V. Jaganmohan Rao and Others

Vs

Commissioner of Income-Tax and Excess Profits Tax, Andhra Pradesh (and vice versa)

Civil Appeals Nos. 893 to 898 and 1381 to 1386 of 1966

(CJI J. C. Shah, V. Ramaswami-I, A. N. Grover JJ)

31.07.1969

JUDGMENT

RAMASWAMY J. -

The assessee, who is the karta of Hindu undivided family, was assessed in that status for the relevant assessment years 1944-45, 1945-46, 1946-47 not only to income-tax but also to excess profits tax. On February 1, 1941, he purchased from Randhi Appalswamy (hereinafter referred to as "the vendor") a spinning mill known as Shri Satyanarayana Spinning Mills, Rajahmundry, for a sum of Rs. 54,731. The purchase was made at a period when there was litigation between the sons of the vendor and the vendor in respect of the spinning mill and other properties. The sons had filed a suit against the father, the vendor, claiming the schedule properties including the mill as joint family properties and for partition of the same. The vendor claimed that the properties were his self-acquired properties of the vendor and dismissed the suit of the plaintiffs. Against the judgment of the District Judge an appeal was filed in the Madras High Court, being A. S. No. 175 of 1938. While the appeal was pending, on Fe

> "R. A. No. 779 which relates to the assessment year 1944-45 :
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> '(1) Whether, on the facts and in the circumstances of the case, in respect of the assessment year 1944-45, the assessment made on the assessee in the status of a Hindu undivided family in respect of Income received by him as receiver could be justified notwithstanding the provisions of section 41 of the Act ?
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> (2) Whether, on the facts and in the circumstances of the case, the assessment of the entire income of Rs. 1,09,613 in the hands of the assessee is valid in the face of the compromise memo dated 7th September, 1945, approved by the court ?
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> (3) Whether, on the facts and in the circumstances of the case, the assessee is entitled to set off Rs. 1,15,000 being the amount paid to the minors for releasing their rights in the property from out of the amount received from the mill ?'"
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> "R. A. No. 780 which relates to assessment year 1945-46 :
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> '(1) Whether, on the facts and in the circumstances of the case, the assessment made under section 34 of the Act is valid in law ?
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> (2) Whether, on the facts and in the circumstances of the case, in respect of the

assessment year 1945-46, the assessment on the assessee in the status of a Hindu undivided family in respect of the income received by him as receiver could be justified notwithstanding the provisions of section 41 of the Act ?

(3) Whether, on the facts and in the circumstances of the case, the assessment of the entire income of Rs. 31,087 in the hands of the assessee is valid in the face of the compromise memo dated 7th September, 1945, approved by the court ?

(4) Whether, on the facts and in the circumstances of the case, the assessee is not entitled to set off Rs. 1,15,000 being the amount paid to the minors for releasing their rights in the property from out of the amount received from the mill ?'."

"R. A. No. 781 which relates to assessment year 1946-47 :

'(1) Whether, on the facts and in the circumstances of the case, in respect of the assessment year 1946-47 the assessment on the assessee in the status of a Hindu undivided family in respect of income received by him as receiver could be justified, notwithstanding the provisions of section 41 of the Act ?

(2) Whether, on the facts and in the circumstances of the case, the assessment of the entire income of Rs. 4,775 in the hands of the assessee is valid in the face of the compromise memo dated 7th September, 1945, approved by the court ?

(3) Whether, on the facts and in the circumstances of the case, the assessee is not entitled to set off Rs. 1,15,000 being the amount paid to the minors for releasing their rights in the property from out of the amount received from the mill ?'."

The Appellate Tribunal pointed out in the statement of the case that question No. 1 in R. A. No. 780 for the assessment year 1945-46 pertained to the earlier assessment year 1944-45 in R. A. No. 779 and also that question No. 2 in R. A. 780 and R. A. No. 779 for the assessment year 1945-46 and the corresponding excess profits tax assessment did not arise in that year but pertained to the earlier assessment year 1944-45 in R. A. No. 779 and the corresponding excess profits tax assessment in R. A. No. 782.

The High Court answered question No. 1 and in R. A. No. 779 and question No. 1 in R. A. No. 780 in the affirmative. The High Court held that reassessment proceedings have been validly initiated under section 34 of the Act. The High Court found that the assessment on the assessee in the status of Hindu undivided family in respect of income received by him as receiver was proper. The High Court thought that the basis of the compromise in the Madras High Court entered into between the assessee and the minor sons of the vendor, Appalaswamy, wherein the assessee paid Rs. 1,15,000 to the minor sons cannot be ignored. The High Court negatived the contention of the income-tax department that the sum of Rs. 1,15,000 was paid to cure a supposed defect in the title and that it was a capital payment. Upon the interpretation of the terms of the compromise the High Court took the view that the amount of Rs. 1,15,000 was paid partly towards acquisition of capital asset and partly towards the discharge of the claim towards

After the Amending Act of 1939 and before the Amending Act of 1948, section 34 stood as follows :

"(1) If in consequence of definite information which has come into his possession the

> Income-tax Officer discovers that income, profits or gains chargeable to income-tax have escaped assessment in any year, or have been under-assessed, or have been assessed at too low a rate, or have seen the subject of excessive relief under this Act, the Income- tax Officer may, in any case in which he has reason to believe that the assessee has concealed the particulars of his income or deliberately furnished inaccurate particulars thereof, at any time within eight years, and in any other case at any time within four years of the end that year, serve on the person liable to pay tax on such income, profits or gins, or in the case of a company, on the principal officer thereof, a notice containing all or any of the requirements which may be included in a notice under sub-section (2) of section 22, and may proceed to assess or reassess such income, profits or gains, and the provision of this Act shall, so far as may be, apply
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> (2) No order of assessment under section 23 or of assessment or reassessment under sub-section (1) of this section shall be made after the expiry, in any case to which clause (c) of sub-section (1) of section 28 applies, of eight years, and in any other case, of four years from the end of the year in which the income, profits or gains were first assessable :...."
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> The first question arising in this case is whether the proceeding under section 34 is legally valid. It was contended by Mr. Narasaraju that the decision of the Privy Council could not be said to be definite information within the meaning of the section. It was said that the Income-tax Officer was fully aware of the circumstances of the case and the assessee and placed all the relevant facts before him, namely, that under the High Court's judgment the vendor was only entitled to one-third share of the income pending the decision of the appeal before the Privy Council. In our opinion there is no justification for this argument. It is not true to say that the assessee brought all the relevant facts before the Income-tax Officer. On the contrary he deliberately suppressed the fact that there was a compromise between himself and the plaintiffs under which he was entitled to the whole of the income from the mill. At any rate the Privy Council's decisions which determined the right of the parties irrespective of t

The second question involved in this case is whether the High Court was right in holding that any portion of the amount of Rs. 1,15,000 was liable to be treated as business expenditure. It is well established that where money is paid to perfect a title or as consideration for getting rid of a defect in the title or a threat of litigation the payment would be capital payment and not revenue payment. What is essential to be seen is whether the amount of Rs. 1,15,000 was paid for bringing into existence a right or asset of an enduring nature. In other words if the asset which is acquired is in its character a capital asset, then any sum paid to acquire it must surely be capital outlay. Money paid in consideration of the acquisition of a source of profit of income is capital expenditure both on principle and authority. In Atherton v. British Insulated and Helsby Cables Ltd. Viscount Cave said :

> "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."

In Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd. Lord Radcliffe observed at page 960 :

> "..... courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income-earning operations. Probably this is an illuminating a line of distinction as the law by itself is likely to achieve....."

It is, however, contended on behalf of the assessee that the amount of Rs. 1,15,000 was paid partly for the acquisition of capital asset and partly to discharge the claim towards profits and hence there should be an apportionment of the amount. It is not possible to accept this contention. It appears from the order of the High Court that the value of the mill was fixed at Rs. 1,15,000 after taking into consideration the fact that the mill was built on a leasehold premises. The value of the machinery was fixed at Rs. 1,36,000 and the leasehold interest was fixed at Rs. 14,000. On this basis the share of the minors as taken to be Rs. 90,000. In respect of the profits the claim of the plaintiffs was taken to be Rs. 85,000. The total claim was therefore Rs. 1,75,000 so that the offer of Rs. 1,15,000 of the release of the claim of the plaintiffs in the mill was held to be fair. The High Court, therefore, certified the compromise to be for the benefit of the minor plaintiffs. In the course of its order dated Septe

> "There are, however, numerous risks which the continuance of the litigation would necessarily involve. The Privy Council might hold that the mill was the self-acquired property of the father, in which case the plaintiffs would get nothing and would incur a liability for costs. It might also be held that, though the property was the family property, the father was entitled as the natural guardian to sell the interest of minor sons in discharge of a binding family obligation. There is the further possibility that by the time the litigation ends the property will have deteriorated and its value will have been materially reduced by the termination of the lease of the land.
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> Taking all these contingencies into consideration we are of opinion that the offer made by the purchaser of Rs. 1,15,000 for the release of the claim, if any, of the two sons in the mill sold to him by their father is a fair offer, the acceptance of which would be beneficial to the minor second plaintiff."

It is true that the High Court took into consideration the income from the mill in testing whether the offer made by the purchase of Rs. 1,15,000 for the release of the claim of the plaintiff was a fair offer. But that does not mean that the sons of Appalaswamy were given as a result of the compromise a share in the profits of the assessee. It is clear from the circumstances of this case that the payment of Rs. 1,15,000 was made by the assessee in order to perfect his title to the capital asset and the assessee is not entitled to set off any portion of the amount as attributable to the lease money. It was a lump sum payment for acquisition of a capital asset and the claim of the plaintiffs for the lease money from the property was merely ancillary or incidental to the claim to the capital asset. In our opinion the High Court was in error in holding that the amount should be apportioned between capital and income. In the result so far as questions Nos. 3 and 4 in R. A. 779, questions Nos. 1 and 2 in R. A. 780

We accordingly allow C. As. Nos. 1381 to 1386 of 1966 to the extent indicated above. C. As. Nos. 893 to 898 of 1966 are dismissed. There will be no order as to costs in either of the two sets of

appeals.

C. As. Nos. 893 to 898 of 1966 dismissed.

C. As. Nos. 1381 to 1386 of 1966 allowed in part.

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