any portion thereof is exempt as arising from the supply of a commodity within its own jurisdictional area within the meaning of the above sub-section."

Both parties were thus agreed that the question about the supply of water to the reservoir within municipal limits may be referred for opinion. The Tribunal, however, made no amendment to the statement of the case. It is no doubt true, as was pointed by their Lordships of the Judicial Committee in the case of Commissioner of Income-tax, B. & O. v. Kameshwar Singh, 1933-1 I. T. R. 94 : (A. I. R. (20) 1933 P. C. 108) that the duty of

the High Court under Section 66, is to decide the questions of law raised by the statement of the case referred to them by the Commissioner and it is for the Commissioner to state formally the questions which arise. Both parties are of the opinion that the question about the supply of water to the reservoir, which is within the municipal limits, should be separately considered and that it does arise. No new facts are needed to consider that matter and, as this case has been pending since 1945, learned counsel for the parties are agreed that the question may be answered by us without further delay which would be caused by an order under Section 66 (4) in referring the case back to the Tribunal for a further statement. In the case of the Commissioner of Income-tax B. & O. v. Kameshwar Singh, 1933-1 I.T.R. 94:(A.I.R. (20) 1933 P.C. 108), cited above, their Lordships of the Judicial Committee deprecated the departure from regular procedure but did not think it proper to decline to express their view on the question informally presented. We follow the same procedure and answer the question "whether the water supplied to the Rakabganj Reservoir was a supply of commodity within the jurisdictional area of the municipal Board and was, therefore, not subject to Income-tax in the affirmative. The income made out of the supply of water at the Rakabganj Reservoir comes under the exceptions in Section 4 (3) (iii), Income-tax Act and is not liable to Income-tax.

10. In view of the fact that both parties have partly succeeded and partly failed, we make no order as to costs.

11. We fix the fee of the counsel for the Commissioner of Income-tax at Rs. 400.

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