Supreme Court of India
H. Dear And Co. (P.) Ltd. vs Commissioner Of Income-Tax ... on 14 December, 1965
Equivalent citations: 1966 60 ITR 546 SC
Author: Shah
Bench: J Shah, K S Rao, S Sikri
JUDGMENT Shah, J.

1. For the period July 1, 1944, to June 30, 1950, the appellant company was permitted under two separate agreements both dated September 14, 1944, with the Maharaja of Jeypore to collect "sleepers and scantlings" approved by the company form logs of sal trees marked by the forest department, in the Ramgiri Forest and Omerkote Nowrangpur range in the Jeypore Estate, in consideration of the compare agreeing to pay as royalty specified percentages of the price at which the "sleepers and Scantligns" were supplied by the company to the Indian railways. By a letter dated January 16, 1950, addressed to the Dewan of Jeypore the company offered to pay enhanced royalty for the period June 1, 1948, to June 30, 1950, in considerate of the Estate granting renewal of the agreements which were about to expire. The collector of Koraput who was the authority to sanction the grant or renewal of the agreement under section 3(1)(a) of the Orissa Preservations of Private Forests Act, 1947, by order dated April 3, 1950, sanctioned renewal of the original agreement for one year from July 1, 1950, to June 30, 1951. A fresh agreements was there after executed on June 13, 1952 for a term of three years with effect from July 1, 1951 under which company was granted the right to cut sal trees marked by the Estates forest department in the arrear agreed upon and to convert the same into "sleepers and scantlings" and to remove them. The agreements provided that the company would pay to Estate subject to a minimum of Rs 40,000 annually (which would not be altered during the term of the agreement) at the rates specified in clause 6 for different types of "sleepers and scatlings" mentioned therein.

2. During the course of negotiations for extensions of the agreement from July 1, 1951, the company agreed to pay royalty enhanced rates for the period July 1 1943 to June 30, 1950, on conditions that the agreement was extended for at least three years. This worked at the rate of Rs. 69,000 per annum. The company then offered by its letter dated March 22, 1951, to pay an additional amount of Rs. 9,000 annually in addition to Rs. 69,000 already agreed to be paid. By another letter dated June 10, 1952 it was confirmed that subject to a lease being signed in the terms of the draft enclosed with the company letter dated June 9, 1951, the company agreed to pay additional amounts in the aggregate at the rate of Rs. 83,000 annually during the term of the lease. A convenient about the additional payments offered to be made by the company was however not incorporated in the agreement dated June 13, 1952.

3. In proceeding for assessment of income-tax in the assessment year 1953-54, the claim of the company to deduct Rs. 83,157 pending during the year of account in addition to the royalty stipulated to be under the agreement dated June 13, 1952 as an allowable expenditure under section 10(2)(xv) of the Indian Income-tax Act was rejected by the Income-tax Officer. The order of the Income-tax was reversed by the Appellate Assistant Commissioner who held that the agreement to pay amounts of money addition to royalty stipulated to be paid under the formal agreement were "additional royalty" solely for the purpose of acquiring logs to be converted into sleeper for sale and

the payments represented "the prime cost of the company's stock-in-trade". In appeal by the Income-tax Officer, the Income-tax Appellant Tribunal confirmed the order to the Appellate Assistant Commissioner. The Tribunal then drew up a statement and submitted the following question for the opinion of the High Court of Judicature at Calcutta :

"Whether on the facts and in the circumstances of the case, and on the correct interpretations of the three enclosure to the letter of the assessee dated the 8th day of July 1954, to the Income-tax Officer concerned the sum of Rs. 83,517 was allowable as an expenditure of a revenue nature ?"

4. The High Court recorded its answer on the question in the negative. In the view of the High Court the expenditure incurred by the company was of the nature of capital expenditure and not revenue. In reaching their conclusion the learned judges assumed that the royalty payable under the agreement dated June 13, 1952 and the additional payment agreed to be made by correspondence between the company and the Dewan of the Estate were of the same character, and that by the agreement dated June 13, 1952, the company did not purchase standing timber, but it was given "a right to extract sleepers". According to the High court, the company had "to enter the forests, to wait for certain trees to be marked, and then to cut such trees according to its requirements for the supply of sleepers to the railway and others, as and when it liked, within the specified period of three years," and that what was acquired under the agreement was not stock-in-trade, but the right to acquire it and upon the principle laid down by the House of Lords in Hood-Barrs v Inland Revenue Commissioners, the company acquired a capital asset of an enduring nature. In the alternative, the High court obeserved, the additional amount agreed to be paid in respect of the period under the original agreements which had expired were in consideration of the Estate granting extension of the agreement which came to an end in the month of June, 1950. Had the agreement not been extended, observed the High court the "business of the company would have been greatly affected and there could be no doubt that by the payments the company acquired a benefit of an enduring nature", and since by the payment of the amounts the company got he benefit of a contract whereby it could continue its business activities for a sufficiently long period to come it was a benefit of an enduring nature and, therefore, the payments were of capital nature.

5. Under section 10(2) of the Act in the computation of the profit of a business carried on by an assessee certain allowances are permitted to be deducted and one such allowances is "expenditure" not being an allowance of the nature described in clauses (i) to (xiv) inclusive and, not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation. "The expenditure in question was, it is common ground, laid out wholly and exclusively for the purpose of the business, and it was not an allowance of the nature described in clauses (i) to (xiv) of sub- section (2) of section 10. It was still not admissible as an allowance, if it was in the nature of capital expenditure.

6. In our view the High Court was not a right in assuming that the royalty agreed to be paid under the terms of the agreement dated June 13, 1952, and the additional payments annually made were of the same character. The High Court was also not right in holding that the royalty paid under the agreement was of the nature of capital expenditure. Under the terms of the agreement dated June 13, 1952 the company had made an arrangements for obtaining what was it stock-in- trade, and

money spent for acquiring stock-in-trade of the business is revenue expenditure. The Income-tax Officer did not disallow the royalty stipulated to be paid under the terms of the agreement dated June 13, 1952 : he only disallowed the additional amounts which related to what was called "back royalty" for the period July 1, 1948, to June 30, 1950. The question referred by the Tribunal also related to the amount of Rs. 83,157 which was paid as an additional amount over and above the royalty agreed to be paid.

7. But we are of the view that the answer recorded on the alternative ground which appealed to the High court must be sustained. The additional payments were worked out on the basis of total royalty paid during the period two years under the earlier agreements, i.e., from June 1, 1948, to June 30, 1950, and were offered to be paid in consideration of the Estate agreeing to grant renewal of those agreement.

8. Under the original agreements of the year 1944, certain payments were stipulated to be made for acquiring the "sleepers and scantlings" and payments were made accordingly by the company. Before the period of the agreements came to an end, the company offered pay for the last two year royalty at the enhanced rate. The offer was conditional : it was binding only if renewal of the agreement was granted as proposed. The offer apparently fell through, when the collector of Koraput sanctioned renewal only for one year. Before the expiry of the year for which renewal was granted, the company made a fresh offer to pay an additional amount of Rs. 78,000 annually. That again was a conditional offer. Finally by letter dated June 10, 1952 the company agreed to make additional payments at the rate of Rs. 83,000 annually provided "a lease" was "signed and registered in terms of the draft enclosed," with the company's letter dated June 9, 1951. It is in the light of these persistent effort made by the company to secure renewal of the agreement for what the high Court called a "sufficiently large d period" that the nature of the payments has to be determined. It was only with a view to persuade the State authorities to "grant a new lease for period of four or five years" that an offer to pay those amounts in addition to the stipulated royalty was made. The was no legal obligation pay those amounts under the terms of the original agreement, and the company offered "as a special case to pay" those additional amounts "on the understanding that the Government will give approval" for renewal of the agreement. The amounts agreed to be paid did not form part of the price of the company stock-in-trade right to collect which was conferred by the agreement dated June 13, 1952. There is no doubt that payment of premium is consideration of the owner of property agreeing to grant a right to take and remove the stock-in-trade of the taxpayer is in the nature of capital expenditure. We, therefore, agree with the High Court on the alternative ground which appeal to them.

9. The appeals, therefore fail and are dismissed with costs. There will be one hearing fee.

10. Appeals dismissed.