
(1980) 04 CAL CK 0008

In the Calcutta High Court

Case No : Income-tax Reference No. 83 of 1977

Chloride India Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 16-04-1980

Acts Referred:

Transfer of Property Act, 1882 — Section 108

Citation : (1980) 18 CTR 356 : (1981) 130 ITR 61

Hon'ble Judges : Sudhindra Mohan Guha, J;Sabyasachi Mukharji, J

Bench : Division Bench

Advocate : D. Pal and R. Murarka, for the Appellant;S. Sen and S. Banerjee, for the Respondent

Judgement

Sabyasachi Mukharji, J.—In this reference u/s 256(1) of the I.T. Act, 1961, the following question has been referred to this court :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the payment of Rs. 4,50,000 was in the nature of capital expenditure ?"

2. In order to appreciate the question we have to refer to the facts as found by the Tribunal. The assessee-company required some more space on account of the growing needs of its business. The assessee company, therefore, started negotiations in respect of premises No. 240E, Acharya Jagadish Chandra Bose Road, Calcutta. The premises were, however, at that time occupied by M/s. Gasper & Co. and in order to obtain vacant possession of the premises, the assessee paid a sum of Rs. 4,50,000 to M/s. Gasper & Company. Thereafter, the assessee claimed the payment of that sum as a revenue expenditure. The ITO disallowed the claim of the assessee on the ground that it was in the nature of capital expenditure. The ITO was of the opinion that the payment to M/s. Gasper & Company was for acquiring a benefit of an enduring nature.

3. The assessee preferred an appeal before the AAC. The AAC held that the

payment made to M/s. Gasper & Co. was in the nature of a premium for the acquisition of vacant premises and that its right to enjoy vacant possession of the property could properly be regarded as a capital asset. The AAC, therefore, held that the money paid to purchase it or acquire it must be held to be capital expenditure.

4. There was a further appeal before the Tribunal. The Tribunal held that M/s. Gasper & Co. was a tenant occupying the premises No. 240E, Acharya Jagadish Chandra Bose Road, Calcutta, The assessee took the premises on lease and paid a sum of Rs. 4,50,000 to M/s. Gasper & Co. to get the vacant possession. According to the Tribunal, it was well settled that the rights of tenancy were valuable rights which the tenant possessed u/s 108, Sub-section (c), of the Transfer of Property Act. The lessee was entitled to hold the property without interruption if he pays the rent. A lease is not a mere contract but is a transfer of interest in property and created a right in rem. According to the Tribunal in order to part with the valuable rights which M/s. Gasper & Co. had, the assessee paid a sum of Rs. 4,50,000. By paying the sum of Rs. 4,50,000 the assessee, according to the Tribunal, obtained vacant possession of the premises which was in the nature of an enduring benefit. The Tribunal further held that, unless that right was obtained, the assessee could not have obtained possession of the premises. In the premises, according to the Tribunal, the payment of Rs. 4,50,000 was in the nature of capital expenditure. The Tribunal was of the opinion that it was immaterial whether the amount was paid to the tenant or to the landlord. The Tribunal discussed the authorities cited before it some of which we will also have occasion to note.

5. In the premises, the Tribunal has referred the question as indicated before u/s 256(1) of the I.T. Act, 1961.

6. Before we discuss the matter further, it may be useful to refer to several decisions to which our attention was drawn. Reliance was placed on the decision in the case of Raja Bahadur Kamakshya Narain Singh of Ramgarh v. CIT [1943] 11 ITR 513. Our attention was drawn to the observations of the Judicial Committee appearing at page 519 of the report. Their Lordships were dealing with the question, under what circumstances payments by the lessors made under the leases may be classed and the Judicial Committee noted that these may be classified as three categories : (i) the salami or premium, (ii) the minimum royalty, (iii) the royalties per ton. According to the Judicial Committee, the salami had been rightly treated as a capital receipt. It was a single payment made for the acquisition of the right of the lessees to enjoy the benefits granted to them by the lease. That general right might properly be regarded as a capital asset and the money paid to purchase it may properly be held to be a payment on capital account. But the royalties stood on a different footing. The minimum royalty was only payable if in any year the royalties on coal raised and despatched were less than the sum fixed as the minimum royalty. We are, in the instant case before us, not really concerned with the question whether the

payment would be a single payment or recurring payment and on that ground would merit consideration as capital expenditure or revenue expenditure.

7. Reliance was then placed on certain observations in the decision of the Supreme Court in BOMBAY STEAM NAVIGATION CO. (1953) PRIVATE LTD. Vs. COMMISSIONER OF Income Tax, BOMBAY., , where the Supreme Court, at page 60 of the report, in the context of controversy whether a particular expenditure was revenue or capital, observed that the question should be viewed in the larger context of business necessity or expediency. If the outgoing or expenditure was so related to the carrying on or conduct of the business, then it might be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which was a condition for the carrying on of the business. The expenditure in such circumstances might be regarded as a revenue expenditure. That was a case, however, dealing with the payment of interest. There, what happened was that, pursuant to a scheme of amalgamation between two shipping companies, the assessee-company was incorporated on August 10, 1953, to take over certain passenger and ferry services carried on by one of them. On 12th August, 1953, the assessee-company took over assets which were finally valued at Rs. 81,55,000 and agreed that the price was to be satisfied partly by the allotment of 29,000 fully paid up shares of Rs. 100 each and the balance was to be treated as a loan secured by a promissory note and hypothecation of all movable properties of the assessee-company. The balance remaining unpaid from time to time was to carry simple interest at 6 per cent. By a supplemental agreement the original agreement was modified to the effect that the balance should be paid by the assessee-company and until it was paid in full the assessee-company should pay simple interest at 6 per cent. per annum on such of the balance as remained due. The balance was also to be secured by the hypothecation of all the movable properties of the assessee-company. In those circumstances the interest that was paid was allowed as business expenditure because it prevented foreclosure under the hypothecation clause.

8. Our attention was drawn to a decision in the case of Commissioner of Income Tax, Assam etc. Vs. The Panbari Tea Co. Ltd., . There the Supreme Court was dealing with the lease dated 31st of March, 1950, by which the assessee-company had leased out two tea estates along with machinery and buildings thereon for a period of 10 years from the 1st of January, 1950, in consideration of a sum of Rs. 2,25,000 as and by way of premium and an annual rent of Rs. 54,000. Of the premium the sum of Rs. 45,000 was payable at the time of the execution of the deed and the balance of Rs. 1,80,000 was payable in 16 half-yearly instalments of Rs. 11,250 each commencing from January 31, 1952. The question before the Supreme Court was, whether the sum of Rs. 11,250 received by the assessee-company towards the premium in the accounting year relevant to the assessment year 1952-53 was revenue or capital receipt. The Supreme Court at p. 425 of the report referred to Section 105 of the Transfer of Property Act and held that the lease of an immovable property was a transfer of a right to

enjoy the property made for a certain time, express or implied, or in perpetuity, in consideration of a price paid or promised or of money, a share of crops, service or any other thing of value, to be rendered periodically or on specified occasions to the transferor by the transferee, who accepted the transfer on such terms, the transferor was called the lessor and the transferee was called the lessee, the price was called the premium and the money, share, service or other thing so rendered was called rent. The section, according to the Supreme Court, therefore, brought out the distinction between the price paid for a transfer of the right to enjoy the property and the rent to be paid periodically to the lessor. When the interest of the lessor was parted with, for a price, the price paid was premium or a salami but the periodical payments made for the continuous enjoyment of the benefits under the lease are all in the nature of rent. The former, according to the Supreme Court, was a capital gain and the latter a revenue receipt. The Supreme Court, however, emphasised that there might be circumstances where the party might camouflage the real nature of the transaction by using clever phraseology, in some case, the so-called premium is in fact advance rent and in others rent is deferred price. We are, however, not concerned in the instant case with that controversy, but the Supreme Court reiterated that the nomenclature used might not be decisive or conclusive in all cases.

9. But the principle that emerges from the said decision is that the price that is paid for parting with possession of the right is a price which can be classified as a capital expense. In this connection, we may also refer to the observations of the Supreme Court in the case of *Gotan Lime Syndicate Vs. Commissioner of Income Tax, Rajasthan and Delhi*, of the report, the Supreme Court observed as follows :

"It is not the law that, in "every case, if an enduring advantage is obtained, the expenditure for securing it must be treated as capital expenditure, for, as pointed out by Channell J., in *Alianza Company v. Bell* [1904] 2 KB 666, "...in the ordinary case, the cost of the material worked up in a manufactory is not a capital expenditure; it is a current expenditure, and does not become a capital expenditure merely because the material is provided by something like a forward contract, under which a person for the payment of a lump sum down secures a supply of the raw material for a period extending over several years." This illustration shows that it is not in every case that an expenditure in respect of an advantage of an enduring nature is capital expenditure. The reason underlying the illustration is that the payments made to enter into a forward contract have relation to the raw material eventually to be obtained. Viscount Cave acknowledged that in certain cases an expenditure for obtaining an enduring advantage need not be capital expenditure, for, he inserted the words "in the absence of special circumstances leading to an opposite conclusion" within brackets.

We are of the opinion that in the present case the royalty payment is not a direct payment for securing an enduring advantage ; it has relation to the raw material

to be obtained. Ordinarily, a mining lease provides for a capital sum payment; but the fact that there is no lump sum payment here cannot by itself lead to the conclusion that yearly payments to be made under the mining lease have relation to the acquisition of the advantage. No material has been placed on the record to show that any part of the royalty must, in view of the circumstances of the case, be treated as premium and be referable to the acquisition of the mining lease."

10. Next decision which must be referred to in this case is the decision of the Madras High Court in the case of Commissioner of Income Tax Vs. S.B. Ramakrishnan, . There the assessee in order to obtain the lease of a new building had paid a sum of Rs. 1,001 to the landlord as an extra payment over and above the stipulated rent and had claimed the deduction of the sum as a revenue expenditure. The claim was disallowed by the departmental authority but allowed by the Tribunal on the view that the expenditure was akin to the payment of rent for the new premises. On a reference, the Division Bench of the Madras High Court held that the expenditure not having been incurred for the purpose of bringing into existence any asset or advantage of an enduring character and the payment not having been made in order to secure the lease for any term of years, but only for the purpose of a continued running of the business, though in a new premises, the sum of Rs. 1,001 was deductible in arriving at the assessee's income. Mr. Justice Veeraswami, as his Lordship then was, had observed, at p. 762, that the object of the assessee was, by incurring business expenditure, to produce profits and not to create any asset of a capital nature.

11. Reliance was also placed on certain observations of the Supreme Court in the case of V. Jaganmohan Rao and Others Vs. Commissioner of Income Tax and Excess Profits Tax, Andhra Pradesh, and our attention was drawn to the observations appearing at p. 380 of the report where the Supreme Court referred to the well-known observations of Viscount Cave in the case of Atherton v. British Insulated and Helsby Cables Ltd, [1926] AC 205 and to the case of "Commr. of Taxes v. Nckanga Consolidated Copper Mines Ltd, [1964] AC 948 ; [1965] 58 ITR 241 and other cases and observed in the facts of that case that the payment of Rs. 1,15,000 was made by the assessee in order to perfect the title to a capital asset, viz., the mill. It was a lump sum payment for the acquisition of a capital asset and the claim of the vendor's sons for the income from the property was merely ancillary or incidental to the claim to the capital asset. Therefore, the High Court took into consideration the value of the mill and the income from the mill separately in testing whether the offer made by the assessee of Rs. 1,15,000 for the release of the claims of the vendor's sons was a fair offer, which did not mean that they were given, as a result of the compromise, a share in the profits. The amount of Rs. 1,15,000 was, therefore, a capital outgoing and it could not be apportioned between capital and income. It is well established that where money is paid to perfect a title or as consideration for getting rid of a defect in the title or a threat of litigation, the payment would be a capital payment and not a revenue payment. The Supreme Court, in those circumstances, dismissed the

appeal from the High Court.

12. Reliance was also placed on certain observations of the Supreme Court in the case of *Dalmia Jain and Co. Ltd. Vs. Commissioner of Income Tax, Bihar, Orissa and Patna*, . The Supreme Court observed at p. 757 of the report as follows:

"The question for decision is whether the litigation expenses incurred by the assessee were for the purpose of creating, curing or completing the assessee's title to capital or whether it was for the purpose of protecting its business. If it is the former then the expenses incurred must be considered as capital expenditure. But, on the other hand, if it is held that the expenses were incurred to protect the business of the assessee, that it must be considered as a business loss. The principle which has to be deduced from decided cases is that, where the expenditure laid out for the acquisition or improvement of a fixed capital asset is attributable to capital, it is a capital expenditure but if it is incurred to protect the trade or business of the assessee then it is a revenue expenditure. In deciding whether a particular expenditure is capital or revenue in nature what the courts have to see was whether the expenditure in question was incurred to create any new asset or was incurred for maintaining the business of the company. If it was the former it is the capital expenditure ; if it is the latter, it is the revenue expenditure."

13. Reliance was also placed on a decision of this court in the case of *Commissioner of Income Tax Vs. De Luxe Film Distributors Ltd.*, , where the assessee-company was a producer and distributor of cinematograph films. It entered into an agreement with one A for financing the production, being the distributor of a film. Disputes arose between A and the assessee-company on the question as to who was the producer of the film. An arbitration award declared A and the company to be joint producers. There were other disputes which were settled by the terms of a settlement. Under its terms A executed a deed of release whereby he gave up all his claims as producer including 40% of the share of profits and other benefits in consideration of an amount of Rs. 20,101 paid to him by the company. On the question, whether this amount represented revenue expenditure on the part of the company, it was held that the decision on the question whether an expenditure was revenue expenditure or capital expenditure depended on the facts of each case. In this case, the sum of Rs. 20,101 was paid to clear the title in the carrying on of the business of the assessee which was clouded by the claims of A. It was emphasised that the assessee was not acquiring any capital asset by the expenditure of the sum nor was it perfecting its title which was already clarified by the award. The sum was spent in the background of business expediency and was, therefore, allowable as revenue expenditure.

14. At p.. 439, after setting out the facts, we had observed as follows :

"It appears to us that in the background of the facts of this case, the sum of Rs. 20,101 was paid to clear the title in the carrying on of the business which was

clouded by the litigation and the counter-claims of Sri Amar Das Mallik. By the expenditure of the said sum, the assessee, in our opinion, was not acquiring any capital asset, as such, viz., his right over the film had already been acquired nor was the assessee perfecting his title which was clarified by the award of the arbitrator. But in running the business or to make the business productive of profit the sum was spent to settle the matter and in that background of expediency of the running of the business this amount was spent. The amount spent for that business expediency, in the background of the facts and circumstances of the case, in our opinion, can be considered to be revenue expenditure and, applying the correct principles, if the Tribunal has taken that view, we find no reason to interfere with that decision of the Tribunal."

15. It appears that so far as M/s. Gasper & Co. was concerned, whether in its hands the said sum received by M/s. Gasper & Co. would be taxed as capital gains came up for consideration in a decision of this court in the case of A. Gasper Vs. Commissioner of Income Tax, , which was in respect of the identical transaction. There having regard to the definition of Section 2(41) of the I.T. Act, 1961, it was held that there was an extinguishment of the right of M/s. Gasper & Co. in the premises in question and, therefore, the amount received in consideration of that extinguishment was exigible to be taxed as capital gains. There it was observed that the assessee could transfer his right of interest in the tenancy. The assessee was entitled to transfer his tenancy right to the transferee in view of Section 147(1)(b) of the West Bengal Premises Tenancy Act and the transfer of the right or interest of a tenant in the tenancy was not absolutely prohibited even where a tenancy right was governed by the West Bengal Premises Tenancy Act, which merely protected the tenant from eviction even where his tenancy had been lawfully determined provided it fulfilled certain conditions mentioned therein. The right of tenancy was, therefore, a transferable property or a capital asset u/s 2(14) of the I.T. Act, 1961. The court found that the assessee was a monthly tenant since 1940, and with regard to a property in Calcutta, the landlord had entered into an agreement for lease on 17th of March, 1967, with the tenant, permitting him to construct a building on the said premises. The assessee was also a party to the agreement and received Rs. 2,25,000 out of the total consideration money of Rs. 4,50,000 on that date. The ITO sought to assess Rs. 1,83,000 as capital gains for the assessment year 1967-68. The Tribunal found that the assessee with the consent of the landlord had transferred his monthly tenancy and leased out the entire tenancy right of the property as the tenant who became a licensee and became a recipient of the sum in question as a result of the transaction. The Tribunal sustained the order of the ITO. Before the High Court, it was pointed out, on behalf of the assessee, that this was not a capital asset and the amount had not been received by the landlord. The third party was not liable to the capital gains taxed u/s 45 of the I.T. Act, 1961. In the context of the facts found it was held that the capital gains was properly leviable.

16. Reliance was placed on the observations of the House of Lords in the case of

IRC v. Carron Company [1968] 45 TC 18. Both sides relied on the observations of Lord Reid at p. 67, where discussing the question whether a particular expenditure ought to be charged to the income or capital asset, Lord Reid at p. 67 of the report, observed as follows :

"I turn now to the more difficult question whether this expenditure ought to be charged to income or capital account. The case for charging it to capital might appear to be strengthened by the magnitude of the sums involved, but again I do not think it would be right to take into account the sums paid to the dissident shareholders in deciding what should be done with the cost of obtaining the new charter. If this, taken by itself, is a proper charge against income, it cannot become chargeable to capital because it was first necessary to buy off these shareholders. And if the smaller sum is chargeable against income it is not suggested that the larger sum could be chargeable against capital. I shall not repeat what I said in *Strick v. Regent Oil Co. Ltd.* [1966] AC 295 ; [1969] 73 ITR 301, with regard to the general manner of approach to this question, nor shall I repeat the analysis of the authorities which I there made.

The main argument for the Crown was that by obtaining the new charter the company obtained an enduring advantage in the shape of a better administrative structure. Of course they obtained an advantage: companies do not spend money either on capital or income account unless they expect to obtain an advantage. And money spent on income account, for example on durable repairs, may often yield an enduring advantage. In a case of this kind what matters is the nature of the advantage for which the money was spent. This money was spent to remove antiquated restrictions which were preventing profits from being earned. It created no new asset. It did not even open new fields of trading which had previously been closed to the company. Its true purpose was to facilitate trading by enabling the company to engage a more competent manager and to borrow money required to finance the company's traditional trading operations under modern conditions. None of the authorities cited is directly in point, and I think that the most apposite general statement in those authorities is that of Lawrence L.J. in *Anglo-Persian Oil Co. Ltd. v. Dale* [1932] 1 KB 124 CA). It "merely effected a change in its business methods and internal organisation, leaving its fixed capital untouched ". As the Lord President put it in the present case (p. 48 of 45 TC):

"The benefit was essentially of a revenue character because the company became able more easily to finance its day-to-day transactions, and more efficiently to carry on its day-to-day manufacture ". "

17. There, what had happened was that the money was spent to remove some recalcitrant shareholders, who were pressing an amendment to the constitution of the company and it was held that by this expenditure incurred no capital asset, as such, was acquired. Reliance was also placed on the observation of Lord Reid himself, which was mentioned in the decision, in the case of *Strick v. Regent Oil Co. Ltd.* [1966] AC 295 ; 43 TC 1 ; [1969] 73 ITR 301. There, at page 317 of

the Appeal Cases, Lord Reid observed, *inter alia*, as follows :

"If the asset which is acquired is in its intrinsic nature a capital asset, then any sum paid to acquire it must surely be capital outlay. And I do not see how it could matter that the payment was made by sums paid annually. But it appears to me that an asset which is nothing more than a right to enjoy a certain advantage over a period is intrinsically of a different character from a thing which a person buys and can immediately use or consume in any way he chooses. If it were not so I can see no reasonable ground for allowing annual payments for such a right as revenue expenses.

I must now turn to the authorities. In *Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.* [1964] AC 948 ; [1965] 58 ITR 241, Lord Radcliffe said:

"Courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve."

Perhaps it is, but the illumination is very dim, and as Lord Radcliffe goes on to say, it "leads to distinctions of some subtlety between profit that is made " out of" assets, and profit that is made " upon" assets or "with" assets." I must say that I distrust as a guide any criterion which leads to verbal distinctions of that kind, but fortunately it is not the only guide.

The "structure" of the profit-making apparatus was dealt with in *Van den Berghs*" case [1935] 19 TC 390 ; 3 ITR 17 but the facts there were very strong, as explained by Lord Macmillan. This company and a Dutch company had long before bound themselves to work in friendly alliance by an elaborate scheme and on the cancellation of their agreement Van den Berghs received a sum of ? 450,000. This was held to be a capital receipt because.

"The three agreements which the appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade. They were not contracts for the disposal of their "products, or for the engagement of agents or other employees necessary for the conduct of their business ; nor were they merely agreements as to how their trading profits when earned should be distributed as between the contracting parties. On the contrary, the cancelled agreements related to the whole structure of the appellants" profit-making apparatus. They regulated the appellants" activities, defined what they might and what they might not do and affected the whole conduct of their business. "

I would think that the two most important of these considerations were that the contracts were not ordinary commercial contracts made in the course of carrying

on the trade, and that, by defining what the company might do and might not do, they affected the whole conduct of the business. I think that in some later cases the metaphor of structure has been used with far less justification."

18. In the instant case before us, the essential question is, by incurring the expenditure, what was it that the assessee was obtaining. Learned advocate for the revenue emphasised that by virtue of the lease, u/s 108(b) of the Transfer of Property Act, the assessee had a right to be put into the possession. By incurring this additional expenditure of Rs. 4,50,000 or on payment of this sum to M/s. Gasper & Co., according to the assessee, they were not obtaining this right to be put into possession under the lease. There was no vacant possession but M/s. Gasper & Co. was in possession along with the lessor. Therefore, according to learned advocate for the assessee, the assessee incurred this sum in order to remove the obstacle relating to the right to possession in the interest of business expediency. It is true that if the petitioner had a right to possession aliunde or independently of the transaction with M/s. Gasper & Co., which is the subject-matter here, then by incurring the expenditure, the assessee would not have acquired any title or right, as such. The assessee would have merely removed the impediment to its carrying on of the business or fully neutralised their asset. But, in the instant case, the Tribunal has found that Gasper was, in fact, a tenant and it has not been found that the tenancy of Gasper had, in fact, been terminated by the original lessor before the transaction with the assessee took place. Therefore, it has not been found by the Tribunal that M/s. Gasper & Co. was continuing as one whose tenancy had expired and it was merely holding over under the Transfer of Property Act. Nor has it been found by the Tribunal that M/s. Gasper & Co. had been continuing as a lessee with any right of revocation of the lease. On the other hand, the Tribunal is categorical in its finding, in view of Section 108(C) of the Transfer of Property Act, that M/s. Gasper & Co. had the right to be in possession. It appears, therefore, that what had happened by this transaction was, before this transaction with the assessee, originally the lessor was in possession along with M/s. Gasper & Co. Therefore, when learned advocate for the assessee contends that u/s 108(b), the assessee had a right to possession, it cannot be read, as such, because Section 108 of the Transfer of Property Act begins with the main clause "in the absence of any contract to the contrary". Therefore, the nature of the transaction that was found by the Tribunal was that M/s. Gasper & Co. had the legal right to be in possession, which legal right, the assessee, in the instant case, had to obtain or had to procure and for procuring that legal right to possession which was with M/s. Gasper & Co. by virtue of Section 108(c), being the lessee of the original landlord, there necessarily had to be the extinction of that right, that is to say, M/s. Gasper & Co.'s right to possession and that right? to possession which flows from the right which M/s. Gasper & Co. obtained, was acquired by the assessee. If the right to possession be a right, which is capital, it is a capital of enduring nature, in the sense fixed capital asset endures. In that view of the matter, in our opinion, the Tribunal was right in coming to the decision that the expenditure was in the

nature of capital expenditure and was not a revenue expenditure. For the aforesaid reasons, the question must be answered in the affirmative and in favour of the revenue.

19. In the facts and circumstances of the case, there will be no order as to costs.

Sudhindra Mohan Guha, J.

20. I agree.