Commissioner of Income-Tax, Madras.

Vs

Ashok Leyland Ltd.

Civil Appeal No. 1989 of 1969

(K. S. Hegde, P. Jagmohan Reddy, I. D. Dua JJ)

03.10.1972

JUDGMENT

HEGDE J. -

1. The Commissioner of Income-tax, Madras, is appealing against the decision of the Madras High Court in a reference under section 66(2) of the Indian Income-tax Act, 1922 (to be hereinafter referred to as the Act), after obtaining certificate of fitness from the High Court.

The question before the authorities under the Act was whether the payment of Rs. 2,50,000 made by the respondent-assessee, which will hereinafter be referred to as the "company" for the termination of managing agency is an allowable deduction in computing the total income of the company for 1956-57. The Income-tax Officer as well as the Appellate Assistant Commissioner rejected the claim of the company that it was a revenue expenditure but the Tribunal in appeal upheld the contention of the company. Aggrieved by the decision of the Tribunal, the Commissioner demanded a case to be stated for obtaining the opinion of the High Court on the question :

> "Whether, on the facts and in the circumstances of the case, the payment of Rs. 2,50,000 made for the termination of managing agency is an allowable deduction in computing the total income of the assessee- company for 1956-57 ?"

The Tribunal refused to state the case taking the view that its findings are findings of fact. Thereafter, the Commissioner moved the High Court under section 66(2) and at the instance of the High Court, the Tribunal stated the case and submitted the aforementioned question of law to the High Court. But, the High Court answered that question in the affirmative and in favour of the company.

Let us now have a look at the facts. The assessee was a public limited company, originally known as Ashok Motors Ltd. It was incorporated on September 7, 1948. The articles of association of the company authorised it to carry on various businesses, such as manufacturers, assemblers, dealers, hirers, repairers of motor cars, motor-cycles, motor-buses, lorries, trucks, etc. In particular it authorised the company "to import into India Austin cars and other Austin products, to assemble Austin products from their components, to undertake the progressive manufacture in Indian, of such parts of Austin products as can under suitable provisions for such manufacture be manufactured thereto, supply Austin products and parts to accredited distributors for resale to the public in India and to provide adequate facilities for the prompt servicing of Austin products in India."

The Company appointed Car Builders Ltd. as their managing agents under an agreement dated

October 18, 1948, for a term of 14 years from the date of its registration. The managing agents were to be paid at the rate of Rs. 2,000 per mensem as office allowance and 10 per cent. of the annual profits with a minimum of Rs. 18,000 per annum in case of inadequacy or absence of profits.

Initially the business of the company consisted in the assembly and sale of Austin cars and Leyland Trucks. During the year 1952, the Government of India referred the question of establishing an automobile industry in India to the Tariff Commission. The company prepared and submitted a comprehensive memorandum to the Tariff Commission for the manufacture of Leyland trucks. It also participated in the proceedings of the Tariff Commission. The Government instructed the company to take up the manufacture of Leyland commercial vehicles. From April, 1954, the company ceased to assemble Austin cars in view of the government decision and engaged itself in the manufacture of Leyland commercial vehicles. The progress of the scheme was reviewed by all the directors on January 24, 1955. when the Union Minister for Commerce and Industry was also present. In the course of the discussion, the Union Minister suggested to the company to invite Leylands to provide capital as and when required till their holding bore to the existing paid up capital in the ratio of 40/45 to 50/55 per cent. Subject to a maximum of half a million pounds. The company was asked to raise the remaining capital in India. The Minister is stated to have assured that the Government would arrange for the required capital in India but that responsibility would be in the nature of contingent liability and that responsibility would be in the nature of contingent liability and that it would accept such a liability only if the managing agency is abolished. The directors pointed out to the Minister that they had already taken steps to terminate the services of the managing agents on payment of compensation.

On January 29, 1955, by means of an agreement between the company and the managing agents, the managing agency agreement was terminated subject to the condition that the managing agents were to be paid compensation in a sum of Rs. 2,50,000. The company paid the said sum during the accounting year ended on December 31, 1955, relevant to the assessment year 1956-57. The company claimed deduction of the same in its assessment as revenue expenditure laid out wholly and exclusively for the purpose of the business in the relevant previous year. It may also be mentioned that at about this time the company entered into an agreement with Leyland Motors Ltd., Leyland U. K. for participation of the said concern with the company for implementing its manufacturing programme.

On the aforementioned fats, the question arises whether the compensation paid to the managing agents can be considered as an expenditure wholly or exclusively laid out for the purpose of the business or whether the same should be considered as a capital expense.

There are numerous decisions of this court, of the High Courts in this country as well as of the courts in England dealing with the controversy whether an item of expenditure should be considered as a capital expenditure or revenue expenditure.

The Act has not defined the expressions "capital expenditure" and "revenue expenditure". The line that divides revenue expenditure from capital expenditure is oftentimes very thin. Hence, the decisions of courts have not been able to give a quietus to the controversy whether an item of expenditure is capital or revenue. The general tests to be applied to distinguish capital expenditure from revenue expenditure have been enunciated in various decisions. There is no difficulty in enumerating those tests. But the difficulty arises when the courts are called upon to apply those tests to a given set of facts. Barring rare exceptions, the facts of no two cases are similar.

A long line of decisions have laid down that when an expenditure is made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

It was urged on behalf of the revenue that the termination of the managing agency has led to reorientation of the business of the company. That termination facilitated the company to enter into collaboration with Leylands. It also made it possible for the company to get financial assistance from the Government if there be need. It was also urged that the compensation was paid at the behest of the Government and was for a non-business purpose. Under these circumstances, it was said that the expenditure cannot be considered as having been incurred to meet any commercial expediency. The learned counsel for the company joined issue on each one of those contentions. He contended that because of the Government policy the company had to give up its assembling activity and take to manufacture of Leyland trucks. For that purpose it sought and obtained the collaboration of Leylands. In view of the change in the business activity of the company, continuance of the managing agency became superfluous. Its continuance meant unnecessary business expenditure for the company. Hence commercial expediency required the company to terminate the services of the managing agents and the managing agents could be got rid of only by paying reasonable compensation. The Tribunal found that the company terminated the services of the managing agents on business considerations. It accepted the plea of the company that, in view of the change in its business activity, the continuance of the managing agents became superfluous. These are findings of act which are not open to question before this court.

There is no doubt that, as a result of the termination of the services of the managing agents, the company got rid of its liability to pay office allowance as well as the commission it was required to pay under the managing agency agreement not only during the accounting year but also for a few years more. The expenditure thus saved undoubtedly swelled the profits of the company. From the facts found, it is clear that the managing agency was terminated on business considerations and as a matter of commercial expediency. There is no basis for holding that by terminating the managing agency, the company acquired any enduring benefit or any income yielding asset. It is true that by terminating the services of the managing agents, the company not only saved the expense that it would have had to incur in the relevant previous year but also for few more years to come. It will not be correct to say that by avoiding certain business expenditure, the company can be said to have acquired enduring benefits or acquired any income yielding asset.

To quote the illustration given by Rowlatt J. in B. W. Noble Ltd. v. Mitchell, in the ordinary case a payment to get rid of a servant when it is not expedient to keep him in the interest of trade would be a deductible expenditure. A payment, made to remove the possibility of a recurring disadvantage cannot be considered as a payment made to acquire an enduring advantage.

In Noble's case, Rowlatt J. had to examine the question whether the item of expenditure concerned in that case was a revenue expenditure. Briefly stated the facts of that case were : Under its articles of association the management of a company of insurance brokers registered in England was vested in its board of directors in London, with powers of delegation. One of the directors was appointed resident director in France. He conducted the French business of the company from an office in Paris under a power of attorney from the company. The company claimed as a deduction from its profits for income-tax purposes a sum 19,200 (in Pounds) payable (by instalments) to a retiring director in the following circumstances : The original directors were appointed for life so long as they held a qualifying number of shares, subject to dismissal forthwith for neglect or misconduct

towards the company. A director so dismissed was only entitled to receive his salary then due and could be required to sell his shares to the other directors at par. He would also have to surrender for cancellation certain notes issued by the company entitling him to participate in surplus profits. Circumstances arose in 1920 and 1921 in which the company might possibly have been justified in dismissing one of the directors, but to avoid publicity injurious to the company's reputation, it entered into negotiation with the director for his retirement. He claimed 50,000 (in Pounds) as compensation; but a compromise was arrived at and embodied in an agreement dated the 30th December, 1921, by which he agreed to retire from the company, to transfer his 300 (in Pounds) 1 shares to the other directors at par value (they were then worth considerably more) and to surrender his participating notes. The company agreed to pay him 19,200 (in Pounds) and the directors to pay him 300 (in Pounds) (as consideration for his shares) making together 19,500 (in Pounds) (payable in five annual instalments) which he agreed to accept in full satisfaction of all claims against the company or the directors. The question was whether the payment of 19,200 (in Pounds) was a deductible expenditure. The Special Commissioners decided against the company but the King's Bench Division as well as the Court of Appeal accepted the company's contention and held that the payment of pound 19,200 made was an admissible deduction in arriving at its profits for income-tax purposes. In the course of his judgment Rowlatt. J. sitting on the King's Bench Division, relied on the observations of the Lord Chancellor in Atherton v. British Insulated and Helsby Cables Ltd. to the effect :

> "'a sum of money expended, not of necessity and with a view to a direct and immediate benefit to the trade, but voluntarily and on the grounds of commercial expediency, and in order indirectly to facilitate the carrying on of the business. may yet be expended wholly and exclusively for the purpose of the trade.'"

These observation of the Lord Chancellor were again quoted with approval by Lord Hanworth M. R. when the matter was taken in appeal to the Court of Appeal.

The next case which may be usefully referred to is the decision in Anglo-Persian Oil Co. Ltd., v, Dale. Therein the assessee-company by agreement made in 1910 and 1914 had appointed another limited company as its agents in Persia and the East for a period of years, upon the terms (inter alia) that the agents should be remunerated by commission at specified rates. With the passage of time the amounts payable to the agents by way of commission increased far beyond the amounts originally contemplated by the company, and after negotiations between the parties, the agreements were cancelled in 1922, the agent company agreeing to go into voluntary liquidation and the company agreeing to pay to the agents pound 300,000 in cash. This sum was in fact paid and the company contended before the Special Commissioner that it was an admissible deduction in computing the company's profits for purposes of income-tax and corporation profits tax. The Special Commissioners rejected this contention and the company appealed. Rowlatt J., sitting in the King's Bench Division, allowed the appeal held that the payment to the agents was an admissible deduction for the purpose of income- tax and corporation profits tax. His decision was affirmed by the Court of Appeal. In the course of his judgment Rowlatt J. observed :

> "Now I want to see how the Commissioner have dealt with it, and what they say is that this was expenditure of a capital nature to secure an enduring benefit for the company's trade by getting rid of an onerous contract. In my judgment that is a finding which is perfectly inconclusive. It does not deal with the question. The question is not merely getting rid of an onerous contract, but an onerous contract for what ? If it is an onerous contract for the payment of wages or commission which are

> chargeable to revenue account in the plainest possible way, and if that is the onerous contract that you are getting rid of, it is impossible to suggest that that is a reason for saying that this is a capital expenditure unless you get rid of that onerous contract (as I pointed out just now) by erecting in its place a capital assets in the nature of - of course I am only using this as an illustrative example - a labour-saving machine which gives you an asset and so dispenses with the expenses of labour. But to say that it is a capital expenditure because it secured an enduring benefit by getting rid of an onerous contract is not to state the material thing, and it is completely inconclusive."

In G. Scammell & Nephew Ltd. v. Rowles, the Court of Appeal held that the expenditure incurred for the termination of a trading relationship in order to avoid losses occurring in the future through that relationship, whether pecuniary losses or commercial inconveniences, is just as much for the purposes of the trade as the making or the carrying into effect of a trading agreement.

The case which can be said to be the nearest to the facts of the present case decided by any Indian court is that decided by the Calcutta High Court in Anglo-Persian Oil Co. (India) Ltd. v. Commissioner of Income-tax. Therein, money was paid by an oil company in a lump sum as compensation for loss of agency whereby the company relived itself of future annual payments of commission chargeable to revenue account. The question was whether the money paid as compensation was allowable as proper deduction from the business profits of the company. The court upheld the contention of the company that it was a revenue expenditure. Further, the court observed that the principle that capital receipt spells capital expenditure or vice versa is simple but it is not necessarily sound. Whether a sum is received on capital or revenue account depends or may depend upon the character of the business of the recipient. Whether a payment is or is not in the nature of capital expenditure depends or may depend upon the character of the business of the payer and upon other factors related thereto.

It is obvious from the facts set out earlier that the compensation paid for termination of the services of the managing agents was a payment made with a view to save business expenditure in the relevant accounting year as well as for a few more years. It was not made for acquiring any enduring benefit or income-yielding asset. We agree with the High Court that the Tribunal was right in its conclusion that the expenditure in question was a revenue expenditure.

In the result this appeal fails and the same is dismissed with costs.

Appeal dismissed.

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