Commissioner of Income-Tax, Mysore

Vs

Mysore Sugar Co. Ltd.

Civil Appeal No. 435 of 1961

(A. K. Sarkar, Raghuvar Dayal, S. K. Das, M. Hidaytullah JJ)

03.05.1962

JUDGMENT

HIDAYATULLAH J. –

This appeal by the Commissioner of Income-tax, Mysore, on a certificate granted under section 66A of the Indian Income-tax Act, is directed against a judgment of the High Court of Mysore dated September 7, 1959, by which the following question referred by the Income-tax Appellate Tribunal, Madras Bench, was answered in favour of the respondent :

> "Whether there are materials for the Tribunal to hold that the sum of Rs. 2,87,422 aforesaid represents a loss of capital ?"

Originally, two questions were referred, but with the second question we are not now concerned. The respondent is a limited liability company called the Mysore Sugar Co. Ltd., in which a very large percentage of shares is owned by the Government of Mysore. We shall refer to the respondent as the assessee company.

The assessee company purchases sugarcane from the sugarcane growers and crushes them in its factory to prepare sugar. As a part of its business operations, it enters into agreements with the sugarcane growers, who are known locally as Oppigedars, and advances them sugarcane seedlings, fertilisers and also cash. The Oppigedars enter into a written agreement called the Oppige, by which they agree to sell sugarcane exclusively to the assessee company at current market rates and to have the advances adjusted towards the price of sugarcane, agreeing to pay interest in the meantime. For this purpose, an account of each Oppigedar is opened by the assessee company. A crop of sugarcane takes about 18 months to mature, and these agreements take place at the harvest season each year, in preparation for the next crop.

In the year 1948-49, due to drought, the assessee company could not work its sugar mills and the Oppigedars could not grow or deliver the sugarcane. The advances made in 1948-49 thus remained unrecovered, because they could only be recovered by the supply of sugarcane to the assessee company. The Mysore Government releasing the hardship appointed a Committee to envisage the matter and to make a report and recommendations. This report was made by the Committee on July 27, 1950, and the whole of the report has been printed in the record of this case. The Oppige bond is not printed, perhaps because it was in Kannada; but the substance of the terms is given by the Committee and the above description fairly represents it nature. The Committee recommended that the assessee company should ex gratia forgo some of its dues, and in the year of account ending June 30, 1952, the company waived its rights in respect of Rs. 2,87,422. The company claimed this

as a deduction under sections 10(2)(xi) and 10(2)(xv) of the Ind

The Appellate Tribunal, however, referred the question for the opinion of the High Court and the High court held that the expenditure was not in the nature of a capital expenditure, and was deductible as a revenue expenditure. It relied upon a passage from Sampath Ayyangar's book on the Indian Income-tax Law and on the decision of this court in Badridas Daga v. Commissioner of Income-tax, to hold that this amount was deductible in computing the profits of the business for the year in question under section 10(1) of the Income-tax Act.

The case has been argued before us both under section 10(1) and section 10(2)(xv), though it appears that the case of the assessee company has changed from section 10(1) to section 10(2)(xi) and section 10(2)(xv) from time to time. The question, as propounded, seems to refer to sections 10(2)(xv) and 10(1) and not to section 10(2)(xi). We, however, do not wish to emphasis the nature of the question posed, because, in our opinion, the central point to decide is whether the money which was given up represented a loss of capital, or must be treated as a revenue expenditure.

The tax under the head "Business" is payable under section 10 of the Income-tax Act. That section provides by sub-section (1) that the tax shall be payable by an assessee under the head "Profits and gains of business, etc." in respect of the profits or gains or any business, etc., carried on by him. Under sub-section (2), these profits or gains are computed after making certain allowances. Clause (xi) allows deduction of bad and doubtful business debts. It provides that when the assessee's accounts in respect of any part of his business are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business is deductible but not exceeding the amount actually written off as irrecoverable in the books of the assessee. Clause (xv) allows any expenditure not included in clauses (i) to (xiv), which is not in the nature of capital expenditure or personal expenses of the assessee, to be deducted, if laid out or expended wholly and exclusively for t

To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt to consider a loss as amounting to a loss of capital. But this is not true of all losses, because loosed in the running of the business cannot be said to be of capital. The questions to consider in this connection are : for what was the money laid out ? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business ? If money be lost in the first circumstance, it is a loss of capital, but if lost in the second circumstance, it is a revenue loss. In the first, it bears the character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses.

This distinction is admirably brought out in some English cases, which were cited at the bar. We shall refer only to three of them. In English Crown Spelter Co. Ltd. v. Baker, the English Crown Spelter Co. carried on the business of zinc smelting for which it required large quantities of "blende". To get supplies of blende, a new company called the Welsh Crown Spelter Company was formed, which received assistance from the English company in the shape of advances on loan. Later, the English company was required to write off Pounds 38,000 odd. The question arose whether the advance could be said to be an investment of capital, because, if they were, the English company would have no right to deduct the amount. If, on the other hand, it was money employed for the business, it could be deducted. Bray J., who considered these questions, observed :

> "If this were an ordinary business transaction of a contract by which the welsh

> Company were to deliver certain blende, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blende, there would be a great deal to be said in favour of the Appellants...It is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered...I can come to no other conclusion but that this was an investment of capital in the Welsh Company, and was not an ordinary trade transaction of an advance against goods..."

The second case, Charles Marsden & Sons Ltd. v. Commissioners of Inland Revenue, is under the excess profits duty in England, and the question arose in the following circumstances : An English company carried on the business of paper making. To arrange for supplies of wood pulp, it entered into an agreement with a Canadian company for supply of 3,000 tons per year between 1917-1927. The English company made an advance of Pounds 3,000 against future deliveries to be recouped at the rate of Pounds 1 per ton delivered. The Canadian company was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the Canadian company (appropriately called the Ha! Ha! Company) neither delivered the pulp nor returned the money. Rowlatt J. held this to be a capital expenditure not admissible as a deduction. He was of opinion that the payment was not an advance payment for goods, observing that no one pays for goods ten years in advance, and that it was a venture to establish a source and money was a

The last case to which we need refer to illustrate the distinction made in such cases is Reid's Brewery Co. Ltd. v. Male. The brewery company there carried on, in addition to the business of a brewery, a business of bankers and money-lenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the brewery company. Certain sums had to be written off and the amount was held to be deductible. Pollock B. said :

> "Of course, if it be capital invested, then it comes within the express provision of the Income-tax Act, that no deduction is to be made on that account."

but held that :

> ".... no person who is acquainted with the habits of business can doubt that this is not capital invested. What it is is this. It is capital used by the Appellants but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders alone, whether it be in the purchase of raw material be they manufacturers, or in the case of money-lenders, be they pawnbrokers or money-lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word."

It was thus held to be use of money in the course of the company's business and not an investment of capital at all.

These cases illustrate the distinction between an expenditure by way of investment and an expenditure in the course of business, which we have described as current expenditure. The first may truly be regarded as on the capital side but not the second. Applying this test to this simple case, it is quite obvious which it is. The amount was an advance against price of one crop. The Oppigedars were to get the assistance not as an investment by the assessee company in its agriculture, but only as an advance payment of price. The amount, so far as the assessee company

was concerned, represented the current expenditure towards the purchase of sugarcane, and it makes no difference that the sugarcane thus purchased was grown by the Oppigedars with the seedlings, fertiliser and money taken on account from the assessee company. In so far as the assessee company was concerned, it was doing no more than making a forward arrangement for the next year's crop and paying an amount in advance out of the price so that the grow

In our judgment, the decision of the High Court is right. The appeal fails and is dismissed with costs.

Appeal dismissed.

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