Travancore Sugars And Chemicals Ltd vs Commissioner Of Income-Tax Kerala on 20 September, 1966

Equivalent citations: 1967 AIR 477, 1967 SCR (1) 423, AIR 1967 SUPREME COURT 477

Author: V. Ramaswami

Bench: V. Ramaswami, J.C. Shah, Vishishtha Bhargava

PETITIONER:
TRAVANCORE SUGARS AND CHEMICALS LTD.

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX KERALA

DATE OF JUDGMENT:
20/09/1966

BENCH:
RAMASWAMI, V.
BENCH:
RAMASWAMI, V.
SHAH, J.C.
BHARGAVA, VISHISHTHA

CITATION:
1967 AIR 477 1967 SCR (1) 423
CITATOR INFO :
R 1972 SC1634 (16)
R 1973 SC 318 (17,19,20)
RF 1973 SC 982 (1)
D 1985 SC1656 (6,8,9,10)
RF 1987 SC 798 (11)

ACT:
Indian Income-tax Act, 1922, s. 10(2)(xv)--Purchase of industrial undertaking from Government-Agreement to pay percentage of net profits to Government annually-Such payment whether revenue or capital expenditure.

HEADNOTE:
The appellant company was formed with a view to taking over certain industrial undertakings from the Government of the

erstwhile State of Travancore. Apart from the cash consideration for the said purchase the appellant agreed to pay to the Government a certain percentage of its net profits every year. In proceedings under the Indian Income-tax Act, 1922, for the assessment year 1958-59 the appellant claimed the amount so paid to be expenditure allowable under s. 10(2) (xv). The High Court in reference proceedings held against the appellant who thereupon came to this Court. It was urged on behalf of the appellant that the annual payment was in the nature of revenue expenditure because it was not related to any part of the purchase price of the assets; on the other hand the Government had undertaken certain obligations under the agreement and the payment was in lieu of these. On behalf of the respondent it was urged that the payment formed part of the consideration for the purchase.

HELD:(i) No single test of universal application can be discovered for- a solution of the question whether a particular expenditure is in the nature of capital expenditure or revenue expenditure. The name which the parties may give to the transaction which is the source of the receipt and the characterisation of the receipt by them are of little consequence. The court has to ascertain the true nature and character of the transaction from the covenants of the agreement tested in the light of surrounding circumstances. [427 D-E]

(ii) The percentage of the net profits payable by the appellant company to the Government under the agreement was payable for an indefinite period without limitation; it was related to the annual profits which flowed from the trading activities of the company having- no relation to the capital value of the assets; it was -also not tied up in any way to any fixed sum a,-reed between the parties as part of the purchase price of the three Government undertakings. There was no reference to any capital sum in this part of the agreement. On the contrary the very nature of the payment excludes the idea that any connection with the capital sum was intended by the parties.

It is true that the purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. The mere fact that the capital sum is payable by instalment specied over a certain length of time will not convert the nature of that payment from the capital expenditure into, a revenue expenditure, but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the particular undertaking. As there was no specific sum fixed in the present case as an addi-tional amount of price payable in addition to the-cash consideration and payable in instalments or by any particular method the annual payment

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made to the Government could not be held to be in the nature of capital expenditure. It was revenue expenditure.[428A-C]

Case-law referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 324 of 1965. Appeal by special leave from the judgment and order dated August 20,1963, of the Kerala High Court in I.T.R. Case No. 16 of 1962.

A. K. Sen, G. L. Sanghi, and B. R. Agarwala, for the appel- lant.

S.T. Desai, S. K. Iyer and R. N. Sachthey for the respon- dent.

The Judgment of the Court was delivered by Ramaswami, J.-The appellant is a limited company incorpora- ted under the Travancore Companies Regulation and is carrying on business, in the State of Kerala,of manufacturing sugar, running a distillery and also a tincture factory. The appellant-company was floated with a veiw to taking over the business assets of a company called 'Travancore Sugars Ltd. (which was being wound up and in which the State Government held the largest number of shares), the Government Distillery at Nagercoil and the business assets of the Government Tincture Factory at Trivandrum. For this purpose an agreement dated June 18, 1937 was entered into between the Government of Travancore and Sir William Wright on behalf of Parry & Co. Ltd., the Promoters of the appellant-company. Under the said agreement the assets of all the three concerns were agreed to be sold by the Government of Travancore to the appellant- company. Clause 3 of the agreement provided that the cash consideration for the sale of assets of the Travancore Sugars Ltd. shall be 3 .25 lakhs rupees. Clause 4(a) provided that the cash consideration for the sale of the Government Distillery shall be arrived at as a result of joint valuation by the Engineers to be appointed by the parties. Clause 5(a) stated that the cash consideration for the sale of assets of the Government Tincture Factory shall be the value according to the books. Under cl. 4(b) and (c) of the agreement the Government undertook to recognise the transfer of the licence from the licensees of the Distillery to the appellant and to secure to it the continuance of the licence for a continuous period of five years after the termination of the then existing licence. Under cl. 5(b) of the agreement the Government agreed to purchase the pharmaceutical products manufactured by the appellant in the Tincture Factory, for its medical requirements. Under cl. 6 of the agreement all books of account and connected documents are to be open to inspection by the authorised officers of the Government. Under cl. 10 the Government was entitled to nominate a director on the Board of Directors of the appellant-

company who would not be entitled to any -voting power or to interfere with the normal management of the company. Apart from the cash consideration referred to in the agreement, cl. 7 of the said agreement provided for futher payments as folows:

> " (7). The Government shall be entitled to twenty per cent of the net profits earned by the company in every year subject however to a maximum of Rupees forty thousand per annum, such net profits for the purposes of this clause to be ascertained by deduction of expenditure from gross income and also after-

(i) provision has been made for depreciation at not less than the rates of allowances provided for in the income-tax law for the time being in force, and

(ii) payment of the Secretaries & Treasurers' remuneration."

By another agreement dated January 28, 1947 the following clause was substituted for the above cl. 7 of the original agreement:

"The Government shall be entitled to ten per cent of the net profits of the Company in every year. For the purpose of this clause net profits means the amount for which the Company's audited profits in any year are assessed to Income-tax in the State of Travancore."

For the assessment year 1958-59 (the corresponding previous year being May 1, 1956 to April 30, 1957) the amount payable to Government under the aforesaid cl. 7 came to Rs 42,480/-. The appellate Assistant Commissioner disallowed the claim of the appellant for deduction of this amount on the ground that it was virtually mere sharing of profits after they came into existence. The appellate Assistant Commissioner relied upon the decision in The Pondicherry-Railway Company v. C.I.T.(1) in disallowing this item of expenditure. The appellant preferred an appeal against the order of the appellate Assistant Commissioner to the Income-tax Appellate Tribunal which held that the case came within the principle of the decision in British Sugar and Manufacturers Ltd. v. Harris. Inspector of Taxes(2) and that the payment of com- mission was an expenditure made in order to earn profits of the business and not an expenditure paid out of earned profits. In the result the Tribunal allowed the appeal by the Company. At the instance of the respondent the Tribunal referred the following question of law to the High Court of Kerala:

"Whether on the facts and in the circumstances of the case, the payment of Rs. 42,480/- by the assessee to the Travancore Government under the agreements dated

(1) 5 I.T.C. 363. 58 I.A. 239.

(2) [1939] I.T.R. 101.

18-6-1937 and 28-1-1947 was allowable under sec. 10 of the Income-tax Act?"

By its judgment dated August 20, 1963, the High Court held that the payment of the aforesaid amount constituted capital expenditure and was not allowable under s.10(2)(xv)of the Income Tax Act. In this view the High Court felt it unnecessary to go into the merits of the respondent's contention that the payment represented only a division of profits. The present appeal is brought, by special leave, from the judgment of the High Court of Kerala dated August 20, 1963.

On behalf of the appellant Mr. Asoke Sen submitted that the payment of Rs. 42,480/- was not capital expenditure but was expenditure of revenue nature which was allowable under s. 10(2) (xv) of the Act. It was pointed out that the annual payments

under cl. 7 were not part of the purchase price of the assets.Reference was made to cls. 3, 4(a) and 5(a) of the agreement and it was said that separate and full considerations were provided for the purchase of the assets of Travancore Sugars Ltd., the Government Distillery and the Government Tincture Factory. In addition to selling these asssets the Government undertook obligations enumerated in cls. 4(b) and (c) and 5(b) already referred to. It was :contended that the appellant agreed to make annual payments to Government in consideration of these obligations. On behalf of the respondent the opposite view-point was presented and it was said that the preamble to the agreement dated January 28, 1947 indicated that the purchase was not merely for the cash consideration recited but also for the payment provided by cl. 7. Reference was made to the following portion of the preamble of the agreement dated January, 28, 1947.

"WHEREAS on 18th June 1937 an agreement (here- inafter called 'the principal agreement) was entered into between M. R. Ry. Rao Bahadur Rajyasevanirata N. Kunjan Pillai Avl., Chief Secretary to Government acting for and on behalf of the said Government of His Highness

-the Maharaja of Travancore of the one part and Sir William Wright, Kt., C.B.E., of Messrs. Parry & Co. Ltd., Madras, acting for and on behalf of the said Messrs. Parry & Co. Ltd., of the other part, whereby the said Government should sell and the company should purchase the assets including the lands of the Travancore Sugars Ltd., with the buildings, out-houses, machinery and other things attached thereto and more particularly described in the Schedule 'A' annexed to the said principal agreement, the factory known as the Government Distilleries situate at Nagercoil in South Travancore with lands, buildings, machinery and other things attached thereto and more particularly described in the Schedule 'B' annexed to the principal agreement, and all the assets of the factory known as the Government Tincture Factory situated at Trivandrum and more particularly described in the Schedule 'C' annexed to the principal agreement for the cash consideration in the said principal agreement mentioned and also in consideration inter alia that the Government should be entitled to 20 Y. (twenty per cent) of the said net profits earned by the Company in every year subject however to a maximum of Rs. 40,000/per annum, such net profits for purposes of the said agreement to be ascertained after the deductions set out in clause 7 of the said agreement."

It is often difficult, in any particular case, to decide and determine whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure. It is net easy to distinguish whether an agreement is for the payment of price stipulated in instalments or for making annual payments in the nature of income. The court has to look not only into the documents but also at the surrounding circumstances so as to arrive at a decision as to what was the real nature of the transaction from the commercial point of view. No single test of universal application can be discovered for a solution of the question. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little

consequence. The court has to ascertain the true nature and character of the transaction from the covenants of the agreement tested in the light of surrounding circumstances. Examining the transaction from this point of view it is clear in the present case that the consideration for the sale of the three undertakings in favour of the appellant was: (1) the cash consideration mentioned in the principal agreement, viz., cls. 3, 4(a) and 5(a), and (2) the consideration that Government shall be entitled to twenty per cent of the net profits earned by the appellant in every year subject to a maximum of Rs. 40,000/- per annum. With regard to the second part of consideration there are three important points to be noticed. In the first place, the payment of commission of twenty per cent on the net profits by the appellant in favour of the Government is for an indefinite period and has no limitation of time attached to it. In the second place, the payment of the commission is related to the annual profits which flow from the trading activities of the appellant-company and the payment has no relation to the capital value of the assets. In the third place, the annual payment of 20 per cent commission every year is not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings. There is no reference, to any capital sum in this part of the agreement. On the contrary, the very nature of the payments excludes the idea that any connec SupCI/66-19 tion with the capital sum was intended by the parties. It is true that the purchaser may buy a running concern and fix a certain price and the price may be payable in a lump sum or may be payable by instalments. The mere fact that the capital sum is payable by instalments spread over a certain, length of time, will not convert the nature of that payment from the capital expenditure into a revenue expenditure, but the payment of instalments in such a case would always have some relationship to the actual price fixed for the sale of the particular undertaking. As we have already mentioned, there is nonspecific sum fixed in the present case as an additional amount of price payable in addition to the cash consideration and payable by instalments or by any particular method. In view of these facts we are of opinion that the payment of the annual sum of Rs. 42,480/ in the present case is not in the nature of capital expenditure but is in the nature of revenue expenditure and the judgment of the High Court of Kerala on this point must be overruled. The view that we have expressed is borne out by the decision of the Court of Appeal in Commissioners of Inland Revenue v. 36/49 Holdings. Ltd. (In Liquidation)(1). In that case, an undertaking was sold and the price consisted of fixed amount and a certain commission payable for an indefinite period. The consideration in the particular agreement which the Court of Appeal had to consider, which was in addition to the fixed amount payable by the purchaser to the vendor, was I shilling for each bicycle not being mechanically propelled bicycle without deduction and pound for each mechanically propelled bicycle without deduction, and this was to be paid on the turnover by the purchasing company. This sum of 1 shilling and pound was to be paid without any limitation of time, and this sum was not related to any special sum as being part of the price to be paid by the purchaser to the vendor. In the course of his judgment, Lord Greene, Master of the Rolls observed as follows at page 182 of the, report.

> "The true nature of a sum payable to a recipient for purposes such as the present is to be ascertained from all the circumstances relevant to that matter-. The true nature of the sum is not necessarily its nature in law, but its nature in business or in accountancy whichever way one likes to put it, because from the legal point of view there may be no difference whatsoever as between the parties between a capital and an income sum. - It may be totally irrelevant to the legal relationships into which they

> are proposing to enter. When, however, the tertius gaudens, in the shape of the Revenue, appears on the scene, that matter which as between the parties may have been a matter of not the slightest importance becomes immediately a matter of very great importance, and it is necessary to examine the circumstances (1) [1943] 25 T.C. 173.

.lm15 of each individual case, including any documents which require to be construed, in order to ascertain what is the character to be attributed to the payment." The same view was taken by the Bombay High Court in Commissioner of Income-tax, Bombay City v. Kolhia, Hirdagarh Co. Ltd. Bombay(1). In that case, there was an agreement between the proprietor of a colliery and C by which it was agreed to promote the assessee company for the purpose of acquiring and carrying on the colliery. The purchase price was fixed at rupees one lac which was to be discharged by the payment of a sum of Rs. 75,000/- in cash and the allotment of fully paid shares of the face value of Rs. 25,000/- to the vendor. It was also agreed that the vendor should be paid the Minimum annual dividend of four annas for every ton of coal raised from the colliery and if there was any deficit in any year the company would make up such deficit, Under the draft Articles of Association of the company the vendor was to get, in respect of the consideration for shares, 500 preference shares or Rs. 50/- each and a fixed cumulative preferential dividend equivalent to four annas per ton of coal raised and railed in each year. The vendor approved the draft articles and in a letter stated that he should get four annas per ton permanently on all coals despatched from the colliery every year, without any hindrance whatsoever. irrespective of any loss or gain to the company. The assessee-company was incorporated and the formal agreement of sale was entered into between it and the vendor. Subsequently it was found impossible to pay to the vendor a fixed dividend and therefore a fresh agreement was executed tinder which the vendor agreed to give up all the dividends to which he was entitled and to permit the company to convert the preference shares into ordinary shares. In consideration of this, the company agreed to pay a commissioner to the vendor at the rate of four annas per ton of steam and rubble coal and three annas per ton of slack coal raised from the colliery and sold and rented by the company from the colliery. The question arose whether the sum representing the commission paid by the assessee company to the vendor under the terms of the agreement was a revenue expenditure. It was held by the Bombay High Court that as the payment made by the assessee company was a payment made for an indefinite period, a payment made in relation to the turnover of the company and not in relation to its profits, and as the payment had no bearing to any specific sum fixed as part of the price for the purchase of the Undertaking, it was in the nature of a revenue payment and not a capital payment. On behalf of the respondent Mr. S. T. Desai referred to the decision of the Judicial Committee in Minister of National Revenue (1) 17 I.T.R. 545.

V. Catherine Spooner(1), In that case, the assessee had sold all her right, title and interest in some land which she owned in freehold to a company in consideration of a certain sum in cash, of certain shares in the company and an agreement to deliver to her 10 per cent of oil produced from the land. The transferee company, after it had commenced operations, struck oil and raised some of it in the year of account, but did not deliver to the assessee any part of the oil produced. The transferee company sold the whole of it and paid over 10 per cent of the gross proceeds to the assessee which she accepted in satisfaction of the royalties reserved to her under the agreements The question arose

whether the amount which the lady received in lieu of the oil was 'annual profit or gain from any other source', and the Appellate Court in Canada held that it was not so, but was a capital receipt. On appeal the Judicial Committee agreed with the Appellate Court in Canada that the case was not without its difficulties, but in the end they said that they were not prepared to differ from the view of the transaction which an eminent Judge like Newcombe, J. had taken and with which all his colleagues had agreed. The decision of the Judicial Committee turned on special facts of that case, viz., that the lady had bargained to receive her share in oil and that there could be no profit or gain out of the transaction of that kind. The case was an exceptional one and the ratio of that decision cannot be applied to the present case where the facts are manifestly different. We may, however, refer to the decision in Jones v. Commissioners of Inland Revenue(") where property was conveyed in consideration of periodical payments, the payment being a share of the profits of the business. In that case, a person sold his interest in certain inventions and letters-patent for pound 750 in cash and a percentage, called a royalty, payable for ten years on the sale of all machines constructed under the patent. Of the sum of pound 750, pound 300 was paid in cash, but the payment of the balance was secured by providing that it would have to be paid by way of 5 per cent on the sale of the machines. It was conceded by the Revenue that this 5 per cent was not to be included in computing the total income of the transferor. A question having arisen with regard to the further 10 per cent. Rowlatt , J. observed as follows:

> "The property was sold for a certain sum, and in addition the vendor took an annual sum which was dependent upon the volume of business done; that is to say, he took something which arose or fell with the chances of the business. When a man does that he takes an income-it is in the nature of income."

The principle of this case applies to the persent case where the facts are closely parallel.

(1) [1933] A.C. 6 4.

(2) [1920] 1 K.13. 711.

It is not, however, possible for us to finally determine this appeal because the High Court has not dealt with the other questions arising in this reference. Even if the payment of the commission to the Government by the assessee is not capital but revenue payment, certain other questions arise for consideration in this case. In the first place, it has to be determined whether the appellant is right in his argument that the payment of the commission is tantamount to diversion of profits by a paramount title. In this connection reliance was placed on behalf of the appellant upon the decision in Raja Bajoy Singh Dudhuria v. Commissioner of Income Tax Bengal(1) in which the assessee succeeded to the family ancestral estate on the death of his father. Subsequently his step-mother brought a suit for maintenance against him in which a consent decree was made directing the assessee to make a monthly payment of a fixed sum to his step-mother and declaring that the maintenance was a charge on the ancestral estate in the hands of the assessee. In computing his income, the assessee claimed that the amounts paid by him to the step-mother under the decree should be excluded. It was held by the Judicial Committee that the sums paid by the assessee to his step- mother were not 'income' of the assessee at all and that the decree of the court by charging the

appellant's whole resources with a specific payment to his step-mother had to that extent diverted his income from him and had directed it to his step-mother, and to that extent what he received for her was not his income. It was not a case of the application by the appellant of part of his income in a particular way; it was rather the allocation of a sum out of his revenue before it became income in his hands. Reliance was also placed on the decision of this Court in Poona Electric Supply Co. Ltd. v. Commissioner of IncomeTax. Bombay City(2) in which a distinction was drawn between real profits ascertained on commercial principles and profits fixed by statute for a specified purpose. In the second place, the respondent has contended that the transaction should be treated as a joint venture with an agreement to share profits between the appellant ,and the Government. In the third place, the High Court has to ,examine whether the requirements of s. 10(2)(xv) have been satisfied in this case. On behalf of the respondent the argument was presented that the payment of commission was a payment out of the profits of the appellant on condition of profits being earned and that it was not a payment made to earn profits. Reference was made to the decision of the Judicial Committee in Pondicherry Railway Co. Ltd. v. Commissioner of Income-tax.(3) The opposite view-point was presented on behalf of the appellant and it was argued that the payment of the commission was a payment wholly and exclusively laid out for the purpose of business and reference was made to the decision of the Judicial Committee in Indian Radio (1) [1933] I.T.R. 135. (2) 57 I.T.R. 521.

(3) 5 I.T.C. 363.

and Cable Communication Co. Ltd. v. Commissioner of Income- tax(1) and to the decision of the Court of Appeal in British Sugar Manufacturers Ltd. v. Harris (Inspector of Taxes).(2) It is necessary that the High Court should consider all these aspects of the case before furnishing an answer to the question of law referred to it.

For these reasons we allow this appeal, set aside the judgment of the High Court of Kerala dated August 20, 1963 and remand the case for being reheard and dealt with in accordance with the directions given in this judgment. The parties will bear their own costs up to this page G.C Appeal allowed.

(1) [1937] 5 I.T.R. 270.

(2) [1939] I.T.R. 101.