
(1953) 07 AP CK 0007

In the Andhra Pradesh High Court

Case No : Income-tax Ref. No. 302 of 1952

Commr. of Income Tax

APPELLANT

Vs

Pingle Industries Ltd.

RESPONDENT

Date of Decision : 31-07-1953

Acts Referred:

Income Tax Act, 1961 — Section 10(2), 66(1)

Citation : (1953) 07 AP CK 0007

Hon'ble Judges : Srinivasachari, J; Manohar Pershad, J

Bench : Division Bench

Advocate : N. Narsimha Iyengar, for the Appellant; K. Srinivasan and K. Venkatachar, for the Respondent

Judgement

1. The question referred to us by the Income Tax Appellate Tribunal, Bombay, for our decision on the application of the Commissioner of Income Tax, Hyderabad is as follows:

Whether the lease money paid by the Assessee company to Nawab Mehdi Jung Bahadur and to Government is capital expenditure or revenue expenditure.

According to the statement of the case, the Assessee company carrying on business under the name and style of the "Tingle" Industries besides running its oil Mills, had taken on lease, stone quarries from Nawab Mehdi Jung Bahadur under a lease-deed dated 9th Meher 1343F which was for a period of 12 years commencing from 1st Ardibehisht 1346P. Under the terms of this lease, the Assessee company was required to pay a sum of Rs. 28,000/- per annum to the lessor; the total amount payable for the entire period amounted to Rs. 3,36,000/- out of which a sum of Rs. 96,000/- was paid at the time of the execution of the lease-deed and the balance of Rs. 2,40,000/- was agreed to be paid at the rate of Rs. 20,000/- per annum in 12 years. For facility of payment it was agreed that this sum of Rs. 20,000/- could be paid in equal instalments of Rs. 1666/10/8 every month. On the expiry of the period of lease, it was renewed for a further period of five years and seven months at an annual rent of Rs.

35,000/-.

The Assessee company has also taken on lease stone quarries from the Government. This lease was for a period of five years and the Assessee company was required to pay Rs. 9,000/- per year and this amount was to be paid in monthly instalments of Rs. 750/- each. Under these leases, the Assessee company acquired the right to extract Shahabad stones from the quarry (flag stones). After extracting these stones, the Assessee company used to sell them after working on them if necessary. The Assessee showed in its books of account that a sum of Rs. 37,000/- was paid as lease money to the lessor and claimed that this amount should be regarded as revenue expenditure to be deducted for the purpose of assessing the income u/s 10, Sub-section 2, Clause 15 of the Indian Income Tax Act. The Income Tax Officer and the Appellate Assistant Commissioner, disallowed the amount claimed for the years 1357 & 1358F respectively treating them as capital expenditure. On appeal the Appellate Tribunal came to a different conclusion and allowed the amount to be deducted holding that the sums paid by the lessee to the Jagirdar and to the Government was an expenditure incurred by the Assessee wholly and exclusively for the purpose of the business of the company and therefore, could not be regarded as capital expenditure. This view of the Tribunal is challenged by the Commissioner of Income Tax.

2. Shri Narsimha Iyengar, the learned advocate for the Department contended that the amounts in question which were paid by the Assessee under the two agreements were in the nature of capital expenditure as they were expended as outlay for the initiation of the business. It was an expenditure necessary for the acquisition of property, or the right of a permanent character, the possession of which was a necessary condition to the carrying on of the business. The business of the Assessee was to extract Shahabad stones from the quarry and sell them. It was not the business of a manufacturer and the expenditure was not for the purchase of raw material for the manufacturing business. The rights obtained under the documents would be in the nature of an asset or an advantage for the enduring benefit of the business and it is not necessary that the benefit should be everlasting. Reliance was placed on the case of--Commissioner of Income Tax, Madras v. Venkatasubba Reddy & Bros. AIR 1949 Mad 568 (A) and it was urged that in this case all the authorities on this point had been sufficiently dealt with.

3. On behalf of the Assessee Shri Srinivasan, the learned advocate urged that the business of the Assessee was of the nature of a manufacturing business. Following up the contention it was urged that in this case the Assessee had not only to extract Shahabad stones from the quarry but had to work on them to make them marketable and then sell them in the market. This would mean that the Assessee was a manufacturing company. Reliance was placed on the unreported decision of the Madras High Court--Abdul Kayoon v. Commissioner of Income Tax Madras decided on 2nd April, 1953 (since reported in K.T.M.T.M. Abdul Kayoom and Another Vs. Commr. of Income Tax, Madras, . In other words,

the point which the learned Counsel for the Assessee most strenuously pressed before us was that here was a case of a manufacturing business.

4. On behalf of the department, it is urged that the case of the Assessee is not that they polish stones and sell them in the market. Their case is that they extract stones, make them into sizes, and sell them in the market and they cannot be said to be a manufacturing firm. On behalf of the Assessee it was urged that the fact that the Assessee company has to polish stones was not denied by the department and in the reference made by the department there is an indication to show that the Assessee has to work on the stones as such that question would be deemed to be an admitted fact.

5. The decision of the question referred to depends upon the determination of the nature of the payments made by the Assessee under the two documents mentioned. Section 10, Sub-section 2 Clause 15 of the Indian Income Tax Act allows certain deductions. The section reads as follows:

Any expenditure (not being in the nature of capital expenditure or personal expenses of the Assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation.

It would, therefore, be clear that the Assessee is entitled to deduct any expenditure laid out or expended wholly and exclusively for the purpose of such business provided it is not his personal expense or capital expenditure. The Income Tax Act does not expressly define what it meant by "capital expenditure" and what would be regarded as "revenue expenditure". In the English Statute the phrase "capital expenditure" is not used. But the words used are "any capital withdrawn from, or any sum employed or intended to be employed as a capital in such trade, business, employment or vocation. In the absence of a definition attempts have been made to evolve tests more or less definite to be applied for the determination of the nature of a particular expenditure.

6. As pointed out in Halsbury's Laws of England Vol. 17 Section 325, it is difficult to lay down a definite series of tests which will cover all cases. One would ordinarily understand capital expenditure as distinguished from revenue expenditure as "an expenditure such as the cost of acquisition of plant, machinery or premises for carrying on of a business while one would understand revenue expenditure to mean the rent of the premises, establishment charges, etc. This, in our opinion, is the broad distinction that would differentiate capital expenditure from revenue expenditure. There is a considerable volume of case law both in India and in England on this subject but it does not enable us to lay down a definite and tangible test to distinguish capital expenditure from revenue expenditure. These decisions are, however, of considerable assistance in deducing certain principles which afford sufficient guidance. We shall first refer to the leading decisions of the English Courts which enunciate principles directly or indirectly applicable to the present case.

7. In the--City of London Contract Corporation Ltd. v. Styles 1387 2 Tax Cas 239

(C), a deduction was claimed with regard to a portion of the sum paid by the company in purchasing the benefit of certain unexecuted contracts and it was contended that though the capital was used to purchase the contract, it was used wholly and exclusively for the purposes of the concern. Bowen L.J. held:

You do not use it for the purpose of your concern which means for the purpose of carrying on your concern but you use it to acquire the concern.

This case lays down one of the tests viz., whether the expenditure is for the acquisition of a business or of rights essential to the carrying on of a business.

8. The second test laid down by Lord Dunedin as Lord President of the Court of Session in--Vallam Barosa Rubber Co. Ltd. v. Farmer 1905 5 Tax Cas 529 (D) viz, that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing that is going to recur every year. This principle was recognised by Viscount Cave L.C. in--"British insulator & Helsby Cables Co. Ltd. v. Atherton 1928 A.C. 205 (E) and generally recognised to be the leading case on the subject. In that case the Appellant company claimed to deduct in the computation of trade profits a sum which it had provided to form the nucleus of the pension fund for its employees. It was held that the sum ought so be debited to capital and could not be deducted.

9. Apart from these, there are other English cases laying down certain different tests as for instance the differentiation between fixed and circulating capital, moneys expended with a view to the acquisition of new licensed premises, expenses incurred in transferring the manufacturing business to a new premises, etc. Thus one of the main tests deducible from the English authorities is whether the expenditure is for the acquisition of the business or of rights essential to the carrying on of the business and exception has been made as regards the expenditure incurred in acquiring raw material for the purpose of manufacturing business of an Assessee which has been held to be of the nature of revenue expenditure.

The leading case on this point is--Golden Horse Shoe (New) Ltd. v. Thurgood (1934) 1 KB 548 (F). That was a case where the company acquired the right to take away and retreat very large dumps of residual deposits resulting from the working of a gold mine and called "tailings." These "tailings" were known to contain a certain amount of gold and by a new process of treatment some of this gold was recovered and sold. It was held that the amount expended in acquiring these tailings was in the nature of revenue expenditure because it was to acquire raw material and therefore the cost of the tailings was a proper deduction.

10. So far as the Indian High Courts are concerned, we would first deal with the Madras decisions. The first case in this connection is the case of the--Commissioner of Income Tax Vs. Chengalvaroya Mudaliar, . In this case, the Assessee entered into an agreement with the Government for excavation of lime shells from certain Government lands under the agreement he was to have the exclusive privilege of excavating lime shells within a specified area for a period of

three years in consideration for a sum of Rs. 27750/- payable in 12 equal quarterly instalments. The Assessee claimed the amounts that were paid to the Government as revenue expenditure and liable to be deducted in the computation of the profits. It was held that these amounts could not be regarded either as rent or the purchase price of the shells but that it was capital expenditure inasmuch as the payment that was made was for the purpose of starting that particular venture.

11. The second case is that of the-- The Commissioner of Income Tax Vs. P.T. Chengalvaroya Chettiar and Another, . This was also a case where the Assessee got by a deed, the exclusive right to excavate shells lying under Government property for three years. It was held following the decision in-- Commissioner of Income Tax Vs. Chengalvaroya Mudaliar, , that the amount was a capital expenditure and not a revenue expenditure, and the Assessee could not claim a deduction.

12. These two decisions were followed in the case of-- K. T. M. T. M. ABDUL KAYUM SAHIB HUSSAIN SAHIB Vs. COMMISSIONER OF Income Tax, MADRAS., by another Pull Bench of that court. There the Assessed acquired the exclusive right for a certain period to collect the "Chunks" from "Chunk-beds" belonging to the Ramnad and Shivganga Samasthan and agreed to pay them a certain amount in equal instalments in consideration of the grant of right. It was held that the amount paid was capital expenditure.

13. The fourth case on this point is that of AIR 1949 Mad 568 (A). In this case the asses-see being a registered firm was carrying on business to win mica and sell it after refinement. They entered into four agreements with the persons who owned certain patta lands in Nellore District, & who had also obtained what are described as patta land agreements from the Government for Mica mining. Under these documents the Assessee, in consideration of the payment of sums of money in instalments, were granted the mining rights in the respective mines. The Assessee claimed a deduction of the amounts paid by them u/s 10(2) of the Income Tax Act. It was held by Rajamannar, C.J. and Yahya Ali, J. that because the Assessee was carrying on a business to win and sell mica, and for this purpose acquired mining rights, the money expended for the acquisition of such rights should be regarded as capital expenditure and not revenue expenditure.

14. The last case of the Madras High Court relied upon by the Assessee-Respondent here is the unreported full bench case which was decided on 2nd April 1953 (since reported in K.T.M.T.M. Abdul Kayoom and Another Vs. Commr. of Income Tax, Madras, . The Assessee in this case was a firm carrying on business in Chunks, to be collected from the sea. For the purpose of the business, the Assessee used to engage divers to collect the chunks from the sea, sort them out and sell them in the market. The Assessee entered into an agreement on 9-11-1945 with the Director of Industries & Commerce, Madras Stale. This agreement was for a period of three years. By this agreement, the Assessee's firm had to pay a sum of Rs. 6111/- in equal annual instalments. The

firm paid the first instalment and claimed the amount as a deductible amount treating it as revenue expenditure. The Income Tax Officer and the Tribunal both disallowed the amount.

The matter came on reference to the High Court u/s 66(1) of the Indian Income Tax Act. The question referred to was:

Whether on the facts and circumstances of the case, the payment of the sum of Rs. 6111/- made by the Assessee under the terms of the agreement was not an item of revenue expenditure incurred in the course of carrying on the business of the Assessee, and, therefore, allowable under the provisions of Section 10(2) of the Indian Income Tax Act.

The matter was referred to a larger bench because it was found necessary that the decision of the Madras High Court in 1939- K. T. M. T. M. ABDUL KAYUM SAHIB HUSSAIN SAHIB Vs. COMMISSIONER OF Income Tax, MADRAS., , required further consideration in view of the decision of the Privy Council in-- AIR 1949 311 (Privy Council) . It was held by their Lordships of the Madras High Court that the amount expended was a revenue expenditure and not a capital expenditure.

15. A similar question had arisen in a full bench case before the Allahabad High Court in--Commissioner of Income Tax v. Tikaram & Sons Ltd. Aligarh AIR 1337 All 708 (K). In this case, the Assessee was carrying on a business of manufacturing bricks. The Assessee was proprietors for a part and the lessees of the remainder piece of land on which it carried on the business and from which it dug the earth for making the bricks. The question arose as to whether the value of the earth dug up and utilised for the manufacture of bricks was of the nature of capital expenditure. It was held that:

the company by taking up this lease had not purchased so many maunds of earth for so many rupees but had acquired lessee's rights in the Immovable property which included the right to dig out earth and use it for the purpose of manufacturing bricks. The position seems to be more analogous to that of a company which is working a quarry or a mine rather than to an ordinary manufacturer who purchases raw materials for purpose of his manufacturing business.

It, therefore, seems that the case of a brick field is very similar to that of a quarry or a mine and the proprietor of the land or the lessee is not a mere purchaser of raw materials but a person who has acquired certain rights in the land and the amount invested by him must, therefore, be treated as capital expenditure within the meaning of Section 10, Sub-section (2) Clause 9, (now Clause 15) of the Indian Income Tax Act.

This decision was followed by the Division Bench of the same High Court- GANESHILAL BHATTAWALA, IN RE.,

16. The Oudh Chief Court in--Sardar Singar Singh and Sons v. Commissioner of Income Tax C.P. & U.P. AIR 1945 Oudh 124 (M), following the decision in

Commissioner of Income Tax Vs. Tika Ram and Sons Ltd., held that the price or compensation for earth mentioned in the deeds was akin to royalties on coal extracted from coal mines and. that the expenditure incurred was of a capital nature. This was also a case which related to a lease of a plot of land for the purpose of excavating earth for the manufacture of bricks.

17. Similar discussion had arisen in--Re. Parmanaud Havellram AIR 1945 Lah 137 (FB) (N). The Assessee in. this case was a manufacturer of Potassium Nitrate and Sodium Chloride. He manufactured his own crude saltpetre at different places and brought to his refineries and analysed it into potassium nitrate and" sodium chloride which were the finished products. Salt bearing land was acquired by the Assessee in different villages from the proprietors on short term leases the Assessee employed his own labourers on the sites who scraped and collected the salt bearing earth and by an elaborate process of evaporation obtained the crude saltpetre which was sent to the refinery. It was held that the sum expended by the Assessee on the leases for acquiring the sites for the purpose of extracting the crude saltpetre was not in the nature of capital expenditure as it was expended for the purpose of running the Assessee's business and not in acquiring it.

Justice Munir who delivered the judgment in the case considered the following among other circumstances appearing from the statement of the case having an important bearing 011 the decision of the question whether the expenditure was in the nature of capital expenditure:

1. That the dominant trade of the Assessee's business was that of a manufacturing business;
2. That the Assessee acquired for his manufacture his own raw material;
3. That the raw material was the crude salt-petre
which may or may not be a marketable commodity.
4. That the Assessee did not sell crude salt-petre but extracted it only for the purpose of subsequently being analysed into potassium nitrate and sodium chloride which were the finished products;
5. That in the extraction of the crude salt-petre an elaborate process was employed and the raw material for its manufacture was "kallar" obtained from the sites acquired by the asses-see under short-term leases, the kallar itself not being a marketable commodity; and
6. That the money paid as consideration for the leases was an outlay from circulating capital, the leases themselves not being a fixed capital asset.

18. The correctness of this decision was questioned in a later case be ton; the same High Court before a bench of five Judges in--Banarasidas Jagannath v. Commr of Income Tax AIR 1947 Lan 162 (FB) (O). In this case the Assesses was a manufacturer of bricks and had obtained certain lands on leases for the

purpose of digging out earth for the said manufacture. The period of the leases varied from six months to three years. It was held that the consideration paid for the leases represented the price of raw material and the Assessee was, therefore, entitled to claim it as revenue expenditure u/s 10(2)(xii) now xv, and the object of the agreements was the procuring of earth for manufacturing bricks and not the acquisition of an advantage of a permanent nature or of an enduring character.

19. In the Nagpur High Court also in the--Income Tax Tribunal Bombay v. Haji Subumiayan Haji Sirajuddin AIR 1946 Nag 241 (P), a similar question had arisen. This was a case of leases for Harra nut and lac. It was held that payments made by the Assessee in consideration of leases of several forests for the right to take harra nut and lac from the forest was capital expenditure and could not be allowed as a deduction u/s 10(2)(xii) of the Income Tax Act. The argument advanced in this case was that the Assessee merely purchased raw material and that the price of the said raw material should be deducted. This argument was not accepted.

20. Shri Srinivasan, the learned advocate, attempted to distinguish the earlier decisions of the Madras High Court on the ground that in those cases the expenditure was incurred for beginning the business. In other words, it was an outlay for the first time and not an expenditure for an already existing business and laid stress on the unreported decision of the Full Bench of the Madras High Court referred to above.

21. From a perusal of the judgment of the Full Bench relied upon by the learned Counsel for the Assessee, it would be evident that the learned Judges sought to lay down that merely because the Assessee was not a manufacturer as, in the case of Mohanlal Hargovind, it could not be said that "this expenditure was not in the nature of a revenue expenditure. Their Lordships posed the question in these words: "Was it the purchase of goods as such or was it the purchase of stores from which the goods emanated". It was observed that if the answer is that it was the material that was purchased and not the material stores, the only expenditure was a revenue expenditure and not a capital expenditure.

22. It is impossible to find any analogy between the facts of the unreported case since reported in K.T.M.T.M. Abdul Kayoom and Another Vs. Commr. of Income Tax, Madras, , or the facts in AIR 1947 Lah 162 (O) or in AIR 1945 Lah 137 (FB) (N), and the facts of the present case. The case under consideration is a simple case of an Assessee acquiring the right to take out from the quarry stones and selling them. This is not a case like that of (1934) 1 KB 548 (F)" in which after the mineral had been won and gotten it was dumped on the surface. Nor is it a case of sale of any raw material as such. The business consists in extracting stones from the quarry. In the case of an agreement under which an Assessee is entitled to excavate all earth to a particular depth to be used as raw material for the manufacture of bricks, it can be said that there is a sale of that quantity of earth. But in the case of an acquisition of the right to extract Shahabad stones it

is impossible to say that there is a sale of so many stones. It would be opposed to commonsense to say that the acquisition of a right to extract stones is a sale of stones as raw material.

It is only in case of the purchase or acquisition of goods which form the stock in trade, circulating and floating capital of the business, that such expenditure could be regarded as a necessary deduction for assessing the profits of the business.

23. On the facts of this case, it is abundantly clear that there is no manufacturing business and the money expended for the acquisition of the right to extract the Shahabad stones would be held to be capital expenditure. Our reply, therefore, to the question referred to us, is that the lease money paid by the Assessee company to Nawab Mehdi Jung Bahadur and to Government is capital expenditure and not revenue expenditure. We do not wish to pass any order as regards the costs of this Court.