

(1959) 06 KL CK 0015
In the High Court Of Kerala
Case No : Income Tax Ref. No. 24 of 1957

Koru

APPELLANT

Vs

Commissioner of Income Tax, Kerala

RESPONDENT

Date of Decision : 11-06-1959

Acts Referred:

Income Tax Act, 1922 — Section 10

Citation : AIR 1960 Ker 41

Hon'ble Judges : M.S. Menon, J; Kumara Pillai, J

Bench : Division Bench

Advocate : T.V. Viswanatha Iyer, S. Narayana Swami, A.V. Ramanatha Iyer and V.R. Venkatakrishnan, for the Appellant; G. Rama Iyer, for the Respondent

Judgement

M.S. Menon, J

1. This is a reference by the Income Tax Appellate Tribunal, Madras Bench, u/s 66(1) of the Indian Income Tax Act, 1922, Counsel for the assessee and the department are agreed that the second of the two questions referred has not been dealt with in the order of the Appellate Tribunal and that the said question need not be answered by us.

2. The first question referred which alone arises for consideration reads as follows:

"Whether the value of Rs. 1,20,000/- aforesaid can be said to be the value of timber on the aforesaid land on the basis of the terms of annexures "A" and "B".

Annexure A is an agreement between the assessee and the Canara Industrial Plantations Limited, dated 5-10-1950 and Annexure B, a sale deed in favour of the assessee by the said company dated 31-8-1951. Two other documents which followed are Annexure C, a deed of mortgage executed by the assessee in favour of the company on 31-8-1951 and Annexure D, an agreement between the assessee and the Indo-Continental Trading Company on 1-10-1951.

3. The Appellate Tribunal dealt with the question as follows in its order dated 26-4-1957;

"By an agreement dated 5-10-1950, with the Canara Industrial Plantations Limbed, (Annexure A) the assessee entered into a contract to exploit the timber in an undeveloped forest along with regular plantation areas belonging to the said Canara Industrial Plantations Ltd. The assessee was to pay a sum of Rs. 1,20,000/- out of which Rs. 25,000/- was paid even before the date of agreement and the balance was to be paid in agreed instalments. The assessee was to cut the standing timber and incidentally had to make the area cultivable). The assessee, with a view to become the ultimate owner of the entire land and together with the standing timber, on 31-8-1951 by a sale deed executed by the aforesaid Canara Industrial Plantations Ltd. (Annexure B) acquired full ownership of the land and the forest for a further consideration of Rs. 30,000/-. Thus, on 31-8-1951, the assessee became the complete owner of both the land and the forest thereon. In between, he did not carry out any exploitation of the timber contemplated by the agreement dated 5-10-1950 aforesaid (Annexure A). The assessee after obtaining full ownership of the area in the manner aforesaid entered into an agreement with Indo-Continental Trading Co. on 1-10-1951 for exploitation of the timber in the forest area of the plantation in question (Annexure D). From the above facts, it follows that what the assessee laid out both over the land and forest thereon was Rs. 1,50,000/- they whole of which is clearly capital in nature and hence, there is no question of allowing Rs. 1,20,000/- or any portion of the above investment as a revenue expenditure or being set off against the kuttikanam receipts which the assessee might receive from persons to whom he gave the right to exploit the timber in the forest in question."

4. The statement of the case in so far as it relates to question under consideration is in the following terms:

"The assessee is an "individual" carrying on inter alia a timber business in the course of which he entered into an agreement on 5-10-1950 with the Canara Industrial Plantations Ltd. copy whereof is annexed hereunto as annexure "A" and forms part of the case, for exploitation of certain undeveloped forest as also the regular plantation areas that belonged to it. Under the terms of this agreement, the assessee was to cut the timber and to make the area fit for plantation. The consideration for the agreement was Rs. 1,20,000/-, Rs. 25,000/- of which was paid and acknowledged before the date of the agreement, and the balance of Rs. 95,000/- payable in four annual instalments.

The assessee thereafter purchased the above property outright from the aforesaid Canara Industrial Plantations by a deed dated 31-8-1951, copy whereof is annexed hereunto as annexure "B" and forms part of the case, for a further consideration of Rs. 30,000/- paid in cash on that day.

By a hypothecation deed dated 31-8-1951, copy whereof is annexed hereunto as

annexure "C" and forms part of the case, the balance or Rs. 95,000/- payable on annexure "A" aforesaid was agreed to be paid as follows:

In December 1951 Rs. 30,000/- In December 1952 Rs. 35,000/- In December 1953 Rs. 30,000/- The assessee did not do any exploitation himself under the aforesaid annexure "A" till 30-9-51. He thereafter entered into an agreement with the Indo-Continental Trading Co., on 1-10-1951 with effect from that date for exploitation of the entire area for a Kuttikanam payable to him at rates mutually agreed upon. The assessee was required by this agreement to construct roads into the forest areas at his own expense. A copy of this agreement is annexed hereunto as annexure "D" and forms part of the case.

During the period from 1-10-1951 to 31-3-1952, the previous year" for this source for the assessment year 1952-53, the assessee received Rs. 22,102/- as Kuttikanam.

It is common ground that exploitation of the above agreement continued in future years too and that as on 31-3-1952 there was timber standing on that land that remained to be exploited".

5. u/s 10 of the Indian Income Tax Act, 1922, an item of expenditure though wholly and exclusively laid out for the purpose of the business, profession or vocation would nevertheless be inadmissible as an allowance if it is of a capital nature. The real controversy in this case is whether the sum of Rs. 1,20,000/- represented a capital or revenue expenditure.

6. The expression "capital expenditure" is not defined in the Act. In *Van Don Berghs Ltd. v. Clark*, (1935) 3 ITR 17, Lord Mac-millan said:

"No infallible criterion or test can be or has been laid down and the decided cases are only helpful in that they indicate the kind of consideration which may relevantly be borne in mind in approaching the problem."

This statement was endorsed by the Supreme Court in *COMMISSIONER OF Income Tax AND EXCESS PROFITS TAX MADRAS Vs. SOUTH INDIA PICTURES LTD.*, and *Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons*, .

7. In *Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal*, , the Supreme Court said that *Atherton v. British Insulated and Helsby Cables Ltd.* (1925) 10 Tax Gas 155 laid down what has "almost universally been accepted as the test for determining what is capital expenditure as distinguished from revenue expenditure" and quoted the following observation of Viscount Cave, L. C. in that decision:

"But there remains the question which I have found more difficult, whether apart from the express prohibitions, the sum in question is (in the words used by Lord Sumner in *Usber's Willshire Brewery Ltd. v. Bruce*, (1914) 6 Tax Cas 399 a proper debit item to be charged against incomings of the trade when computing

the profits of it; or, in other words, whether it is in substance a revenue or a capital expenditure. This appears to me to be a question of fact which is proper to be decided by the Commissioners upon the evidence brought before them in each case; but where, as in the present case, there is no express finding by the Commissioners upon the point, it must be determined by the courts upon the materials which are available and with due regard to the principles which have been laid down in the authorities. Now, in *Vallambrosa Rubber Co. v. Farmer*, (1910) 5 Tax Cas 529, Lord Dunedin as Lord President of the Court of Session, expressed the opinion that "in a rough way" it was not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing which is going to recur every year"; and no doubt this is often a material consideration. But the criterion suggested is not, and was obviously not intended by Lord Dunedin to be, a decisive one in every case; for it is easy to imagine many cases in which a payment, though made "once and for all," would be properly chargeable against the receipts for the year But when an expenditure is made, not only once and for all but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

8. In (1947) 15 ITR 185 Lahore a Full Bench of the Lahore High Court said:

"It is not easy to define the term "capital expenditure" in the abstract or to lay down any general and satisfactory test to discriminate between a capital and a revenue expenditure. Nor is it easy to reconcile all the decisions that were cited before us for each case has been decided on its peculiar facts. Some broad principles can, however, be deduced from what the learned Judges have laid down from time to time." and formulated those principles as follows:

"(1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment; vide Lord Sands in *Commissioners of Inland Revenue v. Granits City Steamship Co.*, (1927) 13 Tax Cas 1 . In *City of London Contract Corporation v. Styles*, (1887) 2 Tax Cas 239, Bowen, L. J., observed as to the capital expenditure as follows:

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."

(2) Expenditure may be treated as properly attributable to capital when it is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade; vide Viscount Cave, L. C., in (1925) 10 Tax Cas 155. "If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment

should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be deducted out of the profits by claiming that it relieves the annual labour bill, the business has acquired a new asset, that is, machinery."

The expressions "enduring benefit" or "of a permanent character" were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset,

(3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it."

9. In *Assam Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal*, the Supreme Court said:

"This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the Principles which emerge from the authorities."

10. In *Stow Bardolph Gravel Co. Ltd. v. Poole* (1954) 35 Tax Cas 459 Birkett L. J. said :

"We listened during today and yesterday to very many cases dealing with a variety of topics. We have heard very many analogies discussed of one kind or another, potatoes, truffles, strawberries, apples and all sorts of other commodities, all designed to ascertain what is true test to be applied to the particular facts of this case."

We have also had our share of minerals, leaves, fruits and vegetables. The "timber cases" to which our attention has been drawn are *Kauri Timber Co. Ltd. v. Commr. of Taxes*, 1913 A. C. 771 , *Maharajadhiraja Bahadur of Darbhanga Vs. Commissioner of Agricultural Income Tax, West Bengal*, and *Hood Barrs v. Inland Revenue Commrs.*, (1958) 34 ITR 238.

11. In (1958) 34 ITR 238 the House of Lords on a construction of the arrangements concerned came to the conclusion that in computing the timber merchants Income Tax liability the sums payable should be treated as capital expenditure and not as the price for stock in trade and that accordingly they should not be debited in calculating his trading profits. One of the observations that Lord Simonds took care to make was:

"It does not follow from this decision that, whenever a timber merchant buy a standing timber in small or large quantities, he cannot debit his profit and loss account with the cost"; and "The issue will be determined by a consideration of all the factors to which the Lord President and Lord Sorn refer, not the least important of them will be whether the purchase is of one tree of thirty thousand."

12. We have been taken through the whole of Annexure A, B, C and D and our conclusion in the light of the principles discussed above is that the sum of Rs. 1,20,000/- represents a capital and not a revenue expenditure whether Annexure A is considered in isolation or in the context of the arrangements that followed.

13. The first of the two questions referred to us is answered as above. No costs.

14. A copy of this judgment under the seal of this Court and the signature of the Registrar will be sent to the Appellate Tribunal as required by Sub-section 5 of Section 66 of the Indian Income Tax Act, 1922.