

M. K. Brothers Private Ltd.

Vs

Commissioner of Income-Tax, Kanpur.

Civil Appeal No. 342 of 1969

(H. R. Khanna, K. S. Hedge, P. Jagmohan Reddy JJ)

29.08.1972

JUDGMENT

KHANNA J. -

1. This appeal on certificate granted by the Allahabad High Court is directed against the judgment of that court whereby it answered the following two questions referred to it under section 66(1) of the Indian Income-tax Act, 1922 (hereinafter referred to as "the Act"), against the appellant and in favour of the revenue :

"(1) Whether, on the facts and on a true and proper interpretation of the agreement dated July 31, 1956, between the British India Corporation and the appellant company, the letter of Sri Kailash Nath Agarwal, the letters of managing directors, the sum of Rs. 43,333 retained by the British India Corporation and adjusted by it to the credit of Sharma & Co. was the assessable income of the appellant company ?

(2) Whether, on the facts and circumstances of the case, the sum of Rs. 43,333 represented an expenditure under section 10 ?"

The matter relates to the assessment year 1956-57. The appellant is a private limited company and Kailash Nath Agarwal is one of its directors. As per agreement dated July 31, 1956, the appellant was appointed with effect from April 1, 1955, the sole selling agent of the Kanpur Cotton Mills for the sale of yarn and cloth manufactured by the said mills. The Kanpur Cotton Mills is owned by the British India Corporation (hereinafter referred to as BIC). Prior to the appellant's appointment Sharma & Co., a partnership firm, was functioning as the sole selling agent of the Kanpur Cotton Mills. The amount due by Sharma & Co. to the Kanpur Cotton Mills as on March 21, 1955, was Rs. 8,39,350-15-6 inclusive of interest. On March 23, 1955, a letter was addressed on behalf of Sharma & Co. to the managing director of BIC stating that an agreement had been entered into with Kailash Nath Agarwal whereby Sharma & Co. had agreed to give up the sole selling agency of the Kanpur Cotton Mills. The managing director of BIC was requested to appoint Kailash Nath Agarwal or any firm or company formed by him for his for this purpose as the sole selling agent in place of Sharma & Co. Reference was also made in that letter to an agreement between Sharma & Co. and Kailash Nath Agarwal in the following words :

"As you will notice from the agreement with Sri Kailash Nath Agarwal we are entitled to receive one-seventh of the commission due to the new selling agency or to a sum of Rs. 50,000 per annum, whichever is greater, till your dues with interest are fully liquidated. We do hereby authorise you to retain this amount thus becoming due

to us out of the commission payable to the agency and adjust the same to our firm's account with the Corporation."

On the same day, i.e., March 23, 1955, Kailash Nath Agarwal addressed a letter to the managing director of BIC informing him of the agreement with Sharma & Co. and requesting for the grant of sole selling agency to the appellant. The letter concluded as follows :

"I hereby authorise you in case you are pleased to grant your sole selling agency to my said firm to retain one-seventh of our commission for adjustment in the account of M/s. Sharma & Co. with minimum of Rs. 50,000 per annum till your dues against them are cleared with interest."

The managing director of BIC later on that day, i.e., March 23, 1955, addressed a letter to Sharma & Co., accepting its resignation from the sole selling agency of the Knapur Cotton Mills and about the appointment of Kailash Nath Agarwal or his nominee as the sole selling agent in succession to Sharma & Co. In regard to the liquidation of dues from Sharma & Co. the managing director of BIC wrote :

"As agreed between Shri Kailash Nath Agarwal and yourselves we shall deduct one-seventh of the commission or Rs. 50,000 whichever is greater out of the commission earned by the new sole selling agents and credit the same to your account with us till our dues against you standing today at Rs. 8,39,350-15-6 are completely liquidated with interest thereon at 6%."

On July 31, 1956, an indenture was executed by BIC and the appellant relating to the appointment of the appellant as the sole selling agent of the Kanpur Cotton Mills for the sale of yarn, cloth and cotton manufactured with effect from April 1, 1955. In this indenture the appellant ratified the agreement entered into by Kailash Nath Agarwal with Sharma & Co. on March 23, 1955, and authorised BIC "to give effect to the said agreement generally and in particular to retain an amount equal to one-seventh of the trade discount of 1 3/4% due to the sole selling agents with a minimum of Rs. 50,000 per annum so that the amount payable to the sole selling agents shall be the amount payable at the rate of 1 3/4% minus the aforesaid amount retained by the corporation as payable to M/s. Sharma & Co." Clauses 12 and 13 of the indenture were as under :

"Clause 12. That in the event of the desolation of M/s Sharma & Co., before the complete repayment of their liability, the sole selling agents agree that the corporation may continue to retain an amount equal to one-seventh of the trade discount of 1 1/3% or Rs. 50,000 whichever is greater and adjust it towards such dues of M/s. Sharma & Co. as may then be outstanding.

Clause 13. That the authority given above to the corporation to retain and adjust a part of the trade discount towards the outstanding against M/s. Sharma & Co. will not be revocable and will be binding on the sole selling agents, their successor, or assigns only so long as they act as the corporation's sole selling agency has been granted to the agents. The agents will have no claim whatsoever to any such amounts retained out of their normal trade discount and adjusted in the account of M/s. Sharma & Co., as if the amount so retained was not payable to them."

During the year under reference, the commission as per terms of the indenture dated July 31, 1956,

payable to the appellant amounted to Rs. 43,333 were retained by BIC under the contract for adjustment against the outstanding dues of Sharma & Co., in accordance with the terms of the indenture. In its statement of account the appellant credited the full amount of commission of Rs. 2,06,283 to its profit and loss account. The sum of Rs. 43,333 was, however, shown as a deduction therefrom. During the assessment proceedings, the Income-tax Officer disallowed the above deduction. The order of the Income-tax Officer in this respect was upheld by the Appellate Assistant Commissioner in appeal as well as by the Income-tax Appellate Tribunal in second appeal. On application filed by the appellant, the Tribunal referred the question reproduced earlier to the High Court. The High Court, as stated above, answered the two questions against the appellant.

In appeal Mr. Maheshwari on behalf of the appellant has argued that the amount of Rs. 43,333 was a permissible deduction and the High Court was in error in deciding this matter against the appellant. There is, in our opinion, no force in this contention and we agree with Mr. Ramachandran, learned counsel for the respondent, that the judgment of the High Court should be upheld. It would appear from the resume of facts given above that in March, 1955, an amount of Rs. 8,39,350-15-6 was due to BIC from the firm, Sharma & Co. who was the previous sole selling agent of the Kanpur Cotton Mills. As a result of agreement between the appellant BIC and Sharma & Co., in lieu of being appointed the sole selling agent of the Kanpur Cotton Mills in place of Sharma & Co. It can, therefore, be said that the appellant got the sole selling agency of the Kanpur Cotton Mills in consideration of its agreeing to pay Rs. 8,39,350-15-6 which was the amount due from Sharma & Co. to BIC. It is not disputed by Mr. Maheshwari that if the amount of Rs. 8,39,350-15-6 had been paid by the appellant in lump sum in consideration of its being appointed the sole selling agent of the Kanpur Cotton Mills, the payment would have constituted capital expenditure as it was an amount paid for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business. The fact that the amount was paid not in lump sum but was paid in installments through deductions out of the commission due to the appellant would not, in our opinion, make any difference. The answer to the question as to whether the money paid is a revenue expenditure or capital expenditure depends not so much upon the fact as to whether the amount paid is large or small or whether it has been paid in lump sum or by instalments, as it does upon the purpose for which the payment has been made and expenditure incurred. It is the real nature and quality of the payment and not the quantum or the manner of the payment which would prove decisive. If the object of making the payment is to acquire a capital asset, the payment would partake of the character of a capital payment even though it is made not in lump sum but by installments over a period of time. On the contrary, payment made in the course of and for the purpose of carrying on business or trading activity would be revenue expenditure even though the payment is of a large amount and has not to be made periodically. As observed by this court in the case of Assam Bengal Cement Co. Ltd. v. Commissioner of Income-tax, 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 purposes 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. We may also in this connection refer to the following observations of this court in the case of P. H. Divecha v. Commissioner of Income-tax :

"It may also be stated as a general rule that the fact the amount involved was large or that it was periodic in character have no decisive bearing upon the matter. A payment may even be described as 'pay' 'remuneration', etc., but that does not determine its quality, though the name by which it has been called may be relevant in determining its true nature, because this gives an indication of how the person who paid the money and the person who received it viewed it in the first instance. The periodicity of the payment does not make the payment a retiring income because periodicity may be the result of convenience and not necessarily the result of the establishment of a source expected to be productive over a certain period. These general principles have been settled firmly by this court in a large number of cases."

Although the above observations were made in the context of periodic receipts, they have a direct bearing even on cases relating to periodic payments.

Mr. Maheshwari has referred to clause 13 of the indenture reproduced above and has contended that the appellant could make no claim to the amount of Rs. 43,333 which had been retained by BIC. This fact, in our opinion, would make no material difference so far as the true nature of that amount was concerned. The amount was deducted by BIC in pursuance of the agreement entered into by the appellant with BIC and Sharma & Co., according to which the appellant had to pay that amount in the form of deduction out of its commission in consideration of being appointed the sole selling agent of the Kanpur Cotton Mills. The present is a case relating to the application of income to discharge a liability incurred not in the course of running the business but a liability under taken for the purpose of acquiring the sole selling agency right which was indisputably an asset of capital nature.

The appeal consequently fails and is dismissed with costs.

Appeal dismissed.

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