
(1972) 04 MAD CK 0020

In the Madras High Court

Case No : Tax Case No. 299 of 1966 (Reference No. 69 of 1966)

Ramakrishna and Co.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 14-04-1972

Acts Referred:

Income Tax Act, 1922 — Section 10(2)

Citation : (1972) ILR (Mad) 354 : (1973) 88 ITR 406

Hon'ble Judges : V. Ramaswami, J;Ramanujam, J

Bench : Division Bench

Advocate : K. Srinivasan, D. Meenakshisundaram and K.C. Rajappa, for the Appellant; V. Balasubrahmanyam and J. Jayaraman, for the Respondent

Judgement

V. Ramaswami, J.—The cinema theatre building known as Chitra Talkies, Madras, was taken on lease by one K. Viswanathan on a

monthly rent of Rs. 3,500 under lease deeds dated May 25, 1956, and May 26, 1956. The lease was for a period of four years from June 1,

1957, with a right to renew the same for a further period of two terms of four years each, Viswanathan was also the holder of a licence for

exhibiting cinema films. He assigned his right, title and interests under the lease deeds to Messrs. Ramakrishna and Company, a partnership firm,

by a deed of assignment dated April 29, 1957. Under this document, Ramakrishna and Company had to pay a sum of Rs. one lakh by way of

consideration to Viswanathan and also pay to the owners of the theatre a monthly rent of Rs. 3,500 which was payable by Viswanathan. This

partnership firm consisting of five partners was registered with the Registrar of Firms on May 1, 1957, and a partnership deed also was executed

on January 2, 1959, It is this firm that is the assessee in the present case.

2. The assessee-firm returned an income of Rs. 42,138 for the assessment year 1960-61 from the business of exhibition of films at Chitra Talkies.

In computing this income the assessee had claimed allowance for a sum of Rs. 9,375 representing a part of the consideration of the sum of Rs. one

lakh paid by the assessee to Viswanathan under the agreement dated April 29, 1957, in addition to a monthly rent at the rate of Rs. 3,500 per

month. The unexpired lease after the assignment in favour of the assessee was 10 years 8 months.

3. The assessee wanted to average the total consideration of Rs. one lakh and spread it over the entire lease period and it is thus he has arrived at

Rs. 9,375 as the proportion for the accounting year in question. The assessee claimed deduction on the ground that this was also the proportionate

rent payable by him in respect of the theatre and that, therefore, he is entitled to a deduction u/s 10(2)(xv) of the Income Tax Act, 1922. The

Income Tax Officer disallowed the claim of the assessee on the ground that the sum of Rs. one lakh paid by the assessee to Viswanathan was a

capital expenditure incurred with a view to bring into existence an advantage of an enduring nature. On appeal by the assessee, the Appellate

Assistant Commissioner confirmed the assessment order. The Appellate Assistant Commissioner was of the view that the amount had not been

paid for the preservation of the business and, therefore, it could not be said to have been laid out wholly and exclusively for the purposes of the

business u/s 10(2)(xv) of the Act. He further held that the assessee could not acquire the business without the payment of Rs. one lakh and so the

expenditure constituted an item of capital expenditure and that, therefore, the disallowance of the claim was proper. The assessee preferred a

further appeal to the Appellate Tribunal. The Tribunal was of the view that there was no proof that the partnership had come into being on April

29, 1957, itself, when Viswanathan assigned his rights to the partnership, and that there was also no proof of payment of Rs. one lakh to

Viswanathan as provided for in the agreement. The Tribunal was prepared to assume that a sum of Rs. 48,000 was paid under the agreement and

that the partnership firm had come into existence on the day of assignment. But even then, it was of the view that it was difficult to say that the

expenditure of Rs. one lakh was incurred for business purposes entitling the assessee to claim a part of it as allowance in the year of account. In

that view, the Tribunal affirmed the order.

4. On the refusal of the Tribunal to refer a question to the High Court, the assessee filed a petition in the High Court u/s 66(2) of the Act and in

pursuance of the order of the High Court dated August 25, 1965, the following question has been referred by the Tribunal for determination :

Whether, on the facts and circumstances of the case, the assessee is entitled to the deduction which he claims ?

5. Before dealing with the contentions of the parties, it is necessary to set out some relevant facts. The theatre was owned by two individuals and

by an identical but separate lease deeds dated May 25, 1956, and May 26, 1956, the owners leased out the theatre in favour of one Viswanathan.

The monthly rent payable was Rs. 1,750 to each owner making a total of Rs. 3,500 a month. Clause 5 of the lease deeds permitted the assignment

of the lease and that in case of assignment both the lessee and his assignee shall be jointly and severally liable to the lessor for the discharge of the

obligations under the lease deeds. The assignment dated April 29, 1957, was in favour of Ramakrishna and Company represented by its five

partners. In the preamble portion of the assignment deed it is stated that the assignee has offered to purchase outright by way of assignment and

transfer all the right, title, future benefit and interest of the assignor in the theatre under the lease deeds for a sum of Rs. one lakh to be paid in the

manner set out in the document. Since the Tribunal was prepared to assume that at least a sum of Rs. 48,000 had already been paid out of the

consideration of Rs. one lakh and the deduction claimed is only Rs. 9,375 it is not necessary for us to set out the mode of payment of the

consideration. The assignment deed further stated that the assignee-firm is liable to pay rent to the owner and also to carefully and diligently

perform the covenants contained in the lease deeds dated May 25, 1956, and May 26, 1956.

6. The question for consideration, therefore, is whether the consideration of Rs. one lakh or any portion thereof could be considered as a business

expenditure and, therefore, an allowable deduction. Section 10(2)(xv) of the Act reads:

10. (2) Such profits or gains shall be computed after making the following allowances, namely :--

(xv) any expenditure (not being an allowance of the nature described in any of the Clauses (i) to (xiv) inclusive, and 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.

7. Therefore, the question for consideration is whether the sum of Rs. one lakh paid under the document is in the nature of capital expenditure laid out or expended wholly and exclusively for the purpose of business.

8. Very eminent judges have time and again pointed out that the terms "" capital expenditure "" or "" revenue expenditure "" are elusive of precise definition and no test could be laid down as a general rule or of universal application. But, in deciding different types of cases they have applied certain broad criteria in each case. In *Vallambrosa Rubber Co, Ltd. v. Farmer*, [1910] 5 T.C. 529 Lord Dunedin said :

.....in a rough way I think it is 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 that is going to recur every year.

9. With reference to this test. Viscount Cave L. C. in *Atherton v. British Insulated and Helsby Cables Ltd.*, [1925] 10 T.C. 155 said that:

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.

10. And in turn he suggested the following test:

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 inclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

11. What is meant by the term "" enduring benefit "" in the above test was not considered to be clear and, therefore, in *John Smith & Son v. Moore*, [1921] 12 T.C. 266 (H.L.) it was held that the test whether the expenditure was part of the circulating as contrasted with fixed capital is a good test in most cases. And this was followed in *Anglo-Persian Oil Co, v. Dale*, [1932]

1 K.B. 124 ; [1931] 16 T.C. 253 (C.A.). The universal

application of this test also was found to be doubtful in many subsequent cases and in some cases the test applied was that the expenditure

incurred in the acquisition of an asset was a capital expenditure and the expenditure incurred in the process of earning of the profit was a revenue

expenditure. This is the principle which was applied in Tata Hydro Electric Agencies Ltd, v. Commissioner of Income Tax, [1937] 5 ITR 202.

Rowlatt J. forcefully put this test in Commissioners of Inland Revenue v. Fergus, [1926] 10 T.C. 665 and to quote his own words:

When you consider the nature of Income Tax, it is to charge Income Tax upon an income producing property or an annual value producing

property when you have got it, although of course you have had to pay to get it first.

12. The Supreme Court, after consideration of a number of cases on the general principles applicable in determining the question, held in Assam

Bengal Cement Co. Ltd. Vs. The Commissioner of Income Tax, West Bengal, , as follows:

If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly

attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any

such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset

or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the

payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and

object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source

or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of

fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating

capital. If it was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it

would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in

the manner above indicated. It has been rightly observed that in the great diversity of human affairs and the complicated nature of business

operations it is difficult to lay down a test which would apply to all situations. One has, therefore, got to apply these criteria one after the other from

the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular

case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductible allowance u/s 10(2)(xv) of the

Income Tax Act.

13. Let us apply these principles to the facts of the present case. The consideration of Rs. one lakh was paid for the acquisition of the lease-hold

right in the cinema theatre in which the assessee wanted to carry on the business of exhibition of cinema films. The licence to exhibit the pictures

was not transferred to the assessee under the deed of transfer. Of course, subsequently the assessee had obtained the licence. The amount of Rs.

one lakh was payable in the manner provided in the deed of transfer. The obligation to pay this amount would not cease by the termination of the

lease by the owner for any default or contravention of the terms of the original lease deed. If the assessee had not agreed to pay this price of Rs.

one lakh for the assignment of the lease, the assignment itself would not have been given. The deed of transfer itself says that in consideration of the

sum of Rs. one lakh paid in the manner provided in the document the lessor was assigning his leasehold interest to the assignee. Without obtaining

this leasehold right in the cinema theatre the assessee could not have begun or carried on his business. It is something like acquisition of a wall for

the purpose of painting. It is only the acquisition of the leasehold right in the theatre that enabled or put the assessee in a position to do his business.

Thus the amount paid was in the nature of premium paid for the purpose of enabling the assessee to carry on his business and it did not form part

of the rent payable in respect of the theatre. In our view, therefore, the amount was paid for the acquisition of a capital asset which enabled the

assessee to carry on his business and that, therefore, it was a capital expenditure and not a revenue expenditure.

14. We are supported in this view by some of the decisions in cases where the facts were very similar to the present case. We would only refer to those cases where the nature of premiums paid for obtaining the leases either in lump sum or payable in instalments was considered. In *Mac Taggart v. B. & E. Strump*, [1925] 10 T.C. 17 the facts were that the assessee had taken a lease of the premises for carrying on business as furniture dealers. At the expiry of the lease the owner refused to execute the lease unless he was paid a sum of ₹ 1,150 in cash in addition to an annual rent of ₹ 397. The assessee paid the sum of ₹ 1,150 in cash to secure the renewal of the lease for five years at the old rent. It was contended on behalf of the assessee that the sum of ₹ 1,150 paid to secure the renewal of the lease was an expenditure incurred by them to enable them to carry on their business and to earn profits and that the payment of that money was really rent paid in advance and that, therefore, they are entitled to a deduction of an aliquot part of that amount referable to the year of accounting which was taken as ₹ 230 by dividing the total amount of ₹ 1,150 by five years, for which period the lease was renewed. It was contended on behalf of the revenue that the payment of ₹ 1,150 was in effect a premium paid for renewal of the lease and consequently no part of that amount was liable to deduction and that the payment of that money was in reality an expenditure of a capital nature. It was held that the said payment was a capital expenditure and that, therefore, no part thereof was admissible as a deduction in computing the profits of the firm's trade. The above is a case where the premium was paid in lump sum even at the time of transfer.

15. In the case decided in *Green v. Favourite Cinemas Ltd.*, [1930] 15 T.C. 390 the premium was payable in instalments. That was a case where the assessee took on lease a cinematograph theatre with its fixtures, furniture, machinery, etc., for 21 years under a lease which provided for an annual rent and payment of a premium of ₹ 65,000. Out of the premium of ₹ 65,000, a sum of ₹ 2,000 was paid on the date of lease and the remaining ₹ 63,000 was to be paid to the lessor at the rate of ₹ 3,000 per annum over the 21 years, the term of the lease. It was held in that case that the payments were capital expenditure. It is very useful to extract the following quotation from the judgment of Rowlatt J. at page 394:

In the present case it is quite clear that if that premium is paid for premises--furnished or unfurnished, with or without other advantages, or for permanent rights, as Lord Clyde puts it, without which you cannot begin the business, that is a capital expenditure, and there is nothing more to be said about it. It is also clear from Adam's case, if from no other, that by dividing it out and making it payable in instalments you do not vary its character of capital expenditure for this purpose. What is this ? It is a very curious document, and the amount seems to have been reached by some consideration of what the theatre was really capable of earning, but according to the lease itself it simply comes to this. There is this premium--I call it a premium, I do not lay any stress upon the word--the lump sum payment, which is payable on demand; but there is no demand to be made for immediate payment so long as these instalments are paid quarterly. So it is, so far, a sum in the nature of a premium, only spread over a period in the form of quarterly payments. Then there is a provision that for default of payment of rent or premium the lease may be forfeited, but, of course, if the lease is forfeited the rent goes; then the premium becomes exigible as a lump sum, notwithstanding that the premises have disappeared, and, therefore, the character of this sum as a premium is maintained because he has had to pay the premium to buy the lease although he has lost the lease by not paying the rent. It looks to me merely like a premium spread over a period.

16. The case reported in *Henriksen v. Grafton Hotel Ltd.*, [1942] 2 K.B. 184 ; 24 T.C. 453 ; [1943] 11 ITR (Supp.) 1 is a decision of the Court of Appeal in which it was held that the annual payment to the licensing justice by lessees of licensed premises were capital expenditure on the ground that the monopoly value payments were imposed for the term of the licence on grant or renewal and that such payments fell into the same class as a premium paid on the grant of a lease and that, therefore, not a deductible revenue expenditure.

17. A similar question came up for consideration by the- Supreme Court in *Assam Bengal Cement Co, Ltd, v. Commissioner of Income Tax*.

There the assessee-company acquired from the Government of Assam a lease of certain limestone quarries on certain half yearly rents and

royalties. In addition to the rents and royalties the assessee also agreed to pay to the lessor, the Government of Assam, annually a sum of Rs.

5,000 during the whole period of 21 years of lease as protection fee and in consideration of that payment the Government undertook not to grant

to any person any lease or licence for limestone in a group of quarries without a condition that no limestone should be used for manufacture of

cement. The assessee also agreed to pay Rs. 35,000 annually for five years as a further protection fee and the Government in consideration of that

payment gave a similar undertaking in respect of the whole of the District. The question for consideration was whether in computing the profits of

the assessee-company the sum of Rs. 5,000 and Rs. 35,000 paid to the Government could be deducted u/s 10(2)(xv) of the Act. It was held by

the Supreme Court that the payment of Rs. 5,000 and Rs. 35,000 were capital expenses and that, therefore, they are not deductible expenditures.

18. The Supreme Court again considered this question in Commissioner of Income Tax, Assam etc. Vs. The Panbari Tea Co. Ltd., The premium

payable in that case was Rs. 2,25,000 and out of this amount a sum of Rs. 45,000 was payable at the time of execution of the lease deed and the

balance of Rs. 1,80,000 payable in 16 half-yearly instalments of Rs. 11,250 commencing from the end of January, 1952. The question was looked

at not from the point of view of the lessee who paid the premium, but from the point of view of the lessor who received the amount. But still, the

Supreme Court held that the sum of Rs. 11,250 was a capital receipt in the hands of the lessor. While so holding the Supreme Court observed that

when the interest of the lessor was parted with for a price, the price paid is premium or salami; but the periodical payment made for the continuous

enjoyment of the benefits under the lease are in the nature of rent. The former is a capital receipt and the latter are revenue receipts.

19. The learned counsel for the assessee in the present case contended that the sum of Rs. one lakh paid under the document was really a rent

paid in advance and that we must look at only the substance of the transaction and not be carried away by the form adopted by the parties. He

elaborated this point by stating that if the amount had been stated in the document itself as a portion of the rent and was made payable in advance it

would have formed part of the rent payable and, therefore, an allowable deduction. But we are of opinion that in deciding questions of this sort,

ifs "" and "" buts "" have no place and the formal transaction which the parties have chosen will be very material on the determination of the question

whether the payments were for a capital outlay and not a revenue expenditure.

20. It was then contended by the learned counsel for the assessee that the test laid down in *Atherton v. British Insulated and Helsby Cables Ltd.*

speaks of an expenditure made not only once and for all but with a view to bring into existence an asset of an "" enduring benefit "" to the business

and this test of "" enduring benefit"" has been accepted by the Supreme Court in the decision in *Assam Bengal Cement Co. Ltd, v. Commissioner of*

Income Tax. But, in the case on hand the period of unexpired lease after the assessee obtaining the licence for exhibition of the cinema film was

only 10 years and 8 months and that the lease was a precarious lease and not of an enduring nature. In this connection, the learned counsel

referred to Clause 3 of the original lease deed which is also binding on the assessee as per the terms of the assignment deed. The relevant portion

of that Clause which was relied on by the learned counsel reads as follows:

In case the lessee failed to pay the rent stipulated for 3 months consecutively the lessor shall have the option of terminating the lease and reentering

on the demised premises and of recovering the entire rent for the full period stipulated above.

21. In our view, this is not a term which makes the tenancy at will. This is one of the methods of enforcement of the payment of rent and the terms

of the lease. This is a penalty provided for the lessee's own default and it did not confer any absolute power of termination of the tenancy to the

lessor. Merely because there is a default clause in the lease deed, which itself will become operative only on default of the lessee, the right acquired

by the lessee under the lease cannot be stated to be not of an enduring nature. In this connection it is also useful to refer to some of the decisions

where the meaning of the term "" enduring benefit "" was considered.

22. The Supreme Court has referred to three of the judgments where this was considered in *Assam Bengal Cement Co. Ltd. v. Commissioner of*

Income Tax. As observed in *Sun Newspapers Ltd. & Associated Newspapers Ltd. v. Federal Commissioner of Taxation*, [1938] 61 C.L.R. 337

when the words " permanent" or " enduring" are used in this connection, it is not meant that the advantage which will be obtained will last for

ever. The distinction which is drawn is that between more or less recurrent expenses involved in running a business and an expenditure for the

benefit of the business as a whole". In *H. J. Rorke Ltd. v. Commissioners of Inland Revenue*, [1960] 1 W.L.R 1132 ; 39 T.C. 194 (Ch.D.) where

the question for consideration was whether the two lump sum payments made by the assessee-company to the owners for the right to enter upon

the land and compensation for diminution in the value of the land respectively in the case, were payments of a capital nature, it was argued on

behalf of the assessee that the payments were not for acquisition of an asset of an enduring nature because it was a mining lease. It was held that

they were of a capital nature. But it would be useful to refer to the argument on behalf of the Crown set out at page 205 :

He says that here what was being acquired by these lump sum payments, or what these payments were helping to acquire, was not stock-in-trade

but rights which would enable the company to obtain stock-in-trade, that is to say, coal. They were not payments for the purchase of coal but

payments to put the company into the position to get coal. Lump sum payments of that character, he says, are necessarily of a capital nature, and

the fact that the leases lasted only for a very short time, that the operations were transient, and that fresh leases were constantly being entered into

and payments of this character constantly being made to farmers or landowners is nihil ad rem.

23. In *Knight (H. M. Inspector of Taxes) v. Calder Grove Estates*, [1954] 35 T.C. 447 the expression "" asset of an enduring nature "" was pressed

into service in the case of an open-cast coal mining lease. It was held therein (at page 453) that,:

That adventure in the nature of things is not likely to continue for more than two or three years, and they prudently arranged for the sale of this

land when the adventure in relation to it comes to an end. No one suggests that the purchase of this is circulating capital or stock-in-trade or

anything of that sort. It is a purchase of land for the adventure, and so, on ordinary principles, the transaction must be regarded as a capital

expenditure, just as when you buy land and put a factory on it, or buy land and sink a shaft. In my judgment, the fact that the adventure is not likely

to continue for many years is quite irrelevant

24. We are, therefore, of opinion that there is no substance in this contention of the assessee.

25. We, accordingly, answer the reference in the negative and against the assessee with costs. Counsel fee Rs 250.