

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Kolhia Hirdagarh Co. Ltd

(Chagla, C.J. Tendolkar, J.)

23.03.1949

JUDGMENT

Chagla, C.J.

1. This reference raises a rather difficult and debatable question whether a certain payment made by the assessee was in the nature of a capital or revenue expenditure. The assessee is the Kolhia Hirdagarh Company, Limited, Bombay. Rai Bahadur Seth Goverdhandas acquired certain mining rights from the Central Provinces Government in 1922, and on 14th September 1939 an agreement was arrived at between Rai Bahadur Goverdhandas and Messrs. Choonilal Manilal, Ltd., for the sale of all the rights that Goverdhandas had to Messrs. Choonilal Manilal, Ltd. By this agreement the consideration that was fixed for the purchase of these rights by Choonilal Manilal, Ltd., was the payment of a sum of Rs. 75,000 in cash to Goverdhandas and the giving of fully paid up shares of the face value of Rs. 25,000 to Goverdhandas and the minimum annual dividend (including its share of income-tax and super-tax) of four annas for every ton of coal raised. Messrs. Choonilal Manilal purchased these rights in order to float the assessee company and in the articles of association of the company the consideration agreed upon to be paid to Goverdhandas was set out in the following manner. Goverdhandas was to get in respect of the consideration for shares of the value of Rs. 25,000 500 preference shares of Rs. 50 each and the dividend on these preference shares was to be a fixed cumulative preferential dividend equivalent to four annas per ton of coal (whether coal was of steam, rubble or slack but not shale) raised and railed in each year. When this draft articles of association were sent to Goverdhandas for his approval, he approved the draft and wrote a letter dated 24th October 1939 where he drew pointed attention to what was the real nature of the transaction between himself and Messrs. Choonilal Manilal, Limited. He pointed out that all that he was anxious to secure was that he should get annas four per ton permanently on all coals despatched from the colliery every year, without any hindrance whatsoever, irrespective of any loss or gain to the company. When the company was incorporated, the obvious difficulty was noticed of carrying out the terms of the agreement. It was impossible to pay a fixed dividend on preference shares irrespective of the fact whether the company made profits or not. It was not possible for the company under the law to

pay any such dividend out of the capital and, therefore, to obviate this difficulty, an agreement was entered into on 6th March 1941; but I may point out that prior to that and subsequently to the letter of 24th October 1939, a formal agreement for sale had already been entered into between Goverdhandas and the assessee company on 30th November 1939, pursuant to one of the articles of association; and in that agreement it is set out what the vendor was selling to the company and among the items described is the goodwill of the business of the company and all coal lying and being at Kolhia in the Chhindwara District, Central Provinces, in which the mines are situated, and all coal derivatives or by-products of coal and the full benefit of all grants and all other patents, licences, leases, rights and benefits, and all other property of whatsoever nature and kind to which the vendor or the said Kolhia colliery is entitled to in connection with the business; and then the agreement sets out the consideration which is, as in the oral agreement, a sum of Rs. 75,000 in cash and as to the balance of Rs. 25,000 by the allotment to the vendor of 500 preference shares of Rs. 50 each in the capital of the company credited as fully paid up. An inventory was prepared by the company in respect of all plant, machinery and other physical assets and was annexed as a schedule to this agreement; and this schedule showed that the buildings and lands were shown as worth Rs. 8,000, the works of transportation, rails, etc., worth about Rs. 70,000 and various tools and articles of machinery were valued at Rs. 20,000 and stores tools were valued at Rs. 2,000, making in all a sum of rupees one lac. It is important to note that neither in this schedule nor in any other part of the agreement any value was assigned either to the good will of the business or to the mining rights which were being sold by Goverdhandas to the assessee company. Now, as I stated earlier, in order to get over the difficulty which was noticed about paying the agreed sum on the preference shares to Goverdhandas, a fresh agreement was entered into on 6th March 1941, and the effect of this agreement was this: that two important alterations were made in the consideration fixed for the purchase of Goverdhandas's undertaking by the assessee company. Goverdhandas agreed to give up all the dividends to which he was entitled on these preference shares up to the date of the agreement, namely, 6th March 1941, and he also agreed to permit the preference shares which he held to be converted into ordinary shares; and in consideration of this, the company agreed to pay commission to Goverdhandas, with retrospective effect from 22nd October 1939, at the rate of four annas per ton of steam and rubble coal and three annas per ton of slack coal raised from Kolhia Colliery any sold and rented by the company from the colliery. Pursuant to this agreement, the assessee company paid a sum of Rs. 7,469 in respect of the account year 1940 and Rs. 9,849 in respect of the account year 1941. In this reference we are concerned with the sum of Rs. 9,849 and the question that arises for our determination is whether the sum of Rs. 9,849 paid by the assessee company to Goverdhandas is a capital sum or a revenue expenditure. The Tribunal took the view that this was in the nature of a revenue expenditure.

2. Now it is never very easy or simple in any particular case to decide and determine whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure. Most cases raise very difficult and debatable questions and very many of them usually lie on the border line; but in order to decide on which side of the line a particular case

falls, it is essential in the first instance to determine what was the real nature of the transaction between the parties which gives rise to this question, and the nature of the transaction that we have to consider in this reference is the agreement of sale by which Goverdhandas sold his whole undertaking to the assessee company. The first question that we have to consider is what was the price that the company had to pay to Goverdhandas for this undertaking? Now, in taxation matters it is not necessary to construe documents from their purely legal aspect. It is open to us not merely to look at the documents themselves, but also to consider the surrounding circumstances so as to arrive at a conclusion as to what was the real nature of the transaction from the point of view of two businessmen who were carrying out this transaction. In all taxation matters more emphasis must be placed upon the business aspect of the transaction rather than on the purely legal and technical aspect and considering the transaction from that point of view, it is clear that the consideration for the sale of this undertaking can clearly be divided into two categories: first payment of a specific sum of Rs. 75,000 and the allocation of 600 preference shares to Goverdhandas; the second category consists of the payment of a commission every year on the production by the company of coal. Now two or three important factors must be borne in mind with regard to part of the consideration that falls under the second category: (i) the payment of commission is for an indefinite period. There is no limitation of time attached to it. (2) The payment of this commission has no bearing to profits but is related to the turnover of the assessee company. (3) No specific amount is mentioned in relation to which the payment of commission is to be attributed. Now a purchaser may buy a going concern and may fix a certain price and that price may be payable in a lump sum or it may be payable by instalments. The mere fact that a capital sum is payable by instalments spread over a certain length of time will not convert the nature of that payment from a capital expenditure into a revenue expenditure; but the payment of instalments would always have some relationship to the actual price fixed for the sale of the particular undertaking. Now, in this case the most significant and outstanding fact is that apart from the sum of a lakh of rupees, no specific sum is fixed as being added to the price of Rs. 1,00,000 and payable by instalments or by a particular mode or method. Therefore, we are left in this position that the parties merely fixed the sum of Rs. 1,00,000 as the specific price of the sale of the agreement and the parties also agreed that an indefinite sum for an indefinite period should be paid by the purchaser to the vendor so long as the collieries were in a working condition. Now, on these facts the question arises whether the payment of commission every year by the assessee company to the purchaser is in the nature of a capital expenditure or in the nature of a revenue expenditure. Various cases have been cited before us both by Sir Jamshedji and Mr. Joshi, and the one case which, in my opinion, is almost indistinguishable from the facts which we have to consider is a very recent decision of the English Court and which is reported in *Commissioners of Inland Revenue v. 39/49 Holdings, Ltd¹*. In that case also an undertaking was sold and the price consisted of a fixed amount and a certain commission payable for an indefinite period. The consideration in this particular agreement which the English Court had to consider, which was in addition to the fixed amount payable by the purchaser to the vendor, was 1 shilling for each bicycle not being mechanically propelled bicycle without deduction and 1 for each mechanically propelled bicycle without deduction, and this was to be paid on the turnover by the

purchasing company. This sum of 1 shilling and 1 was to be paid without any limitation of time, and this sum was not related to any special sum as being part of the price to be paid by the purchaser to the vendor. Lord Greene, Master of the Rolls, in delivering judgment says (page 182) :

"The true nature of a sum payable to a recipient for purposes such as the present is to be ascertained from all the circumstances relevant to that matter. The true nature of the sum is not necessarily its nature in law, but its nature in business or in accountancy whichever way one likes to put it, because from the legal point of view there may be no difference whatsoever as between the parties between a capital and an income sum. It may be totally irrelevant to the legal relationships into which they are proposing to enter. When, however, the tertius gaudens, in the shape of the Revenue, appears on the scene, that matter which as between the parties may have been a matter of not the slightest importance becomes immediately a matter of very great importance, and it is necessary to examine the circumstances of each individual case, including any documents which require to be construed, in order to ascertain what is the character to be attributed to the payment."

It is also interesting to note that in this case no value was given to the goodwill and it is also important to note that in view of one of the questions submitted to us, Lord Greene not only looked at the formal documents executed by the parties but also took into consideration certain minutes which were extraneous to the documents in order to ascertain what was the real nature of the transaction between the parties; and in coming to the conclusion that the payment made by the assessee company in respect of the sum of 1 shilling for each bicycle and 1 in respect of a mechanically propelled bicycle was not in the nature of a capital expenditure but was a revenue expenditure. Lord Greene dissects the contract and says that it is divisible in two parts. He says that it is a sale of assets for a purchase price built up by two groups of elements, one group quite obviously of a capital nature and the other group of a periodical nature; and then dealing with the second element, he first emphasized the fact that payments are to be made in perpetuity, and the learned Master of the Rolls expressed his difficulty to class under the category of capital a perpetual payment. The next element he considers is that the payments in respect of the second group are related to the turnover and the sums are not fixed in reference to costs; and the last point that the learned Master of the Rolls observed is that the sums payable which vary under that rule are not tied in any way or related in any way to any special sum whatsoever, The learned Master of the Rolls then observed (p. 183) :

"Indeed, regarding the payment as a payment which may continue in perpetuity, it seems impossible to say that it is to be regarded as payment by instalments of a capital sum."

Then the learned Master asks himself the question : "What is the capital sum?" and he says (page 183) :

"Not merely, therefore, is there no reference to or dependence upon any capital sum, but the very nature of the payments appears to exclude the idea that any connection with any such capital sum was ever present to the mind of anybody."

3. Now the very three tests which are applied by the learned Master of the Rolls are present in the case before us. The payment to be made by the assessee company is perpetual. It is the payment to be made on every ton of coal produced by the company and, therefore, the payment has relation to turnover and not to profits and this payment is not related to any fixed sum agreed upon between the parties as part of the purchase price of the undertaking. It, therefore, seems to me that in all its important and significant aspects the case we are considering is indistinguishable from the case before the English Court and, with respect, I would agree with the decision arrived at by the Court of Appeal in England and hold that the particular payment in this case is a revenue expenditure and not a capital expenditure.

4. I may briefly look at some of the other cases which were cited at the bar. Sir Jamshedji has contended--and with some force--that the payment of commission by the assessee company to Goverdhandas may be likened to the payment of royalty, and Sir Jamshedji has relied on a decision of the Privy Council reported in *Kamakshya Narain Singh v. Commissioner of Income-tax, B. & O.*, which held that royalties are in the nature of revenue expenditure and not capital expenditure. The leases purported to grant unto the lessees for 999 years various mining rights and in return for those rights the lessees were to pay a sum by way of salami or premium and an annual sum as royalty computed at a certain rate per ton on the amount of coal raised and coke manufactured, subject always to a minimum annual sum. It was contended on behalf of the assessee that the sums received as salami and royalty did not constitute income but were capital receipts representing the price of the minerals removed. The Privy Council held that the minimum royalty being a species of annual guarantee was income flowing from the covenants in the lease and was in no sense a payment on capital account; and it further held that it was fallacious to envisage the royalty payable every year under the terms of the lease as merely the price of the actual tons of coal. The Privy Council further held that it was more of a compensation which the lessees paid the lessor for that species of occupation which the contract between them allowed and it was, therefore, income from other sources within the meaning of Section 12 of the Act. Of course it is to be noted that in this case the Privy Council was looking at the matter from the point of view of the vendor and not from the point of view of the purchaser, and what was held was that a royalty received by the vendor of his mining rights was income in his hands and not capital. We are rather concerned in this case to consider what the nature of the payment is when the purchaser pays to the vendor a commission which may be likened to a royalty. To a similar effect is another Privy Council case reported in *Gopal Saran Narain Singh v. Commissioner of Income-tax, B. & O.*, . In that case the assessee owned a certain share in an estate and he conveyed his share and the consideration for the transfer was, among other things, an annual payment of a certain sum to the assessee for his rights; and the

question was whether the annual payment to the assessee was receipt of income or of a capital sum. The Privy Council held that it was income receipt as the owner of an estate had exchanged a capital asset for a life annuity which was income in his hands and not a case in which he had exchanged his estate for a capital sum payable in instalments. This case again deals with an amount received as consideration by the vendor. As against this, Mr. Joshi has relied on another Privy Council case which is also a case of royalty and that is reported in *Minister of Nat. Rev. v. C. Spooner*² That was a case from Canada. In that case the assessee entered into an agreement with an oil company by which she sold to the company 20 acres of her land and the price for this transaction was a fixed sum of money and issue to the assessee of a certain number of fully paid shares in the company and a 'royalty' of 10 per cent. of all the oils produced from the lands; and the Privy Council held that the share of the oil reserved to the assessee was not a 'royalty' in the ordinary sense but was in effect payment by instalments of part of the price of the lands which she had sold to the company; it was not 'income' but a capital receipt and the amount paid to the assessee was not assessable to income-tax. Now, Mr. Joshi has pointed out that in this case also the delivery of 10 per cent. of oil was for an indefinite period and it had no relation to any specific sum fixed as the price. Frankly this case has caused me considerable difficulty and it may appear as if this case is not reconcilable with the case reported in *Commissioner's of Inland Revenue v. 36/49 Holdings, Ltd*³. But one or two aspects of this case may be pointed out. The Privy Council particularly emphasized the fact in their judgment that the assessee agreed to receive her share in the oil produced in kind and not in money and that seems to have been one factor which led the Privy Council to the conclusion that in this particular agreement what was received by the assessee was not 'royalty' in the sense in which 'royalty' is ordinarily understood where certain cash is paid on the basis of production. The second aspect of the case is that their Lordships themselves frankly admit that the case they were deciding was not without its difficulties, and they were really affirming the unanimous decision of the Supreme Court of Canada; and finally, as I have pointed out with regard to the earlier royalty cases, the Privy Council was considering not whether the delivery of 10 per cent. of oil by the company to the assessee was capital or revenue expenditure as far as the company was concerned but whether it was capital or revenue income in the hands of the assessee. There may easily be cases when, although in the hands of the vendor a particular receipt may be capital receipt, yet in the hands of the purchaser it may be a revenue expenditure. It is also important to note that this case was relied upon by the Patna High Court in the case reported in *Commissioner of Income-tax v. Gopal Saran Narain Singh*⁴, by the Judge who gave the dissenting judgment and from which decision an appeal was preferred to the Privy Council and which was decided in the case to which I have referred, namely, *Gopal Saran Narain Singh v. Commissioner of Income-tax, B. & O.* The Privy Council have expressed no opinion as to the correctness or otherwise of the decision reported in *Minister of Nat. Rev. v. Spooner* (1933-1 I. T. R. 299 P. C.) (supra); but they have refused to agree with the views of the dissenting Judge who relied on this case for his decision.

5. On a review of these authorities, I must again confess that the case is by no means free from difficulty. All the Judges, either here or in England, who have considered this intricate question

as to whether a particular payment is capital expenditure or revenue expenditure have always prefaced their judgment by saying that the matter is not very easy to decide, and I think I find myself in very good company when I echo their sentiments and say that it is not easy to decide whether this particular payment is capital or revenue payment. But I am fortified in the decision I have arrived at by the case to which Sir Jamshedji has referred, namely, the decision in Commissioners of Inland Revenue v. 36/49 Holdings, Ltd., ((1943) 25 Tax Cas. 173). There may be other decisions which may perhaps seem to have taken a different view ; but as that is a very recent decision and as the facts there are practically identical with the facts we have to consider in this case. I think on the whole I would take the same view as the Court of appeal took in that case and hold that as the payment made by the assessee is a payment made for an indefinite period, a payment made in relation to the turnover of the company and not in relation to its profits, and as this payment has no bearing to any specific sum fixed as part of the price for the purchase of the undertaking, this payment is in the nature of revenue payment and not capital payment.

6. We would, therefore, answer both the questions submitted to us in the affirmative.

7. Commissioner to pay the costs.

Tendolkar, J.

8. I. agree.

Cases Referred.

1(1943) 25 Tax Cas. 173

21933-1 I. T. R. 299 (P. c.)

3(1943) 25 Tax Cas. 173

413 Pat. 661; (A. I. R. (21) 1934 Pat. 384 F.B)