
(1995) 03 RAJ CK 0049

In the Rajasthan High Court

Case No : Income Tax Reference No. 25 of 1986

Commissioner of Income Tax

APPELLANT

Vs

Jaipur Mineral Development Syndicate

RESPONDENT

Date of Decision : 31-03-1995

Acts Referred:

Income Tax Act, 1961 — Section 37

Citation : (1995) 03 RAJ CK 0049

Hon'ble Judges : V.K. Singhal, J;V.G. Palshikar, J

Bench : Division Bench

Advocate : G.S. Bafna, for the Appellant; N.M. Ranka, for the Respondent

Judgement

V.K. Singhal, J.—The Income Tax Appellate Tribunal has referred the following question of law arising out of its order dated February 13, 1986, for the assessment year 1974-75 ;

" Whether, on the facts and in the circumstances of the case, the Tribunal is right in holding that the compensation of Rs. 20,000 paid by the assessee-company to S. Zoraster and Go. is allowable as business expenditure ?"

2. The brief facts of the case are that the assessee was owed a sum of Rs. 15,00,000 from S. Zoraster and Company and in order to liquidate the said liability entered into an agreement to purchase the cinema building along with accessories known as "Prem Prakash" at Jaipur. The consideration for the said transfer was agreed at a figure of Rs. 17 lakhs and in the agreement entered into, it was provided that the effect to the agreement shall be given within a period of five years from the date of agreement. It was also provided that if the assessee fails to fulfil the agreement, then it would pay Rs. 20,000 to S. Zoraster and Company. The case of the assessee-company is that subsequently they realised that the objects contained in the memorandum of association did not permit them to run a cinema and, therefore, the assessee could not go ahead with the said agreement and backed out. In view of the clause contained in the

agreement an amount of Rs. 20,000 was paid to S. Zoraster and Company as compensation. The said amount was claimed as deduction in the Income Tax assessment proceedings for the assessment year 1974-75. The Income Tax Officer was of the view that the expenditure is of capital nature and, therefore, it cannot be allowed u/s 37 of the Act. In the appeal before the Commissioner of Income Tax (Appeals), it was found that the compensation has been paid to a sister concern and is not in the course of money-lending business, but in the course of an agreement to purchase the picture hall which is not covered by the objects clause of the company and hence the compensation was not paid in the course of the assessee's business. The disallowance was upheld.

3. In the second appeal before the Income Tax Appellate Tribunal, it was found by the Tribunal in its order dated February 13, 1986, that the amount has been considered as income in the hands of S. Zoraster and Company. The Tribunal found that the intention of the assessee-company was clear that the transaction was entered, into with a view to clear old outstanding dues and when they realised that the company cannot run the cinema as it was not provided for in the objects clause of the company, the agreement was not honoured. The Tribunal found that the expenditure of compensation was in the nature of exploration in respect of a project which project subsequently having been realised as not viable was abandoned. The expenditure of compensation was accordingly allowed as business expenditure.

4. In the case of CIT v. M.Ct.M. Corporation Pvt. Ltd. [1995] 211 ITR 95 the Madras High Court has considered the case of the assessee-company which was engaged in trading, investment and money-lending business and negotiated for the sale of a house belonging to it. The sale was not completed and the amount of advance was forfeited. The question was raised that the said forfeited amount constitutes income of the assessee and as such is liable to tax. The High Court observed that the amount forfeited was regarded as estimate of the loss of profits which the assessee would otherwise have made on the transaction being completed. The buyer was freed from the obligation to buy the house and the assessee was also enabled to offer the house for sale to others. The amount forfeited represented compensation for the loss of income or the profits, to the assessee and has to be regarded as revenue receipt as the capital asset continued to exist as before, not in any manner affecting the activities of the assessee.

5. In the case of Commissioner of Income Tax, Andhra Pradesh Vs. Balaji Chitra Mandir, the Andhra Pradesh High Court observed that where compensation is paid to a person for cancellation of a contract which does not affect the trading structure of his business nor deprives him of what, in substance, is his source of income, termination of the contract being a normal incident of the business and such cancellation leaves him free to carry on his trade, the receipt is revenue. Where, however, by the cancellation of an agreement, the trading structure of the assessee is impaired or such cancellation results in the loss of what may be

regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agreement is normally a capital receipt.

6. In *Commissioner of Income Tax, Nagpur Vs. Rai Bahadur Jairam Valji and Others*, it was observed by the apex court that when once it is found that a contract was entered into in the ordinary course of business, any compensation received for its termination would be a revenue receipt, irrespective of whether its performance was to consist of a single act or a series of acts spread over a period. In this respect it differs from an agency agreement. It was also observed that where a person who is carrying on business is prevented from doing so by an external authority in exercise of a paramount power and is awarded compensation therefor, whether the receipt is a capital receipt or a revenue receipt will depend upon whether it is compensation for injury inflicted on a capital asset or on a stock-in-trade.

7. In the case of *Glenboig Union Fireclay Co. Ltd. v. IRC* [1922] 12 TC 427 it was held by the House of Lords that the amount received for compensation in respect of the fireclay left unworked was not a profit earned in the course of the company's trade, but was a capital receipt, being a payment made for the sterilisation of a capital asset. The amount received as damages for the wrongous interdict was not a trading profit of the company, but was merely the equivalent of expenditure incurred in protecting a capital asset which subsequently turned out to be unproductive owing to the exercise by the Railway company of its statutory powers.

8. The Madras High Court, in the case of *Coimbatore Anupparpalayam Bank Ltd. Vs. Commissioner of Income Tax, Madras*, was considering the case of a banking company which purchased three items of properties belonging to its debtors in court sales in execution of decrees obtained against them. The said properties were sold subsequently. It was held that the properties at the time they were purchased represented the converted form of the stock-in-trade of the banking business of the assessee, viz., money, and, therefore, unless there was clear and irrefutable evidence that the assessee intended to take the equivalent of their value out of its money-lending business, the profit made by the resale of the properties must necessarily be regarded as profits of the money-lending business. It was further observed that there was no indication whatever to show that the assessee " ever sought to treat the acquisition of these properties as investment or to show that the amounts spent on their acquisition and improvement ceased to be part of the stock-in-trade of its business, the profit realised by their sale was taxable profit of its business.

9. In the case of *Bansilal Gangaram Vs. Commissioner of Income Tax, Bombay*, the Bombay High Court was also considering the question of acquisition of properties in lieu of debt. The property acquired and sale of such property was held assessable as income from business. In the case of *KARUMURU VENKATA RAMANADHAM Vs. COMMISSIONER OF Income Tax, HYDERABAD.*, the Andhra Pradesh High Court has also taken the same view in respect of lands acquired as

stock-in-trade of the assessee's business and the profit realised on sale of the land was held to be income liable to tax from the money-lending business.

10. In the case of *Narain Dutt Chimwal Vs. Commissioner of Income Tax, U.P., Lucknow*, the apex court was considering the case of a money-lending business where the properties were subject to mesne encumbrances purchased by the assessee. The amount paid to mesne encumbrancers was debited to money-lending account. The shortfall after obtaining decree against mortgagors was claimed and allowed as bad debt. Subsequently, sale of plots in part of land purchased was considered to be the profit of the assessee's money-lending business.

11. In *Mallett v. Staveley Coal and Iron Co. Ltd.* [1927] 13 TC 772 the King's Division Bench observed that the consideration paid to the lessor for surrender of seams of coal is an expenditure of capital nature and not an admissible deduction from profit for Income Tax purposes. Justice Rowlatt observed that the expense of acquiring the lease is the expense of acquiring a capital asset and is a capital expenditure. All receipts and payments in connection with acquiring and disposing of leaseholds of minerals to be worked by collieries are capital transactions. The payment was not considered to get rid of the annual charge against revenue in future but was the payment to get rid of the loss in the business. The money was considered to be paid in order pro tanto to go out of business.

12. The apex court in *SWADESHI COTTON MILLS CO. LTD. Vs. COMMISSIONER OF Income Tax, U. P. (NO. 2)*, has observed that where the payment is paid to avoid a larger capital expenditure that would not have served the interests of the company. Such a payment is in the nature of capital expenditure and not an expenditure incurred wholly or exclusively for the purpose of business. The payment was neither made for the purpose of earning profits nor for the purpose of furthering, protecting or continuing its business which was carried on from day-to-day. The payment was made with the object of avoiding an unnecessary investment in capital assets and was an amount which was altogether outside the account of profits and gains, in the computation of which deductions are allowable for expenditure incurred wholly and exclusively for earning those profits and gains. In this case, the decision of *"Countess Warwick" Steamship Company Ltd. v. Ogg* [1924] 8 TC 652 was relied on where the dispute was with regard to a contract for construction and purchase of a new ship which was cancelled and payment of ₹60,000 was made. It was observed that the said payment is in the nature of capital expenditure and was not an admissible deduction in the computation of profits.

13. The *Edward Keventer(S) Private Limited Vs. Commissioner of Income Tax, Delhi*, has held that the compensation paid to the owner of land for breach of a contract to take the lease of land was not an expense laid out wholly and exclusively for the purpose of business ; it was a capital expenditure.

14. In Commissioner of Income Tax, Madras Vs. Ashok Leyland Ltd., the apex court observed : "whether a payment is or is not in the nature of capital expenditure depends or may depend upon the character of the business of the payer and upon other factors related thereto".

15. In Atherton v. British Insulated and Helsby Cables Ltd. [1925] 10 CTC 155 Lord Chancellor observed : "a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business, may yet be expended wholly and exclusively for the purposes of the trade".

16. The Calcutta High Court in New Central Jute Mills Ltd. v. CIT [1982] 156 ITR 742 has observed that the damages paid on failure to honour an agreement for sale of land related to a capital asset of the company and is not an allowable deduction.

17. The various decisions which have been relied upon by learned counsel for the assessee show that if any property is acquired in the course of money-lending business for the satisfaction of the claim, then it will be considered to be the income from business. The authorities relied on are in a different context and the dispute in the present matter is as to whether the compensation, which has been paid by the assessee, of Rs. 20,000 to S. Zoraster and Company is allowable as business expenditure. Section 57 of the Act provides the expenditure which could be claimed as business expenditure. According to the said section, expenditure which is in the nature of capital expenditure cannot be allowed. It is no doubt true that in the present case the source of income is not destroyed. The Tribunal has proceeded on the fact that the intention of the assessee is clear that the transaction was entered into only with a view to clear the old outstandings. They realised that the company cannot run a cinema as the same was not provided as an object in its memorandum of association, the company had necessarily to withdraw from the agreement which led to payment of the compensation. For liquidating the liability in respect of business which has been carried on by the assessee the debtor may discharge the same by paying in cash or kind. The kind may be in respect of movable or immovable property. The basic fact remains that S. Zoraster and Company was liable to make the payment of debt to the extent of about Rs. 15 lakhs and it was in these circumstances that an agreement was entered into on December 30, 1968, to purchase Prem Prakash Cinema for a consideration of Rs. 17 lakhs. The agreement has contemplated that if the transaction is not completed for any reason within a period of five years then a compensation of Rs. 20,000 has to be paid. So it was in the accounting period from January 1, 1973, to December 31, 1973, i.e., assessment year 1974-75, when the period of five years was lapsing, the assessee settled the liability in terms of the contract by making the payment of Rs. 20,000 by way of compensation for not complying with the terms of contract. The debt was not of money-lending business, but was of business and the business of money lending

was not carried on by the assessee in which any debt is to be realised. The business where the commodities are sold on credit and sum is realised, cannot be considered to stand on the same footing.

18. In the light of the various decisions and the facts of this case, it has to be examined whether the expenditure incurred is a capital expenditure or is an expenditure wholly and exclusively for the purpose of business. Ordinarily, the word "capital expenditure" refers to the expenditure which is of a permanent nature or for securing tangible or intangible property, corporeal or incorporeal rights or enduring benefit to the business. An expenditure may be "once for all" or in respect of fixed capital or for an enduring benefit. Purchase of capital asset and stock-in-trade demarks the distinction between capital and revenue expenditure. If the asset is acquired as stock-in-trade then it will be revenue expenditure. In *V. Jaganmohan Rao and Others Vs. Commissioner of Income Tax and Excess Profits Tax, Andhra Pradesh*, it was observed by the apex court that the money paid to perfect a title or as consideration for getting rid of a defect in the title or a threat of litigation would be a payment of capital nature. The asset which was sought to be acquired in the present case was an immovable property, namely, the Prem Prakash Cinema. The agreement itself contemplated that the sale deed would be executed within a period of five years. It was at the end of the fifth year that the payment of Rs. 20,000 was paid as compensation as contemplated in the agreement because of non-fulfilment of the contract. The assessee might be intending to carry on the business of exhibiting films in the cinema hall and thus a capital asset was sought to be acquired. It was on account of the absence of an object clause in the memorandum and articles of association that the said agreement was not honoured. Whatever the circumstances might have been are not required to be considered residing the possibility of change in the memorandum and articles of association and long lapse of more than four years the question remained that the said payment pertains to a capital asset which itself was capable of being exploited as a business asset, and any payment of compensation in respect thereof, for not executing the agreement could only be considered as a capital expenditure. If the liability of dues of Rs. 15 lakhs was to be satisfied with the purchase of that property it was possible, if the object clause of memorandum and articles of association had so provided, to consider that the said asset was the stock-in-trade. But in the present case, it could not be considered to be stock-in-trade and was a capital asset. The observation of the apex court in the case of *Swadeshi Cotton. Mills Co. Ltd. v. [1907] 63 ITR 65* referred to above are very relevant.

19. In these circumstances, we are of the view that the compensation paid by the assessee to Messrs. S. Zoraster and Company cannot be considered to be a business expenditure allowable u/s 37 of the Act and was a capital expenditure. Simply because the payment in the hands of the recipient has been considered as revenue income, it is not necessary that in all cases it will have the same character in the hands of the person who has made the payment. Section 37 of

the Act has specifically excluded an expenditure which is capital in nature and since the expenditure is considered to be of capital nature, therefore, we are of the view that the reference is to be answered in favour of the Revenue and against the assessee.