

PATNA HIGH COURT

Electric Supply Co. Ltd

Vs

Commissioner of Income Tax

Misc. Judicial Case No. 403 of 1952

(Ramaswami and Choudhary, JJ.)

29.04.1954

JUDGMENT

Ramaswami, J.

1. In this case the assessee is a public limited company called the Monghyr Electric Supply Company, Ltd., which carries on the business of supply of electricity in the towns of Monghyr and Jamalpur. The assessment in this case relates to the assessment year 1947-48 and the corresponding accounting year is financial year 1946-47 ending with 31st of March 1947. During this accounting year the assessee Company received a sum of Rs. 8,674 as cost of service connection from different consumers. During the same year the Company spent in its turn a sum of Rs. 7,504 on the materials and labour involved in the installation of the service connection. The amount of Rs. 7,504 was made up as follows :

(a)	Stores i.e., wire, brackets etc. (From Stores account).	Rs. 2,81
(b)	Do. (Directly purchased).	Rs. 1,21
(c)	Do. (Out of Salary Bills).	Rs. 785
(d)	Do. Wages Bills.	Rs. 2,68
		Rs. 7,50

In its book account the Company treated the service connection receipt amounting to Rs. 8,674 as revenue receipt and included this amount in its total return of income which was Rs. 2,52,728. The Company treated, however, the amount of Rs. 7,504 which was spent on the service connection as capital expenditure. The Company consequently claimed depreciation on the amount of Rs. 7,504 which had been spent on the service connection. In the course of assessment proceeding the Income-tax Officer refused to accept the Company's claim that the amount of Rs.

8,674 should be treated as capital receipt and not as revenue receipt. The Income-tax Officer considered that the amount of Rs. 8,674 should be treated as revenue receipt and was liable to be taxed in the hands of the assessee.

The Income-tax Officer, however, treated the amount of Rs. 7,504 spent on service connection as capital expenditure and allowed depreciation at the rate of 10 per cent. The assessee took an appeal to the Appellate Assistant Commissioner and contended that the amount of Rs. 8,674 should be treated as capital receipt. The appeal was allowed by the Appellate Assistant Commissioner who accepted the contention of the assessee and excluded the amount of Rs. 8,674 from the total income of the assessee which was liable to be taxed. The Appellate Assistant Commissioner adopted this course in view of the decision of the Bombay High Court in - '*Commissioner of Income Tax v. Poona Electric Supply Co. Ltd.*', The Income-tax Officer took an appeal to the Income-tax Appellate Tribunal from the decision of the Appellate Assistant Commissioner. The contention of the Income-tax Officer was that the amount of Rs. 8,674 should be treated as revenue receipt and should not have been excluded from the total income of the assessee Company. The appeal was allowed by the Appellate Tribunal who held that the amount of Rs. 8674 should be treated as revenue receipt and was liable to be taxed. The Tribunal thought that the decision of the Bombay High Court in Poona Electric Supply Company's case was not applicable as the contribution made by the consumer in that case was for an extension of the mains. The Tribunal further held that the expenditure of Rs. 7,504 on service connection should be deducted from the amount of Rs. 8,674 which was the contribution made by the consumers and only the excess of Rs. 1,170 should be added to the total income of the assessee Company.

2. In this state of facts the Appellate Tribunal has submitted the following questions of law for the opinion of the High Court :

1. Whether the sum of Rs. 8,674 representing the total of the amount received on account of service connection charges was liable to inclusion in the company's business income for the assessment year 1947-48? and 2. Whether the sum of Rs. 7,504 representing the expenditure incurred by the company in giving service connections was deductible in arriving at the company's income from business for the year 1947-48?

3. As regards the first question Mr. Dutt who appears on behalf of the assessee presented the argument that the Appellate Tribunal was wrong in holding that the expenditure incurred on the service connection did not bring into existence an asset or an advantage of lasting character. Counsel also made the submission that the Appellate Tribunal misdirected themselves in law in holding that the decision of the Bombay High Court in - '*Poona Electric Supply Company's case*' was not applicable to the present case. In my opinion the argument of Mr. Dutt must be accepted as correct and the Appellate Tribunal had no justification for holding that the decision of the Bombay High Court in - '*Poona Electric Supply Company's case*' was distinguishable. The Tribunal observed that in the Bombay case the contribution made by the Government was for the

purpose of extending the mains, but in the present case the contribution made by the consumer was for the purpose of installation of service line. The Tribunal also said that the utility of service connection was confined to a particular consumer and if for any reason service was disconnected the wires and other materials used for installing the service connection have no recovery value. I do not think these considerations have any bearing on the question as to whether the expenditure on service connection is of capital nature or if it is of revenue nature.

Mr. Narayan Row, one of the Members of the Tribunal, stated in course of the order that the expenditure on service connection comprises chiefly of the cost of copper wire (steel pipe) and wages. He added that it was possible that if the consumer lived at a distance from the mains, the Company would be required to put up a pole or two poles for the carriage of the current. In such a case the expenditure incurred on the poles would be of a capital nature. I do not think that the distinction made by Mr. Narayan Row is a valid distinction. The question at issue does not turn upon the fact whether the expenditure was incurred in copper wire or in putting up poles. The true question to be asked in this case is this-Is the expenditure on the service connection made with a view to bring into existence an asset or an advantage for the lasting benefit of the business of the assessee? It is the admitted position in this case that electric current cannot be supplied to consumers without the installation of service connection. It is also admitted that the life of the service connection is about 10 years, for the Income-tax Officer granted an allowance of 10 per cent. depreciation on the basis that the service connection was in the nature of a capital asset. It is clear that the service connection is of a quasi-permanent character and that the service connection is installed essentially in order to supply electricity to consumers. To put it in other words, the service connection is an income producing asset-it is an asset or an advantage for the substantial benefit of the business of electric supply carried on by the assessee. These considerations are, in my opinion, sufficient to stamp the expenditure on service connection with the character of a capital expenditure and there is no revenue quality in that expenditure.

4. This conclusion that I have come to is consistent with the principle laid down by important authorities. In - '*British Insulated and Helsby Cables, Ltd. v. Atherton*'², the Lord Chancellor said :

"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."

It is true that the period for which the service connection would last will be about 10 years or thereabout. But that does not mean that the asset which is brought into existence is not of an "enduring benefit to the business". In my opinion, the service connection which has been installed by the assessee in this case has enough durability to justify its being treated as a capital asset. To put it differently, the service connection which has been installed by the assessee must

be regarded as reaching the dignity of capital asset and expenditure on the creation of this asset must be treated as a capital expenditure and not an expenditure from revenue. This view is in accordance with the principle laid down by the Court of Appeal in - *'Henriksen v. Grafton Hotel, Ltd.'*³, (C). In that case the respondent Company was the tenant of a fully-licensed hotel, the lease providing that the tenant should pay all charges imposed in respect of the licenses by virtue of the Licensing (Consolidation) Act, 1910. On the renewal of the license in March 1934 and in March 1937, sums in respect of monopoly value were imposed, payable in installments. The Company appealed against assessments under Sche. D claiming that the installments of monopoly value should be deducted in computing the assessments. The Commissioners allowed the appeal, but on reference to the High Court, Lawrence, J., gave judgment in favor of the Crown. An appeal was taken by the assessee to the Court of Appeal who allowed the appeal holding that the installments were capital sums and that the installments did not lose their capital nature because the Company had undertaken to pay them under its lease, and that they were not admissible deductions for income-tax purposes. 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 Commrs. v. Adam'*⁴, 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 license is no doubt properly regarded as part of the working expenses for the year".

5. But the question in this case is not whether the amount of Rs. 7,504 is a capital expenditure but whether the amount of Rs. 8,674 contributed by the consumer should be treated as revenue receipt. I have nevertheless discussed the question of the character of the expenditure of Rs. 7,504 on service connection because the answer to that question has a material bearing on the question as to the character of the receipt of Rs. 8,674 which was paid by the consumer to the assessee Company. The argument of Mr. Dutt on behalf of the assessee is that the amount paid by the consumers for meeting the cost of service connection was a capital receipt in the hands of the Company. The argument was that the money paid towards the recoupment of the expenditure of capital asset must be treated as a capital receipt. In my opinion the argument must be accepted as correct. It is true that in the books of account the assessee Company has treated the receipt from the consumers for installing service connection as revenue receipt. But the Company was bound to adopt this method of accounting since R. 32 read with Annexure, requires that receipts

from the consumers for service connection should be shown as revenue receipt. This mode of accounting is not however binding upon this court or upon the Income-tax authorities. In determining the question whether the receipt is of a capital nature or of income nature we have got to look to the substance of the matter and we have to examine what is the true effect and character of the payment made by the consumers. The amount was paid by the consumers as required by para. 6 of the Schedule to the Indian Electricity

Act. Para 6 states that the licensee is bound to comply with the requisition of an owner or an occupier of a house for supply of electricity provided that the person making the requisition tenders to the licensee a written contract, in an approved form, binding himself to take a supply of energy for not less than two years at current rates and also pay to the licensee the cost of so much of any service line as may be laid down on the property for supplying electricity and also of so much of any service line as it may be necessary to lay down beyond one hundred feet from the licensee's distributing main, although not on that property. The contribution made by the consumers is therefore a contribution compelled by the statute for the purpose of installation of the service line. In my opinion the contribution of Rs. 8,674 made by the consumers has the character of a capital receipt for the amount has been paid in advance for installation of a capital asset.

6. This view is consistent with the decision of the Bombay High Court in - 'AIR 1947 Bombay 263. The principle laid down in that case applies to the present case where the facts are almost parallel. The same principle has been laid down in an English case, - '*the Seaham Harbour Dock Co. v. Croog*'⁵, (E). In that case a dock company contemplating an extension of its dock applied to the Unemployment Grants Committee for financial assistance. The Committee consented to sanction grants from time to time, as the work progressed and was paid for, equivalent to half the interest for two years on approved expenditure met out of loans. Payments were made on this basis several times a year for some years. Assessments to income-tax were made upon the Company upon the footing that these payments were part of its annual profits or gains. It was held by Rowlatt, J., that the payments were annual profits or gains liable to income-tax. This decision was reversed by the Court of appeal who took the view that the amounts paid by the Unemployment Grants Committee should not be included in revenue subject to income-tax. The Crown appealed to the House of Lords and the decision of the Court of Appeal was affirmed and it was held that the grants made by the Unemployment Grants Committee was not a trade receipt in the hands of the dock company and that it ought not to be included in revenue for the purpose of tax. At p. 353 Lord Buckmaster states :

"Now I do not myself think that the matter can be put more succinctly than it was put by Mr. Hills when he said- 'Was this a trade receipt?' and my answer is most unhesitatingly: No. It appears to me that it was nothing whatever of the kind. It was a grant which was made by a government department with the idea that by its use men might be kept in employment, and it was paid to and received by the Dock Company without any special allocation to any particular part of their property, either capital or revenue, and was simply

to enable them to carry out the work upon which they were engaged, with the idea that by so doing people might be employed. I find myself quite unable to see that it was a trade receipt, or that it bore any resemblance to a trade receipt. It appears to me to have been simply a grant made by the Government for the purposes which I have mentioned, and in those circumstances cannot be included in revenue for the purposes of tax."

7. The same view has been taken by the English Court of Appeal in another case, - *'Boyce v. Whitwick Colliery Co., Ltd'*⁶, (F). In that case a Colliery Company and an Urban District Council had entered into an agreement for the supply of surplus water from the Company's collieries to the Council, which carried on a water undertaking on the terms: (1) that the Company should erect such buildings, plant, etc., as were necessary for the pumping, distribution, etc., of the water and (2) that the Council should pay annually to the Company (a) a fixed sum (b) a sum equal to one-thirtieth of the cost of the works; (c) interest on any portion of such cost for the time being unpaid; and (d) a sum of 1d. per thousand gallons of water supplied. The agreement was to continue in force for 30 years at the end of which the buildings, plant, etc., were to remain the property of the Company, but, in the event of the Company ceasing to work its collieries during the continuance of the agreement, the Council were to be allowed to continue pumping the water. It was held by the Court of appeal upon these facts that the agreement between the Company and the Council in effect provided for two distinct matters, viz., (a) a supply of water at an agreed price and (b) the construction of the works necessary to provide the supply of water, upon terms that the Council should reimburse the Company the cost of these works. It was further held by the Court of Appeal that the annual payments equal to one-thirtieth of such cost were not part of the payments for the supply of water but were repayments of the capital cost of the works, and were, accordingly, capital receipts not assessable to income-tax in the hands of the Company. In the course of his judgment Romer L. J. states as follows : "At the time when that agreement was entered into it is sufficiently plain that the Colliery Company, though no doubt well equipped both as regards machinery and buildings for the purpose of carrying on a colliery business, were not properly equipped in either respect for the purpose of supplying water to the Urban District Council. The Urban District Council were desirous that water should be supplied to them by the Colliery Company and they, therefore, must have recognized that, if a contract was to be entered into by the Colliery Company for supplying water to them, the Colliery Company must put themselves into a position, by the provision of adequate machinery and buildings, to do so. If, in those circumstances the Colliery Company had agreed with the Urban District Council that they would themselves erect the necessary buildings and machinery for the purpose and the District Council had agreed that, in consideration of their so doing, the Council would repay to the Colliery Company, by thirty yearly installments, the cost to which the Colliery Company had been thereby, put, I cannot conceive that anyone could contend successfully that the sums so paid by the District Council to the Colliery Company were liable to income-tax, even though, at the end of the thirty years, the buildings and plant, which presumably by that time would not be worth very much, should remain the property of the Colliery Company. A tax payer can make a capital expenditure upon the land of a third party; it

is, nonetheless, a capital expenditure even if it is upon the land of a third party and not upon his own land."

8. Applying the principle of these authorities to the present case I am clearly of opinion that the payment of Rs. 8,674 on account of the cost of service connection is a capital receipt in the hands of the assessee Company, and ought not to be included in the Company's income for the assessment year 1947-48. An argument was advanced by Mr. R. J. Bahadur that the question whether a certain item of receipt is of a capital nature or of a revenue nature ought to be treated as a question of fact which the

Appellate Tribunal was competent to determine and the High Court should not interfere with that finding on a reference made under Section 66, Indian Income-tax Act. In my opinion the argument is not well founded. The question at issue is not a pure question of fact but is a mixed question of fact and law and if the Appellate Tribunal has applied a wrong legal principle in determining this question the matter passes from the realm of fact into the realm of law and High Court is entitled to interfere with the finding of the Appellate Tribunal in such a case. In - '*Anglo-Persian Oil Co., Ltd. v. Dale*⁸', Lord Hanworth states as follows :

"It was argued that the finding of the Commissioners in the present case ought to be accepted as one of fact within their own sphere, and so not the subject of appeal as a question of law. This argument is not, to my mind, well founded. The cases upon this point of what is attributable to revenue, and what to capital account, run upon fine lines of distinction, and the Commissioners have to direct themselves correctly upon the questions of law that are involved. The deductions that are permissible must be examined from the point of view of law. They cannot be said to be simply questions of fact irrespective of the principles of law. It is, therefore, necessary to consider the principles upon which items have been held to belong to capital or revenue and the characteristics which have been held to turn a particular item into the one category or the other."

9. For the reasons I have expressed I consider that the amount of Rs. 8,674 received by the assessee on account of service connection charges was a capital receipt and was not liable to inclusion in the assessee's business income for the year 1947-48. In view of the answer to the first question it is not necessary to consider or furnish any answer to the second question which has been referred by the Appellate Tribunal. The assessee is entitled to the cost of this reference from the Income-tax Department. Hearing fee Rs. 250.

Choudhary, J.

10. I agree.

Answer accordingly

Cases Referred.

¹ AIR 1947 Bom 263

²(1926) AC 205

³(1942) 24 Tax Cas 453

⁴(1928) 14 Tax Cas 34

⁵(1931) 16 Tax Cas 333

⁷(1934) 18 Tax Cas 655

⁸(1931) 16 Tax Cas 253