
(1979) 03 KL CK 0013

In the High Court Of Kerala

Case No : Income-tax Reference No's. 82 to 84 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Jacobs (P.) Ltd.

RESPONDENT

Date of Decision : 01-03-1979

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1979) 2 ILR (Ker) 78 : (1979) 120 ITR 197

Hon'ble Judges : V.P. Gopalan Nambiyar, C.J.;G. Balagangadharan Nair, J

Bench : Division Bench

Advocate : P.K.R. Menon, for the Appellant; K.S. Paripoornan and G. Sivarajan, for the Respondent

Judgement

Gopalan Nambiyar, C.J.—These three references by the Commissioner of Income Tax, u/s 256(1) of the I.T. Act, arise out of three different appeals disposed of by the Appellate Tribunal for the assessment years 1972-73 to 1974-75. The assessee is a private limited company, in the name and style M/s. Jacob (P.) Ltd. formed for taking over some of the assets and liabilities of a predecessor firm. The said firm was carrying on business in wholesale in liquor. It was also the sole selling agents of M/s. McDowells & Co, Ltd. which was having a distillery at Shertallai. There was no written agreement conferring the sole selling agency between M/s. McDowells & Co. and the firm. But it is beyond dispute that the firm had the right of sole selling agency vis-a-vis the company in the earlier years. Two of the partners of the firm floated the limited company which is the assessee in this case. The main business of the company was to be the same as that of the firm. By an agreement dated September 24, 1970, the company undertook to take over some of the assets and liabilities in the business done by the firm. The terms and conditions of the agreement would be noticed presently. The company was also to be given the right to carry on the business in continuation of the firm. In consideration of assigning the rights to carry on the business of sole selling agency the firm was to be entitled to a royalty of Re. 1 per case of liquor sold by the company. It was also provided that the company

was to pay 2.31 lakhs of rupees in fully paid shares to the partners of the firm, as consideration for the sale.

2. For the accounting year ended 30th September, 1971, the assessee-company paid Rs. 21,584 by way of royalty to the firm. For the accounting year ended September 30, 1972, it paid Rs. 16,165 under the same account and for the year ended September 30, 1973, Rs. 27,492. In their Income Tax returns these were claimed as business expenditure. The ITO allowed the claim for the year 1972-73, but he reopened the assessment u/s 147(b) and held that the deduction was not allowable. For the remaining two years 1973-74 and 1974-75, the officer disallowed the claim even in the original assessment. The officer took the view that royalty was a consideration paid for taking over the capital asset, viz., the sole selling agency business, and, therefore, was a capital expenditure. On appeal by the assessee, the AAC agreed with the ITO. On further appeal to the Tribunal, the Tribunal held that the ITO and the AAC were not justified in their view, relying largely on the decision of the Supreme Court in Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala, . The Tribunal, to put matters briefly, held that the deductions claimed by the assessee in the three assessment years in question were allowable deductions. The following question of law has accordingly been referred for our determination :

"Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was justified in holding that the royalties paid by the assessee-company to the firm was an allowable expenditure ?"

3. The question that we have to consider is whether the amount sought to be deducted represents a capital expenditure or a revenue expenditure. The problem is a familiar one that has haunted the courts time and again for determination, and which, each time has proved to be an elusive will-of-the-wisp. Decisions are numerous, which have dealt with, and explained, the principle to be applied in telling one type of expenditure from the other. We do not propose at this point of time, and at this stage of the development of the law, to survey the history of these decisions. We venture to quote the observations made by Mr. Justice Hidayatullah (as he then was) in K.T.M.T.M. Abdul Kayoom and Another Vs. Commissioner of Income Tax, , where the learned judge observed :

"None of the tests is either exhaustive or universal. Each case depends on its own facts, and a close similarity between one case and another is not enough, because even a single significant detail may alter the entire aspect. In deciding such cases, one should avoid the temptation to decide cases (as said by Cordozo) by matching the colour of one case against the colour of another."

4. To the same effect are numerous other decisions, both English as well as Indian. We spare ourselves the need and the responsibility of examining these. A collection of the different principles highlighted in various decisions dealing with this aspect of the matter, will be found in the well known treatise by Kanga and

Palkhivala on Income Tax (7th edn.) Vol. I, pages 479 to 485. At page 486, the learned authors, after discussions, have stated the position that no test can be said to be of universal application. The learned authors have quoted the Supreme Court's decision in *Gotan Lime Syndicate Vs. Commissioner of Income Tax, Rajasthan and Delhi*, where it was stated! "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". That is only to show that even the principle of enduring benefit or advantage, which at one time rode supreme, cannot be accepted as of universal application. The safe principle to be followed is that the decision must essentially depend upon the facts and circumstances disclosed by each individual case. We turn to the document which is annex. A to the statement of the case. The material part of it reads as follows :

"Agreement dated 24-9-70

THIS AGREEMENT made the Twenty-fourth day of September One thousand Nine Hundred and Seventy BETWEEN JACOBS a partnership-firm carrying oil business in wholesale of Indian made foreign liquors, foreign liquors and other soft drinks at Ernakulam, Cochin, hereinafter called the "Vendors" of the one part and JACOBS (PRIVATE) LIMITED, a company registered under the Companies Act, 1956, having its Registered Office at Cochin, hereinafter called the "Company" of the other part witnesseth that :

WHEREAS the company, having the power under the Memorandum of Association, to do so, desires to buy the selective assets and liabilities from the Vendors in the business done by them under the name and style of "JACOBS" and having goodwill.

AND WHEREAS the Vendors have been and are the exclusive owners of the said business and its goodwill and other rights.

AND WHEREAS the Vendors are desirous of selling to the company the selective assets and liabilities,

AND WHEREAS the Vendors had also authorised the company to negotiate and take up the rights of sole selling agency of "McDOWELLS".

AND WHEREAS the company has been formed with a view inter alia to act as sole selling agents of "McDOWELLS".

AND WHEREAS by Clause III-B(3) of the Memorandum of Association of the company, it is provided that the company shall enter into the agreement herein referred to, being this agreement.

NOW the parties to this agreement do hereby agree and covenant as follows :

1. The vendors shall sell and the company shall purchase as a going concern all assets and rights and undertake to discharge liabilities both the assets and liabilities (sic) described in Schedule and also the right to carry on business as sole selling agents of McDowells, Sherthallai, with the right to carry on the said

business in continuation of the Vendors" business with all rights mentioned in the Schedule to this agreement and all debts and actionable claims due to the Vendors along with all the securities relating to the same and with all benefits attached to the securities for such debts in connection with the said business and all rights and benefits arising from all contracts to which the Vendors are or may be entitled in connection with the said business.

2. In consideration of assigning the rights to carry on business of sole selling agency of "McDowells" the Vendors will be entitled to a Royalty of Rupee one per case for every case sold by the company.

3. In consideration of the said Sale, by the Vendor to the company, the company shall pay Rs. 2,31,000 (Rupees Two lakhs Thirty one thousand only) in fully paid 231 equity shares of Rs. 1,000 each but the company shall allot to (1) Thomas Jacob (2) Mrs. Lalitha Jacob (3) Jacob (4) Susan Thomas (5) Jacob Thomas and (6) Mrs. Susan Thomas as Vendors" nominees, 110 shares of Rs. 1,000 each out of the said 231 shares of Rs. 1,000 each otherwise payable to the Vendors with the result that the Vendors, viz., (1) Susanna Jacob (2) Rachael Thomas (3) Beena Jacpb and (4) George Jacob partners of M/s. Jacobs, shall be allotted 121 shares of the nominal value of Rs. 1,000 each as fully paid up. The shares shall be allotted as under :....."

5. The provisions of the document have appeared to us to be rather complex and ingenious. The preambulatory part states that the vendors are desirous of selling to the company the selective assets and liabilities and have also authorised the company to negotiate and take up the rights of sole selling agency of "McDOWELLS ". At this stage, it appears as if the vendor"s desire extended only to sale of the assets and liabilities and to an authorisation to negotiate and take up the rights of sole selling agency and no more. When we turn to Clause 1 of the agreement, that clearly and unequivocally refers to two distinct items, viz., (I) a sale as a going concern, of the assets and rights and the liabilities of the vendors described in the Schedule ; and (2) sale of the right to carry on business as sole selling agents of McDowell & Company, Sherthallai, together with the right to carry on the said business in continuation of the vendors" business. Clause 2 again unequivocally proceeds on the basis that there was an assignment of the sole selling agency business and that the consideration for the same is one rupee per case of liquor sold by the company. Clause 3 provides that Rs. 2,31,000 shall be the consideration of "the said sale". What is the meaning to be attributed to the term "the said sale"? It might, in one sense, comprehend the composite sale or the sale of the two different assets, indicated in Clause 1 which we have earlier described. But, having regard to the intervening Clause, viz., Clause 2, which expressly deals with assignment of the right to carry on the sole selling agency of McDowell & Co., it appears to us that Clause 3 can deal only with the residue, or the remaining part of what was sold, viz., the assets and the rights of the vendors. The consideration provided by Clause 2 represents a consideration for sale of the right of the sole selling agency. The assessee would

not be entitled to deduction of the receipts under this head, as it represents a capital receipt, viz., purchase of a capital asset for carrying on business.

6. We are content to rest our conclusion as above, on the terms of the document. But we have been taken through a plethora of decisions by counsel for the assessee and also for the revenue. Counsel for the revenue placed reliance on the decisions of the Supreme Court in *M.K. Brothers (P) Ltd. Vs. Commissioner of Income Tax, Kanpur*, and in *Commissioner of Income Tax, West Bengal II, Calcutta Vs. Coal Shipment (P) Ltd.*, . He relied, besides, on the decisions of the Madras High Court in *Fenner Woodroffe and Co. Ltd. Vs. Commissioner of Income Tax*, and the decision of the Delhi High Court in *The Commissioner of Income Tax, Delhi Vs. Naya Sahitya, Delhi*, .

7. Counsel for the assessee on the other hand, placed the strongest reliance on the decision of the Supreme Court in *Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala*, , the principles in which were reaffirmed and restated by the Supreme Court, when the matter went up again to that court, after remand directed on the earlier occasion, vide *The Commissioner of Income Tax, Kerala, Ernakulam Vs. The Travancore Sugar and Chemicals Ltd.*, . It would be convenient if we examine the principle laid down in the *Travancore Sugars Ltd.*'s case. The appellant-company in that case was floated to take over certain assets of an undertaking by the Government of Travancore. It entered into an agreement with the Government of Travancore, whereby the assets of a sugar company and a distillery and a tincture factory, run by the Government, were agreed to be sold to the appellant-company to be floated for that purpose. The cash consideration for the sale of the assets of the sugar manufacturing concern was Rs. 3.25 lakhs; and that, for the sale of the distillery, was to be arrived at by joint valuation; and that for the tincture factory was to be the book value. The Government agreed to recognise a transfer of the licence for the distillery transferred to the company and also to grant a fresh licence for a period of 5 years after the termination of the existing licence. The company was to sell its products of the distillery to the Government at prices to be fixed by it. The Government had to buy the pharmaceutical products of the company at prices not exceeding cost plus 15 per cent. Apart from the cash consideration of Rs. 3.25 lakhs by Clause 7 of the agreement, the Government was to be entitled to 20% of the annual net profits subject to a maximum of Rs. 40,000, after providing for depreciation, and for remuneration of the secretaries and treasurers. By an amendment, the Government was to be entitled to 10% of the annual net profits, explained to mean the net amount for which the company's audited profits were assessed to Income Tax. The question arose whether the amount payable to the Government under Clause 7 was an allowable deduction u/s 10 of the Indian I.T. Act, 1922. The High Court took the view that the amount constituted capital expenditure and was not allowable as a deduction. On appeal, the Supreme Court held that the amount payable under Clause 7 was in the nature of revenue expenditure. As certain questions of fact had to be ascertained and clarified, the matter was remanded for further enquiry. In the course of its

judgment, the Supreme Court observed (p. 571) :

"With regard to the second part of the consideration there are three important points to be noticed. In the first place, the payment of commission of twenty per cent, on the net profits by the appellant in favour of the Government is for an indefinite period and has no limitation of time attached to it. In the second place, the payment of the commission is related to the annual profits, which flow from the trading activities of the appellant-company and the payment has no relation to the capital value of the assets. In the third place, the annual payment of 20 per cent. commission every year is not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings. There is no reference to any capital sum in this part of the agreement. On the contrary, the very nature of the payments excludes the idea that any connection with the capital sum was intended by the parties. It is true that the purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. The mere fact that the capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from the capital expenditure into a revenue expenditure, but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the particular undertaking. As we have already mentioned, there is no specific sum fixed in the present case as an additional amount of price payable in addition to the cash consideration and payable by instalments or by any particular method. In view of these facts we are of opinion that the payment of the annual sum of Rs. 42,480 in the present case is not in the nature of capital expenditure but is in the nature of revenue expenditure and the judgment of the High Court of Kerala on this point must be overruled."

8. In the light of the principles laid down by the above ruling, counsel for the assessee raised a two-fold argument before us. In the first place, he argued that on a conspectus of the provisions of annex. A, what was sold was only the assets and the business, and the sole selling agency was part of what was included in this sale, and did not, by itself, constitute a separate item of bargain in the document of sale. Secondly, even assuming that the sole selling agency also formed an independent item of bargain in the transaction evidenced by the document, the consideration for the same still had to be regarded as only a revenue expenditure and not a capital expenditure in the light of the three principles formulated by the Supreme Court in the Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala, . On the other hand, counsel for the revenue argued that the document (annex. A) relates to two distinct items of sale, viz., sale of the assets and rights of the vendors and sale of the sole selling agency's rights ; that consideration for these two items were distinctly and separately provided ; and, therefore, the consideration for the sole selling agency business would constitute only a capital expenditure and not a revenue expenditure liable to deduction under the I.T. Act. Alternatively, he argued that even on the principle of the Travancore Sugars and Chemicals Ltd.

Vs. Commissioner of Income Tax, Kerala, , the facts presented for determination would be distinguishable, and the third test formulated by the Supreme Court in the passage quoted supra, would not stand satisfied.

9. Counsel for the revenue placed strong reliance on the decision of the Supreme Court in M.K. Brothers (P) Ltd. Vs. Commissioner of Income Tax, Kanpur, . The facts there were that one S and Co. were the sole selling agents of the Kanpur Cotton Mills owned by the British India Corporation. An amount of Rs. 8,39,330 was due to the Corporation. The company entered into an agreement with K to assign their sole selling agency in favour of K or his nominee. K or his nominee agreed to pay the company 1/7th of the commission (accruing to K or his nominee) as sole selling agents. It was further agreed that the Corporation should have the right to retain that part of the commission, and adjust it towards the debt due to it from S and Co. until the debt was wholly repaid with interest. The Corporation agreed to this arrangement and entered into a separate contract with the assessee, K's nominee, embodying the foregoing terms. For the assessment year 1956-57, the assessee earned a commission of over Rs. 2,00,000 and the Corporation retained a sum of over Rs. 43,000 out of this. The assessee-company credited the full amount of commission to its profit and loss account and showed the sum of Rs. 43,000 odd as deduction therefrom. The question arose whether the deduction was allowable or not. In dealing with the question the Supreme Court observed (p. 43) :

"Mr. Maheshwari has referred to Clause 13 of the indenture reproduced above and has contended that the appellant could make no claim to the amount of Rs. 43,333 which had been retained by BIC. This fact, in our opinion, would make no material difference so far as the true nature of that amount was concerned. The amount was deducted by BIC in pursuance of the agreement entered into by the appellant with BIC and Sharma & Co., according to which the appellant had to pay that amount in the form of deduction out of its commission in consideration of being appointed the sole selling agent of the Kanpur Cotton Mills. The present is a case relating to the application of income to discharge a liability incurred not in the course of running the business but a liability undertaken for the purpose of acquiring the sole selling agency right which was indisputably an asset of capital nature."

10. Counsel for the revenue placed strong reliance on the clear and strong statement of the Supreme Court that the liability undertaken for acquiring the sole selling agency right was indisputably an asset of a capital nature. He placed reliance also on the decision in Commissioner of Income Tax, West Bengal II, Calcutta Vs. Coal Shipment (P) Ltd., . The observations, at page 908, of Hidayatullah J. (as he then was) have already been quoted. At page 909, the Supreme Court continued its discussion in regard to the tests laid down to distinguish capital expenditure from revenue expenditure, and then observed as follows :

"There are some other tests like those of fixed capital and circulating capital for

determining the nature of the expenditure. An item of disbursement can be regarded as capital expenditure when it is referable to fixed capital. It is revenue when it can be attributed to circulating capital. It is not the case of any party that this test of fixed and circulating capital can be invoked in this case nor has reference been made to some of the other tests. The case which has been set up on behalf of the revenue is that, as the object of making the payments in question was to eliminate competition of a rival exporter, the benefit which ensued to the respondent was of an enduring nature and, as such, the payment should be treated as capital expenditure. We find ourselves unable to accede to this contention because we find that the arrangement between the respondent and M/s. H. V. Low & Co. Ltd. was not for any fixed term but could be terminated at any time at the volition of any of the parties. Although an enduring benefit need not be of an ever-lasting character, it should not, at the same time, be so transitory and ephemeral that it can be terminated at any time at the volition of any of the parties. Any other view would have the effect of rendering the word "enduring" to be meaningless. No cogent ground or valid reason has been given to us in support of the contention that, even though the benefit from the arrangement to the respondent may not be of a permanent or enduring nature, the payments made in pursuance of that arrangement would still be capital expenditure."

11. Lower down, the court stated:

"Although we agree that payment made to ward off competition in business to a rival dealer would constitute capital expenditure if the object of making that payment is to derive an advantage by eliminating the competition over some length of time, the same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any time. How long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and the facts of each individual case."

12. The decision of the Madras High Court in *Fenner Woodroffe and Co. Ltd. Vs. Commissioner of Income Tax*, refers to and distinguishes the *Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala*, . It does not refer to *M.K. Brothers (P) Ltd. Vs. Commissioner of Income Tax, Kanpur*, . Counsel for the revenue commented that the decision had relied on the dissenting judgment of Sikri C. J. in *Devidas Vithaldas and Co. Vs. Commissioner of Income Tax, Bombay*, . He also referred to the comment in *Kanga* at p. 488 and again at p. 458. The Delhi decision in *The Commissioner of Income Tax, Delhi Vs. Naya Sahitya, Delhi*, is helpful to the revenue. But counsel for the assessee complained that it does not make a comprehensive survey of the authorities.

13. In the light of the principles laid down by the above decisions, and concentrating ourselves on the facts and the circumstances disclosed in this case, and particularly on the provisions of the document, we repeat that, on our analysis, there were two distinct and different items of sale and that the

consideration for the sale of the sole selling agency business expressly mentioned in Clause 2 was only expenditure of a capital nature, and not a revenue expenditure deductible under the Indian I.T. Act.

14. Counsel for the revenue seems also to be well founded in his contention that the principle of the decision in Travancore Sugars and Chemicals Ltd. Vs. Commissioner of Income Tax, Kerala, cannot strictly have application here. The third test formulated in that decision is that the payment of commission was not relating to, or tied up in any way to, any fixed sum agreed between the parties as part of the purchase price of the three undertakings. The same cannot be said to be the position here in view of the clear and unambiguous terms, and the clear and unmistakable provisions of Clause 2 of the deed. By the said clause Re. 1 per case sold is expressly made the consideration for the assignment of the sole selling agency. On these considerations, we are of the opinion that the view taken by the Tribunal was not correct. In the result, we answer the question law referred to us in the negative, i.e., in favour of the revenue and against the assessee. There will be no order as to costs.

15. A copy of this judgment under the seal of the court and the signature of the Registrar will be communicated to the Tribunal as required by law.