Assam Bengal Cement Co. Ltd vs The Commissioner Of Income-Tax,West ... on 11 November, 1954

Equivalent citations: 1955 AIR 89, 1955 SCR (1) 876, AIR 1955 SUPREME COURT 89

Author: Natwarlal H. Bhagwati

Bench: Natwarlal H. Bhagwati, Mehar Chand Mahajan

PETITIONER:
ASSAM BENGAL CEMENT CO. LTD.

Vs.

RESPONDENT:
THE COMMISSIONER OF INCOME-TAX,WEST BENGAL

DATE OF JUDGMENT:
11/11/1954

BENCH:
BHAGWATI, NATWARLAL H.
BENCH:
BHAGWATI, NATWARLAL H.
MAHAJAN, MEHAR CHAND (CJ)
DAS, SUDHI RANJAN
AIYYAR, T.L. VENKATARAMA

CITATION:
1955 AIR 89 1955 SCR (1) 876

ACT:
Indian Income-tax Act (XI of 1922), s. 10(2)(xv)-Capital expenditure-Revenue expenditure-Meaning of and distinction between the two.

HEADNOTE:
Section 10(2)(xv) of the Indian Income-tax Act, 1922, uses the term 'capital expenditure' for which no allowance is given to the assessee. The term 'capital expenditure' is used as contrasted with the term 'revenue expenditure in respect of which the assessee is entitled to allowance under section 10(2) (xv) of the Act.
As pointed out by the Full Bench of the Lahore High Court in Benarsidas Jagannath, In re [(1946) 15 I.T.R. 185] it is not

easy to define the term 'capital expenditure' in the abstract or to lay down any general and satisfactory test to discriminate between a capital and a revenue expenditure. Though it is not easy to reconcile all the decided cases on the subject, as each case had been decided on its peculiar facts, some broad principles could be

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deduced from what the learned judges have laid down from time to time:

(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: vide Lord Sands in Commissioners of Inland Revenue v. Granite City Steamship Company ([1927] 13 T. C. 1) and City of London Contract Corporation v. Styles ([1887] 2 T. C. 239).

(2)Expenditure may be treated as properly attributable to capital when it 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: vide Viscount Cave, L.C., in Atherton v. British Insulated and Helsby Cables Ltd. ([1926] 10 T.C. 155). If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be deducted out of the profits by claiming that it relieves the annual labour bill, the business has acquired a now asset, that is, machinery.

The expressions 'enduring benefit' or 'of a permanent character' were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset.

(3)Whether for the purpose of the expenditure, any capital was withdrawn, or, in 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. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it.

One has got to apply these criteria, one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductible allowance under

section 10(2)(xv) of the Indian Income-tax Act, 1922. The question has all along been considered to be a question of fact to be determined by the Income_ tax Authorities on an application of the broad principles laid down above and the Courts of law would not ordinarily interfere with such findings of

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fact if they have been arrived at on a proper application of those principles.

The assessee acquired from the Government of Assam a lease for 20 years (with a clause for renewal) in respect of certain limestone quarries situated in Khasi and Jaintia Hills. In addition to the rents and royalties for lease the assessee as the lessee had to pay two further sums as protection fees' under the covenants contained in clauses 4 and 5 of the lease. Under clause 4 the portection was in respect of another group of quarries called the Durgasil area, and the lessor undertook not to grant for this area any lease, permit or prospecting licence regarding limestone to any other party except with a condition that no limestone should be used for the manufacture of cement. This protection was given in consideration of a sum of Rs. 5,000 annually payable by the assessee during the whole period of the lease. Under clause 5 a further protection was given by the lessor to the lessee in respect of the whole of the Khasi and Jaintia Hills District for which lessee was to pay annually Rs. 35,000 to the lessor for 5 years. According to these covenants the assessee in his capacity as the lessee paid the lessor a sum of Rs. 40,000 for the accounting years 1944-45 and 1945-46.

Held, that the sum of Rs. 40,000 was a capital expenditure inasmuch as it was incurred for the acquisition of an asset or advantage of an enduring nature for the whole of the business and Was no part of the working or operational expenses for carrying on the business of the assesses. Accordingly the payment of Rs. 40,000 was not an allowable deduction under section 10(2)(xv) of the Indian Income-tax Act, 1922.

Countess Warwick Steamship Co. Ltd. v. Ogg [1924] 2 K.B. 292), City of London Contract Corporation v. Styles [18871 2 T.C. 239), Vallambrosa Rubber Co., Ltd. v. Farmer ([1910] 5 T.C. 529), Ounsworth (Surveyor of Taxes) v. Vickers Limited ([19151 6 T.C. 671), Atherton v. British Insulated and Helsby Cables, Ltd. ([1925] 10 T.C. 1.55), Usher's case ([1915] 6 T.C. 399), John Smith & Son v. Moore (H. M. Inspector of Taxes), ([19211 12 T.C. 256), Anglo-Persian Oil Co. v. Dale ([1932] 1 K.B. 124), Golden Horse Shoe (New) Ltd. v. Thurgood (H. M. Inspector of Taxes), ([1933]18 T.C. 280). Van Den Berghs, Limited v. Clark (H. M. Inspector of Taxes) (I 19341 19 T.C. 390), Tata Hydro-Electric Agencies, Limited, Bombay v. Commissioner of Income-tax, Bombay Presidency and Aden ([19371 L.R. 64 I.A.

215), Sun Newspapers Ltd. and the Associated Newspapers Ltd. v. The Federal Commissioner of Taxation ([1938] 61 C.L.R. 337), Munshi Gulab Singh and Sons. v. Commissioner of Income-tax ([1945] 1-4 I.T.R. 66), Commissioner of Income-tax, Bombay v. Century Spinning Weaving and Manufacturing Co. Ltd. ([1946] 15 I.T.R. 105), Jagat Bus Service Saharanpur v. Commissioner Of Income-tax, U.P. & Ajmer Merwara ([1949] 17 I.T.R. 13), Commissioner of Income-tax, Bombay v. Finlay Mills Ltd., ([1952] S.C.R. 11), Commissioner of Income-tax v. Piggot Chapman. & Co.
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([1949] 17 I.T.R. 317) and Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd. ([1942] 2 K.B. 184), referred to.
Benarsidas Jagannath, In re, ([1946] 15 I.T.R. 185), approved.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 162 of 1952. Appeal from the Judgment and Order dated the 7th day of June, 1951, of the High Court of Judicature at Calcutta in Income-tax Reference No. 60 of 1950 arising out of the Order dated the 22nd day of November, 1949, of the Income-tax Appellate Tribunal in I.T.A. Nos. 1026 and 1027 of 1948-49 N. C. Chatterjee for the appellant.

Porus A. Mehta for the respondent.

1954. November, 11. The Judgment of the Court was delivered by, BHAGWATI J.-This appeal from the judgment And order of the High Court of Judicature at Calcutta with leave under section 66-A (2) of the Indian Income-tax Act raises an interesting question as to the line of demarcation between capital expenditure and revenue expenditure. On the 14th November, 1938, the appellant company acquired from the Government of Assam a lease of certain limestone quarries, known as the Komorrah quarries situated in the Khasi and Jaintia Hills District for the purpose of carrying on the manufacture of cement. The lease was for 20 years commencing on the 1st November, 1938, and ending on the 31st October, 1958, with a clause for renewal for a further term of 20 years. The rent reserved was a half-yearly rent certain of Rs. 3,000 for the first two years and thereafter a half-yearly rent certain of Rs. 6,000 with the provision for payment of further royalties in certain events. In addition to these rents and royalties two further sums were payable under the special covenants contained in clause& 4 and 5 of the lease as " protection fees ". Under clause 4 the protection was in respect of another group of quarries called the Durgasil area, the lessor undertaking not to grant any lease, permit or prospecting licence regarding the limestone to any other party therein without a condition that no limestone should be used for the manufacture of cement in consideration of a sum of Rs. 5,000 payable annually during the whole period of the lease. Under clause 5 a further protection was given in respect of the whole of the Khasi and Jaintia Hills District, a similar undertaking being given by the lessor in consideration of a sum of Rs. 35,000 payable annually but only for 5 years from the 15th November, 1940. In the accounting years

1944-45 and 1945-46 the company paid its lessor sums of Rs. 40,000 in accordance with these two covenants and claimed to deduct the sums in the computation of its business profits under the provisions of section 10(2) (xv) of the Income-tax Act in the assessments for the assessment years 1945-46 and 1946-47. The Income-tax Officer, the Appellate Assistant Commissioner and the Appellate Tribunal rejected the contention of the company and the following question, as ultimately reframed, was at the instance of the company referred by the Tribunal to the High Court for its decision :-

> " Whether, in the circumstances of the case, the two sums of Rs. 5,000 and Rs. 35,000 paid under clauses 4 and 5 of the deed of the 14th November, 1938, were rightly disallowed as being expenditure of a capital nature and so not allowable under section 10(2) (xv) of the Indian Income-tax Act ".

The High Court answered the question in the affirmative and hence this appeal.

Clauses 4 and 5 of the deed of lease may be here set out :-

> 4. The lessee shall pay to the lessor Rs. 5,000 (Rupees five thousand) only annually during the period of the lease on November 15th starting from November 15th, 1938, as a protection fee. In consideration of that protection fee the lessor undertakes not to allow any person or company any lease permit or prospecting licence for limestone in the group of quarries as described in Schedule 2- and delineated in the plan thereto annexed and therein coloured blue called the Durgasil area without a condition in such lease permit or prospecting licence that no limestone ,shall be used for the manufacture of cement.
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> 5.Besides the above protection fee the lessee shall pay to the lessor annually the sum of Rs. 35,000 (Rupees thirty five thousand) only for five years starting from the 15th day of November, 1940, as a further protection fee so long as the total amount of limestone quarried by the lessee in a year does not exceed 22,00,000 maunds per year whether quarried in the area of this lease or elsewhere or obtained by purchase from other quarries in the Khasi and Jaintia Hills by the lessees. If, however, in any year the total amount of limestone converted into cement at the lessee's Sylhet,Factory exceed 22,00,000 maunds the lessee will be entitled to an abatement at the rate of Rs. 20 for every 1,000 maunds quarried in excess of 22,00,000 maunds and the lessee shall pay the sum of Rs. 35,000 less the abatement calculated on the basis hereinbefore mentioned. Limestone which is not converted into cement at the lessee's factory in Sylhet district will not entitle the lessee to any abatement in the protection fee. The lessor in consideration of the said payment undertakes not to allow any person or company any lease permit or prospecting licence for limestone in the whole of Khasi and Jaintia Hills district without a condition in such lease permit or prospecting licence that no limestone extracted shall be used directly or indirectly for the manufacture of cement.

The lessor will be empowered to terminate this agreement for the payment of a protection fee at any time after it has run for 5 years by giving six month,%' notice in writing by registered letter addressed to 11, Clive Street, Calcutta but the lessee will not be entitled to terminate this agreement during the currency of the lease except with the consent of the lessor.

It is not clear as to what was meant by the last provision contained in clause 5, the lessee in the event of his having paid the sum of Rs. 35,000 for the 5 years having nothing else to do but enjoy the benefit of the covenant on the part of the lessor during the subsequent period of the lease. This provision is however immaterial for our purposes.

The line of demarcation between capital expenditure and revenue expenditure is very thin and learned Judges in England have from time to time pointed out the difficulties besetting that task. Lord Macnaghten a Dovey v. Cory(1), administered the following warning:-

> I do not think it desirable for any tribunal to do that which Parliament has abstained from doing-that is, to formulate precise rules for the guidance or embarrassment of business men in the conduct of business affairs. There never has been, and I think there never will be, much difficulty in dealing with any particular case on its own facts and circumstances; and, speaking for myself, I rather doubt the wisdom of attempting to do more." Rowlatt J. also expressed himself much to the same effect in Countess Warwick Steamship Co. Ltd. v. Ogg(1):
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> "

It is very difficult, as I have observed in previous cases of this kind, following the highest possible authority, to lay down any general rule which is both sufficiently accurate and sufficiently exhaustive to cover all or even a great number of possible cases, and I shall not attempt to lay down any such rule."

Certain broad tests have however been attempted to be laid down and the earliest was the one indicated in the following observations of Bowen L.J. in the course of the argument in City of London Contract Corporation v. Styles (3) :-

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

The expenditure in the acquisition of the concern would be capital expenditure; the expenditure in carrying on the concern would be revenue expenditure.

Lord Dunedin in Vallambrosa Rubber Co., Ltd. v. Farmer (4), suggested another criterion at page 536 :

> Now, I don't say that this consideration is absolutely final or determinative, but in a rough way I think it is not a bad criterion of what is capital (1) [1901] A.C. 477, 488.

(2) [1924] 2 K.B. 292, 298.

(3)(1887) 2 T.C. 239, 243.

(4)(1910) 5 T.C. 529, 536.

expenditure as against what is income expenditure to say that capital expenditure is a thing that is a going to be spent once and for all, and income expenditure is a thing that is going to recur every year."

This test was adopted by Rowlatt J. in Ounsworth (Surveyor of Taxes) v. Vickers Ltd. (1), and after quoting the above passage from the speech of Lord Dunedin he observed that the real test was between expenditure which was made to meet a continuous demand for ex. penditure as opposed to an expenditure which was made once for all. He however suggested in the course of his judgment another view-point and that was whether the particular expenditure could be put against any particular work or whether it was to be regarded as an enduring expenditure to serve the business as a whole, thus laying the foundation for the test prescribed by Viscount Cave L.C. in Atherton's case (2).

Atherton v. British Insulated and Helsby Cables Ltd. (2), laid down what has almost universally been accepted as the test for determining what is capital expenditure as distinguished from revenue expenditure. Viscount Cave L.C. there observed at page 192:-

> "But there remains the question, which I have found more difficult, whether apart from the express prohibitions, the sum in question is (in the words used by Lord Sumner in Usher's case(3)), a proper debit item to be charged against incomings of the trade when computing the profits of it; or, in other words, whether it is in substance a revenue or a capital expenditure. This appears to me to be a question of fact which is proper to be decided by the Commissioners upon the evidence brought before them in each case ; but where, as in the present case, there is no express finding by the Commissioners upon the point, it must be determined by the Courts upon the materials which are available and with due regard to the principles which have been laid down in the authorities. Now, in Vallambrosa Rubber Company v. Farmer (4). Lord Dunedin, as Lord President of the Court of Session, expressed the opinion that "in a rough way" it was (1)(1915) 6 T.C. 671.
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> (2)(1925) 10 T.C. 155.
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> (3)(19I4) 6 T.C. 399.
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> (4)(19IO) 5 T.C. 529. 536, "not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all and income expenditure is a thing which is going to recur every year" ; and no doubt this is often a material consideration. But the

> criterion suggested is not, and was obviously not, intended by Lord Dunedin to be a decisive one in every case; for it is easy to imagine many cases in which a payment, though made "once and for all", would be properly chargeable against the receipts for the year..... But when an expenditure is made, not only once and for all. but with a view to bringing into existence an asset or an advan-

tage 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."

Viscount Haldane however in John Smith & Son v. -Moore (H. M. Inspector of Taxes) (1), suggested another test and that was the test of fixed or circulating capital, though even there he observed that it was not necessary to draw an exact line of demarcation between the fixed and circulating capital. The line of demarcation between fixed and circulating capital could not be defined more precisely than in the description of Adam Smith of fixed capital as what the owner turns to profit by keeping it in his own possession, and circulating capital as what he makes profit of by parting with it and letting it change masters. This test was adopted by Lord Hanworth M.R. in Anglo-Persian Oil Co. v. Dale (2), where he observed:-

> " I am inclined to think that the question whether the money paid is provided from the fixed or the circulating capital comes as near to accuracy as can be suggested. Lord Cave's test, that where money is spent for an enduring benefit it is capital, seems to leave open doubts as to what is meant by "enduring" ..... (1) (1921) 12 T.C. 266, 282.
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> (2) [1932] 1 K.B. 124,138.

It seems rather that the cases of Hancock (1) and of Mitchell v. B. W. Noble, Ltd. (2) and of Mallet v. Staveley Coal & Iron Co. (3), give illustrations that the test of fixed or circulating capital is the true one; and where, as in this case, the expenditure -is to bring back into the hands of the company a necessary ingredient of their existing business-important, but still ancillary and necessary to the business which they carry-onthe expenditure ought to be debited to the circulating capital rather than to the fixed capital, which is em. ployed in and sunk in the permanent-even if wasting -assets of the business." This preference of his was reiterated by Lord Hanworth M.R. in Golden Horse Shoe (New) Ltd. v. Thurgood (H. M. Inspector of Taxes) "The above cases serve to establish the difficulty of the question rather than to affirm any principle to be applied in all cases. Indeed, in the last case cited, Atherton v. British Insulated and Helsby Cables Ltd. (5) Lord Cave says that a payment 'once and for all'-a test which had been suggested by Lord Dunedin in Vallambrosa Rubber Company' v. Farmer(1), was not true in all cases, and he found authority for that statement in Smith v. Incorporated Council of Law Reporting for England and Wales (7) and the Anglo-Persian case(8) already referred to is another. The test of circulating, as contrasted with fixed capital, is as good a test in most cases, to my mind, as can be found ; but that involves the question of fact, was the outlay in the particular case from fixed or circulating capital ?"

Romer L.J. at page 300 pointed out the difficulties in applying this test also.

"Unfortunately, however, it is not always easy to determine whether a particular asset belongs to the one category or the other. It depends in no way upon what may be the nature of the asset in fact or in law. Land may in certain circumstances be circulating
(2) [1919] 1 K.B. 25.

(2) (1927] 1 K.B. 719.

(3) (1928] 2 K.B. 405.

(4) (1933) 18 T.C. 280, 298.

(5) (1925) 10 T.C. 155, 192.

(6) (1910) 5 T.C. 529.

(7) [1914] 3 K.B. 674.

(8) [1932] 1 K.B. 124.

capital. A chattel or a chose in action may be fixed capital. The determining factor must be the nature of the trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital. The machinery with which a manufacturer makes the articles that he sells is part of his fixed capital. The machinery that a dealer in machinery buys and sells is part of his circulating capital, as is the coal that a coal merchant buys and sells in the course of his trade. So, too, is the coal that a manufacturer of gas buys and from which he extracts his gas. "

In Van Den Berghs, Limited v. Clark (H. M. Inspector of Taxes)(1), Lord Macmillan however veered round to Viscount Cave's test and expressed his disapproval of the test of fixed and circulating capital. He reviewed the various authorities and stated :

" My Lords, if the numerous decisions are examined and classified, they will be found to exhibit a satisfactory measure of consistency with Lord Cave's principle of discrimination. "

As regards the test of fixed and circulating capital he observed, at page 432 :-

" I have not overlooked the criterion afforded by the economists' differentiation between fixed and circulating capital which Lord Haldane invoked in John Smith & Son v. Moore(1), and on which the Court of Appeal relied in the present case, but I confess that I have not found it very helpful. "

The Privy Council in Tata Hydro-Electric Agencies, Limited, Bombay v. Commissioner of Income-tax, Bombay Presidency and Aden(1), pronounced at page 226:-

> "What is money wholly and exclusively laid out for the purposes of the trade' is a question which must be determined upon the principles of ordinary commercial trading. It is necessary, accordingly, to attend (1) (1935) 19 T.C. 390.
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> (2) (1921) 12 T.C, 266, (3) (1937) L.R, 64 I.A. 215.

to the true nature of the expenditure, and to ask oneself the question, is it a part of the company's working expenses; is it expenditure laid out as part of the process of profit earning ?"

> In the case before them they came to the conclusion that the obligation to make the payments was undertaken By the appellants in consideration of their acquisition of the right and opportunity to earn profits, i.e., of the right to conduct the business and not for the purpose of producing profits in the conduct of the business. The distinction was thus made between the acquisition of an income-earning asset and the process of the earning of the income. Expenditure in the acquisition of that asset was capital expenditure and expenditure in the process of the earning of the profits was revenue expenditure. This test really is akin to the one laid down by Bowen L.J. in The City of London Contract Corporation Ltd. v. Style8(1).
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> Dixon J. expressed a similar opinion in Sun Newspapers Limited and the Associated Newspapers Limited v. The Federal Commissioner of Taxation(1), at page 360:-
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> " But in spite of the entirely different forms, material and immaterial, in which it may be expressed, such sources of income contain or consist in what has been called a 'profit- yielding subject," the phrase of Lord Blackburn in United Collieries Ltd. v. Inland Revenue Commissioners(3). As general conceptions it may not be difficult to distinguish between the profit yielding subject and the process of operating it. In the same way expenditure and outlay upon establishing, replacing and enlarging the profit-yielding subject may in a general way appear to be of a nature entirely different from the continual flow of working expenses which are or ought to be supplied continually out of the returns of revenue. The latter can be considered, estimated and determined only in relation to a period ,or interval of time, the former as at a point of time. For the one concerns the instrument for earning profits (1) (1887) 2 T.C. 239.
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> (2) (1038) 61 C.L.R. 337.
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> (3) (1930) S.C. 215, 220.

and the other the continuous process of its use or employment for that purpose.

These are the three criteria adopted for distinguishing capital expenditure from revenue expenditure though it must be said that preponderance of opinion is to be found in support of Viscount Cave's test as laid down in Atherton's case(1).

Viscount Cave's test has also been adopted almost universally in India: vide Munshi Gulab Singh & Sons V. Commissioner of Income-tax(2), Commissioner of Income-tax, Bombay v. Century Spinning, Weaving & Manufacturing Co. Ltd.(1), Jagat Bus Service, Saharanpur v. Commissioner of Income-tax, U. P. & Ajmer Merwara(4), and Commissioner of Income-tax, Bombay v. Finlay Mills Ltd.(5). In Commissioner of Income-tax, Bombay v. Century Spinning, Weaving & Manufacturing Co., Ltd.(3), Chagla J. observed, at page 116:-

> " The legal touchstone which is almost invariably applied is the familiar dictum of Viscount Cave in Atherton's case(1)..... Romer L.J. felt that this definition had placed the matter beyond all controversy -see remarks in Anglo-Persian Oil Co.'s case(6). But Lord Macmillan in Van Den Bergh's case(1), felt that Romer L.J. had been unduly optimistic and the learned Law Lord was of the opinion that the question whether a particular expenditure fell on one side of the line or other was a task of much refinement. But on the whole I think that the definition of Viscount Cave is a good working definition ; and if one were to supplement it with the definition suggested by Mr. Justice Lawrence in Southern v. Borax Consolidated Ltd.(1), whether an expenditure had in any way altered the original character of the capital asset, we have a legal principle which can be applied to any set of given facts.
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> (1) (1925) to T.C. 155.(5) (1952] S.C.R. 11. (2) [1945]14 I.T.R. 66.(6) [1932] 1 K.B. 124. (3) [1946] 15 I.T.R. 105.(7) (1935) 19 T.C. 390. (4) [1949] 18 I.T.R. 13(8) [1942] 10 I.T.R. Suppl. 1, 6.

In Benarsidas Jagannath, In re(1), a Full Bench of the Lahore High Court attempted to reconcile all these decisions and deduced the following broad test for distinguishing capital expenditure from revenue expenditure. The opinion of the Full Bench was delivered by Mr. Justice Mahajan as he then was, in the terms following:

> " It is not easy to define the term 'capital expenditure' in the abstract or to lay down any general and satisfactory test to discriminate between a capital and a revenue expenditure. Nor is it easy to reconcile all the decisions that were cited before us for each case has been decided on its peculiar facts. Some broad principles can, however, be deduced from what the learned Judges have laid down from time to time. They are as follows :-
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> 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: vide Lord Sands in Commissioners of Inland Revenue v. Granite City Steamship Company(1). In City of London Contract Corporation v.

Styles(1), at page 243, Bowen L.J. observed as to the capital expenditure as follows :

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

2. Expenditure may be treated as properly attributable to capital when it 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: vide Viscount Cave L.C. in Atherton v. British Insulated and Helsby Cables Ltd.(1). If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be (1) [1946] 15 I.T.R. 185. (3) (1887) 2 T.C. 239. (2) (1927) 13 T.C. 1, 14. (4) (1925) 10 T.C. 155.

deducted out of the profits by claiming that it relieves the annual labour bill, the business has acquired anew asset, that is, machinery.

The expressions 'enduring benefit' or 'of a permanent character' were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset.

3.Whether for the purpose of the expenditure, any capital was withdrawn, or, in 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. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it". This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the principles which emerge from the authorities. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlay whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital expenditure. The question however arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. If the expenditure is made for acquiring or bringing into existence an. asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the

payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. It is only in those cases where this test is of no avail that one may go to the test of fixed or circulating capital and consider whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital. If it was part of the fixed capital of the business it would be of the nature of capital expenditure and if it was part of its circulating capital it would be of the nature of revenue expenditure. These tests are thus mutually exclusive and have to be applied to the facts of each particular case in the manner above indicated. It has been rightly observed that in the great diversity of human affairs and the complicated nature of business operations it is difficult to lay down a test which would apply to all situations. One has therefore got to apply these criteria, one after the other from the business point of view and come to the conclusion whether on a fair appreciation of the whole situation the expenditure incurred in a particular case is of the nature of capital expenditure or revenue expenditure in which latter event only it would be a deductible allowance under section 10(2) (xv) of the Income- tax Act. The question has all along been considered to be a question of fact to be determined by the Income-tax authorities on an application of the broad principles laid down above and the courts of law would not ordinarily interfere with such findings of fact if they have been arrived at on a proper application of those principles. The expression "once and for all" used by Lord Dunedin has created some difficulty and it has been contended that where the payment is not in a lump sum but in instalments it cannot satisfy the test. Whether a payment be in a lump sum or by instalments, what has got to be looked to is the character of the payment. A lump sum payment can as well be 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 as well be spread over a number of years and yet retain its character as a capital expenditure. (Per Mukherjea J. in Commissioner of Income-tax v. Piggot Chapman & Co.(1). The character of the payment can be deter- mined by looking at what is the true nature of the asset which has been acquired and not by the fact whether it is a payment in a lump sum or by instalments. As was otherwise put by Lord Greene M.R. in Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd.(2):

> "The thing that is paid for is of a permanent quality although its permanence, being conditioned by the length of the term, is shortlived. A payment of this character appears to me to fall into the same class as the payment of a premium on the grant of a lease, which is admittedly not deductible".

The case of Tata Hydro-Electric Agencies Ltd., Bombay v. Commissioner of Income-tax, Bombay Presidency and Aden(3) affords another illustration of this principle. It was observed there:-

> "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".

(1) [1949] 171.T.R. 3I7. 329.

(3) (193 7) L. R. 64 1, A 215.

(2) [1942] 2 K.B. 184.

The expression "once and for all" is used to denote an expenditure which is made once and for all for procuring an enduring benefit to the business as distinguished from a recurring expenditure in the nature of operational expenses. The expression "enduring benefit" also has been judicially interpreted. Romer L.J. in Anglo-Persian Oil Company, Limited v. Dale(1) agreed with Rowlatt J. that by enduring benefit is meant enduring in the way that fixed capital endures:

> "An expenditure on acquiring floating capital is not made with a view to acquiring an enduring asset. It is made with a view to acquiring an asset that may be turned over in the course of trade at a comparatively early date".

Latham C. J. observed in Sun Newspapers Ltd. & Associated Newspapers Ltd. v. Federal Commissioner of Taxation(2):

> "When the words 'permanent' or 'enduring' are used in this connection it is not meant that the advantage which -will be obtained will last for ever. The distinction which is drawn is that between more or less recurrent expenses involved in running a business and an expenditure for the benefit of the business as a whole e.g -"enlargement of the goodwill of a company permanent improvement in the material or immaterial assets of the concern".

To the same effect are the observations of Lord Greene M. R. in Henriksen (H.M. Inspector of Taxes) v. Grafton Hotel Ltd. (3) above referred to.

These are the principles which have to be applied in order to determine whether in the present case the expenditure incurred by the company was capital expenditure or revenue expenditure. Under clause 4 of the deed the lessors undertook not to grant any lease, permit or prospecting license regarding limestone to any other party in respect of the group of quarries called the Durgasil area without a condition therein that no limestone shall be used for the manufacture of (1) (1932] 1 K.B. 124, 146.

(2) (1938) 61 C.L.R. 337, 355.

(3) (1942) 24 T.C. 453.

cement. The consideration of Rs. 5,000 per annum was to be paid by the company to the lessor during the whole period of the lease and this advantage or benefit was to enure for the whole period of the lease. It was an enduring benefit for the benefit of the whole of the business of the company and came well within the test laid down by Viscount Cave. It was not a lump sum payment but was

spread over the whole period of the lease and it could be urged that it was a recurring payment. The fact however that it was a recurring payment was immaterial, because one bad got to look to the nature of the payment which in its turn was determined by the nature of the asset which the company had acquired. The asset which the company had acquired in consideration of this recurring payment was in the nature of a capital asset, the right to carry on its business unfettered by any competition from outsiders within the area. It was a protection acquired by the company for its business as a whole. It was not a part of the working expenses of the business but went to appreciate the whole of the capital asset and make it more profit yielding. The expenditure made by the company in acquiring this advantage which was certainly an enduring advantage was thus of the nature of capital expenditure and was not an allowable deduction under section 10(2)(xv) of the Income-tax Act.

The further protection fee which was paid by the company to the lessor under clause 5 of the deed was also of a similar nature. It was no doubt spread over a period of 5 years, but the advantage which the company got as a result of the payment was to enure for its benefit for the whole of the period of the lease unless determined in the manner provided in the last part of the clause. It provided protection to the company against all competitors in the whole of the Khasi and Jaintia Hills District and the capital asset which the company acquired under the lease was thereby appreciated to a considerable extent. The sum of Rs. 35,000 agreed to be paid by the company to the lessor for the period of 5 years was not a revenue expenditure which was made by the company for working the capital asset which it had acquired. It was no part of the working or operational expenses of the company. It was an expenditure made for the purpose of acquiring an appreciated capital asset which would no doubt by reason of the undertaking given by the lessor make the capital asset more profit yielding. The period of 5 years over which the payments were spread did not make any difference to the nature of the acquisition. It was none the less an acquisition of an advantage of an enduring nature which enured for the benefit of the whole of the business for the full period of the lease unless terminated by the lessor by notice as prescribed in the last part of the clause. This again was the acquisition of an asset or advantage of an enduring nature for the whole of the business and was of the nature of capital expenditure and thus was not an allowable deduction under section 10(2)(xv) of the Act. We are therefore of the opinion that the conclusion reached by the Income-tax authorities as well as the High Court in regard to the nature of the payments was correct and the sums of Rs. 40,000 paid by the company to the lessors during the accounting years 1944-45 and 1945-46 were not allowable deductions under section 10(2)(xv) of the Act. The appeal therefore fails and must be dismissed with costs. Appeal dismissed.