C.I.T., West Bengal II, Calcutta

Vs

Coal Shipment (P) Ltd.

Civil Appeals Nos. 1494-1498 of 1971

(K.S. Hegde, A.N. Grover, H.R. Khanna JJ)

14.10.1971

JUDGMENT

KHANNA, J. -

1. This judgment would dispose of five Civil Appeals Nos. 1494 to 1498 of 1971, by Special Leave filed by the Commissioner of Income-tax, West Bengal, against the judgment of Calcutta High Court whereby the question referred to that court under Section 66(1) of the Indian Income-tax Act, 1922 (hereinafter referred to as the Act), for five assessment years was answered in favour of the assessee-respondent - Coal Shipments (P) Ltd. During the pendency of the appeals, the name of the respondent was changed to Heilgers Investment Ltd.

2. The matter relates to the assessment years 1951-52, 1952-53, 1953-54, 1954-55 and 1955-56, the corresponding accounting years for which ended on March 31, 1951, March 31, 1952, March 31, 1953, March 31, 1954 and March 31, 1955 respectively.

3. The respondent was one of the companies which exported coal from India to Burma before the Second World War. Amongst the other exporters were Messrs. Karamchand Thaper and Brothers Ltd., Messrs. Macheill Barry Ltd., Messrs. Andrew Yule & Co. Ltd. and Messrs. H. V. Low & Co. Ltd. The shipment of coal to Burma Railways before the war was the subject of open tender. After the cessation of hostilities in 1946, it became possible to resume the export of coal to Burma. In order to overcome the difficulties in the conduct of the trade following the war, the members of the coal trade in Bengal formed an association styled Coal Exporters and charters Association. The respondent-company as well as Messrs. H. V. Low & Co. Ltd., were two of the major members of the said association. When Messrs. H. V. Low & Co. Ltd., learnt of the resumption of coal export to Burma by the respondent in 1946, they also expressed intention to export coal to Burma. Thereupon the two companies came to an understanding and arrived at a mutual arrangement or agreement on the following lines :

(i) Messrs. H. V. Low & Co. Ltd., would not export coal to Burma during the subsistence of the agreement.

(ii) Messrs. H. V. Low & Co. Ltd., would assist the respondent in procuring coal for shipment to Burma.

(iii) The respondent would carry on the coal shipping business and pay Messrs. H. V. Low & Co. Ltd., at the rate of Rs. -/5/- per ton (subsequently raised to Rs. 1/5/- per ton) of coal shipped to Burma.

4. According to the respondent, the last shipment of coal under the above arrangement was made in June, 1954, after which the arrangement came to an end automatically and the Government of Burma made some other arrangement for its coal requirement.

5. The assessee-respondent claimed to have made the following payments to Messrs. H. V. Low & Co. Ltd., or their nominees in pursuance of the aforesaid agreement during the period of five accounting years from April 1, 1950, to March 31, 1955 :

Year Rs.1951-52 91,1491952-53 1,77,8981953-54 3,03,6311954-55 2,32,3551955-56 79,917##

The amounts mentioned above were taxed in the hands of Messrs. H. V. Low & Co. Ltd. The respondent claimed the payment of the above amounts as admissible business expenditure for the assessment years in question. The Income-tax Officer held that the expenditures claimed could not be allowed, as there was no written agreement in proof of the alleged arrangement and it was not possible to say that the payments were made for the purpose of the assessee's business. The Income-tax Officer further held that even assuming that the payments were made to keep off Messrs. H. V. Low & Co. Ltd., from the Burma trade, they were payments to secure a monopoly and were not, therefore, allowable as revenue expenditure. The Appellate Assistant Commissioner on appeal upheld the order of the Income-tax Officer.

6. When the matter came up in second appeal before the Income-tax Appellate Tribunal, the Tribunal found that there was some discrepancy in the facts stated on behalf of the assessee and the Revenue. The Tribunal thereupon required the respondent-company to swear an affidavit in support of the facts relied upon by it. In pursuance thereof, Sir Walter Michelmore, Director of Managing Agents of the respondent-company filed an affidavit. Sir Walter was also examined orally before the Tribunal. The case was thereupon remanded to the Income-tax Officer to verify the facts as stated in the affidavit of Sir Walter and report back to the Tribunal. The Income-tax Officer after making further investigation submitted his report. In deciding the appeal, the Tribunal formulated two points for its decision :

(1) Were the payments made for the purpose of the assessee's trade in terms of the alleged agreement?

(2) If the answer to the above question is in the affirmative, did the assessee acquire a monopoly by such payment?

Both the questions were answered in favour of the respondent by the Tribunal. It was held that the payments were made in pursuance of the alleged agreement in the interest of the respondent's trade. The version of the respondent about its agreement with Messrs. H. V. Low & Co. Ltd., was accepted. According to the agreement, Messrs. H. V. Low & Co. Ltd., agreed to assist the respondent in procuring coal for export to Burma whenever asked to do and further agreed not to export coal to Burma during the subsistence of the arrangement. The agreement was found to have been acted upon and it was held that Messrs. H. V. Low & Co. Ltdl., supplied varying quantities of coal to the respondent for shipment to Burma. It was further held that the respondent-company did not acquire any monopoly rights to carry on Burma trade and the impugned payments were made to carry on the trade in a more facile and profitable manner. The Tribunal found that the arrangement arrived at verbally between the respondent and Messrs. H. V. Low & Co. Ltd., was a temporary measure liable to be terminated at will and the respondent-company did not derive any advantage of an enduring character by such payments. The expenditures in question were, in the opinion of the

Tribunal, attributable to revenue and not to capital. As such, they were held to be permissible expenditures under Section 10(2)(xv) of the Act.

7. On application filed by the Revenue, the following question was referred to the High Court :

> "Whether on the facts and in the circumstances of the case, the payments made by the assessee to Messrs. H. V. Low & Co. Ltd., or their nominees were of a capital nature and as such not allowable under Section 10(2)(xv) of the Income-tax Act, 1922?"

It was not disputed before the High Court that there was an agreement between the respondent and Messrs. H. V. Low & Co. Ltd., on terms stated by the respondent and that the payments in question were made under that agreement. The High Court held that the arrangement entered into by the respondent with Messrs. H. V. Low & Co. Ltd., was not such as was likely to have an enduring beneficial effect. In the opinion of the High Court, there was no certainty of duration and the arrangement could be terminated or revoked at any time. The consideration of the arrangement, it was observed, was not paid once for all but was related to uncertain shipments to be made. The arrangement, it was further held, did not create any monopoly or bring about any capital advantage to the assessee. The respondent was held entitled to claim the deduction of the expenditures under Section 10(2)(xv) of the Act. In the result, the question referred to the Court was answered in the negative and in favour of the assessee.

8. We have heard Mr. Desai on behalf of the appellant and Mr. Palkhiwala on behalf of the respondent and are of the opinion that there is no merit in these appeals. The Tribunal has found that the amounts in question were paid by the respondent to Messrs. H. V. Low & Co. Ltd., in pursuance of the agreement according to which Messrs. H. V. Low & Co. Ltd., were to assist the respondent in procuring coal for shipment to Burma and were themselves not to export coal to Burma during the subsistence of the agreement. The above findings of fact are, for the purpose of these proceedings, binding upon the appellant and consequently no attempt was made either in the High Court or in this Court to assail them. The payments which were made by the respondent to Messrs. H. V. Low & Co. Ltd., it would thus appear, were because of the assistance rendered by them for shipment of coal to Burma and for abstaining from exporting coal to Burma during the subsistence of the agreement. So far as the payment is concerned which was made to Messrs. H. V. Low & Co. Ltd., for assistance to the respondent in procuring coal for shipment to Burma, it was admittedly an item of revenue expenditure. The controversy between the parties has centered on the point as to whether that part of the payment which was made because of Messrs. H. V. Low and & Co. Ltd., having agreed not to export coal to Burma during the subsistence of the agreement constituted capital expenditure or revenue expenditure.

9. Mr. Desai on behalf of the appellant contends that as the payment was made for warding off competition by rival coal exporters the payment should be held to be a capital expenditure. The fact that there was no certainty of the duration of the arrangement between the respondent and Messrs. H. V. Low & Co. Ltd., and the same could be terminated at any time, according to the learned counsel, is wholly immaterial. As against that, Mr. Palkhiwala argues that in order to constitute capital expenditure, the object of the expenditure should be to secure an advantage of enduring nature. When there is no certainty of the duration of the arrangement and the same can be revoked at any time, the advantage cannot be said to be of an enduring character and the expenditure cannot be held to be of a capital nature. Further as the payment was related to the quantum of coal shipped to Burma in the course of trading activity and was not connected with the capital value of the assets, the payment, Mr. Palkhiwala submits, should be considered to be revenue expenditure. In our

opinion, there is considerable force in Mr. Palkhiwala's submission.

10. Judicial decisions have, from time to time, laid down some broad principles in order to determine whether an expenditure is of a capital nature or revenue nature. Despite the enunciation of those principles, it is not always easy to decide the question in the context of the circumstances of an individual case. Considerable difficulty is experienced in border line cases. It was in this connection that Hidayatullah, J., (as he then was) observed in Abdul Kayoom v. Commissioner of Income-tax, (44 ITR 689.) that "none of the tests (laid down in various authorities) is either exhaustive or universal. Each case must depend on its own facts, and a close similarity between one case and another is not enough because even a single significant detail may alter the entire aspect. In deciding such cases, one should avoid the temptation to decide cases..... by matching the colour of the one case against the colour of another".

11. It may be apposite at this stage to refer to some of the broad tests which have been laid down to distinguish the capital expenditure from revenue expenditure. In the case of Atherton v. British Insulated and Helsby Cables Ltd., (10 TC 155.) Lord Cave, L. C., laid down the following criterion which has been referred to in most of the subsequent cases :

> "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."

The Courts have to bear in mind, according to the dictum laid down in the above case, whether it was an expenditure forming "part of the cost of the income-earning machine or structure" as opposed to part of "the cost of performing the income earning operations". In that case, the House of Lords dealt with a fund which had been created by the respondent-company as a nucleus of a pension fund for its employees. After handing over the money to trustees for the employees, the company claimed that the money should be charged to revenue. The claim of the company was rejected by the House of Lords on the ground that the payment of money created for itself an enduring benefit or advantage which was of a capital nature.

12. In the case of Robert Addie and Sons' Collieries Limited v. The Commissioners of Inland Revenue, (8 TC 671.) Lord President Clyde gave the following test :

> "It is necessary accordingly to attend to the true nature of the expenditure, and to ask one's self the question, is it a part of the Company's working expenses? - is it expenditure laid out as part of the process of profit earning? - or, on the other hand, is it a capital outlay? - is it expenditure necessary for the acquisition of property or of rights of a permanent character, the process of which is a condition of carrying on its trade at all?

13. The expression 'once and for all' used in the dictum laid down in Atherton's case (supra) was referred to by Bhagwati, J., speaking for this Court in the case of Assam Bengal Cement Co. Ltd., v. Commissioner of Income-tax, West Bengal, (27 ITR 34.) and it was observed that the expression was used to denote an expenditure which is made once and for all for procuring an enduring benefit to the business as distinguished from a recurring expenditure in the nature of operational expenses. The character of the payment can be determined, it was added, by looking at what is the true nature

of the asset which has been acquired and not by the fact whether it is a payment in a lump-sum or by instalments. It is also an accepted proposition that the words 'permanent' and 'enduring' are only relative terms and not synonymous with perpetual or ever-lasting.

14. There are some other tests like those of fixed capital and circulating capital for determining the nature of the expenditure. An item of disbursement can be regarded as capital expenditure when it is referable to fixed capital. It is revenue when it can be attributed to circulating capital. It is not the case of any part that this test of fixed and circulating capital can be invoked in this case nor has reference been made to some of the other tests. The case which has been set up on behalf of the revenue is that as the object of making the payments in question was to eliminate competition of a rival exporter, the benefit which enured to the respondent was of an enduring nature and, as such, the payment should be treated as capital expenditure. We find ourselves unable to accede to this contention because we find that the arrangement between the respondent and Messrs. H. V. Low & Co. Ltd., was not for any fixed term but could be terminated at any time at the volition of any of the parties. Although an enduring benefit need not be of an everlasting character, it should not, at the same time, be so transitory and ephemeral that it can be terminated at any time at the volition of any of the parties. Any other view would have the effect of rendering the word 'enduring' to be meaningless. No cogent ground or valid reason has been given to us in support of the contention that even though the benefit from the arrangement to the respondent may not be of a permanent or enduring nature, the payments made in pursuance of that arrangement would still be capital expenditure. Such a contention indeed was repelled by the Judicial Committee in the case of Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd. (58 ITR 241.) The respondent-company in that case together with two other companies - Rhokana Corporation Ltd., and Bancroft Mines Ltd., formed a group for carrying on the business of copper mining. Following a steep fall in the price of copper in the world market the group, in common with other producers, decided voluntarily to cut their production by 10 per cent. In effecting the cut, it was agreed that Bancroft Mines Ltd., should cease production for one year and that the respondent-company and Rhokana Corporation Ltd., should undertake between them the whole group programme for the year reduced by the overall cut of 10 per cent. It was further agreed to pay a sum to Bancroft Mines Ltd., to compensate it for the abandonment of the production for the year. Question arose whether the compensation which the respondent-company had paid to Bancroft Mines Ltd., was expenditure of capital nature? The Judicial Committee held that the compensation paid was an allowable deduction in determining the respondent company's taxable income. The expenditure, in the view of the Judicial Committee, had no analogy with expenditure for the purpose of acquiring a business or a benefit of long term or enduring contract. Viscount Radcliffe who delivered the judgment while dealing with the question of expenditure observed :

> "It bought one right only, the right to have Bancroft out of production for 12 months. While, no doubt, money paid to acquire a business or to shut a business down for good or to acquire some contractual right to last for years may well be capital expenditure, it seems a contradiction in terms to speak of what Nchanga thus acquired, which exhausted itself and was created to exhaust itself within the 12 months' period within which profits are ascertained, as constituting an enduring benefit or as an accretion to the capital or income-earning structure of the business. If the expenditure is to be treated as capital expenditure at all, it cannot be for any reason such as that."

Although we agree that payment made to ward off compensation in business to a rival dealer would constitute capital expenditure if the object of making that payment is to derive an advantage by

eliminating the competition over some length of time, the same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any time. How long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and the facts of each individual case.

15. In the case of Assam Bengal Cement Co. Ltd., case (supra), the appellant-company acquired from the Government of Assam a lease of certain lime-stone quarries for a period of twenty years for the purpose of carrying on the manufacture of cement. In addition to the rent and royalities, the appellant agreed to pay the lessor annually a sum of Rs. 5,000/- during the whole period of the lease as a protection fee and in consideration of that payment the lessor undertook not to grant to any person any lease, permit or prospecting licence for lime-stone in a group of quarries without a condition that no lime-stone should be used for the manufacture of cement. The appellant also agreed to pay Rs. 35,000/- annually for five years as a further protection fee and the lessor in consideration of that payment gave a similar undertaking in respect of the whole district. It was held by this Court that as a result of the annual payment of the amounts of Rs. 5,000/- and Rs. 35,000/-, there enured an advantage to the appellant for the whole period of the lease and as such it was capital expenditure.

16. Apart from the above, we find that the payments made to Messrs. H. V. Low & Co. Ltd., were related to the actual shipment of coal in the course of the trading activities of the respondent and had no relation to the capital value of the assets. The payments were not related to or tied up in any way to any fixed sum agreed between the parties. The dictum laid down by this Court in Travancore Sugars and Chemical Ltd., v. Commissioner of Income-tax, Kerala, (62 ITR 566.) in the circumstances it attracted. The appellant-company in that case was to take over the assets of sugar manufacturing concern, a distillery and a tincture factory of the Government of Travancore. The promoters of the appellant-company in that connection entered into an agreement with the Government. The cash consideration for the sale of the assets of the sugar manufacturing concern was Rs. 3.25 lakhs, that for the sale of the distillery was agreed to be arrived at as a result of joint valuation and that for the sale of the assets of the tincture factory was the book value. The Government agreed to recognise the transfer of the licence for the distillery to the appellant-company and to secure the continuance of the licence for a period of 5 years after the termination of the existing licence. The Government also agreed to purchase the pharmaceutical products manufactured by the appellant-company. Apart from the cash consideration, Clause 7 of the agreement provided that the Government would be entitled to 20 per cent. of the annual net profits subject to a maximum of Rs. 40,000/- after providing for depreciation and remuneration of the secretaries and treasurers. Clause 7 was amended in January, 1947, to the effect that the Government would be entitled to 10 per cent. of the annual net profits. Question arose whether an amount of Rs. 42,480/- which was payable under Clause 7 of the agreement was a permissible expenditure under Section 10 of the Income-tax Act. It was held that the above payment was in the nature of revenue expenditure and not capital expenditure. Ramaswami, J., speaking for the Court dealt with the matter in the following words :

> "Examining the transaction from this point of view, it is clear in the present case that the consideration for the sale of the three undertakings in favour of the appellant was : (1) the cash consideration mentioned in the principal agreement, viz., Clauses 3, 4(a) and 5(a) and (2) the consideration that Government shall be entitled to twenty per cent. of the net profits earned by the appellant in every year subject to a maximum of Rs. 40,000/- per annum. With regard to the second part of the consideration there are three important points to be noticed. In the first place, the

> payment of commission of twenty per cent. on the net profits by the appellant in favour of the Government is for an indefinite period and has no limitation of time attached to it. In the second place, the payment of the commission is related to the annual profits which flow from the trading activities of the appellant-company and the payment has no relation to the capital value of the assets. In the third place, the annual payment of 20 per cent. commission every year is not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings. There is no reference to any capital sum in this part of the agreement. On the contrary, the very nature of the payments excludes the idea that any connection with the capital sum was intended by the parties."

The above observations, in our opinion, have a direct bearing on the present case.

17. Mr. Desai has referred to the following observations of Lord Greens in Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd. (11 ITR 10.):

> "It appears to me that there can be no difference in principle between a payment out-and-out for monopoly value and a payment in respect of a term. Each licence granted for term must stand by itself since an application for its renewal falls to be treated as an application for a new licence. This is what I mean when I say that there is a false appearance of periodicity about these payments. Whenever a licence is granted for a term, the payment is made as on a purchase of a monopoly for that term. When a licence is granted for a subsequent term, the monopoly value must be paid in respect of that term, and so on. The payments are recurrent if the licence is renewed; they are not periodical, so as to give them the quality of payments which ought to be debited to revenue account. The thing that is paid for is of a permanent quality, although its permanence, being conditioned by the length of the term, is short-lived. A payment of this character appears to me to fall into the same class as the payment of a premium on the grant of a lease which is admittedly not deductible."

18. Particular reliance has been placed by Mr. Desai upon the concluding part of the above observations. The portion relied upon, in our opinion, has to be read in the context of the preceding lines and the facts of that case. The lessees of the licenced premises in that case, under a covenant in their lease, paid annually certain sums imposed by the licensing justices as instalments of the monopoly on the grant and renewal of the licence for three years, period. It was contended that those sums were not capital payments but should be regarded as revenue payments. It was held that monopoly value payments were imposed for the term of the licence on grant or renewal though the fact that permission was given to pay by yearly instalments gave a false appearance of periodicity. Such payments, in the opinion of the Court, fell into the same class as a premium paid on the grant of a lease and as such should be regarded as of capital nature. It is obvious that the question involved in that case was different and the appellant can derive no assistance from it.

19. The appeals consequently fail and are dismissed with costs. One set of costs.

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