Commissioner Of Income-Tax, Tamil Nadu ... vs Madras Auto Service (P) Ltd. Etc on 12 August, 1998

Equivalent citations: AIR 1998 SUPREME COURT 2667, 1998 AIR SCW 2707, 1998 TAX. L. R. 938, (1998) 5 JT 507 (SC), 1998 (2) UPTC 1045, 1998 (6) ADSC 50, 1998 (6) SCC 404, (1998) 3 SCR 1121 (SC), 1998 (3) SCR 1121, (1998) 99 TAXMAN 575, 1998 (5) JT 507, (1998) 148 CURTAXREP 398, (1998) 4 SCALE 537, (1998) 233 ITR 468, (1998) 147 TAXATION 215, (1998) 6 SUPREME 359

Author: Sujata V. Manohar

Bench: Sujata V. Manohar, S. Rajendra Babu

PETITIONER:
COMMISSIONER OF INCOME-TAX, TAMIL NADU II, MADRAS

Vs.

RESPONDENT:
MADRAS AUTO SERVICE (P) LTD. ETC.

DATE OF JUDGMENT: 12/08/1998

BENCH:
SUJATA V. MANOHAR, S. RAJENDRA BABU

ACT:

HEADNOTE:

JUDGMENT:

THE 12TH DAY OF AUGUST, 1998 Present :

Hon'ble Mrs. Justice Sujata V. Manohar Hon'ble Mr. Justice S. Rajendra Babu K.N. Shukla, Sr. Adv., (S. Rajappa,) Adv. for B.K. Prasad, Adv. with him for the appellant T.A. Ramachandran, Sr. Adv. Mrs. Janaki Ramachandran, Ms. H . Wahi, Advs. with him for the Respondents J U D G E M E N T The following Judgment of the Court was delivered :

[With C.A. Nos. 6066-67 (NT) of 1983] Mrs. Sujata V. Manohar. J.

The assessee is a limited company carrying on the business of sale of motor parts. Its head-office is at Madras. It has a branch at Bangalore. Under an agreement of lease dated 1st of February, 1966, the assessee obtained from M/S. Hajira Comer and Mrs. Rabia Bai Razack a lease of premises Nos. 64 and 64/1 situated at Sri Narasimharaja Road, Bangalore for a period of 39 years commencing from 1st of January, 1966. Under the terms and conditions of the lease, the lessee (that is to say the assessee), had the right to demolish at its own expense the existing premises and appropriate to itself all the material thereof without paying to the lessors any compensation and construct a new building thereon to suit the purpose of their business as per the plan approved by the lessors. Under Clause 2 of the lease deed, the lessee was required to pay a rent of Rs. 1000/- per month for the first fifteen years, Rs. 1500/- per month for the next ten years, Rs. 1650/- per month for the next ten years and Rs. 2000/- per month for the remaining years. The lease deed further provided that the new construction shall, right from t he commencement of the work, be the property of the lessors; and upon completion of the work of construction the lessee will have only the right to be a tenant for a period of 39 years under the existing lease subject to the payment of rent and observation of other terms and conditions of the lease. The lessee shall not be entitled under any circumstances for any compensation whatsoever on account of its putting up the new construction in the place of the old.

Acting under the lease agreement the assessee invested a sum of Rs. 1,62, 835/- in the previous year relevant to the assessment year 1968/69 and Rs. 50, 937/- during the succeeding year in constructing a new building on the said land. The assesee claimed before the Income-tax Officer the expenditure of the said sums of Rs. 1, 62,835/- and Rs. 50, 937/- in the relevant assessment years as capital loss. In the alternative, the assessee claimed depreciation on capital investment; in the alternative, the assessee claimed deduction of the payments as business expenditure or as extra rent for the lease. Ultimately, the Income-tax Tribunal has held that the expenditure of the said two amounts for the construction of a new building is in the nature of business expenditure for proper carrying on of the business of the assessee. The Tribunal has, therefore, treated these amounts as revenue expenditure and allowed a deduction in that regard to the assessee. The claim of the department that the expenditure was capital expenditure and was, therefore, not deductible was negatived by the Tribunal.

On the application of the department the Tribunal referred the following question to the High Court for its determination under Section 256(1) of the Income-tax Act, 1961 :

"Whether on the fact and in the circumstances of the case the Appellate Tribunal was right in holding that the building expenses of Rs. 1,62,835/- are not liable to be taken into account as deductible expenditure in arriving at the real income of the assessee

fro the assessment year 1968-69?"

For the next assessment year, a similar question was raised in regard to the second sum of Rs. 50,937/-. The High Court has, by the impugned judgment, upheld the view of the Tribunal and has held that the two amounts constitute revenue expenditure for the concerned assessment years and are deductible in order to arrive at the income of the assessee for the said assessment years. The present appeals are filed by the department from the impugned judgment of the High Court.

The assessee in the present case has spent the amounts in question in order to construct a new building after demolishing the old building. The new building, however, from inception was to belong to the lessor and not to the assessee. The assessee, however, had the benefit of the existing lease in respect of the new building at the agreed rent for a period of 39 years. The Tribunal has found, as a fact, that the rent as stipulated in the lease was extremely low. It rental rate for the area in which the building was situated was much higher and would be not less than Rs. 12,000/- as against which the maximum rent the assessee would be paying was only Rs. 2,000/-. This concessional rent was on account of the fact that the new building was constructed by the assessee at its own cost.

In order to decide whether this expenditure is revenue expenditure or capital expenditure, one has to look at the expenditure from a commercial point of view. What advantage did the assessee get by constructing a building which belonged to somebody else and spending money for such construction? The assessee got a long lease of a newly constructed building suitable to its own business at a very concessional rent. The expenditure, therefore, was made in order to secure a long lease of new and more suitable business premises at a lower rent. In other words, the assessee made substantial savings in monthly rent for a period of 39 years by expending these amounts. The saving in expenditure was saving in revenue expenditure in the form of rent. Whatever substitutes for revenue expenditure should normally be considered as revenue expenditure. Moreover, assessee in the present case did not get any capital asset by spending the said amounts. The assessee, therefore, could not have claimed any depreciation. Looking to the nature of the advantage which the assessee obtained in a commercial sense, expenditure appears to be revenue expenditure.

The test for distinguishing between capital expenditure and revenue expenditure in our country was laid down by this Court in Assam Bengal Cement Co. Ltd. v. Commissioner of Income-tax, West Bengal (27 ITR 34). In that case, the appellant-company had acquired from the Government of Assam lease of certain lime-stone quarries for a period of 20 years for the purpose of manufacture of cement. The lessee had, inter alia, agreed to pay an annual sum during the whole period of the lease as a protection fee and in consideration of that payment, the lessor undertook not to grant to any person any lease, permit or prospecting licence for

lime-stone. This Court examined tests laid down in various cases for distinguishing between capital expenditure and revenue expenditure. One of the standard tests now in use was laid down in the case of Atherton v. British Insulated and Helsby Cables Ltd. ([1925] 10 Tax. Cases 155). It said : "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 capita." Whether by spending the money any advantage of an enduring nature has been obtained or not will depend upon the facts of each case. Moreover, as the above passage itself provides, this test would not apply if there are special circumstances pointing to the contrary. This Court in the above case summarised the tests as follows :(p. 44) :

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.

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.....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.

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.

(underlining ours) Relying upon the second test enumerated above, learned counsel for the appellant has submitted that the assessee got enduring benefit of a capital nature by spending the amount because the assessee obtained a new building for a period of 39 years. The difficulty, however, in the present case, arises from the fact that this building was never to belong to the assesseee. Right from inception, the building was of the ownership of the lessor. Therefore, by spending this money, the assessee did not acquire any capital asset. The only advantage which the assessee derived by spending the money was that it got the lease of a new building at a low rent. From the business point of view, therefore, the assessee got the benefit of reduced rent. The High Court has, therefore, rightly considered this as obtaining a business advantage. The expenditure is, therefore, to be treated as revenue expenditure.

Although there are a number of cases dealing with this question, we will limit ourselves to examining a few cases where the assessee, by expending money, created and asset of an enduring

nature. However, the asset so created did not belong to the assessee. In such a situation the courts have held that the expenditure was for better carrying on of the business of the assessee and could be allowed as revenue expenditure, looking to the circumstances of each of those cases. Thus in Lakshmiji Sugar Mills Co. P. Ltd. v. Commissioner of Income-tax, New Delhi (82 ITR 376) the assessee company was carrying on the business of manufacture and sale of sugar. It paid to the Cane Development Council certain amounts by way of contribution for the construction and development of roads between various sugarcane-producing centres and the sugar factories of the assessee. The roads remained the property of the Government. This Court held that the expenditure was not of a capital nature and had to be allowed as an admissible deduction in computing the profits of the assessee's business. The expenditure was incurred for the purpose of facilitating the running of the assessee's motor vehicles and other means employed for transportation of sugarcane to its factories.

In the case of L.H. Sugar Factory and Oils Mills (P) Ltd. v. Commissioner of Income-tax, U.P. (125 ITR 293), the assesee was carrying on the business of manufacture and sale of sugar. It has its factory in U.P. The assessee paid a contribution towards meeting the cost of construction of roads in the area around its factory under a sugarcane development scheme. The question was whether this amount was deductible in computing the assessee's profits. The Court held that it was. Because although the advantage secured was of long duration, it was not an advantage in the capital field because no tangible or intangible asset was acquired by the assessee; nor was there any addition to or expansion of the profit making apparatus of t he assessee. The amount was contributed for the purpose of facilitating the business of the assessee and making it more efficient and profitable. It was, therefore, revenue expenditure.

In the case of Commissioner of Income-tax, Bombay City- I v. Associated Cement Companies Ltd. (172 ITR 257) the respondent-company entered into an agreement to supply water to the municipality and provide water pipelines as also to supply electricity for street lighting and put up a transmission line for that purpose. The assessee also agreed to concrete the main road from the factory to the railway station. The amounts expended for these purposes were held to be revenue expenditure since the installations and accessories were the assets of the municipality and not of the assessee. The expenditure, therefore, did not result in creating any capital asset for the company. The advantage secured by the respondent was immunity from liability to pay municipal rates and taxes for a period of 15 years. This Court said that had these liabilities been paid, the payments would have been on revenue account. Therefore, the advantage secured was in the field of revenue and not capital.

In the case of Commissioner of Income-tax v. Bombay Dyeing and Manufacturing Co. Ltd. (219 ITF 521) the company contributed to the State Housing Board certain amounts for construction of tenements for its workers. The tenements remained the property of the Housing Board. It was held that the expenditure was incurred wholly and exclusively on the welfare of the employees and, therefore, constituted legitimate business expenditure. As the assessee company acquired no ownership rights in the tenements, this Court said that the expenditure was incurred merely with a view to carry on the business of the company more efficiently by having a contented labour force.

All these cases have looked upon expenditure which did bring about some kind of an enduring benefit to the company as a revenue expenditure when the expenditure did not bring into existence any capital asset for the company. The asset which was created belonged to somebody else and the company derived an enduring business advantage by expending the amount. In all these cases, the expense has been looked upon as having been made for the purpose of conducting the business of the assessee more profitably or more successfully. In the present case also, since the asset created by spending the said amounts did not belong to the assessee but t he assessee got the business advantage of using modern premises at a low rent, thus saving considerable revenue expenditure for the next 39 years, both the Tribunal as well as the High Court have rightly come to the conclusion that the expenditure should be looked upon as revenue expenditure.

In the premises, the appeals are dismissed with costs.