

# ALLAHABAD HIGH COURT

Jagat Bus Service

Vs.

Commissioner of Income-tax

Misc. Case No. 69 of 1947

(Malik, C.J. and Seth, J.)

26.10.1949

## JUDGMENT

### **Malik, C.J.**

1. This is a reference by the Income tax Appellate Tribunal, Bombay, under Section 66(1), Income-tax Act of 1922. The assessment year in question was 1943-44 and the financial year was 1942-43. The assessee was a registered firm, Messrs. Jagat Bus Service, Saharanpur. It carries on the business of running motor cars, buses and trucks on hire. On 12th June 1940, the assessee entered into an agreement with the Tehri Durbar for plying motor vehicles on hire on the Munikireti-Dhaul-sut-Deoprayag Kirtinagar Motor Road within the territories of the Tehri Garhwal State. The agreement was for a period of five years commencing from 13th April 1940 and the assessee was given monopoly rights for plying motor car vehicles on hire on this road. Before this agreement was entered into, motor vehicles could run on this road but they were liable to pay a sum of Rs. 10 per trip per motor vehicle. Under this agreement, the assessee had to pay a sum of Rs. 20,000 annually as nazarana in the beginning of each year. The assessee was, however, entitled to a proportionate reduction should the road remain impassable for more than sixty days in any one year for the number of days exceeding sixty. The agreement further provided that the assessee had to maintain a fleet of ten buses and trucks and one car to cope with traffic requirements and that they had to arrange for further extra vehicles during the rush season. The rates chargeable by the assessee were fixed in a tariff schedule attached to the agreement and the document also provided that all servants of the State travelling on duty were to travel free. There are certain other terms contained in the agreement but they do not seem to affect the decision of the question.

2. The road was not in a motorable condition for several months in the year in question and the assessee claimed proportionate reduction and instead of Rs. 20,000 the assessee had to pay a sum of Rs. 5,000 only in the year 1942-43 commencing from 13th April 1942. The question for

decision is whether the sum payable to the Tehri Garhwal State for the use of the road is in the nature of a capital expenditure and is, therefore, not deductible from the income or is in the nature of a revenue expenditure.

3. The Income-tax Officer came to the conclusion that the real nature of the agreement was that for a sum of one lakh payable by instalments of Rs. 20,000 a year the assessee was given the monopoly rights in the use of the road for a period of five years and the expenditure was, therefore, in the nature of a capital expenditure and could not be deducted from the income. This view was affirmed by the Appellate Assistant Commissioner as also by the Tribunal. The Tribunal was of the opinion that the amount was payable by the assessee for acquiring monopoly rights to ply motor buses on hire on the particular route and it was not a payment made for the use of the road and for keeping the road in good condition as it was no business of the assessee what the State did with the money received from him. Reliance was placed by the Tribunal on the decision in *Singar Singh and Sons v. Commr. of Income-tax, U.P. and C.P.*<sup>1</sup>. On an application made by the assessee the Tribunal has referred to this Court the following point of law for our opinion :

"Whether the payment of Rs. 5,000, part of the amount stipulated under the agreement dated 12th June, 1940 between the Tehri-Garhwal State and the applicant is admissible as a deduction under Section 10(2)(xii), Income-tax Act, 1922 ?"

4. Mr. Gopal Swarup Pathak has urged that, when the agreement provided for payment of Rs. 20,000 each year, with deductions if the road was not in a motorable condition, the department was not justified in treating this as an agreement to pay one lakh by instalments of Rs. 20,000. He has further urged that, if the assessee had to pay for each motor vehicle a sum of Rs. 10 per trip, the payment would have come to much more, and the sum of Rs. 10 payable per trip could not be said to be any thing but revenue expenditure, and that, if the assessee managed to have this expenditure reduced by paying lump sum for the whole year and secure at the same time a monopoly by giving an additional advantage to the employees of the Durbar in allowing them to travel free, it could not be said that the amount so paid changed its character and became capital expenditure.

5. The assessee employed seven trucks and one motor car during this year for about four months and there can be no doubt that if the assessee had to pay at the rate of Rs. 10 per trip the amount would have come to much more than Rs. 5,000, even if these vehicles had to make only one trip a day. I can find no clear evidence however as to how many trips each vehicle did during this period to enable me to come to a correct conclusion. In the agreement, which is in English, the assessee is called the monopolist and by the agreement it is said that a monopoly is being given to the assessee and the sum of Rs. 20,000 is the nazrana payable by the monopolist for the monopoly and the other advantages secured under the agreement. The question, therefore, arises whether this sum of Rs. 20,000 was paid by the assessee to acquire a monopoly right which

caused a substantial increase in the value of the goodwill of the company, or it was merely a sort of tax or levy made by the State for the permission to grant the use of the road, and the exclusive right of user which was given to the assessee was only an incidental part thereof.

6. The assessee wanted the sum of Rs. 5000 to be deducted out of the income from his business under Section 10(2)(XIII), Income-tax Act which reads as follows :

<sup>1</sup>1944 (12) ITR 504 : (AIR 1946 Oudh 124)

"any expenditure [not being in the nature of capital expenditure or personal expenses of the assessee] laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

It is clear that the sum of Rs. 5000 is not personal expenses of the assessee. The question is whether it is in the nature of capital expenditure.

7. The words 'capital expenditure' have not been defined in the Income-tax Act. It is, however, well settled that the words 'profits', 'gains' and 'capital' are to be construed according to their ordinary signification in commerce or accountancy. The question, what is capital expenditure, has been subject-matter of debate and consideration in a very large number of cases. In the case of *British Insulated and Helsby Cables Ltd., v. Atherton*<sup>2</sup>, various tests were recapitulated from decisions in previous cases, such as that 'capital expenditure is a thing going to be spent once and for all, and income expenditure is a thing that is going to recur every year' from the decision of Lord Dunedin in *Vallambrosa, Rubber Co. v. Farmer*<sup>3</sup>, and, again, that income expenditure is "a proper debit item to be charged against incomings of the trade when computing the profits of it" per Lord Sumner in *Usher Wiltshire Brewery Ltd. v. Bruce*<sup>4</sup>, The Lord Chancellor said that "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." Lord Atkinson also relied on the observations of Lord Danedin quoted above with the amendment proposed by Rowlatt, J. in *Ounsworth v. Viewers, Ltd.*<sup>5</sup>, to the following effect :

"I take it, and indeed both sides agree, that no stress is there laid upon the words 'every year' the real test is between expenditure which is made to meet a continuous demand, as opposed to an expenditure which is made once for all."

There is a further test given in the judgment of Lord Atkinson whether the expenditure could be regarded as forming part of the cost by which the profits and gains for that year have been acquired in which case it would be revenue expenditure.

8. The Income-tax Officer as well as the Appellate Assistant Commissioner interpreted the trust deed to mean that the monopoly rights were acquired on payment of a lump sum of a lakh of

rupees payable by annual instalments of Rs. 20,000. This interpretation was probably attempted to be put on the agreement to bring it within the dicta of Lord Dunedin in the case of *Vallambrosa Rubber Co. (1910 SC 519)*. The Tribunal has held that this interpretation was not correct. As a matter of fact, this interpretation was not possible on the terms of the document as the document provided for payment each year after deductions for each day beyond sixty days when the road was not passable.

9. Great reliance is placed by Mr. Pathak, learned counsel for the assessee, on the decision in *Ogden v. Medway Cinemas, Ltd*<sup>6</sup>, where the respondent company had acquired by assignment the rights of an assignor under an under

<sup>2</sup>1926 AC 205 : (95 LJ KB 336)

<sup>4</sup>(1915) AC 433 at p. 468 : (84 LJ KB 417)    <sup>6</sup>(1934) 18 Tax Cas 691

<sup>3</sup>1910 SC 519 at p. 625

<sup>5</sup>1915-3 KB 267, at p. 273 : (84 LJ KB 2096)

lease by which he became lessee of premises used as a cinema hall, together with the use of fixtures, fittings and furniture at a yearly rent, and a deed supplementary to the under lease by which he was granted the goodwill of the cinema business carried on at these premises subject to a payment of "500 per annum. The deed was for a period of 13 years and was to cease if the under-lease was terminated. It included an option for the purchase of the head lease of the premises and the good will for "3,600. The views of the Lord President in *The*

*Commissioners of Inland Revenue v. Adam*<sup>7</sup>, were relied upon which were as follows :

"Suppose that the consideration for the right had been an annual rent of the site stipulated for as such, it would, I think, have been difficult to displace the view that the rent was a proper revenue charge. But (the contract taking the form it does) it is equally difficult to put out of view the fact that the consideration is not a rent but a capital price. The contract might easily have assumed either form."

Finlay, J. held on the interpretation of the actual language used and certain circumstances mentioned by him that this was a revenue payment for the use during a certain period of certain valuable things and rights.

10. In the case of *Mohanlal Hargovind of Jubbulpore v. Commissioner of Income-tax, C.P. and Berar, Nagpur*<sup>8</sup>, it was held that the contract only gave the assessee the right to go on the spot and collect the Tendu leaves without giving them any right in the property and there was, therefore, no difference between buying the Tendu leaves from a shop after they had been collected by some one else and getting a right to collect them from the forest on payment of the price. It was further held that the assessee had only bought raw materials for his trade and that this was in the nature of a revenue payment. Their Lordships of the Judicial Committee quoted with approval the observations of Channell, J. at p. 673 of the report in *Alianza Co. v. Bell*<sup>9</sup> that it was

"a current expenditure, and does not become a capital, expenditure merely because the

material is provided by something like a forward contract, under which a person for the payment of a lump sum down secured a supply of the raw material for a period extending over several years."

11. In *Racecourse Betting Control Board v. Wild*<sup>10</sup>, the owners of a racecourse had erected certain buildings for the purpose of operating a totalisator and had granted to the Racecourse Betting Control Board a license to use those buildings in consideration of an yearly payment. This annual sum was declared to be not only for the enjoyment and exercise of the right of user but also in repayment by yearly instalments of the capital value of the cost of construction. It was held by Macnaghten, J., on the interpretation of the deed that it was revenue payment. From the point of view of the buyer this was clearly a revenue payment, while from the point of the payee it had the appearance of a capital payment.

12. Reliance is placed on behalf of the Commissioner of Income-tax on the case of

<sup>7</sup>(1928) 11 Tax Cas. 34 at p. 41 : (1928 SC 738)

<sup>9</sup>1904-2 KB 666

<sup>8</sup>1949 WN 358 : (AIR 1949 PC 311)

<sup>10</sup>(1938) 22 Tax Cas 182 : (1938-4 All England Reporter 487)

*Kneeshaw v. Abertoli*<sup>11</sup>). In that

case the licensee of licensed premises had to pay certain annual instalments in respect of the monopoly value of 751, fixed by the Justices under the Licensing (Consolidation Act, 1910 (10 Edw. VII and 1 Geo. VC 24), Section 14. The question was whether this was a capital expenditure. It was held that this was a capital payment and was not deductible.

13. In a similar case of *Henriksen v. Grafton Hotel Ltd*<sup>12</sup>, instalments paid by a tenant to the landlord towards the monopoly value fixed by the licensing Justices were held to be capital payment by the Court of appeal. This payment represents the difference between the value which the premises will bear when licensed and the value of the same premises if they were not licensed.

14. On the strength of these two cases, it is argued that the payment of Rs. 20,000 being fixed to secure a monopoly to the assessee, it must be held to be in the nature of a capital expenditure.

15. The next case relied upon is *Associated Portland Cement Manufacturers, Ltd. v. Inland Revenue Commissioners*<sup>13</sup>, In that case two retiring Directors agreed on payment of a large sum of money not to carry on a rival business. It was held by the Court of Appeal that by buying off two potential competitors the company had improved the value of their good will and had accordingly brought into existence an advantage for the enduring benefit of the trade. One of the tests mentioned by Lawrence, J., in the case of *Southern v. Borax Consolidated Ltd*<sup>14</sup> was quoted :

".....if it could be said here that this expenditure had in any way altered the original character of the capital asset which was acquired by the respondent company, I should have taken the view that the payment was in respect of capital, but, as, in my opinion, the

capital asset of the respondent company remained absolutely unaltered, that payment is properly attributable to revenue."

16. Mr. Pathak, on behalf of the assesses, has cited two decisions of the Lahore High Court, *In re Parma Nand Haveh Ram*<sup>15</sup>, and *In re Benarsidas Jagannath*<sup>16</sup>, In the case of Benarsidas Jagannath (1947-15 ITR 185 : AIR 1947 Lahore 162 FB), the assessee, who was a manufacturer of bricks, had obtained certain lands on leases for the purpose of digging out earth. It was held that this was a revenue expenditure and must be interpreted to mean a purchase of raw material, earth, for the making of bricks - Mehr Chand Mahajan, J. laid down three propositions which were as follows : "(1) Outlay is deemed to be capital when it is made for the initiation of a business, for extension of a business, or for a substantial replacement of equipment.

(2) Expenditure may be treated as properly attributable to capital when it is made net only ones and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade.

(3) Whether for the purpose of the expenditure, any capital was withdrawn, or, in

<sup>11</sup>(1940) 2 KB 295: (1940) 3 All England Reporter 500 <sup>13</sup>(1946) 1 All England Reporter 68 : (62 ILR 115).

<sup>12</sup>(1942) 2 KB 181: (1942-1 All England Reporter 678)

<sup>14</sup>(1940) 4 All England Reporter 412 at p. 418 : (1941-1 KB 111) <sup>16</sup>1947-15 ITR 185 : (AIR 1947 Lah 162 FB)

<sup>15</sup>1945-13 ITR 157: (AIR 1945 Lah 137 FB)

other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital."

17. In *Commissioner of Income tax, Madras v. Siddareddy Venkatasubba Reddy and Bros*<sup>17</sup>, the assessee had taken on lease certain mica mines for periods varying from five to nine years for winning mica and selling it in the market. The assessee claimed the deduction of the money paid to the lessors under the four documents. It was held that this was in the nature of a capital expenditure.

18. The decision in each case, of the question, whether an item of expenditure is revenue expenditure or capital expenditure, depends upon a variety of circumstances, e.g., the nature of the expenditure, the source from which the money was spent, whether the payment was made once and for all or is a recurring expenditure and whether the asset acquired is going to be a source of permanent income or it exhausts itself either during the course of the year when it was acquired or within a short period thereafter. The main test is its permanency i.e., whether the value of the capital of the company or its assets or its goodwill is permanently increased by reason of such expenditure. It is impossible to lay down any test which would meet all cases, for example, a firm carrying on the business of plying motor vehicles for hire might decide to increase its business and lay down a new road connecting two places. This would be in the nature of a capital expenditure. If, on the other hand, it spends money every year for the running repairs to the road, that might be in the nature of a revenue expenditure. Similarly, a firm dealing in

machinery might buy machinery for sale which would be revenue expenditure, while an industrial concern might buy machinery to replace worn-out machinery and that would be in the nature of capital expenditure. Even in the case of an industrial concern minor repairs which have to be frequently made and which are known as running repairs are revenue expenditure, while replacement of costly machinery is capital expenditure. It is, therefore, difficult to lay down any test which could be applied to every case. To my mind, 'capital' means an asset which has an element of permanency about it and which is capable of being a source of income and 'capital expenditure' must, therefore, generally mean an acquisition of an asset and the asset must be intended to be of lasting value. While income or revenue expenses are generally running expenses incurred in earning profit or expenses incurred with the primary object of an immediate return or acquisition of assets which are not of lasting value and are likely to get exhausted or consumed in the process of the return or a very limited number of returns.

19. Coming to the facts of the case before us, the amount of Rs. 5,000 was paid out of the income made in the course of the year. The payment was not made once and for all but had to be made every year. Without incurring this expenditure, it was not possible for the company to make the profit which it is intended to be taxed, and if the assessee had to pay Rs. 10 per trip per vehicle which was the tax payable, the company would have had to pay much more. Having taken all these facts into consideration, I am of the opinion that the sum of Rs. 5,000 was in the nature of a revenue expenditure and was deductible out of the income.

<sup>17</sup>1949 17 ITR 15: (AIR 1949 Mad 568)

20. The assessee must get the costs of these proceedings which are assessed at a sum of Rs. 500.

**Seth, J.**

21. I agree.

Reference answered.