PATNA HIGH COURT

Commissioner of Income-tax

Vs

Ranchi Electric Supply Co. Ltd

Misc. J.C. Nos.330 and 331 of 1951

(Ramaswami and Choudhary, JJ.)

22.04.1954

JUDGMENT

Ramaswami,J.

1. In this case the assessee is a public limited company. The assessment year is 1947-48 and the accounting year is from 1-1-1946 to 31-12-1946. During this accounting year the assessee incurred an expenditure of Rs.8,582 for installing new electric connections to consumers. The assessee received in its turn a total sum of Rs.8,520 from the respective consumers for having taken the new electric connections. In the course of assessment proceeding the assessee claimed that the expenditure of Rs.8,582 was expenditure on capital account and that depreciation should be allowed on this amount. The assessee also made a claim that the receipt of Rs.8,520 from the consumers was of capital nature and ought not to have been taken into account for the assessment of tax. The Income-tax Officer rejected both the contentions raised by the assessee. The Income-tax Officer held in the first place that the receipt from the consumers for service connection was of revenue nature and was liable to be taxed. The Income-tax Officer further held that the expenditure of Rs.8,582 was also revenue in nature. The Income-tax Officer rejected the claim of depreciation on this amount but deducted that amount from the gross income liable to be taxed. An appeal was taken by the assessee to the Appellate Assistant Commissioner and the only question argued before him was whether the expenditure of Rs.8,582 was of capital nature and whether the assessee was entitled to be granted depreciation on this amount. The appeal was dismissed by the Appellate Assistant Commissioner. The matter was again taken in appeal to the Income-tax Appellate Tribunal and the only question again argued was whether the expenditure of Rs.8,582 was of capital nature and whether the assessee should be granted depreciation allowance. The appeal was allowed by the Appellate Tribunal on the finding that the amount of Rs.8,582 was expenditure on capital account and the assessee was entitled to depreciation on the whole of this amount under Section 10(2)(vi), Income-tax Act. The Tribunal took the view that depreciation is to be allowed to the assessee on the whole amount of Rs.8,582 without deducting the amount of Rs.8,520 as contribution made by the consumers for installing service connection. In support of their view the Tribunal referred to the decision of the Bombay High Court in - *'Commissioner of Income-tax v.*

Poona Electric Supply Co. Ltd[1]*.,*

2. In these circumstances the Appellate Tribunal has submitted the following questions of law for the opinion of the High Court

> "(1) Whether in the circumstances of the case, the Tribunal was right in holding that receipts from service connections are capital receipts? and (2) Whether, in the circumstances of the case, depreciation is allowable on the amount of cost incurred on service connection"?

3. In our opinion the first question does not arise out of the order of Tribunal within the meaning of Section 66(1) of the Act and the High Court is not competent to decide that question. It is admitted position that the question whether the receipt from the consumers for service connection is capital receipt or revenue receipt was not raised before the Appellate Assistant Commissioner. The assessee was content with the order of the Income-tax Officer that the receipt was of revenue character and preferred no appeal on that question to the Appellate Assistant Commissioner. Before the Tribunal also neither the assessee not the Income-tax Department raised the question whether the receipt from service connection was of capital nature or of revenue nature. For the first time the Income-tax Department raised the question in the application made to the Tribunal for reference under Section 66(1) of the Act. An objection was taken on behalf of the assessee before the Tribunal that the question did not arise out of the order of the Tribunal and could not properly be the subject-matter of reference to the High Court under Section 66(1) of the Act. The application was rejected by the Appellate Tribunal. The Income-tax Department thereupon moved the High Court under Section 66(2) of the Act. It is true that the High Court had at that stage asked the Tribunal to state a case on both the questions of law. It is nevertheless clear that the question as to the character of the receipt from the consumers for service connection was not raised before the Tribunal and was not dealt by it in its appellate order. It follows that the High Court had no jurisdiction to call for a statement of a case on this question. The matter has been elaborately discussed by a Bench of this Court in -*'Kamal Singh v. Commissioner of Income-tax*[2]*',* It was pointed out in that case that the special jurisdiction of the High Court under Section 66(2) depends upon the strict fulfilment of the preliminary conditions required by the section and unless the question of law was actually raised by the parties before the Tribunal or dealt with in the order of the Tribunal the High Court has no jurisdiction to discuss and answer that question of law. For these reasons we do not propose to furnish any answer to the first question, which has been referred by the Tribunal in this case.

4. As regards the second question Mr. R.J. Bahadur on behalf of the Income-tax Department made the submission that the amount of Rs.8,582 must be treated as revenue receipt and the assessee was not entitled to any depreciation under Section 10(2)(vi) of the Act. Mr. Bahadur did not dispute the correctness of the decision of the Bombay High Court in AIR 1947 Bombay 263, but the argument of the learned counsel was that the present case was distinguishable and cannot be governed by the decision of the Bombay High Court. In our opinion the argument of Mr. Bahadur cannot be accepted as correct. The question depends in the first place, upon the interpretation of Section 10(2)(vi) of the Act which states that the assessee is entitled to an allowance

> "in respect of depreciation of such buildings, machinery plant or furniture being the property of the assessee, a sum equivalent (where the assets are ships other than ships ordinarily plying on inland waters), to such percentage on the original cost thereof to the assessee as may in any case or class of cases be prescribed and in any other case, to such percentage on the written down value thereof as may in any case or class of cases be prescribed .....".

In this connection Section 10(5)(a) is also important, Section 10(5)(a) states-

> "In sub-section (2), 'paid' means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section; 'plant' includes vehicles, books, scientific apparatus and surgical equipment purchased for the purposes of the business, profession or vocation; and 'written down value' means- (a) in the case of assets acquired in the previous year, the actual cost to the assessee.....".

The question to be determined involves the correct interpretation of the phrase "actual cost to the assessee" which occurs in Section 10(5)(a) of the Act. It was pointed out by Mr. Bahadur that the assessee has recouped the cost of installing the service connection from the consumers to the extent of Rs.8,520 and this amount should not therefore be treated as actual cost incurred by the assessee within the meaning of Section 10(5)(a) of the Act. I do not think that the submission is right. In considering what is the actual cost to the assessee for the service connection the question as to the source from which the money came is wholly immaterial. The only point to be determined is what is the actual cost of installation of service connection and not what is the proportion of the cost which is contributed by the assessee or which is contributed by the consumers to whom service connection is given. That is the true meaning of the expression "actual cost to the assessee" which occurs in Section 10(5)(a). The conception of depreciation which is allowed under Section 10(2)(vi) involves the conception of replacement of the particular machinery or of the particular service connection and examined from this standpoint also it is clear that the phrase "actual cost to the assessee" which occurs in Section 10(5)(a) of the Act must be interpreted to mean the actual cost incurred in installing service connection irrespective of any consideration as to the amount actually contributed by the assessee or the amount actually recouped ultimately from the consumers. This view is in accordance with the decision of the Bombay High Court in AIR 1947 Bombay 263. The same principle has been laid down by the House of Lords in an English case, - *'Corporation of Birmingham v. Barnes[3]',* (C). In that case the Corporation of Birmingham had entered into an agreement with a company to lay a tramway track and establish a tramway service to the company's works and, by virtue of the work having been completed and the service established by a certain date, received from the company, in accordance with the terms of the agreement, a specified sum. The Corporation had also expended a considerable amount on the renewal, etc., of their
tramway tracks, in respect of which they received grants from the Unemployment Grants Committee. These grants were made by the Ministry of Labour under certain conditions to local authorities to assist them in carrying out at once approved schemes of work of public utility on which a substantial number of unemployed persons could be engaged. The question was raised whether the payment by the company and the grant from the Unemployment Grants Committee should be taken into account in ascertaining, under Rule 6(6) of Cases I and II of Schedule D, the

'actual cost' to the Corporation of the tramway tracks in question for the purposes of computing depreciation allowance. Rule 6(6) of Cases I and II of Schedule D of the English Act is in the following terms:

> "No deduction for wear and tear, or repayment on account of any such deduction, shall be allowed for any year if the deduction, when added to the deductions allowed on that account for any previous years to the person by whom the trade is carried on, will make the aggregate amount of the deductions exceed the actual cost to that person of the machinery or plant, including in that actual cost any expenditure in the nature of capital expenditure on the machinery or plant by way of renewal, improvement, or re-instatement."

It was held by Lord Atkin that the question should be answered in the negative and that the payment by the company and the grant from the Unemployment Grants Committee should not be taken into account in ascertaining the "actual cost" to the Corporation of the tramway tracks under Rule 6(6) of cases I and II of schedule D.
At page 216, Lord Atkin states:

> "But it is said that the words 'to that person' in the phrase 'actual cost to that person' plainly indicate that the section is intending to confine the relief to an aggregate equal to the sum of money which the person has defrayed out of his own resources, the cost of the burden which has ultimately fallen upon him. My Lords, I confess I do not think that this is the natural meaning of the words. What a man pays for construction or for the purchase of a work seems to me to be the cost to him; and that whether someone has given him the money to construct or purchase for himself, or before the event has promised to give him the money after he has paid for the work, or after the event has promised or given the money which recoups him what he has spent. In the present case the Corporation paid the whole of the cost of the tramways out of their funds unless the first half of the Dunlop contribution was so applied, as to which there is no evidence, nor is it material. I myself should not have thought the answer of Birmingham Corporation to the question put by Lord Justice Romer would have been what he suggests. On the hypothesis that the Dunlop Company had recouped the Corporation the whole of the cost of the first tramway I should have thought the answer to 'what did it cost you?' or 'what did it actually cost you?' would have been 'It actually cost us £54,752 but none of the burden of that cost will fall on the Corporation, for the Dunlop Company have paid us the full amount.'. I think the same result is arrived at by saying 'actual cost to that person' is the same thing as the amount expended by the person."

5. Applying the principle laid down in these authorities I hold that the amount of Rs.8,520 which was paid by the consumers on account of service connection should not be taken into account in calculating the actual cost to the assessee for the purposes of allowing depreciation under Section 10(2)(vi) read with Section 10(5)(a), Income-tax Act.

6. I wish to add that the law has been changed by the Income-tax Amendment Act of 1953. The effect of the amendment is that the decision of the Bombay High Court in AIR 1947 Bombay 263 has been nullified so far as the contributions made by Government or public or local authorities are concerned. By means of the Amending Act a new explanation has been added to Section 10(5)(c) which is in the following terms:

> "For the purposes of this sub-section, the expression 'actual cost' means the actual cost of the assets to the assessee reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by Government or by any public or local authority, and any allowance in respect of any depreciation carried forward under Clause (b) of the proviso to Clause (vi) of sub-section (2) shall be deemed to be depreciation 'actually allowed'."

The new amendment does not apply to this case. But even if it had applied, my decision would not have been different, for the new explanation only relates to contributions made directly and indirectly by Government or public or local authoirity and not the contributions made by private consumers.

7. Mr. R.J. Bahadur also put forward the argument that the amount of Rs.8,582 which was spent by the assessee in installing service connection was an expenditure out of income and not capital expenditure and so the assessee was not entitled to any depreciation on the cost of installing the service connection. I am unable to accept this argument. The Tribunal held that the case was governed by the decision of the Bombay High Court in AIR 1947 Bombay 263. The Tribunal accordingly held that the expenditure on service connection was an expenditure on capital account and the assessee Company was entitled to ask for depreciation on that amount. In my opinion the view taken by the Tribunal is undoutedly correct. The true test to be applied is this - Is the expenditure made with a view to bring into existence an asset or an advantage for the enduring benefit of the electric supply business? It is admitted position that the service line is of a quasi-permanent character and that installation of service lines essential if electricity is to be supplied to the consumers. In other words, the service line which is installed is an income producing asset of a substantial character. The order of the Income-tax Officer shows that upon electric fittings depreciation of 10 per cent. is normally allowed. Upon this basis the life of electric service line would be about 10 years and it is difficult to accept the argument of Mr. Bahadur that there is any revenue quality in the expenditure incurred over service connection. In my opinion the asset created in this case has enough durability to justify its being treated as a capital asset and the expenditure incurred for installation of service connection must therefore be treated as a capital expenditure.

8. This view is in accordance with the principle laid down by the Lord Chancellor in - *'British Insulated and Helsby Cables, Ltd. v. Atherton*[4]*',* where he states:

> "But 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. For this view there is already considerable authority."

The same principle has been reiterated by the Court of Appeal in a recent English case, - *'Henriksen v. Grafton Hotel', Ltd*[5]. In that case tenants of licensed premises, by agreement with the landlord, paid by installments the monopoly value fixed by the licensing justices when granting the license under Section 14 of the Licensing (Consolidation) Act, 1910. In computing their profits for the purposes of income-tax they claimed to deduct, as disbursements wholly and exclusively laid out for the purposes of their trade, the amount of the installments. In these circumstances it was held by the Court of Appeal that the tenants were not entitled to make any such deductions, and that payments of the character in question fell into the same class as the payments of a premium on the grant of a lease or the expenditure on improvements to the property which justices might require to be made as a condition of granting a licence. In the course of his judgment Lord Justice Du Parcq states:

> "It is true that the period for which the right was acquired in this case was three years and no more, and a doubt may be raised whether such a right is of 'enduring benefit' or 'of a permanent character'. These phrases, in my opinion, were introduced only for the purpose of making it clear that the 'asset' or 'right' acquired must have enough durability to justify its being treated as a capital asset. This is borne out, so far as Lord Clyde's judgments are concerned, by the fact that in - *'Inland Revenue Commissioners v. Adam*[6]*',* the duration of the right acquired was eight years, and that his Lordship there spoke of its 'relatively permanent character'. 'Permanent' is indeed a relative term, and is not synonymous with 'everlasting'. In my opinion the right to trade for three years as a licensed victualler must be regarded as attaining to the dignity of a capital asset, whereas the payment made for an excise licence is no doubt properly regarded as part of the working expenses for the year".

9. Reference was made by Mr. Dutt in the course of his argument to para. 6 of the Schedule to the Indian Electricity Act (9 of 1910) which imposes a duty upon the licenses to instal new service connection upon requisition made by the owner or occupier of any Premises situated within the area of supply provided that the person making the requisition complies with certain conditions. Proviso (b) to para. 6 of the Schedule empowers the company to realize the cost of service connection from the consumers. Further, sub-clause (2) of para. 6 of the Schedule imposes a duty upon the company to maintain the service line. Reference was also made by the counsel to annexure-V of the rules framed under the Act relating to the model form of accounts

to be kept by the Electric Companies. The model form states that the cost of service connection should be adjusted towards the capital account. This view of legislative authority is of course not binding upon me or the Income-tax authorities. But it reinforces the reasons I have already given for reaching the finding that the amount of Rs.8,582 which is the expenditure incurred by the assessee in installing service connection is in the nature of capital expenditure.

10. For the reasons I have expressed I consider that the second question referred to the High Court by the Appellate Tribunal must be answered in favour of the assessee. The Income-tax Department must pay the cost of this reference. Hearing fee Rs.250.

Choudhary, J.

11. I agree.

Questions answered accordingly.

Cases Referred.

[1] AIR 1947 Bom 263
[2] AIR 1954 Pat 540
[3](1935) 19 Tax Cas 195
[4](1926) A.C. 205
[5](1942) 2 KB 184
[6](1928) S. C. 738