CALCUTTA HIGH COURT

Commissioner of Income-Tax

Vs.

Piggot Chapman and Co

Income-Tax Ref. No. 10 of 1947

(G.N. Das and R.P. Mookerjee, JJ.)

22.02.1949

JUDGMENT

R.P. Mookerjee, J.

1. This is a reference under Section 66 (1), Income Tax Act. On an application by the Commissioner of Income Tax Calcutta the following question of law has been formulated by the Tribunal for answer by this Court.

> "Whether in the circumstances of the case a sum of Rs. 6698/- paid out to Mr. Mitchell-Innes wholly and exclusively for the purposes of the business was a revenue expenditure so as to be allowable as an admissible deduction under Section 10 (2) (XII), Income Tax Act (as it stood before its amendment in 1946)."

2. Messrs. Piggot Chapman and Co. is a firm of exchange brokers Mr. Mitchell-Innes and Mr. Danbeny who were working in partnership as exchange brokers, under the name and style of Halford Smith and Co. entered into an agreement on 22-10-1919 with the partners of the assessee-firm Piggot Chapman and Co. It is not necessary for our present purpose to state in full the terms of this agreement. Broadly speaking Messrs. Mitchell-Innes and Danbeny who were the sole exchange brokers of Messrs. Ralli Brothers were under this agreement to sell their goodwill and the business of exchange brokers with the stipulation that they would not carry on business as exchange brokers or be interested in any such business at Calcutta or at any place within a radius of 100 miles from Calcutta for a period of twenty years unless and until this agreement was rescinded in any of the manners detailed in the agreement. In consideration of the agreement Piggot Chapman and Co. were to make certain payments and continue to pay annuities under certain stipulations.

3. As a result of this agreement the assessee Co. continued to act as the sole exchange broker of the firm Ralli Brothers. But before the expiry of the period of twenty years stipulated in the above agreement Messrs. Ralli Brothers took in other brokers as exchange brokers in addition to the assessee firm. Under the terms of the agreement this was an occasion for terminating the

agreement.

4. Another agreement however which is marked as exhibit B in this record was executed at this stage in 1927 by the partners of the assessee firm and Mr. Mitchell-Innes. It does not transpire whether Mr. Danbeny who had an interest in the firm of Halford Smith and Co. and was a party to the agreement of 1919 had or had not any further interest in the business or had executed any other document as was done by Mr. Mitchell-Innes.

5. In view of the fact that the decision in this case depends on an interpretation of the terms contained in this agreement of 1927 fuller details of the terms have to be stated. Mr. Mitchell Innes was to transfer four seats in the Calcutta Exchange Brokers Association, belonging to the firm Messrs. Halford Smith and Co. in favour of the assessee-firm. The goodwill of the firm Halford Smith and Co. was to be absolutely transferred in favour of the assessee-firm. The consideration mentioned in the agreement was £ 4000, for transferring the four seats in the Association above mentioned and for the sale of the goodwill. It was further agreed that Mitchell-Innes would not in future and at any time work as exchange broker or in any way compete with the assessee-firm and the consideration for such agreeing not to enter into competition with the assessee-firm as exchange brokers in Calcutta were annuities payable during the life-time of Mitchell-Innes to him and after his death to his wife. The payment of the annuities was made contingent and payable only and so long as the brokerage earned from Messrs. Ralli Brothers and two other firms was not less than the double of the amount of such payment of annuity in each year. In certain circumstances the annuity was to be proportionately reduced and if the firm Ralli Brothers ceased to carry on business in Calcutta the annuities would forthwith cease.

6. The question referred by the Tribunal is whether the payment of the annuity as under the agreement of 1927 to Mitchell Innes should be considered as a revenue expenditure or a capital one. Whether the deduction allowed under Section 10 (2) (XII), Income Tax Act, would be allowed would depend on the answer as to whether such payment is an item of revenue expenditure or a capital one.

7. Section 10, Income Tax Act indicates the method for calculating the profits or gains of a business. Sub-section (2) of that Section recites a number of allowances of which only Clause (XII) is relevant for our present purpose. The taxable income is to be determined after making allowance of :

> "(XII) 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."

8. To attract the operation of Clause (XII) the following conditions must be satisfied :

> 1. The expenditure was not in the nature of capital expenditure.
> 2. Such expenditure had been expended "wholly and exclusively" for the purpose of such business.

9. The finding in the present case is that the amount of Rs. 6698/- referred to in the question was

paid to Mitchell-Innes wholly and exclusively for the purposes of the business. The only question therefore now is whether this payment is to be considered to be an item of capital expenditure or a revenue one. The findings arrived at and on the basis of which this reference is made are in the following forms :

10. Reverting to the facts of the case before us there can be no doubt that the payments are made annually and they are so made to shut out competition or in other words for the purpose of keeping Mr. Mitchell-Innes out of Calcutta and prevent him from competing with the assessee in this trade. By keeping out a probable competitor the applt. hoped to get more customers and to earn more profits. This was the only object of the payment of the annual sums. Mr. Mitchell-Innes had a pull with Messrs. Ralli Brothers and if he were to return to Calcutta he might be employed by Ralli Brothers. This would have been detrimental to the assessee's business. In the interest of his business that is to say to smooth the way as regards his future business operations and with a view to earning more profits by getting more customers the assessee thought fit to keep Mr. Mitchell-Innes out of his way. There is no question of the acquisition of a new business in this case nor can it by any stretch of imagination be suggested that the annual sums constitute a price paid for the acquisitions of something which is analogous to the goodwill of Mr. Mitchell's business. There is no warrant for this supposition and indeed the agreement cannot countenance any such suggestion. Further it is not possible to hold that the expenditure brought into existence an advantage for the enduring benefit of the assessee's trade within the meaning of the expression used by Lord Cave and later explained by Romer, L. J. The expenditure did not result in the acquisition of anything of a kind which could rightly be described as a new asset or as an addition to the fixed capital of the firm. The acquisitions derived from the payment were metaphysical rather than physical.

11. We may at this stage deal with one of the contentions raised, based on an interpretation of Clause 2 of the agreement dated 23-2-1927. It was argued that the annuity payable was a consideration for transfer of the goodwill of the firm as also for restraining Mitchell-Innes from carrying on the profession of an exchange broker in Calcutta and as such the payment must be deemed at least in part to be for the acquisition of the goodwill and accordingly on Capital account. It is not necessary for our present purpose to go into the question whether expenses incurred for the acquisition of goodwill is an expenditure on revenue or Capital account as in our view Clause 2 of the Agreement cannot be so interpreted as to mean that the annuity payable was in any way a consideration even in part for the acquisition of the goodwill. Under Clause 1 it is made abundantly clear that the consideration for the four Seats in the Calcutta exchange Brokers Assocn. and for the good will of the firm was a lump sum of £ 4000/- payable by quarterly instalments within three years. It is also made clear in Clause 1 that the consideration for these two items was not by way of annuity but on Capital account. In Clause 2 of the agreement the annuity is made payable only as a consideration for Mitchell-Innes refraining from competing with Piggot Chapman and Co. as exchange brokers in Calcutta. The only question therefore in this Case is whether periodical payments in consideration of a person refraining from competition is an item of revenue expenditure or not.

12. In this view we are not called upon to consider the various authorities as to the character of payments if made for the acquisition of goodwill.

13. "The question of allocation to Capital or income runs on five lines of distinction" (*'Anglo-*

Persian Oil Co., Ltd. v. Dale'[1]*,*) "What is capital and what is attributable to revenue account is a puzzling question to many accountants" and though it is not possible to lay down any satisfactory definition to cover all cases (*British Insulated and Helsby Cabs Ltd. v. Atherton*[2]*',* Per Pollock M. R.), in a large number of cases working principles have been attempted to be formulated. In simple cases the distinction between capital and revenue is well marked but in cases near the border line the position is altogether different. Very often when one applies logic to them some of the different decisions become indefensible. They are generally decided as matters of convenience and according to what are deemed to be principles of commercial accounting. It is impossible to lay down satisfactory tests in a general way for differentiating between capital and revenue expenditure. Bearing these in mind we may proceed to consider how far and to what extent some or more of these principles may be attracted to the facts of the present case.

14. In determining whether a particular item of expenditure comes under category of capital or revenue it is necessary to consider carefully the nature of the concern, the ordinary course of business usually adopted by such firms, the object with which an expense is incurred and the actual effect thereof. It is only then that it can be decided under what category a particular expenditure falls. In the case now before us the goodwill of the firm in which Mitchell-Innes was interested had for a separate consideration been transferred to the assessee Piggot Chapman and Co. entitling the latter to the benefit of the connections of Mitchell-Innes with Messrs. Ralli Brothers. The annuity which is made payable to Mitchell-Innes and to his wife is in consideration of Mitchell-Innes not entering into competition during his life time with Piggot Chapman and Co. There is no question that under this latter provision a benefit accrues in favour of Piggot Chapman and Co., but is it of an enduring nature? One very important provision is introduced in the agreement which must not be overlooked. The payments are made contingent upon the receipt by Piggot Chapman and Co. of a certain amount from Messrs. Ralli Brothers with the further proviso that under certain circumstances the entire annuity may be stopped irrespective of the fact whether or not Piggot Chapman and Co. continues to receive brokerage from Messrs. Ralli Brothers or whether annuities continue to be paid till the end of the two lives. Mitchell-Innes is restrained from entering into competition with the assessee firm till the end of his natural life. There can be no question that Mitchell-Innes is definitely and permanently kept out of the field of competition.

15. It is quite clear that the payment of the annuity is not made for the initiation of business or for the substantial replacement of equipment and cannot come within the test as indicated in *'Commissioners of Inland Revenue v. Granite City Steamship Co*[3]*.',* There is no doubt that this expenditure is being incurred not once and for all but the question is whether this brings into existence an asset or an advantage for the enduring benefit of trade and thus attracting the often-quoted principle enunciated by Viscount Cave in *'British Insulated and Helsby Cables Ltd. v. Atherton*[4]*',* at p. 213. An advantage is to be considered to be an enduring benefit of a trade if the benefit accruing is not of a transient nature but is of such durability as to justify it being treated as a capital asset. In the opinion of Lawrence, J., in *'Henrikson v. Grafton Hotels Ltd*[5]*,* affirmed by the Court of appeal

[1](1932) IKB 124
[2] (1926) 10 Tax Cas 155
[3](1927) SC 705 : 13 Tax Cas 1 5(1942) 1 All England Reporter 18
[4](1926) AC 205

reported in (1942) 1 All England Reporter 678, a benefit accruing for 3 years was considered to

be an enduring benefit.

16. It is further to be remembered that monopoly value though payable in instalments and not in a lump sum is of the nature and quality of a capital payment. A payment out and out for a monopoly value and payment spread over a term are not differentiated in principle. But whether payments made by a firm for avoiding trade competition are or are not of a capital nature depends on a fine distinction. The divergent views expressed in the different decisions in India and England cannot always be reconciled.

17. Facts which are to some extent similar to those now before us are to be found in *'R. S. Munshi Gulab Singh and Sons v. Commissioner of Income Tax Lahore*[5]*',* In this case the assessee firm carrying on business of printing and publishing books entered into an agreement with certain rival firms to pay them in certain proportion a share of the estimated profits of the assessee in so far as they executed Govt. orders and that also in consideration of such rival firms quoting uniform rates with the assessee in the tenders invited by Govt. The question was whether the amount so paid by the assessee to the other firms could be characterised as expenditure incurred solely for the purpose of earning the profits or laid out or expended wholly and exclusively for the purpose of such business. Mahajan, J., observes at p. 86 :

> "All that could be said was that the assessee in order to carry on his business of the printing press was by incurring this expenditure getting work to run his press to its full capacity and to his maximum advantage but it could not be said that he was acquiring a new business or in other words was incurring this expenditure to acquire a concern."

The classical observations of Bowen, L. J., in *'City of London Contract Corporation v. Styles*[6]*',* at p. 243 are quoted with approval.

> "You do not use it (capital) for the purpose of your concern which means for the purpose of carrying on your concern but you use it to acquire the concern."

18. It cannot be suggested that each individual contract obtained by an assessee concern or expenditure incurred to get an item of work for the concern is an amount spent to acquire the concern. Expenditure incurred in canvassing custom or in securing better rates than otherwise would be obtainable for the work executed in this concern with the object of obtaining increased profits is not capital expenditure. According to the ordinary commercial usage and mode of drawing up the profit and loss account Mahajan, J., thus concluded at p. 87 :

> "In my opinion the expenditure incurred in the present case is in the nature of an annual business expense incurred to run the press to its full capacity and to earn the maximum amount of profit. No part of it can be said to have been embarked to

[5] AIR 1947 Lah 82

[6](1887) 2 Tax Cas 239

> purchase the business. The sums paid to competing firms to tender the same rates as tendered by the assessee are paid with the sole purpose and object of earning

substantial profits in running the printing press business. The whole object of this payment is to tender rates for work that bring in lucrative profits."

19. The tests applied by the Judicial Committee in *'Tata Hydro Electric Agencies Ltd. Bombay v. Commissioner of Income Tax Bombay*[7]*',* are not attracted on the facts of the present case. It is incontestable that in the care before the Judicial Committee the facts were absolutely clear that the expenditure had been incurred for acquiring the concern of the Managing Agents and not for running the concern. The assessee Company by making the payment closed down the Managing Agencies and wanted to make their own arrangements for effecting sales at those places. It was further clear to be in the nature of capital expenditure and the following observations of the Judicial Committee indicate that that case has no application to the facts of the present one.

"Their Lordships recognise and the decided cases show how difficult it is to discriminate between expenditure which is and expenditure which is not incurred solely for the purpose of earning profits or gains. In the present case their Lordships have reached the conclusion that the payments in question were not expenditure so incurred by the appellants. They were certainly not made in the process of earning their profits these were not payments to creditors for goods supplied or services rendered to the appellants in their business they did not arise out of any transactions in the conduct of their business. That they had to pay money to them from their business but that is not the statutory criterion. They must have taken this liability into account when they agreed to take over the business. In short the obligation to make these payments was acquisition of the right and opportunity to earn profits that is of the right to conduct the business and not for the purpose of producing profits in the conduct of the business. If the purchaser of a business undertakes to the vendor as one of the terms of the purchase that he will pay a sum annually to a third party irrespective of whether the business yields any profits or not It would be difficult to say that the annual payments were made solely for the purpose of earning the profits of the business."

20. In passing it may be noticed again that the mere fact that a payment is a lump sum or a recurring one cannot by itself determine conclusively the nature of the expenditure. The character of the payment is to be examined to determine whether it is of a revenue or capital nature. It may be that a lump sum payment is made for liquidating certain recurring claims which are clearly of a revenue nature and on the other hand payment for purchasing a concern which is 'prima facie' an expenditure of a capital nature may be spread over a number of years and will still retain its character as a capital expenditure.

21. In *'John Moore v. Stewarts and Lloyds Ltd*[8]*.',* the Court of Session was called upon to interpret the effect of a term in the agreement between two Companies carrying on similar business whereby in return for an undertaking to make up the yearly profits of one Company to a certain amount of commanding interest was obtained in the management of

[7]64 IA 215 : ILR (1937) Bom 388
[8](1906) 43 Sc LR 811 : 6 Tax Cas 501

the other this payment was found to be for the purpose of its trade for affording opportunities to the assessee firm to sell its goods at a better price and a deduction was allowed for income tax purposes. The principal question which arose for decision was whether such a finding by the Commissioners of Taxes was a question of fact or of law and incidentally observations are made on the merits. The Lord President frankly admitted that the decision as to the nature of the payment was attended with considerable difficulty but ultimately accepted the view that the point raised was not a question of law but a question of facts . Reference to this decision therefore as being an authority for the proposition that payments made for avoiding trade competition so as to earn larger profits is an expenditure of a capital nature is not quite justified as that was the decision of the Commissioners of Taxes and was not fully considered by the Court of Session as a question of law.

22. The earliest Indian decision referred to is that of *'Commissioner of Income Tax, Madras v. Alaganan Chetty*[9]*',* A question was no doubt raised as to the character of payment made to a competitor for inducing him not to compete with the Assessee but the limited question was whether such payment was incurred solely for the purpose of earning such profits or gains and not on the question whether such payments were of a revenue or capital nature. This case also is not therefore of any assistance on the specific point which arises for decision in the present case.

23. Reliance has been placed by the Revenue authorities on *'Associated Portland Cement Manufacturers Ltd. v. Kerr*[10]*',* which follows the observations of Lawrence, J., in *'Collins v. Adamson Joseph and Co*[11]*.',* where the point for decision was about the nature of payment made by a Company to a retiring director in restraint of future competition by him Macnaghten, J., explains the 'ratio decidendi' of a decision to which he was himself a party, *'Deverell Gibson and Hoare Ltd. v. Rees*[12]*',* and indicated that the particular director had sold his 'connection as a printer' and afterwards was paid £ 600 which was regarded as an unwarranted withdrawal of capital because the Co. could not properly reduce its capital without the sanction of the Court, although at p. 471 of the report observations are made which implies that the learned Judge thought that the said Director had received the aforesaid amount of £600 in consideration of an obligation not to compete with the company, as a matter of fact, however there was no consideration for the payment. The earlier case *'Deverell Gibson and Hoare Ltd. v. Rees*[13]*',* also cannot be of any help as the facts are different. But the later case of 1945 already referred to is of some assistance. *'Colling v. Joseph Adamson and Co*[14]*.',* on which reliance is placed by Macnaghten, J., the facts are altogether different. The finding of the Special Commissioners that the acquisition of the business of a member of the Association instead of allowing such sale to a non-member it was for the acquisition of a valuable right which is to be regarded as a capital expense but not as a trading expense. If the payment of the annuity to Mitchell-Innes had not been made contingent upon the receipt of income, from Messrs. Ralli Brothers the observations of Lawrence, J., and Macnaghten, J., would have been of great force.

24. On the special facts arising in this particular case and on the interpretation of the

[9] AIR 1928 Madras 902 : 3 I T C 44 [11](1938) 1 KB 477 [13](1943) 25 Tax Cas 467
[10](1945) 2 All E R 535 [12](1943) 25 Tax Cas 467 [14](1938) 1 KB 477

terms of contract as evidenced by the agreements particularly Ex. B it must be held that the amount in question was not an item of capital expenditure but was a revenue expenditure allowable as an admissible deduction under Section 10 (2) (XII), Income-tax Act, as it stood before its amendment in 1946. The question raised must therefore be answered in the affirmative.

The assessee respondent is entitled to the cost of the hearing in this Court.

G. N. Das, J.

15. I agree.

Reference answered in affirmative.