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"LOCAL AUTHORITY" UNDER THE CLUTCHES OF "TAX AUTHORITY"—A CASE STUDY OF U. P. JAL NIGAM[1]

JUSTICE DR. SATISH CHANDRA[2]

"Local authorities" like U. P. Jal Nigam are claiming exemption under section 10(20) of the Income-tax Act, 1961 for its income. Their main argument is that it were created by different statutes passed by the State legislatures wherein status of "local authority" was granted. On the other hand, Income-tax Act, after an amendment by Finance Act, 2002, is not recognizing these authorities/corporations created by the "State" as "local authority" and is bringing the same under the tax clutches as assessees. The sole dispute is whether such entity like U. P. Jal Nigam-assessee can be treated as "local authority" or not.

Regarding U. P. Jal Nigam–assessee, a brief history is that in the year 1894-95, a small Sanitary Engineering Branch with its headquarters at Allahabad was established under the administrative control of U. P. Public Works Department. A few technical assistants were deployed in the branch and this unit was entrusted with the job of preparation of projects of water supply which were to be executed by the contractors or large engineering companies. The first sanitary division was established with a skeleton staff in the year 1913-14 at Saharanpur. Promulgating of U. P. Municipalities Act in the year 1916 bestowed some powers in local bodies. Creation of local bodies in towns ushered in pressure building to provide better amenities especially drinking water. Royal sanitary commission constituted by the Government visited all parts of the State to take stock of drinking water and sanitation facilities and submitted its report towards the end of the year 1920. Consequently, in the year 1927, the then existing Sanitary

1. See [2011] 338 ITR 248 (All)
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Engineering Branch was enlarged and given the status of a full fledged department. This new department was named Public Health Engineering

all the works related to Public Health Engineering including works related to sewerage and water supply. In the year 1946, State of United Province created a department known as Local Self-Government Engineering Department (hereinafter referred to as "LSGED"), which was the converted form of PHED and in this department, all the engineering works of local self Government were entrusted.

In the year 1975, U. P. Jal Nigam was constituted by Notification dated June 18, 1975 issued by the State Government under section 3 of the Uttar Pradesh Water Supply and Sewerage Act, 1975 (hereinafter referred to as the "Act" for the sake of brevity) and the **status of the Nigam was a "local authority" under sub-section (3) of section 3 of the Act**.

Soon after the amendment made by the Finance Act, 2002, for the assessment year 2002-03, the Assessing Officer has mentioned in his order that the assessee consisted of three wings, namely, (i) Jal Nigam Wing ; (ii) Nalkoop Wing ; and (iii) Construction and Design Wing. The Assessing Officer has observed that at **the most activities of Jal Nigam Wing are that of a local authority** whereas the activities of the remaining two wings are not at all of a "local authority". Finally, he observed that as the activities of Jal Nigam Wing appears to be that of a local authority, its income has been treated as exempt under section 10(20) of the Income-tax Act, 1961. In First appeal, the Commissioner of Income-tax (Appeals) has partly upheld the order by observing that all the three wings are covered by section 10(20) of the Income-tax Act and accordingly deleted the addition. Being aggrieved, the department filed an appeal before the Tribunal, who vide its impugned order dated January 25, 2008 observed that the Assessing Officer has treated the assessee as a "local authority" in respect of income accruing to it from the activities of Jal Nigam Wing. Therefore, the status of the assessee was that of "local authority." Regarding the remaining two wings, namely, Nalkoop Wing and Construction and Design Wing, the Tribunal observed that these wings were also exempted under section 10(20) of the Income-tax Act. So, as a whole, the assessee is a "local authority" as was held in the previous assessment years. In the backdrops, a question emerges for consideration and the same needs to be examined from different aspects. The question is—

"Whether, in the facts and circumstances of the case, the assessee Corporation is "local authority" and entitled for benefit of exemption under section 10(20) of the Income-tax Act, 1961 ?"

It may be mentioned that the "local authority" or Authority has not been defined in the Income-tax Act. The word "Authority" has been used in different contexts. The meaning of the word "Authority " given in *Webster's Third International Dictionary* is that an "authority" is a public administrative agency or corporation having quasi-governmental powers and authorised to administer revenue-producing public enterprises. The view of the term "authority" has been accepted by the Supreme Court in *Rajasthan State Electricity Board* v. *Mohan Lal,* AIR 1967 SC 1857 in the context of the meaning of the term "other authorities" occurring in article 12 of the Constitution.

Article 12 of the Constitution defining the State which would include "such authorities within the territory of India or under the control of the Central or State Governmental". Since modern Governments perform a large number of functions through autonomous bodies serving as instrumentalities of the State having considerable authority under the statutes, which creates them, the word **"authority"** has been understood in a wider sense, so that the law applicable under the Constitution would apply for income-tax purposes as well. In *Sukhdev Singh* v. *Bhagatram Sardar Singh Raghuvanshi,* AIR 1975 SC 1331 ; [1975] 45 Comp Cas 285 (SC) ; [1975] 47 FJR 214, it was observed that the reason for adopting a proper view of article 12 is that the Constitution should, wherever possible, be so construed so as to avoid arbitrary application of power against individuals by centers of power. The emerging principle appears to be that a public corporation being a creation of the State is a subject-matter of constitutional limitation as the State itself. Further, the governing power, wherever located, must be subject to the fundamental constitutional limitations.

It is in such a view, it was found that statutory bodies like Life Insurance Corporation of India and Oil and Natural Gas Commission were the "authorities" since these corporations do have independent personality in the eye of law and they serve as instrumentalities of the Government, though they may be subject to control of the Government. In *Ramana Dayaram Shetty* v. *International Airport Authority of India,* AIR 1979 SC 1628, a statutory body was held to be an authority wherein the concept of instrumentality or agency was regarded as the touchstone for the inference. A society registered under the Societies Registration Act with substantial Government control and funding as in the case of Indian Council of Scientific Research was found to be an authority as held in the case of

Sabhajit Tewary v. *Union of India,* AIR 1975 SC 1329. Even a company, which was not formed under any special statute, was held to be an authority and therefore a State from the functional point of view, because of the brooding presence of the State behind the operations of the company so that it could be called semi-statutory and semi-non-statutory though non-statutory in origin but having statutory flavour in its operations and functions, so that it was in effect an alter ego of the Central Government having been formed as a Government company by transferring a Government undertaking as pointed out in *Som Prakash Rekhi* v. *Union of India* [1980] 57 FJR 370 ; [1981] 51 Comp Cas 71 (SC) ; AIR 1981 SC 212. In *Ajay Hasia* v. *Khalid Mujib Sehravardi* AIR 1981 SC 487, the hon'ble Supreme Court laid down the following tests for the inference whether a body is instrumentality of the Government and therefore an authority or not :

"1. If the entire share capital of the body is held by the Government, it goes a long way towards indicating that a body is an instrumentality of the Government.

2. Where the financial assistance given by the Government is so large as to meet almost entire expenditure of the body, it may indicate that the body is impregnated with Governmental character.

3. It is a relevant factor if the body enjoys monopoly status which is conferred or protected by the State.

4. Existence of deep and pervasive State control may afford an indication that the body is a state instrumentality.

5. If the functions performed by the body are of public importance and closely related to Governmental functions, it a relevant factor to treat the body as an instrumentality of the Government."

However, the words "local" or "local authority" have not been defined in the Act, though, they are exempted from the clutches of tax by virtue of section 10(20) of the Income-tax Act, 1961, which is reproduced as hereinunder :

"10.(20) the income of a **local authority** which is chargeable under the head 'Income from house property', 'Capital gains' or 'Income from other sources' or from a trade or business carried on by it which accrues or arises from the supply of a commodity or service (not being water or electricity) within its own jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area :

Explanation.—For the purposes of this clause, the expression 'local authority' means—

(i) Panchayat as referred to in clause (d) of article 243 of the Constitution ; or

(ii) Municipality as referred to in clause (e) of article 243P of the Constitution ; or

(iii) Municipal Committee and District Board,

legally entitled to, or entrusted by the Government with, the control or management of a Municipal or local fund ; or

(iv) Cantonment Board as defined in section 3 of the Cantonments Act, 1924 (2 of 1924)."

From the above, it is clear that the income of the "local authority" arising from its supply of a commodity or service, such as, supply of electricity or water, for domestic or industrial purposes, within its own jurisdictional area, is exempt. The reason for exempting income of a "local authority" arising from its activities within its jurisdictional area is that the money collected in the name of water, sewerage tax or fee from the inhabitants of local area is utilized on behalf of the inhabitants. The habitants consider such services to be for a public purpose, for their comfort or well being and in doing so, they cannot be said to have in view the making of any profit. The income derived by "local authority" from its activities outside its area was chargeable to income-tax by amendment under the Finance (No. 2) Act, 1997, with effect from April 1, 1997. The income outside the municipal limits from water or electricity, is exempted.

Even after the amendment to section 10(20), the assessee is covered by item (iii) of the said *Explanation* as it is a "local authority" performing municipal functions and as it is legally entitled to the control of local fund, namely, market fund. In this connection, it may be pointed out that the Jal Nigam-assessee has no power and authority to levy and collect fees called "Water Fees" directly, and in fact, it levies and collects "Water/Sewerage Fees" through the local bodies like municipalities, and the fact that the Government exercises control, does not take away the statutory power of the assessee.

However, as mentioned earlier that no definition of "local authority" is defined in the Income-tax Act, so the definition of "local authority" is to be borrowed from section 3(31) of the General Clauses, Act, 1897 which is as follows :

"local authority shall mean a municipal committee, district board, body of court commissioner, or other authorities legally entitled to, or entrusted by the Government with, the control or management of a municipal or local fund ;"

Though section 3(3) of the U.P. Jal Nigam regards itself as being a "local authority", for the purposes of the Income-tax Act, the meaning of expression "local authority" as contained in the General Clauses Act, which is a Central Act, has to be seen. Merely because the U.P. Jal Nigam regards itself as a local authority, that would not, in law, make it a "local authority" for the purpose of section 10(20) of the Income-tax Act. The test for determining whether a body is a "local authority" had been laid down by the hon'ble Supreme Court in *R. C. Jain's* case, AIR 1981 SC 951 ; [1981] 58 FJR 285. The hon'ble Supreme Court while considering the status of Delhi Development Authority held that it shall be the "local authority". Their Lordships held that Delhi Development Authority is an independent entity and elected by inhabitants of the area ; possesses autonomy to decide for itself the question of policy affecting the area administered by it. It has been entrusted by the statute with governmental functions and duties as are usually entrusted to municipal bodies of inhabitants of locality like health and education services, water and sewerage, town planning and development, roads, markets, transportation, social welfare services, etc. It has been entrusted for the purpose of civic duties and functions and also empowered to raise funds for the furtherance of its activities and the fulfilment of their project by levying taxes, reduce charges or fees which is in addition to money provided by the Government or obtained by borrowing or otherwise. The relevant portion of para 2 of the aforesaid judgment is reproduced as under (page 952 of [1981] AIR SC) :

". . . First, the authorities must have separate legal existence as Corporate bodies. They must not be mere Governmental agencies but must be legally independent entities. Next, they must function in a defined area and must ordinarily, wholly or partly, directly or indirectly, be elected by the inhabitants of the area. Next, they must enjoy a certain degree of autonomy, with freedom to decide for themselves questions of policy affecting the area administered by them. The autonomy may not be complete and the degree of the dependence may vary considerably but, an appreciable measure of autonomy there must be. Next, they must be entrusted by Statute with such Governmental functions and duties as are usually entrusted to municipal bodies, such as those connected with providing amenities to the inhabitants of the locality, like health and education services, water and sewerage, town planning and development, roads, markets, transportation, social welfare services, etc. Broadly we may say that they may be entrusted with the performance of civic duties and functions which would otherwise be Governmental duties and functions. Finally, they must have the power to raise funds for the furtherance of their

activities and the fulfilment of their projects by levying taxes, rates, charges, or fees. This may be in addition to moneys provided by Government or obtained by borrowing or otherwise. What is essential is that control or management of the fund must vest in the authority."

A proper and careful scrutiny of the language of section 3(31) of the General Clauses Act suggests that an authority in order to be a "local authority", must be of a like nature and character as a municipal committee, district board or body of port commissioners, possessing, therefore, many, if not all, of the distinctive attributes and characteristics of a municipal committee, district board, or body of port commissioners, but possessing one essential feature, namely, that it is legally entitled to or entrusted by the Government with the control and management of a municipal or local fund. What then are the distinctive attributes and characteristic, all or many of which a municipal committee, district board or body of port commissioners shares with any other "local authority"?

First, the authorities must have separate legal existence as corporate bodies. They must not be mere Governmental agencies but must be legally independent entities. Secondly, they must function in a defined area and must ordinarily, wholly or partly, directly or indirectly, be elected by the inhabitants of the area. Thirdly, they must enjoy a certain degree of autonomy, with freedom to decide for themselves questions of policy affecting the area administered by them. The autonomy may not be complete and the degree of dependence may vary considerably but there must be an appreciable measure of the autonomy. Fourthly, they must be entrusted by statute with such Governmental functions and duties as are usually entrusted to municipal bodies, such as those connected with providing amenities to the inhabitants of the locality, like health and education services, water and sewerage, town planning and development, roads, markets, transportation, social welfare services etc. Broadly they may be entrusted with the performance of civic duties and functions, which would otherwise be Governmental duties, and functions. Finally, they must have the power to raise funds for the furtherance of their activities and the fulfilment of their projects by levying taxes, rates charges, or fees. This may be in addition to money provided by Government or obtained by borrowing or otherwise. What is essential is that control or management of the fund must vest in the "local authority". In the context of applicability of the Bonus Act, 1965, the question that arose was whether the Delhi Development Authority was a "local authority" or not, in construing the meaning of the expression "local authority" as defined in section 3(31) of the General Clauses Act.

The hon'ble Supreme Court then examined the provisions of the Delhi Development Act and came to the conclusion that the said authority had attributes of a "local authority" as defined by section 3(31) of the General Clauses Act.

The decision in *R. C. Jain's* case, AIR 1981 SC 951 was then followed in *Calcutta State Transport Corporation's* case [1996] 219 ITR 515 (SC) where the corporation had contended though it was a "local authority" but it was observed that the definition of Corporation was not similar to the definition of the Delhi Development Act, so that it was not a "local authority."

However, after the insertion of the *Explanation,* by the Finance Act, 2002 whereby "local authority" stood defined exhaustively, it was not necessary to invoke section 3(31) of the 1897 Act. The Notes on Clauses in the Finance Bill, 2002, show that Parliament intended to restrict the exemption to Panchayat and Municipality, as referred to in article 243(d) and article 243P(e) of the Constitution of India, Municipal Committees and District Boards, legally entitled to or entrusted by the Government with the control or management of a local fund as well as Cantonment Boards as defined under section 3 of the Cantonment Act, 1924. In this connection, the assessee i.e. U.P. Jal Nigam is not mentioned in the *Explanation.* Therefore, it would not be proper to read U.P. Jal Nigam into the *Explanation* particularly when section 10(20) of the 1961 Act is an exemption provision.

Applying the ratio of the aforesaid decisions to the facts of the present case, it appears that it is not possible to hold that the U.P. Jal Nigam is a "local authority" within the meaning of that expression as contained in section 3(31) of the General Clauses Act, 1897. In *R. C. Jain's* case, AIR 1981 SC 951, it has been held that the "local authority" must have the nature and character of a municipal committee, district board, body of port commissioners. The principle of **ejusdem generis** is not applicable because there is no distinct genus or category running through the bodies named earlier. The local authorities which are specifically mentioned in section 3(31) of the General Clauses Act can clearly be regarded as local bodies, which are intended to carry on self-government. It is for this reason that this definition states that such an authority must have control or management of a municipal or local fund. Municipal committee, district board, body of port commissioners are entities which carry on Government affairs in local areas and they would give colour to the words "local authorities" occurring in section 3(31) of the General Clauses Act, 1897. To put it differently, "local authority" referred to in section 3(31) must be similar or akin to municipal committee, district board or body of port commissioners.

In *R. C. Jain's* case, AIR 1981 SC 951, at least five attributes or characteristics of an authority falling under section 3(31) of the General Clauses Act have been mentioned. At least three of the five attributes mentioned in the passage quoted above from *R.C. Jain's* case, AIR 1981 SC 951, are absent here.

Needless to mention that, the members of the assessee are not wholly or partly, directly or indirectly, elected by the inhabitants of the area. According to section 4 of the U.P. Jal Nigam, the Nigam consisted of a chairman and seven members. The chairman is nominated by the State Government. The general manager appointed by the Nigam with the approval of State Government must be belonging to the category, who in the Government's opinion, possesses administrative experience in matters relating to water supply and sewerage works. The expression "local fund" occurring in section 3(31) of the General Clauses Act would mean the fund of a local self-government. In *R. C. Jain's* case, AIR 1981 SC 951 for deciding whether the Delhi Development Authority was a local authority, as already mentioned, the court had examined as to whether its fund consisted of any funds flowing directly from any taxing power vested in the Delhi Development Authority.

In the case of the assessee i.e. U. P. Jal Nigam, it is the income from the construction and maintenance of water purification and treatment plants, which goes to augment its funds. Like any commercial organization, it makes profit from trading activities and it has been given the power to raise loans. Whereas municipal or local funds are required to be spent for providing civic amenities, there is no such obligation on the respondent to do so. Merely because section 40 of the U.P. Jal Nigam states that the fund of the Nigam "shall be a local fund" which would be deemed to be "Nigam Fund" that would not make it a local fund as contemplated by section 3(51) of the General Clauses Act.

Thus, in the light of aforesaid discussion and the amended provisions pertaining to "local authority" as per Income-tax Act, 1961, any income earned by Uttar Pradesh Jal Nigam which is chargeable under the head "Income from house property", "Capital gains", "Income from other sources" or from trade or business carried on by it which accrues or arises from the supply of water or electricity within or outside its own jurisdictional area is not exempt under section 10(20). Therefore, it is incorrect to come to the conclusion that U.P. Jal Nigam is a "local authority" and entitled to exemption under section 10(20) of the Income-tax Act.

The attention may also be drawn to section 3(3) of U. P. Water Supply and Sewerage Act, 1975 (hereinafter referred to as U. P. Act No. 1975), which reads as under :

"3.(3) The Nigam shall for all purposes be deemed to be a local authority and not a company or a corporation owned by the State Government having shares and shareholders."

It may be mentioned that in the U. P. Forest Corporation Act, 1974, section 3(3) provides that for all purposes, it shall be the "local authority". Similar words are used in the U. P. Act No. 1975. In the case of *CIT* v. *U.P. Forest Corporation* [1998] 230 ITR 945, the hon'ble Supreme Court has discussed the provisions pertaining to section 10(20) of the Income-tax Act. The Division Bench judgment of the Allahabad High Court had allowed the exemption holding the U. P. Forest Corporation as a "local authority". But the hon'ble Supreme Court set aside the judgment and held that U. P. Forest Corporation is not a "local authority" though under section 3(3) of the U.P. Forest Corporation Act, 1974, it is provided that for all purposes it shall be the local authority. Their lordship has relied upon the ratio of *R. C. Jain's* case, AIR 1981 SC 951 while reversing the judgment of the Allahabad High Court, to quote relevant portion is as under (page 956 of 330 ITR) :

"In the case of the respondent-corporation, the Act does not enable it to levy any tax, cess or fee. It is the income from the sale of the forest produce which goes to augment its funds. It has no power under the Act of compulsory exaction such as taxes, fees, rates or charges. Like any commercial organization it makes profit from sale of forest produce and it has been given the power to raise loans. Whereas municipal or local funds are required to be spent for providing civic amenities, there is no such obligation on the respondent to do so. Merely because section 17 of the U. P. Forest Corporation Act states that the fund of the corporation 'shall be a local fund' that would not make it a local fund as contemplated by section 3(31) of the General Clauses Act.

In our opinion, therefore, the High Court was not correct in coming to the conclusion that the respondent was a 'local authority' and entitled to exemption under section 10(20) of the Act.

Coming to the question whether the income of the respondent is held for charitable purposes and, therefore, exempt from tax by virtue of section 11(1) of the Act, we find no such contention was raised by the respondent before the income-tax authorities. In order to take advantage of the provisions of section 11 of the Act, a trust or institution has to get itself registered."

Parliament. There is no "repugnance" where the encroachment is not substantial or the subject-matter of the legislation is not the same.

Accordingly, the Union law is to prevail where the State law is repugnant to it. In the case of *Deep Chand* v. *State of U. P.* AIR 1959 SC 648, it was observed that when there is a direct conflict between the provisions, the State law may be repugnant. In the case of *Zaverbhai Amaidas* v. *State of Bombay* [1955] (1) SCR 799, it was observed that where one law cannot be obeyed without disobeying the other law, then the State law may be repugnant. In the case of *Sitaram* v. *State of Rajasthan* [1995] 1 SCC 257 (para 4), it was observed that even when the Central law is not exhaustive, repugnancy may arise if it occupies the same field as the State Act. The test of "pith and substance" has been applied to determine whether the State law has substantially transgressed on the field occupied by the law of Parliament as observed in the case of *Vijay Kumar Sharma* v. *State of Karnataka,* AIR 1990 SC 2072.

The same is also applicable when the constitutionality of a taxing law is impeached as per the ratio laid down in the case of *State of Bombay* v. *United Motors India Ltd.* [1953] 4 STC 133 ; [1953] SCR 1069 and reversibility in this context would include re-probability in the enforcement of the taxing statute.

By applying the above mentioned test, it is crystal clear that Income-tax Act is a self-contained code, which is passed by the Parliament and it will prevail over the State Act, namely, U.P. Water Supply and Sewerage Act, 1975. However, there is an exception provided in article 254(2) of the Constitution that if the President assents to a State law, it will prevail over the Central law, if both laws are dealing with a concurrent list. But this is not the case with "local authority" viz-a-viz exemption under income-tax. Thus, the provision made in section 3(3) of the Act is of no use to the assessee.

The question still remains as to why Parliament has used the words "Municipal Committee" and "District Board" in item (iii) of the said *Explanation* to section 10(20) of the Income-tax Act. It appears that Parliament has defined "local authority" to mean—a Panchayat as referred to in clause (d) of article 243 of the Constitution of India and Municipality as referred to in clause (e) of article 243P of the Constitution of India. However, there is no reference regarding "local authority" in the article 243 after the words "Municipal Committee" and "District Board". It appears that the terms Municipal Committee and District Board in the said *Explanation* are used out of abundant caution. In 1897, when the General Clauses Act was enacted, Municipal Committees and District Boards were already in

existance in India. They continued even thereafter. In some remote place, it is possible that there exists a Municipal Committee or a District Board. Therefore, apart from a Panchayat and Municipality, Parliament in its wisdom decided to give exemption to Municipal Committee and District Board. Earlier, there were District Board Acts in various States. Most of the States have repealed those Acts. However, it is quite possible that in some remote place a District Board may still exist. Therefore, Parliament decided to give exemption to such Municipal Committees and District Boards. Hence, Parliament has retained exemption for Municipal Committee and District Board apart from Panchayat and Municipality. This view finds support from the provisions contained in Part IX of the Constitution of India. Article 243N provides for continuance of existing laws and Panchayats. It states, inter alia, that notwithstanding anything in Part IX, any law relating to Panchayats in a State immediately before the commencement of the Constitution (Seventy-third Amendment) Act, 1992, which is inconsistent with the provisions of Part IX, shall continue to be in force until repealed by a competent Legislature. Similarly, under Part IX-A there is article 243ZF which refers to the "Municipalities". This article, inter alia, states that notwithstanding anything in Part IX-A, any provision of any law relating to Municipalities in force in a State immediately before the commencement of the Constitution (Seventy-fourth Amendment) Act, 1992, which is inconsistent with the provisions of Part IX-A, shall continue to be in force until amended or repealed by a competent Legislature. It appears that article 243N and article 243ZF indicates that there could be enactments which still retain entities like Municipal Committees and District Boards, if they exist, and Parliament intends to give exemption to their income under section 10(20) of the Income-tax Act, 1961.

Moreover, Parliament in its wisdom has used the word "local" as prefix to the word "authority". The word "local" confines the jurisdiction or area of functions of the authority within specified limit under a statutory provision or Act possessing different features and functional activities provided under Part IXA of the Constitution.

Article 243W contains power of authorities and responsibility of muni-

and 243ZA are reproduced as under :

"243W. *Powers, authority and responsibilities of Municipalities, etc.*—Subject to the provisions of this Constitution, the Legislature of a State may, by law, endow—

(a) the Municipalities with such powers and authority as may be necessary to enable them to function as institutions of self-government and such law may contain provisions for the devolution of powers and responsibilities upon Municipalities, subject to such conditions as may be specified therein, with respect to—

(i) the preparation of plans for economic development and social justice ;

(ii) the performance of functions and the implementation of schemes as may be entrusted to them including those in relation to the matters listed in the Twelfth Schedule ;

(b) the Committees with such powers and authority as may be necessary to enable them to carry out the responsibilities conferred upon them including those in relation to the matters listed in the Twelfth Schedule.

243X. *Power to impose taxes by, and Funds of the Municipalities.*— The Legislature of a State may, by law—

(a) authorise a Municipality to levy, collect and appropriate such taxes, duties, tolls and fees in accordance with such procedure and subject to such limits ;

(b) assign to a Municipality such taxes, duties, tolls and fees levied and collected by the State Government for such purposes and subject to such conditions and limits ;

(c) provide for making such grants-in-aid to the Municipalities from the Consolidated Fund of the State ; and

(d) provide for constitution of such Funds for crediting all moneys received, respectively, by or on behalf of the Municipalities and also for the withdrawal of such moneys therefrom,

as may be specified in the law.

243ZA. *Elections to the Municipalities.*—(1) The superintendence, direction and control of the preparation of electoral rolls for, and the conduct of, all elections to the Municipalities shall be vested in the State Election Commission referred to in article 243K.

(2) Subject to the provisions of this Constitution, the Legislature of a State may, by law, make provision with respect to all matters relating to, or in connection with, elections to the Municipalities."

In the instant case, the fact remains that Jal Nigam is a corporate and its area extends to the whole of U.P. under section 1 of the 1975 Act but it has got no jurisdiction to impose tax other than fees under the tariff schedule,

construction designing. They seem to be engaged in commercial activities. Accordingly, the assessee does not seem to be a "local authority" under section 10(20) of the Income-tax Act, more so when interpreted keeping in view the provisions contained in Part IXA of the Constitution given effect from June 1, 2003 as well as section 3(31) of the General Clauses Act, 1897.

Now let us also examine whether claim of exemption under article 289 of the Constitution of India is tenable with respect to income of U. P. Jal Nigam after it has lost the status of "local authority" with effect from April 1, 2003.

The provisions of article 289(1) are as follows :

(1) The property and Income of a State shall be exempt from Union taxation.

(2) Nothing in clause (1) shall prevent the Union from imposing or authorizing the imposition of any tax to such extent, if any, as Parliament may by law provide in respect of a trade or business of any kind carried on by, or on behalf of, the Government of a State, or any operations connected therewith, or any property used or occupied for the purposes of such trade or business, or any income accruing or arising in connection therewith.

(3) Nothing in clause (2) shall apply to any trade or business, or to any class of trade or business, which Parliament by law declares to be incidental to the ordinary functions of Government.

In section 3(58) of the General Clauses Act, 1897, "State" has been defined. On a combined reading, it appears that articles 285 and 289 provide for the immunity of the property of the Union and the State from mutual taxation, according to the federal principle. Article 289(1) provides

[illegible] can be claimed under this clause, if the income in question is of some authority other than State, e.g., a statutory corporation, which is a separate juristic entity, even though its shares are owned by the State itself, or when the authority/corporation is State-controlled, as per the ratio laid down in *A.P.S.R.T.C.* v. *ITO* [1964] 34 Comp Cas 473 ; [1964] 52 ITR 524 ; AIR 1964 SC 1486. Further, a business carried on by a State is not exempted from Union Taxation unless Parliament has declared such business to be incidental to the functions of Government under article 289(3) of the Constitution, as was held in the case of *New Delhi Municipal Council Corporation* v. *State of Punjab,* AIR 1997 SC 2847. Hence, the income of a Corporation/Nigam is not the Income of State under article 289(1)

The hon'ble Supreme Court, in the case of *Andhra Pradesh State Road Transport Corporation* v. *ITO* [1964] 34 Comp Cas 473 ; [1964] 52 ITR 524, has clearly maintained that the income derived by corporation was not the income of the State under article 289(1) by observing that (page 532 of 52 ITR) :

"If a trade or business is carried on by the State departmentally and is income is derived from it, there would be no difficulty in holding that the said income is the income of the State. If a trade or business is carried on by a State through its agents appointed exclusively for that purpose, and the agents carry it on entirely on behalf of the State and not on their own account, there would be no difficulty in holding that the income made from such trade or business is the income of the State. But difficulties arise when we are dealing with trade or business carried on by a corporation established by a State by issuing a notification under the relevant provisions of the Act. The Corporation, though statutory, has a personality of its own and this personality is distinct from that of a State or other shareholders. It cannot be said that a shareholder owns the property of the corporation or carries on the business with which the corporation is concerned. The doctrine that a corporation has a separate legal entity of its own is so firmly rooted in our notions derived from common law that it is hardly necessary to deal with it elaborately ; and so, prima facie, the income derived by the appellant from its trading activity cannot be claimed by the State which is one of the shareholders of the corporation."

Similarly, in the case of *Vidarbha Housing Board* v. *ITO* [1973] 92 ITR 430 (Bom), it was held that :

"It was clear, therefore, that the income and property of the board could not be regarded as the income and property of the State Government, with the result that the immunity claimed by petitioner board under article 289(1) of the Constitution was clearly not available to the petitioner board."

"Having considered as to whether the assessee-Gujarat Industrial Development Corporation, Ahmedabad is entitled or is not entitled to exclude its income from liability under the Indian Income-tax Act, we are clearly of the opinion that from their total income, no exclusion could be made on the ground that it is a State as contemplated by the article 289(1) of the Constitution of India. The State is entirely different from the Corporations which are created by laws which are enacted either by Parliament or by State Legislatures for different and distinct purposes. They are separate entities in law. They sue and are sued in their own capacities and for any contractual liability of the corporation ; no person can sue the

State because every corporation in itself is not the State but a separate legal entity. Under these circumstances, our opinion on the first question would be in the affirmative, and we hold that the decision of the Tribunal is right. Therefore, this point is decided in favour of the Revenue and against the assessee."

In a judgment on this subject, dated May 3, 2006, in Civil Appeal (Civil) 6382 of 2003 (*Adityapur Industrial Area Development Authority* v. *Union of India* [2006] 283 ITR 97 (SC)) the hon'ble apex court reiterated the same principle by observing that (page 103 of 283 ITR) :

"Having regard to the provisions of the Bihar Industrial Area Development Authority Act, 1974, particularly section 17 thereof, we have no manner of doubt that the income and that the appellant/authority constituted under the said Act is its own income and that the appellant/authority manages its own funds. It has its own assets and liabilities. It can sue or be sued in its own name. Even though, it does not carry on any trade or business within the contemplation of clause (2) of article 289, it still is an authority constituted under an Act of the Legislature of the State having a distinct legal personality, being a body corporate, as distinct from the State".

Having considered all aspect of the matter, it is crystal clear that the U. P. Jal Nigam could not claim exemption from Union taxation under article 289(1) of the Constitution of India.

That apart, for the purpose of exemption of tax, it shall also be necessary to examine whether the income of the authority is for a charitable purpose or not. By virtue of exemption under section 11 of the Income-tax Act to avail the benefit or advantage of section 11 of the Act, a trust or institution has to get itself registered, which seems to be not a case with regard to the U.P. Jal Nigam. Section 2(15) of the Income-tax Act, defines "Charitable purpose" which includes relief to the poor, education, medical relief, and the advancement of any other object of general public utility.

Subject to the provisions of section 60 to 63 of the Income-tax Act, the following income shall not be included in the total income of the previous year of the person in receipt of the income, derived from property held under trust wholly for charitable or religious purpose, to the extent to which such income is applied for such purpose in India :

The conditions to be fulfilled for getting exemption from taxation of the income under section 11 of the Income-tax Act are :

(i) The property is held under trust wholly for charitable or religious purposes.

(ii) Where the income that could not be applied for such purposes is not accumulated or set apart is in excess of a certain limit as provided in the section, which is 15% of the income from such property.

(iii) Form 10B is submitted before filing the return if any income could not be so applied as it was not received or for any other reason.

(iv) The Registration under section 12A is granted by the Commissioner and

(v) The conditions provided under section 13 are satisfied.

Coming to the question whether the income of the U. P. Jal Nigam is held for charitable purpose and, therefore, exempt from tax by virtue of section 11(1) of the Act, no such contention was ever raised by the assessee before the income-tax authorities. But it has academic value.

U.P. Jal Nigam has never moved any application for the purpose of getting registration under section 12AA of the Income-tax Act, 1961 and has never claimed its income to be exempt under section 11 of the Income-tax Act, 1961, even after the amendment of the section 10(20) of the Income-tax Act, 1961, with effect from April 1, 2003. In the backdrops of the facts, let us also examine the section whether, if U.P. Jal Nigam had applied for registration under section 12AA of the Income-tax Act, 1961 and had obtained requisite registration as aforesaid, would such registration would entitle U.P. Jal Nigam to claim exemption under section 11 of the said Act. It may be mentioned that granting registration under section 12AA of the Act does not give blanket exemption to the assessee under section 11 of the Act. The institution-assessee may be registered under section 12AA but still they may not be eligible for exemption under section 11 of the Act.

Further, after examining the provisions, it is evident that the benefit cannot be extended to the assessee as it is not a trust/institution having charitable nature. So, its income cannot be exempted under section 11 of the Income-tax Act, 1961.

After discussing the legal matrix pertaining to the "local authority", the position is that Jal Nigam-assessee cannot be considered as a "local authority". But the fact remains that the assessee has three wings and in the case of the first wing i.e. Jal Nigam Wing, it is evident that it is providing essential services, namely, water and sewerage. Hence, its activities can be considered as falling under the definition of "local authority", specially when the Assessing Officer himself for the assessment year 2002-03 has mentioned that **the activities of Jal Nigam Wing are that of a "local authority"** whereas the activities of the remaining two wings, namely, (i) Construction and Design wing ; and (ii) Nalkoop wing are not at all that

of a "local authority". So, the tax authority has suo motu granted the exemption under section 10(20) of the Income-tax Act only to the First Wing i.e., Jal Nigam Wing.

Regarding the remaining two wings of the assessee, namely, Nalkoop Wing and Construction and Design Wing, there is no reason to disagree with the tax authority, who has rightly held that the activities are not the activities of the "local authority". Hence, the income of these two wings is subject to tax.

But the fact remains that with effect from April 1, 2002, by the Finance Act, 2002, the benefits of section 10(20A) and 10(29) were dropped and many Government companies/corporations/undertakings were saddled with considerable liability. These entities were putting pressure on the Government for restoration of the exemption, especially Port Trust and various other Government agencies who claimed that they were victims of these changes. Therefore, instead of restoring the exemption, at least, for State undertakings, Parliament did the next best thing by practically restoring the exemption indirectly by inserting clause (xii) under section 36(1),which allowed any expenditure not being a capital expenditure incurred by a corporation or body corporate by whatever name called, constituted or established by a Central, State or provincial Act for the objects and the purpose authorized by the Act under which the corporation or body corporate was constituted or established. The deduction was authorized from the date on which the exemption was withdraw retrospectively by the Finance Act, 2002, that is April 1, 2002.

Needless to mention that in the instant case, the annual accounts of the Nigam were kept separately in three parts—Jal Nigam, Construction and Design Services, and Nalkoop Wing. Consolidation of Financial Statements of all the three wings have been done from the financial year 2002-03 and have since been maintained on the same pattern. For the assessment year 2002-03, an indirect benefit was provided by the then section 36(1)(xii) of the Income-tax Act, which reads as under :

"(xii) any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act for the objects and purposes authorised by the Act under which such corporation or body corporate was constituted or established ;"

It may be mentioned that the above provision was substituted by the Finance Act, 2007, with effect from April 1, 2008. The substituted provision is as under :

Section 36(1)(xii)

"any expenditure (not being in the nature of capital expenditure) incurred by a corporation or a body corporate, by whatever name called, if,—

(a) it is constituted or established by a Central, State or Provincial Act ;

(b) such corporation or body corporate, having regard to the objects and purposes of the Act referred to in sub-clause (a), is notified by the Central Government in the Official Gazette for the purposes of this clause ; and

(c) the expenditure is incurred for the objects and purposes authorised by the Act under which it is constituted or established ;"

It is evident that substituted provision is applicable, with effect from April 1, 2008. So, the same is not applicable for the previous assessment years and the same will have to be governed by the then law.

However, now three sections, namely, 10(20), 10(20A) and 10(29) are not providing the exemption from tax being not a "local authority", but the same probably strengthens the case for exemption wherever the more liberal application of the meaning of the word "authority" is possible. Again, the indirect restoration of the exemption by the new provision 36(1)(xii) may not apply for all the bodies which may qualify for treatment as "local authority" since this provision may be construed as applicable only for those bodies formed by special Acts like Port Trust Act, Warehousing Corporation Act, Jal Nigam and so on.

Whether by applying the benefit of section 36(1)(xii) of the Income-tax Act, the erstwhile "local authorities" can get any benefit from the strong clutches of the income-tax authority, is a litmus test which remains to be seen.