

Travancore Sugars and Chemicals Ltd.

Vs

Commissioner of Income-Tax, Kerala

Civil Appeal No. 324 of 1965

(J. C. Shah, V. Ramaswami – I, V. Bhargava JJ)

20.09.1966

JUDGMENT

RAMASWAMI, J. -

The appellant is a limited company incorporated under the Travancore Companies Regulation and is carrying on business, in the State of Kerala, of manufacturing sugar, running a distillery and also a tincture factory. The appellant-company was floated with a view to taking over the business assets of a company calls "Travancore Sugars Ltd." (which was being wound up and in which the State Government held the largest number of shares), the Government Distillery at Nagercoil and the business assets of the Government Tincture Factory at Trivandrum. For this purpose an agreement dated June 18, 1937, was entered into between the Government of Travancore and Sir William Wright on behalf of Parry & Co. Ltd., the promoters of the appellant-company. Under the said agreement the assets of all the three concerns were agreed to be sold by the Government of Travancore to the appellant-company. Clause 3 of the agreement provided that the cash consideration for the sale of assets of the Travancore Sugars Ltd

"(7) The Government shall be entitled to twenty per cent of the net profits earned by the company in every year subject however to a maximum of rupees forty thousand per annum, such net profits for the purposes of this clause to be ascertained by deduction of expenditure from gross income and also after -

(i) provision has been made for depreciation at not less than the rates of allowances provided for in the income-tax law for the time being in force, and

(ii) payment of the secretaries and treasurers' remuneration."

By another agreement dated January 28, 1947, the following clause was substituted for the above clause 7 of the original agreement :

"The Government shall be entitled to ten per centum of the net profits of the company in every year. For the purpose of this clause net profits means the amount for which the company's audited profits in any year are assessed to income-tax in the State of Travancore."

For the assessment year 1958-59 (the corresponding previous year being May 1, 1956, to April 30, 1957) the amount payable to the Government under the aforesaid clause 7 came to Rs. 42,480. The Appellate Assistant Commissioner disallowed the claim of the appellant for deduction of this

amount on the ground that it was virtually mere sharing of profits after they came into existence. The Appellate Assistant Commissioner relied upon the decision in Pondicherry Railway Co. Ltd. v. Commissioner of Income-tax in disallowing this item of expenditure. The appellant preferred an appeal against the order of the Appellate Assistant Commissioner to the Income-tax Appellate Tribunal which held that the case came within the principle of the decision in British Sugar Manufacturers Ltd. v. Harris (Inspector of Taxes), and that the payment of commission was an expenditure paid out of earned profits. In the result the Tribunal allowed the appeal by the company. At the instance of the respondent the Tribunal referred the follo

"Whether, on the facts and in the circumstances of the case, the payment of Rs. 42,480 by the assessee to the Travancore Government under the agreements dated June 18, 1937, and January 28, 1947, was allowable under section 10 of the Income-tax Act ?"

By this judgment dated August 20, 1963, the High Court held that the payment of the aforesaid amount constituted capital expenditure and was not allowable under section 10(2) (xv) of the Income-tax Act. In this view the High Court felt it unnecessary to go into the merits of the respondent's contention that the payment represented only a division of profits. The present appeal is brought, by special leave, from the judgment of the High Court of Kerala dated August 20, 1963.

On behalf of the appellant Mr. Asoke Sen submitted that the payment of Rs. 42,480 was not capital expenditure but was expenditure of revenue nature which was allowable under section 10(2) (xv) of the Act. It was pointed out that the annual payments under clause 7 were not part of the purchase price of the assets. Reference was made to clauses 3, 4(a) and 5(a) of the agreement and it was said that separate and full consideration were provided for the purchase of the assets of Travancore Sugars Ltd., the Government Distillery and the Government Tincture Factory. In addition to selling these assets, the Government under took obligations enumerated in clauses 4(b) and (c) and 5(b) already referred to. It was contended that the appellant agreed to make annual payments to the Government in consideration of these obligations. On behalf of the respondent the opposite view-point was presented and it was said that the preamble to the agreement dated January 28, 1947, indicated that the purchase was not merely for the

"WHEREAS on 18th June, 1937, an agreement (hereinafter called the principle agreement), was entered into between M. R. Ry. Rao Bahadur Rajyasevanirata N. Kunjan Pillai Avl., Chief Secretary to the Government acting for and on behalf of the said Government of His Highness the Maharaja of Travancore of the one part and Sir William Wright, Kt., C. B. E., of Messrs. Parry & Co. Ltd., Madras, acting for and on behalf of the said Messrs. Parry & Co. Ltd., of the other part, whereby the said Government should sell and the company should purchase the assets including the lands of the Travancore sugars Ltd., with the buildings, out-houses, machinery and other things attached thereto and more particularly described in the Schedule 'A' annexed to the said principal agreement, the factory known as the Government Distilleries situate at Nagercoil in South Travancore with lands, buildings, machinery and other things attached thereto and more particularly described in the Schedule 'B' annexed to the principal agreement, an

It is often difficult, in any particular case, to decide and determined whether a particular expenditure is in the nature of capital expenditure in the nature of revenue expenditure. It is not easy to distinguish whether an agreement is for the payment of

price stipulated in instalments or for making annual payments in the nature of income. The court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The same which the parties may give to the transaction which is source of the receipt and the characterization of the receipt by them are of little consequence. The court has to ascertain the true nature and character of the transaction from the covenants of the agreement tested in the light of surrounding circumstances. Examining the transaction from this point of view, it is cle

"The true nature of a sum payable to a recipient for purposes such as the present is to be ascertained from all the circumstances relevant to that matter. The true nature of the sum is not necessarily its nature in law, but its nature in business or in accountancy whichever way one likes to put it, because from the legal point of view there may be no difference whatsoever as between the parties between a capital and as income sum. It may be totally irrelevant to the legal relationships into which they are proposing to enter. When, however, the tertius gardens, in the share of the Revenue appears on the scene, that matter which as between the parties may have been a matter of not the slightest importance becomes immediately a matter of very great importance, and it is necessary to examine the circumstances of each individual case, including any documents which require to be construed, in order to ascertain what is the character to be attributed to the payment."

The same view was taken by the Bombay High Court in *Commissioner of Income-tax v. Kolhia Hirdagarh Co. Ltd.* In that case, there was an agreement between the proprietor of a colliery and C by which it was agreed to promote the assessee-company for the purpose of acquiring and carrying on the colliery. The purchase price was fixed at rupees one lakh which was to be discharged by the payment of a sum of Rs. 75,000 in cash and the allotment of fully paid shares of the face value of Rs. 25,000 to the vendor. It was also agreed that the vendor should be paid the minimum annual dividend of four every ton of coal raised from the colliery and if there was any deficit in any year the company would make up such deficit. Under the draft articles of associations of the company the vendor was to get, in respect of the consideration for shares, 500 preference shares of Rs. 50 each and a fixed cumulative preferential dividend equivalent to four annas per ton of coal raised and railed in each year. The vendor approved the dr had no bearing to any specific sum fixed as part of the price for the purchase of the undertaking, it was in the nature of a revenue payment and not a capital payment.

On behalf of the respondent Mr. S. T. Desai referred to the decision of the Judicial Committee in *Minister of National Revenue v. Catherine Spooner*. In that case, the assessee had sold all her right, title and interest in some land which she owned in freehold to a company in consideration of a certain sum in cash, of certain shares in the company and an agreement to deliver to her 10 per cent. of oil produced from the land. The transfer-company, after it had commenced operation, struck oil and raised some of it in the year of account, but did not deliver to the assessee any part of the oil produced. The transfer-company sold the whole of its and paid over 10 per cent. of the gross proceeds to the assessee which she accepted in satisfaction of the royalties reserved to her under the agreement. The question arose whether the amount which the lady received in lieu of the oil was "annual profit or gain from any other source," and the Appellate Court in the Canada held that it was not so, but was a capital receipt

"The property was sold for the certain sum, and in addition the vendor took an annual sum which was dependent upon the value of business done; that is to say, he took something which arose or fell with the chances of the business. When a man does that he takes an income; it is in the nature of income....."

The principle of this case applies to the present case where the facts are closely parallel.

It is not, however, possible for us to finally determine this appeal because the High Court has not dealt with the other questions arising in this reference. Even if the payment of the commission to the Government by the assessee is not capital but revenue payment, certain other question arise for consideration in this case. In the first place, it has to be determined whether the appellant is right in his argument that payment of the commission is tantamount to diversion of profits by a paramount title. In this connection reliance was placed on behalf of the appellant upon the decision in Raja Bejoy Singh Dudhuria v. Commissioner of Income-tax, in which the assessee succeeded to the family ancestral estate on the death of his father. Subsequently his step-mother brought a suit for maintenance against him in which a consent decree was made directing the assessee to make a monthly payment of a fixed sum to his step-mother and declaring that the maintenance was a charge on the ancestral estate in the hands of t

It is necessary that the High Court should consider all these aspects of the case before furnishing an answer to the question of law referred to it. For these reasons we allow this appeal, set aside the judgment of the High Court of Kerala dated August 20, 1963, and remand the case for being reheard and dealt with in accordance with the directions given in this judgment. The parties will bear their own costs up to this stage.

Appeal allowed. Case remanded.

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