# Hasimara Industries Ltd. vs Commissioner Of Income Tax & Anr. on 10 September, 1997

## Equivalent citations: (1998)147CTR(SC)98

JUDGMENT

BY THE COURT :

Under appeal is the judgment and order of Division Bench of the High Court at Calcutta answering the following question raised in a reference under s. 256 of the IT Act, 1961, in the negative and against the assessee :

"Whether, on the facts and in the circumstances of the case and on a proper interpretation of the terms and conditions of the leave and licence agreement executed on 19th October, 1963, the Tribunal was right in holding that the loss of Rs. 20 lakhs which had been deposited by the assessee with Saksaria Cotton Mills Ltd., pursuant to cl. 17 of the said agreement, arose in the carrying on the assessees business and was incidental to it and was accordingly allowable as a business loss ?"

2. The High Court noted the facts found by the Tribunal, as under :

"The assessee is a public limited company. It owned several tea estates and its main income was from sale of tea. Devenport & Co. (P) Ltd., are the managing agents of the assessee. In 1960, the assessee altered its memorandum of association with the approval of the Calcutta High Court for the purpose of diversifying its activities and it took cotton business in addition to its business in tea. Saksaria Cotton Mills Ltd. was also a public limited company and in 1957, it was in the process of liquidation. The assessee, along with one Sri S. L. Bajoria, a shareholder of Devenport & Co. (P) Ltd., produced a scheme which was approved by the High Court and the liquidation proceedings came to an end. The assessee and Sri S. L. Bajoria entered into an agreement for the lease of the mills from Saksaria Cotton Mills Ltd. There was a partnership in the lease between the assessee and Sri S. L. Bajoria in a certain ratio. That lease was for the period from 28th January, 1961, to 30th October, 1961. After the expiry of the period of lease, the assessee alone entered into a financing agreement with Saksaria Cotton Mills Ltd., and that agreement remained in force from 1st November, 1961, to 31st March, 1963. After the expiry of the financial agreement, the assessee entered into another agreement with Saksaria Cotton Mills Ltd., on 19th October, 1963, for a period of three years from 1st April, 1963 to 31st March, 1966. This agreement was described as a leave and licence agreement. In accordance with cl. 17 of the agreement, the assessee deposited Rs. 20 lakhs on 3rd April, 1963, with Saksaria Cotton Mills Ltd., and Saksaria Cotton Mills Ltd. handed over its properties to the assessee. The assessee ran the mills. The leave and licence

agreement, after expiry of the period stipulated in that agreement, was extended up to 30th June, 1966. The Tribunal was informed by counsel for the assessee that the extension was on the same terms and conditions on which the leave and licence agreement had been made. The assessee made a credit entry of Rs. 1,40,000 being the interest receivable by it from Saksaria Cotton Mills Ltd., on the deposit of Rs. 20 lakhs at the rate of 7 per cent per annum. This entry was reversed in the year under consideration. During the extended period of three months, the assessee paid insurance premium, rates and taxes and other expenses for the whole of the year though the extended period was only for three months. The assessee debited these expenses for the remaining nine months to the account of Saksaria Cotton Mills Ltd. The amounts debited were Rs. 1,48,470 for insurance premium and Rs. 1,42,882 for rates and taxes and other expenses. The interest amount of Rs. 1,40,000 and these expenses aggregated to Rs. 4,31,352. The amount of Rs. 20 lakhs of the deposit and the expenses of Rs. 4,31,352 remained unpaid by Saksaria Cotton Mills Ltd. Saksaria Cotton Mills Ltd. had its own business after 30th June, 1966, but suffered loss and was ultimately closed down on 18th October, 1967, and went into liquidation on 12th March, 1968. The assessee wrote off the above amounts of Rs. 20 lakhs of deposit and Rs. 4,31,352 as having become irrecoverable on account of incapacity of Saksaria Cotton Mills Ltd. to pay the same. The assessee claimed these amounts as deductions by way of bad debts.

The ITO disallowed the assessees claim for deduction of the said amount of Rs. 20 lakhs holding that it was capital expenditure. The AAC reversed that view and the Tribunal affirmed the decision in first appeal. The High Court, in reference, in the judgment under appeal before us, disagreed with the Tribunal. The High Court said that there could "be little doubt, having regard to the nature of the agreement, that the amount of Rs. 20 lakhs was deposited for the purpose of securing the contract under which the assessee had acquired the right to work the mills belonging to the licensor-company. In other words, the assessee acquired a profit-making apparatus. The deposit was made for the purpose of acquisition of a profit-making apparatus. It did not make the assessee a trade creditor of the cotton mills company;" also, that it found it "difficult to accept the contention that the deposit was made in the course of the day-to-day business of the assessee. The assessee was not engaged in the business of reviving sick cotton mills. The assessees day-to-day business did not include taking lease of cotton mills or entering into licensing agreements with other cotton mill companies. The assessees usual business was manufacture and sale of tea. It wanted to enter into cotton manufacturing business. To effectuate this purpose, it did not set up a cotton mill of its own but merely acquired the right to operate the mills belonging to another company under a leave and licence agreement. The deposit was not made in the course of profit-making but was made for the purpose of acquiring a profit-making apparatus for a period of three years.

Under these circumstances, it must be held that the loss suffered by the assessee was on capital account and the amount could not be deducted from the assessees income

as business loss."

3. The agreement of leave and licence contains the clause (cl. 17) under which the deposit of Rs. 20 lakhs was made by the assessee with the licensor-company. That clause reads thus :

> "For the due observance and performance of the terms and conditions herein so contained, the licensee shall deposit and keep deposited with the licensor during the subsistence of this licence a sum of Rs. 20,00,000 (rupees twenty lakhs only). The said deposit shall carry interest at the rate of 7 per cent, per annum. The amount of deposit shall be repaid to the licensee on termination or expiry of the licence after deducting therefrom any monies that may have become due to the licensor at the time of such termination or expiry of the licence."

4. On behalf of the assessee it was submitted that the assessee did not commence the cotton business as a new venture for the first time in 1963 when the said leave and licence agreement was entered into, for it was an admitted fact that the assessee had, as far back as 1960, and with the approval of the High Court at Calcutta, amended its memorandum of association for the purposes of carrying on the cotton business. It had entered into a partnership with one Bajoria and that partnership had run the said cotton mills on lease for a period of nine months. The High Court was, therefore, in error in taking the view that the cotton business had commenced with the taking on leave and licence of the said cotton mills. In counsels submission, the deposit of Rs. 20 lakhs made as aforestated had been lost to the assessee by reason of the winding up of the licensor-company and it had rightly claimed that loss as a business loss, for its business in cotton had suffered that loss.

5. Learned counsel referred to the judgment of this Court in Empire Jute Co. Ltd. vs. CIT (1980) 124 ITR 1 (SC) This Court drew attention to the tests for distinguishing between capital and revenue expenditure and observed that no test was paramount or conclusive. Lord Cave, L.C. In Atherton vs. British Insulated and Helsby Cables Ltd. (1925) 10 Tax Cases 155 (HL) had said :

> ".... when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset on 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."

Lord Radcliffe, in Commissioner of Taxes vs. Nchanga Consolidated Copper Mines Ltd. (1965) 58 ITR 241 (PC) had observed that what was material to consider was the nature of the advantage in a commercial sense and it was only where the advantage was in the capital field that the expenditure would be disallowable. Lord Reid, in IRC vs. Carron Company (1968) 45 Tax Cases 18 (HL), had noted that expenditure had been incurred to remove antiquated restrictions which were preventing profits from being earned and, on that account, held the expenditure to be of a revenue character. In the case before it, this Court found, on a parity of reasoning, that the expenditure incurred by the assessee for the purpose of removing a restriction on the number of working hours for which it could operate the looms, with a view to increasing its profits, was a revenue expenditure.

6. Learned counsel for the Revenue drew our attention to the judgment of the Privy Council in CIT vs. Motiram Nandram (1940) 8 ITR 132 (PC) upon which the High Court had relied.

It must be said at once that the case of Motiram Nandram (supra) bears considerable similarity to the case that is before us. The assessee therein carried on business in cloth, yarn and moneylending. In 1930 it deposited with an oil company Rs. 50,000 in consideration of an agreement. Thereunder, the assessee was appointed the organising agents of the oil company for a period of five years for a stated area. It was to recommend selling agents. Sales were to be conducted entirely by the oil company and the selling agents, but the assessee was to receive a certain commission on all goods sold by the selling agents within the stated area and also on all sales of oil effected in the stated area by the oil company. The deposit was to remain at the disposal of the oil company for the purpose of the oil companys business and was to carry interest at the rate of 7 per cent per annum until it was repaid out of the deposits made by the selling agents. After the assessee had recovered a part of its deposit, the oil company went into liquidation and, though the assessee obtained a decree for Rs. 39,500 against the oil company, it was unable to realise the decretal amount. The assessee claimed in the year 1932-33 that the aforesaid amount should be deducted from its other income as a business loss. The Privy Council did not accept the assessees case. It said :

> "When the deposit is considered in relation to the organising agency, the special terms of the agreement of 17th December, 1930, are important since various suggestions have been made as to the true character of the deposit. One suggestion is that the deposit should be looked upon as the purchase price of goods paid to the company in advance and thus a mere trading expense; but this cannot be accepted. It would be a highly inaccurate statement of the effect of the agreement. The Rs. 50,000 was doubtless laid out with a view to earning profits in the business of organising agents in addition to the interest of 7 per cent, but it was not so laid out with reference to any particular transaction carried out in the course of such business. It was in one aspect a loan made to the company but it was not a loan made in the course of carrying on the business of organising agents or in the course of the business of a money-lender. It was not a recurring expenditure. On the other hand, it was contemplated that in whole or in part the deposit should be returned to the assessees by the receipt of deposit from selling agents; so that if the Rs. 50,000 does fall to be regarded as invested in a business of organising agents, it was invested with a prospect that it might be a temporary investment and not a permanent one - in other words that the capital might later be withdrawn from the business. The question in such a case as the present must be what is the object of the expenditure ? And it must be answered from the standpoint of the assessees at the time they made it - that is, when they were embarking upon the business of organising agents for the company. The deposit was clearly exacted by the company as a condition of the assessees being given an agency which they hoped to manage profitably. Their Lordships think that the purpose of being permitted to engage in such a business must be considered to be a purpose of securing an enduring benefit of a capital nature, and that the deposit cannot, upon a true view of the terms of the agreement and the circumstances of the case, be regarded as an expenditure made in the course

of carrying on an existing agency, or any other business."

7. We are in no doubt whatever that the High Court was right in concluding that the amount of Rs. 20 lakhs had been deposited by the assessee with the licensor-company for the purpose of securing the licence under which the assessee had acquired the right to work the licensors cotton mills. This is clear from the fact that the deposit was made pursuant to a clause in the leave and licence agreement. Had a deposit as required by that clause not been made, the assessee would not have secured the licence of the cotton mill. At that time the assessee was doing no business in cotton. The deposit was, clearly, made for the purpose of acquiring a profit-making asset to carry on business in cotton. It cannot, therefore, be held that the deposit was made on the revenue account or that the loss thereof must be treated as a business loss. The loss thereof was a loss suffered on the capital account and could not be deducted on the basis that it was a business loss.

The High Court has answered the question correctly. The appeal is dismissed, with costs.