
(1982) 03 MAD CK 0027

In the Madras High Court

Case No : Tax Case No"s. 1561 and 1562 of 1977

Commissioner of Income Tax

APPELLANT

Vs

Madras Auto Service Ltd.

RESPONDENT

Date of Decision : 09-03-1982

Acts Referred:

Income Tax Act, 1961 — Section 45

Citation : (1983) 33 CTR 106 : (1985) 156 ITR 740

Hon'ble Judges : S. Padmanabhan, J;N.V. Balasubramanian, J

Bench : Division Bench

Advocate : J. Jayaraman, for the Appellant; S. Swaminathan, for the Respondent

Judgement

Balasubrahmanyam, J.—The assessee in this case is a company carrying on business in automobile parts in Madras and other places. It took

out a lease of land and building at Bangalore for housing its branch in that city. The floor area of the building was 8,000 square feet or so. The

building was in a good business locality. But it was old or rather old-fashioned. The landlord was not in a position to put money of his own to

remodel the building or build it anew. But the assessee was prepared to do the demolition and reconstruction, if allowed, at its own cost and

expense. The landlord was agreeable to this course, if the assessee were willing to forego the ownership of the new building, even as it was being

raised brick by brick. The assessee found it worthwhile accepting these terms, because the landlord was willing to grant the lease on a long-term

basis for a term of 39 years at considerably low rents, as compared with prevailing rates for similar business accommodation in the vicinity. The

monthly rent demanded by the landlord was Rs. 1,000 to begin with, and would go up to the maximum of Rs. 2,000 for the last four years of the

lease. The prevailing rent in that area for the assessee's floor area of 8,000 square feet worked out to not less than Rs. 12,000 at the rate of Rs. 2

or Rs. 2.50 per square foot. The assessee, therefore, accepted the landlord's terms and entered into the tenancy. It then demolished the existing

building on the demised land and raised a new construction in its place. This job took two years to complete. The assessee incurred expenditure of

Rs. 1,62,335 in the first year and Rs. 50,937 in the next year. The question which arose in the relevant Income Tax assessments of the assessee

was whether this expenditure was capital or revenue. There was little or no doubt in the mind of the Income Tax Officer that the amount spent by

the assessee for demolition and reconstruction of the branch office building was for business purposes. He, however, disallowed the expenditure

on the ground that was capital in nature. The Tribunal, on the contrary, held that it was revenue expenditure.

2. The matter is now before us on a case stated. Although the parties have joined issue on the question whether the expenditure is capital or

revenue, the question of law propounded by the Tribunal in this case is general in form, thus :

Whether, on the facts and in the circumstances of the case, the amounts of Rs. 1,62,835 and Rs. 50,937 could be allowed to be deducted in

computing the total income of the assessee for the assessment years 1968-69 and 1969-70 ?

3. We may first dispose of two arguments in this case, one on each side, as wholly untenable. For the assessee, it had been urged that the amount

in question represented advance rent paid by it to the landlord. Nothing can be more farther from the truth. The only advance spoken of in the

agreement of tenancy is a sum of Rs. 3,000. The expenditure which calls for our decision is not the advance paid as such. It is expenditure for

demolition and reconstruction of the office building in the leasehold land. The Tribunal themselves did not consider this argument seriously. Even

Mr. Swaminathan, the assessee's learned counsel, did not pursue this line before us.

4. Not less far-fetched was a contention put forward on the Department's side. It was said that the expenditure amounted to a premium for the

lease and hence capital expenditure. Here again, the facts are different and they do not evidence payment of a premium. The construction cost

incurred by the assessee can, by no stretch, be equated to a premium on lease. The assessee did not acquire the right to use and occupy the leasehold on condition that the existing building should be pulled down and reconstructed at the assessee's cost without reimbursement from the landlord. On the contrary, the lease was to run its course, on the rents agreed to, for the entire 39 years even if the assessee had been using the old building, as it existed. The assessee's expenditure for demolition and reconstruction could not, therefore, amount to a premium for the lease even indirectly.

5. The Department's attempt before us was obviously to bring the present case within the framework of the aphorism that rent is revenue, but premium is capital. We have shown how the facts do not bear a discussion along those lines. But even otherwise, there is no reason, on principle, why the two kinds of consideration for a lease must be so distinguished. Strictly, in terms of legal definition, rent is paid for use and occupation. If, however, premium is regarded, in the language of the economists, as the price paid for the acquisition of a leasehold interest in the property, so for that matter, is rent. It is not a consideration for anything less than that. The only outward difference between the two is that whereas rent is a recurring payment, premium is an "once and for all" payment. But nobody who knows his Income Tax would set any store by this supposed contrast between the two. And yet, over a period of years, courts have persisted in disallowing premium as capital expenditure and allowing rent as revenue expenditure, however short the lease be in the former case and, however long it be in the latter case. Arguments also in the past had followed the practice of treating the premium for a lease as a balance-sheet item, while regarding rent as a profit and loss account item. Recent trends in accountancy principles and practice, however, tend to blur the distinction between the two. Accountants have taken to writing off either in whole or in part certain balance-sheet items as deferred revenue expenditure. There is no reason in principle why premium on lease cannot be regarded as deferred revenue expenditure, to be allowed as a whole in the year of payment, or more scientifically still, written off in portions as the years of the lease roll by. But perhaps, the distinction between premium and rent is too well entrenched in Income Tax for rethinking by the judicial

process. However, we might at least ensure that every case should proceed on a reasonable view of the facts first, amenable to legal interpretation

in one way rather than in another. The present argument of the Department that the assessee's expenditure in question is akin to a premium on

lease fails even at the first stage of factual inquiry.

6. It was then urged for the Department that the expenditure in question was laid out for the enduring benefit of the assessee's trade and hence it

must be capital in nature. This argument again was inspired by a catch phrase, perhaps the most enduring catch phrase, in Income Tax law. We

grant that the facts in the present case do lean countenance to the description of the expenditure as one incurred with a view to derive enduring

trade benefits. For, the assessee knew full well what advantages it was going and for how long when it ventured to spend money of its own on

putting up a permanent structure which it could never call its own. But the question is, can this case be properly brought within the formula of

enduring benefit enumerated by Viscount Cave in the well-known *Atherton's* case [1925] 10 TC 155 ? It is perhaps, not so well-known that the

learned Lord Chancellor himself did not lay down this test as the only, or the most unerring, test of capital expenditure in every case. In the passage

oft-quoted from his judgment, exceptions to the doctrine have also been generally indicated in a parenthesis which has escaped all but the closest

study. It was only given to a few later-day rulings like Lord Radcliffe's decisions in *Commr. of Taxes v. Nchanga Consolidated Copper Mines*

Ltd. [1965] 58 ITR 241 and *Bhagwati J.'s* decision in *Empire Jute Co. Ltd. Vs. Commissioner of Income Tax*, to highlight the exceptions and put

the rule of enduring benefit in its proper place, A few years earlier, in *Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax*,

West Bengal, , the elder *Bhagwati J.*, had had occasion to observe that enduring benefit is not always the acid test of capital expenditure. The

learned judge referred to various other leads pursued by courts to resolve the capital versus revenue controversy. His conclusion was that wisdom

lay in adopting that test which was most appropriate to the nature of the case.

7. The Tribunal approached the problem in this case not by asking the question, how enduring was the benefit to the assessee, but by asking a

different question, what saving the expenditure effected and how ? Referring to

the lease agreement between the parties in this case and other surrounding circumstances, the Tribunal concluded that by incurring the expenditure on the terms laid down in the agreement, the assessee virtually got itself relieved of revenue payments monthly or annually for the duration of the lease. The Tribunal obviously had in mind the prevailing rents in the market and the tempting prospect of the assessee not having to pay rent to the landlord at those higher rates while at the same time securing to itself an assured accommodation in a good locality in building designed and constructed according to its own standards of convenience. The Tribunal obviously referred to the savings in rent charges which the expenditure on building vouchsafed to the assessee under the lease agreement.

This aspect of the expenditure, according to the Tribunal rendered the expenditure as revenue in character.

8. Mrs. Nalini Chidambaram, learned junior standing counsel for the Department, did not seem to contest the principle that expenditure which tends to relieve or save a taxpayer from a series of future revenue out goings would itself be a revenue outgoing. What she pressed for our consideration was that this principle had been adopted by the Tribunal in the present case without the requisite factual data. She said that the Tribunal was not justified in accepting the assessee's plea that there was an enormous saving in the rent bill at the rates at which it was able to secure the accommodation under its agreement with the landlord. She granted that there were references in the order of the Tribunal to the prevailing rents in Bangalore at the rate of Rs. 2 or Rs. 2.50 per square foot, but she dismissed them as not being backed up by acceptable evidence.

9. We see no justification for this criticism. The assessee had put for ward this particular point not for the first time before the Tribunal but earlier too, before the Appellate Assistant Commissioner of Income Tax. That authority rejected the assessee's contention as untenable in law, but said nothing against the facts which the assessee had placed in support. On the contrary, its order refers in detail to all the factual data placed by the assessee, such as for instance, the floor area of the assessee's building, the prevailing rents in the locality on square foot basis, and the like. It is on these factual data that the Tribunal took up their consideration of the legal

aspects of the contention before them. It was certainly open to the Department to question the assessee's facts. But that does not seem to have been attempted at all by them at any appropriate stage of the proceedings. They have not, in any case, challenged the factual basis of the Tribunal's order by raising a pertinent question of law to that effect. We cannot, therefore, countenance the present argument that the Tribunal's order is based on no materials. Our tax reference procedure does not permit the use of the butt end when the pistol misses fire. It is against the rules; it is also sign of bad marksmanship.

10. As to the principle on which the Tribunal had based its decision allowing the expenditure as a revenue item, there can be no doubt as to its validity. The principle had been fairly well established, although lacking the enchantment of a terse catch-phrase. The principle was laid down in the clearest terms, and perhaps for the first time, in the Anglo-Persian Oil Company's case [1931] 16 TC 253, on which the assessee's learned counsel, Mr. Swaminathan, principally lied in argument. We think it necessary to state briefly the facts of that case and the ground of decision which they prompted. An English Company having business the world over appointed an agent in Persia (now called Iran) for a term of years. Under the agency agreement, the agent was to be paid remuneration by way of commission calculated at certain rates. The mechanics of rate-fixing was such that as business in Persia increased, the size of the agent's commission tended to become higher and higher as the years went by. The commission payment turned out to be costly more than what the company originally envisaged. Accordingly, before the control period came to a close, the company paid of a lump sum pound 300,000 in case to the agent and had the agency contract cancelled. This course was adopted by the company as the only way to relieve itself of the huge draw upon its resources by way of payment of annual commission to the agent. The question was, whether, in the events that happened, the payment of pound 300,000 was not capital expenditure, but a revenue outgoing. The learned judge described the nature of the payment in various ways. He said that it was ""in lieu of"" future payments of commission; that it was to redeem"" the future payments; and also that it ""compressed"" the future payments. Rowlatt J.'s decision was upheld by the Court of Appeal. The

principle of this decision has been held to apply to cases arising under our Income Tax Act - vide CIT v. Ashok Leyland Ltd. [1972] 86 ITR 546.

11. The ruling of courts on this point is but an extension of the principle that whatever substitutes or surrogates a revenue expenditure is also

revenue expenditure. The surrogated expenditure may be a lump sum payment. It may be laid out at any stage. But if it saves the taxpayer from

incurring in the very year or in other years other revenue payments either in whole or in part, then the expenditure has to qualify as revenue

expenditure.

12. We are satisfied that the principle of Anglo-Persian Oil Company's case [1931] 16 TC 253 was properly applied by the Tribunal to this case.

The expenditure incurred by the assessee for pulling down the old building and putting up a new one was heavy. Normally, it might have been

regarded as a capital outgoing and the building a capital asset. But the terms of the agreement under which the assessee incurred the expenditure

and the surrounding circumstances showed clearly that the assessee must have jumped at the offer only because of the obvious savings in rent

charges which the whole project involved for it. For no business concern in proper possession of its senses would have spent so much money on a

building only to find another claim for its title, unless there were recurring advantages to compensate the money spent. Learned junior standing

counsel remarked that there was nothing in the recitals of the agreement which indicated what the assessee's motivations could have been in

entering upon such a venture. We accept that the agreement does not say a word about why the assessee agreed to these terms. At the same time,

it does not also say why the landlord was satisfied with Rs. 1,000 or Rs. 2,000 as rent for a space which would any day have fetched him Rs.

12,000 ? These facts have been gathered by the Tribunal from the surrounding circumstances. The recital cannot put everything down. In any case,

this is a matter of lack of draftsmanship and not lack of connecting evidence.

13. Mrs. Nalini Chidambaram referred to three Indian cases, the decisions in which, according to her, cannot be explained in terms of an

expenditure taking its colour from what it saves or relieves the taxpayer otherwise from. They are : (1) Commissioner of Income Tax, Bombay

City-I Vs. Menora Hosiery Works Pvt. Ltd., , (2) Taj Mahal Hotel, Secunderabad

Vs. Commissioner of Income Tax, Hyderabad, however,

derive assistance from these decisions because the courts have not considered whether the deduction claimed is in respect of expenditure which is

in lieu of, or in compression of, or in redemption of, future revenue payments. The reference to Anglo-Persian Oil Company's case [1931] 16 TC

253 is conspicuous by its absence in these decision. They do not, therefore, advance our present discussion.

14. We uphold the decision of the Tribunal because the principle on which they based their conclusion is quite appropriate to the interpretation of

the relevant facts. We have only a minor reservation to make which, however, does not materially affect the result. The discussion of the problem

by the Tribunal as well as by the parties had gone on the finding of fact that what we have here is an item of expenditure. We are not sure that it is

an expenditure item. If the assessee spends money in constructing a house and retains its ownership, the money spent might be regarded as an item

of expenditure in the sense that it results in bringing into existence an asset. The asset may, in some cases, be intangible as when we expend money

to pay workman whose immediate return is only labour or service, although the labour might go into making things or articles. But in the present

case, the assessee spent Rs. 1,62,835 and Rs. 59,937 in two years, but what was the outcome in terms of the emergence of a tangible or

intangible asset ? Precisely, nothing. For the asset belonged to the landlord, brick by brick the assessee would be building and brick by brick the

assessee would be losing the ownership of the building too. In these events, it would be more appropriate to regard the whole money as lost to the

assessee. It is money lost as much as money expended. But the rules as to allowance of losses is not far different in Income Tax from allowance of

expenditure. The expenditure must be for the sole purpose of the business and it must not be capital expenditure. As for loss, it must be incidental

to the taxpayer's business and it must not be capital loss. The tests to determine capital losses are much the same as those for capital expenditure.

15. For all the above reasons, we answer the question of law in the affirmative and against the Department. The assessee is entitled to its casts.

Counsel's fee Rs. 500 one set. Certificate for leave to appeal :

16. Although the question of law in this case was whether a particular item of

expenditure was capital or revenue, it raises a peculiar problem of application of the principle which, in our experience, does not often arise. On our consideration of the principle bearing on the subject, we decided the case against the Department. Learned standing counsel for the Department applied for oral leave for appeal to the Supreme Court against our decision. Having regard to the importance of the principle involved, we are satisfied that this is a fit case for issue of a certificate of fitness of appeal to the Supreme Court. We issue the certificate accordingly.