Commissioner of Income Tax, U. P., Lucknow

Vs

British India Corporation Ltd., Kanpur

Civil Appeal No. 1163 (Nt) of 1974

(Sabyasachi Mukharji, S. Natarajan JJ)

03.02.1987

JUDGMENT

SABYASACHI MUKHARJI, J. -

1. This is an appeal from the judgment and order of the High Court of Allahabad dated November 25, 1971.

2. The Income Tax Appellate Tribunal had referred to the High Court the following question for its opinion :

> Whether, on the facts and in the circumstances of the case, the expenditure of Rs. 50,000 was a capital expenditure which could not be allowed as a deduction under Section 10(2)(xv) of the Income Tax Act, 1922 ?

3. The assessee carried on the business of manufacture and sale of woollen goods, cotton textiles and hides and leather products. The activity of tanning hides and manufacturing leather products was carried on under the name and style of Cooper Allen and North West Tannery branches. For the assessment year 1959-60, under the Income Tax Act, 1922, the relevant accounting year of which being the calendar year ending on December 31, 1958, the assessee had claimed a deduction of Rs. 50,000 paid to Messrs Textile & General Supplies Private Ltd., Bombay (hereinafter referred to as "Textile & General Supplies"). The assessee's claim was made on the basis that the assessee was bound under an agreement with Messrs Charles Walker & Co., London to pay that amount to Textile General Supplies for meeting the initial expenditure for establishing it as distributor of the assessee's products. The Income Tax Officer rejected the claim, and the Appellate Assistant Commissioner upheld that decision. The assessee went up in appeal before the Income-tax Appellate Tribunal. The Tribunal also rejected the claim of the assessee. At the instance of the assessee, the Tribunal made a reference on the aforesaid question to the High Court.

4. The question is whether the assessee was entitled to claim deduction in the computation of its profits and gains of business in respect of the expenditure in question, not being in the nature of capital expenditure, laid out or expended wholly or exclusively for the purpose of such business. In other words, on the background of the facts in controversy in this case whether it was revenue expenditure or capital expenditure.

5. This question has been discussed in various decisions. It is settled that the question must be viewed from the practical point of view. There are deluge of cases and no principle can be laid out with substantial accuracy which will be applicable in all the cases. The answer to the question must

depend on the facts and circumstances of each case and on the application of the principles of law as laid down by the courts. The agreement in question in this case between the assessee with Charles Walker stipulated that Charles Walker would permit the use by the assessee of a number of registered trade marks specified in the agreement and further disclose and make known to the approved officers of the assessee the technique, practices and application of specialised tanning processes. Besides providing for the provision of technical supervision by Charles Walker and payment by way of salary, travelling expenses and maintenance to the personnel sent out by it to India, the agreement also provided that in the event of liberalisation of imports Charles Walker would limit its export to India of certain products. The assessee undertook to pay to Charles Walker technical fees calculated at 5 per cent on the selling price of the products produced by the processes disclosed to it. Paragraph 7 of the agreement was to the following effect :

> The second participant (the assessee) agrees to appoint Textile and General Supplies Private Ltd., Army and Navy Building, Mahatma Gandhi Road, Bombay-1, India, a nominee of the first participant (Charles Walker) as distributors of the second participant for the sale of industrial leather manufactured by the second participant in India for the period of this agreement at a discount of 15 per cent (fifteen per cent) on the prices at which industrial leather covered by this agreement are sold to textile mills and other consumers. In addition the second participant will pay Rs. 50,000 (Rs. Fifty thousand only) to the distributors for meeting the initial expenses of establishing the distributorship of the second participant on the express understanding that the first participant will not part with his interest in Textile & General Supplies Private Ltd. without the prior approval in writing of the second participant.

6. Seven years was the period of the agreement as agreed.

7. It is clear from paragraph 7 as aforesaid read in the background of the entire facts that the assessee was obliged to appoint Textile & General Supplies, nominee of Charles Walker, as its distributors for the sale of industrial leather manufactured by it in India. The assessee was obliged by the aforesaid agreement to pay Rs. 50,000 to the distributors for meeting the initial expenses of establishing the distributorship.

8. An Agreement was entered into by the assessee with Textile & General Supplies in which after referring to the agreement with Charles Walker it was stipulated that the distributors would receive a discount of 15 per cent of the sale price fixed by the assessee and that the agreement would extend for the period of seven years. Significantly, no reference was made to the obligation of the assessee to pay Rs. 50,000 to the distributors, a condition which was mentioned in the agreement with Charles Walker alone. The obligation to pay Rs. 50,000 to the distributors was one of the conditions subject to which the assessee became entitled to the use of the registered trade marks and to the disclosure of the technical practices and application of the specialised processes to be supplied by Charles Walker. This clause regarding appointment contained in paragraph 7 formed an integral part of the agreement and was a consideration for the receipt of the benefit from Charles Walker under the agreement.

9. It was a condition to get the technical knowledge of the know-how that their nominee should be appointed as distributor and for the setting up of the distributor's business Rupees 50,000 was required to be paid. This was in essence an integral part of the bargain for the acquisition of the technical knowledge to have this particular distributor.

10. Numerous decisions have dealt with this question. In British Sugar Manufactures Ltd. v. Harris (Inspector of Taxes) ((1939) 7 ITR 101 (CA), the Court of Appeal in England dealt with this question and Romer, L.J. at page 108 of the report observed in dealing with the question which was similar to the present one that the real question is, is the payment that has to be made by the trader under the contract in question a mere division of profits with another party or is it a payment to the other party, the amount of which is ascertained by reference to the profits ? The Lord Justice observed that it was a difficult question. In that case the Lord Justice held that the payment was made to earn profit. It was a condition precedent to the acquisition of the know-how that the payment had to be made for installation of the set-up of the distribution arrangement. Rowlatt J. in the case of Countess Warwick Steamship Co. Ltd. v. Ogg ((1924) 2 KB 292, 298) observed that it is very difficult to lay down any general rule which is both sufficiently accurate and sufficiently exhaustive to cover all or even a great number of possible cases. Only broad tests could be laid down. Some of such tests were laid down by this Court in Assam Bengal Cement Co. Ltd. v. CIT. ((1955) 27 ITR 34 (SC) This Court discussed the broad principles at page 45 of the report. It is not necessary to reiterate all these principles but one of the tests was that the aim and object of the expenditure was one of the guiding factors. The aim and object of incurring the expenditure in this case was the acquisition of the know-how.

11. This Court again in the case of CIT v. Ciba of India Ltd. ((1968) 69 ITR 692 (SC) discussed the principles applicable in determining whether the expenditure in such circumstances was capital or revenue in nature. See also Travancore Sugars and Chemical Ltd. v. CIT ((1966) 62 ITR 566 (SC), CIT v. Coal Shipments P. Ltd. ((1971) 82 ITR 902 : (1971) 3 SCC 736 : AIR 1972 SC 1634), and Empire Jute Co. Ltd. v. CIT ((1980) 124 ITR 1 : (1980) 4 SCC 25 : 1980 SCC (Tax) 335). This Court observed what was material to consider was the nature and the advantage in obtaining the asset in a commercial sense. Also see L. H. Sugar Factory and Oil Mills (P) Ltd. v. CIT ((1980) 125 ITR 293 : (1981) 1 SCC 44 : 1981 SCC (Tax) 19).

12. These principles have been summarised in the Kanga and Palkhiwala's Income Tax, 7th edn., volume 1, pp. 484 to 488. But the cases referred emphasis that no test of universal application can be laid down.

13. The question posed in this appeal has to be decided bearing the aforesaid principles in mind. It is clear that Rs. 50,000 was really part of the price paid by the assessee to obtain the know-how. It is clear that pursuant to paragraph 7, the assessee was bound to appoint Textile and General Supplies, nominee of Charles Walker, as its distributor for the sale of leather manufactured by it in India. Contemporaneously, an agreement was entered into by the assessee with Textile & General Supplies in which after referring to the agreement with Charles Walker it was stipulated that the distributors would receive a discount of 15 per cent of the sale price fixed by the assessee and that the agreement would extend for a period of seven years. Significantly, no reference was made to the obligation of the assessee to pay Rs. 50,000 to the distributors, a condition which was in the agreement with Charles Walker alone.

14. It is clear that paragraph 7 referred to hereinbefore was an integral part of the agreement with Charles Walker and was a part of the consideration for the receipt of the benefit. It is not possible to find out the reasons which persuaded Charles Walker to insist upon the appointment of Textile & General Supplies as distributors of the assessee. It was a necessary condition of the agreement with Charles Walker. It was Perhaps done to protect the technical know-how which Charles Walker was parting so that the distributors would be a nominee of Charles Walker.

15. Having regard to the nature of the agreement and having regard to the facts that the organisational set up under the distributorship agreement was to endure for seven years and upon the expiry of the period, the assessee had no relationship with the organisation and that the period of agreement between the assessee and distributors was contemporaneous with the agreement between the assessee and Charles Walker under which the assessee became entitled to use the registered trade marks, it must be considered to be a revenue expenditure. Considerable emphasis has been laid by the revenue on the fact that in paragraph 7 of the agreement with Charles Walker, it was mentioned that Rs. 50,000 would be paid to the distributors for meeting the initial expenses. We are of the opinion that in the facts and circumstances of the case, this was a revenue expenditure because it was part of the price for the acquisition of technical know-how and the condition of the appointment was a stipulation mentioned by Charles Walker. In the premises, we are of the opinion that the High Court was right in the view it took.

16. The appeal therefore fails and is accordingly dismissed with costs.

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