Supreme Court of India
Commissioner Of Income-Tax, ... vs Travancore Sugar & Chemicals Ltd on 27 October, 1972
Equivalent citations: 1973 AIR 982, 1973 SCR (2) 738
Author: P J Reddy
Bench: Reddy, P. Jaganmohan

PETITIONER:
COMMISSIONER OF INCOME-TAX, KERALA, ERNAKULAM

Vs.

RESPONDENT:
TRAVANCORE SUGAR & CHEMICALS LTD.

DATE OF JUDGMENT27/10/1972

BENCH:
REDDY, P. JAGANMOHAN
BENCH:
REDDY, P. JAGANMOHAN
DUA, I.D.

CITATION:
1973 AIR 982 1973 SCR (2) 738
1973 SCC (3) 274
CITATOR INFO :
D 1976 SC 640 (11)
F 1985 SC1656 (9)

ACT:
Indian Income-Tax Act 1922, Section 10(2)(xv)--Payment of fixed percentage of the profits annually, apart from the cash consideration, for taking over of the undertaking, whether deductible.

HEADNOTE:
The appellant Company was floated with a view to take over the assets of the three Government concerns, namely, Sugar Factory, a distillery and tincture factory and to run them. Clause 3 of the agreement provided that the cash consideration for the sale of assets shall be Rs. 3.25 lakhs. Clause 4(b) and (c) provided for the continuation of the distillery licence in favour of the appellant. The Government was to purchase the pharmaceutical products from the company under clause 5(b). The Government had a right to nominate a Director on the Board of Directors. Clause 7 of the agreement read "Government shall be entitled to 20% of the net profits earned by the Company in every year subject, however, to the maximum of Rs. 40,000/- per annum. Such net profits for the purpose of this clause to be

ascertained by deductions of expenditure from gross income and also after (i) provision has been made for depreciation at net loss than the rates of allowance provided for in the Income Tax Act for the time being in force, and (ii) payment of the Secretaries and Treasurer's remuneration"., By subsequent agreement, the percentage was reduced to 10%. For the assessment year 1958-59, the amount payable to the Government under the aforesaid clause 7 came to Rs. 42,480/-. The appellant claimed that the payment of the said amount was an expenditure of the revenue nature and was allowable under section 10(2)(xv) of the Act. The claim was disallowed by the Income Tax Officer and the Appellate Assistant Commissioner, but was allowed by the Tribunal holding that the payment was an expenditure made in order to earn profits of the business and not an expenditure paid out of the earned profits. At the instance of the respondent, the Tribunal referred the following question of law to the High Court of Kerala.

"Whether on facts and in the circumstances of the case, the payment of Rs. 42,480/- by the assessed to the Travancore Government under the agreements, dated June 18, 1937 and January 28, 1947 was allowable u/s 10 of the income-tax Act." The Kerala High Court held that the payment constituted capital expenditure and was not allowable under section 10(2) (xv) of the Income-tax Act. On appeal 'by the appellant to Supreme Court, the Supreme Court reversed the High Court judgment and remanded the matter to the High Court. On remand, the High Court held that the said expenditure was deductible.

Rejecting the appeal,

HELD : (i) Once the crucial question is decided that the expenditure is a revenue expenditure and not of capital nature, the answer to the reference should be in the affirmative. Whether the expenditure is to be

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further considered as expenditure incurred at the very inception deductible as an over-riding charge on the whole of the profit making apparatus failing under section 10(1) or whether it is an expenditure which apart from it being a revenue expenditure is also wholly and exclusively laid out for the purpose of trade, would not make any difference to the answer. [746G]

(ii)Held further, the assessee had no choice at the time of the inception as a condition of its coming into existence to agree to the several terms stipulated by the Government for transferring the profit-earning assets. There are obligations in the contract which are inter-linked with the transfer of assets notwithstanding the fact that the Company paid a price fixed for the transfer of assets. Under the contract, the company had to engage only the Travancore labour and staff, that it had to take apprentices recommended by the Government and train them and that there was no limitation as to the period the company had to pay

the annual sum out of the net profits, nationally computed for that purpose after deduction of certain items mentioned in clause 7. All this appears to be stipulation for payment of an amount for a concession granted to it and is therefore deductible at its inception. [751A]
(iii)Held further, that clause (xv) of Sub-section 2 of Sec. 10 is confined tothe payments wholly and exclusively laid out for the purpose of businessin which expenditure of a revenue nature would also be included along with the expenditure of various other categories. The contention that the said clause covers expenditure of both the capital and revenue nature and also payments wholly and exclusively laid out for the purpose of business, was rejected.
Pondicherry Rly. Co. v. Income-tax Commissioner, 58 I.A. 239, The Union Cold Storage Co. Ltd. v. Adamson (H.M. inspector of Taxes), 16 T.C. 292 at 331, Indian Radio Etc. Co. Ltd. v. Commissioner of Income-tax, Bombay, 5 I.T.R. 270 and British Sugar Manufacturers Ltd. v. Harris, 7 I.T.R. 101 = [1938] 2 KB 220, referred to.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2161 of 1969.

Appeal by certificate from the judgment and order dated April 5, 1968 of the Kerala High Court at Ernakulam in Incometax Referred Case No. 16 of 1962.

N.D. Karkhanis, B. D. Sharma and R. N. Sachthey, for the appellant.

Sukumar Mitra and T. A. Ramachandran, for the respondent. The Judgment of the Court was delivered by JAGANMOHAN REDDY J.-This is a second round of litigation because on' the first occasion this Court allowed Appeal No. 324 of 1965 on September 20, 1966 and remanded the case for being re-heard and dealt with in accordance with the directions given in that judgment. After the matter went back a Division Bench of the Kerala High Court, Raghavan, J. (as he then was) and Issac, J. heard the matter but as there was difference of opinion between the learned Judges the case was placed before Mathew, J. (as he then was) who agreed with the judgment of Raghavan, J.This is an appeal against that judgment by certificate. Inasmuch as this Court had earlier considered the case we. may take the facts as stated in the following passage in that judgment:

"The appellant is a limited company incorporated 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 view to taking over the business assets of a company called "Travancore Sugars Ltd." (which was being would 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 3.25lakh rupees. Clause 4(a) provided that the cash considerationfor the sale of the Government Distillery shall be arrived at asa result of joint valuation by the engineers to be appointed bythe 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 clause 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 clause 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 clause 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 clause 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, clause 7 of the said agreement provided for further payments as follows :

> "(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--
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> (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
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> (ii) payment of the secretaries and treasurers' remuneration."
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> By another agreement dated January 28, 1947, the following clause was substituted for the above caluse 7 of the original agreement : "The Government shall be entitled to ten per centum 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 the Government under the aforesaid clause 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 Pondicherry Railway Co. Ltd., v. Commissioner of Income-tax [(1931] 5 I.T.C. 363; 58 I.A. 239] 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 Manufacturers Ltd. v. Harris (Inspector of Taxes) (1939) 7 I.T.R. 101 (C.A.), and that the payment of commission 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 June 18, 1937, and January 28, 1947, was allowable under section 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 section 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 in that case who is the respondent before us it was 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 assets, the Government undertook obligations enumerated in cls. 4(b), 4(c) and 5 (b) already referred to. It was contended that the appellant agreed to make annual payments to the Government in consideration of these obligations. On behalf of the respondent the opposite viewpoint 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 port-ion of the preamble of the agreement dated January 28, 1947:

> "Whereas on 18th June 1937, an agreement (hereinafter called the principal agreement) was entered into between M. R. Ry. Rao Bahadure Rajyasevanirata N. Kunjan Pillai Avl., Chief Secretary to the 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 fully 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 parti- cularly described in he

> 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% 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 the purposes of the said agreement to be ascertained after the deductions set out in clause 7 of the said agreement."

This Court while recognising that it is difficult--as indeed all Judges have found it difficult-to determine whether a particular expenditure is in the nature of capital expenditure or in the nature of revenue expenditure and that it was not 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, observed that not only the documents but the surrounding circumstances have to be looked into to ascertain what was the real nature of the transaction from the commercial point of view. It examined the transaction and was of the view that the consideration for the sale of the three undertakings in favour of the appellants was (1) the cash consideration mentioned in the principal agreement, viz., clauses 3, 4(a) and 5 (a) and (2) the consideration that Government shall be entitled to 20 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 the consideration there are three important points to be noticed. In the first place, the payment of commission of 20% 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% 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. It was also noticed that there is no reference to any capital sum in this part of the agreement but on the contrary, the very nature of the payments excludes the idea that any connection with the capital sum was intended by the parties. Having considered the several aspects of the transaction and having observed that 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 account but the payment of instalments in such a case would have always some relationship to the actual price fixed for the sale of the particular undertaking, this Court rejected the contention of the Revenue that the amount paid to the Government by the assessee was an expenditure of a capital nature in these words :

> "In view of these facts we are of opinion that the payment of the 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 over- ruled."

After this finding for which this Court found support from the decision in Commissioner of Inland Revenue v. 36/49 Holdings Ltd. (In Liquidation) (1), Commissioner of I.T. v. Kolhia Hirdagarh Co. Ltd.,(2) and the decision of the Judicial Committee in Jones v. Commissioner of Inland Revenue (3) is nonetheless observed that it is not possible for it to finally determine this appeal and that even if the payment of commission to the Government by the assessee is not capital but revenue payment

certain questions would arise for consideration in this case which the High Court has not dealt with in the reference. These questions as stated in that decision were : Firstly, it has to be determined whether the appellant is right in his argument that the payment of commission is tantamount to diversion of profits by a paramount title; secondly, the contention of the respondent that the transaction should be treated as a joint venture with an agreement to share profits between the appellant and the Government'. and thirdly, it has to be considered whether the requirements of s. 10(2)(xv) have been satisfied in this case. It was pointed out on behalf of the appellants in that case who are respondents before us that the payment of commission was a payment wholly or exclusively laid out for purposes of business. In the circumstances set out above the matter was remanded to the High Court of Kerala.

Before that High Court the second contention whether the transaction should be treated as a joint venture with an agreement to share profits was not pressed and therefore that matter was not considered. Mathew, J. (as he then was) noted that the Supreme Court had held that the payment was not in the nature of capital payment but was in the nature of revenue payment because the unpaid purchase price was neither a fixed sum nor an amount which could be ascertained by any method. In this view he considered only the first and third contentions which called for (1) 25 T.C. 173.

(2) 17 I.T.R. 545.

(3) [1921] K.B. 711.

determination by that Court. The learned advocate for the Revenue however at the. outset tried to assail the statement of Mathew J. that the Supreme Court had held that the amount paid to the Government was not a capital expenditure but a revenue expenditure because he realised that if that finding be assailed then it would be immaterial whether the amount paid to the Government amounted to diversion of the profits before they reached the assessee by an over-riding title or whether it was otherwise an allowable deduction under s. 10(2)(xv) of the Income-tax Act, 1922. In support of the stand taken by him, he: submits that a decision of this Court cannot be otose and if that is so then it must be assumed that the question whether the amount is of a capital expenditure or revenue expenditure is still open not only for the Kerala High Court to determine but also for this Court to go into. We cannot accept this contention in the light of the finding given by this Court where not only did it hold that the amount of Rs. 42,480 was not capital expenditure but that it was also a revenue expenditure. Having so held this Court went further and said that the judgment of the Kerala High Court on that point must be over-ruled. Can there be anything more categorical than this finding? We think not. Raghavan, J. did hint at this incongruity when after pointing out that this Court had held that the payment was not in the nature of a capital payment but was in the nature of revenue payment he said :

> "Still the Supreme Court observed since, the other questions..... were not decided by this Court the Supreme Court could not give an answer to the question referred."

The learned advocate for the Revenue finding himself in this difficulty attempted to create a dichotomy under which according to him both the capital and revenue nature of the expenditure as well as the payment being wholly and exclusively laid out for the purpose of the business are included in the aforesaid clause (xv) of sub-s. (2) of s.

10. But we are unable to understand the sequitur. Even supposing that these two kinds of expenditure are included, if the expenditure is of one or the other it becomes deductible.

We find no justification for this contention because a cursory reading of that provision would show that it is merely confined to the payments wholly and exclusively laid out for the purpose of the 'business in which expenditure of a revenue nature would also be included along with the expenditure of various other categories. Section 10(1) and 2(xv) are as follows :-

> "(1) The tax shall be payable by an assessee under the head "Profits and gains of business, profession or vocation" in respect of the profits and gains of any business, profession or vocation carried on by him.
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> (2)Such profits or gains shall be computed after making the following allowances, namely:-
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> (i)to (xiv)
>
> (xv)any expenditure not being an allowance of the nature described in any of the 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."

Clause 1 of the section deals with the payment of tax by the assessee in respect of the profits and gains of business, profession or vocation. It is contended that in constituting the profits of the business any payment_ made as a diversion from profits by paramount title has to be deducted before computing profits. In so far as S. 10(2)(xv) is concerned it takes note of the fact that there may be deductions of the nature described in cls. (1) to

(xiv) of sub-s. (2) and that such expenditure is not of a capital nature or personal expenses of the assessee. The expenditure of a capital nature is certainly not an expenditure which is deductible for computing profits though it may be an expenditure wholly and exclusively laid out for the purposes of the business etc. If this expenditure is not of a capital nature but of a revenue nature it is certainly deductible under this clause. All other expenditure which is not included in (i) to (xiv) or which is not at the very inception deductible as an overriding charge on the whole of the profit-making apparatus will be deductible if it is laid out or expended wholly and exclusively for purposes of such business. The disallowance of personal expenses is because that has been dealt with under s. 7 which deals with expenses wholly and necessarily incurred in the performance of duties and therefore are

not included in this clause.

Once the crucial question is decided by this Court that the expenditure is not of a capital nature but is a revenue expenditure, we should have thought that the matter ended there and that the answer to the reference was certainly in the affirmative. Whether the expenditure is to be further considered as expenditure incurred at the very inception deductible as an over-riding charge on the whole of the profit-making apparatus falling under s. 10(1) or whether it is an expenditure, which apart from it being a revenue expenditure, is also wholly and exclusively laid out for purposes of trade determined upon the principle of ordinary commercial trading would not make any difference to the answer which could be given on the basis of the expenditure being revenue expenditure and not capital expenditure. Even so, Mathew, J. after referring to the several decisions, posed the question, namely, when a trader makes a payment which is computed in relation to the profits, the question that arises is, does the payment represent a mere division of profits with any, party or is it an item of expenditure the amount of which is ascertained by reference to profits, to which his answer was "the payment would be allowable in the second case but not in the first." Even on the other question whether the payment is an expenditure wholly and exclusively laid out for purposes of trade and ascertained with reference to profits, an examination of the several cases to which a reference has been made by the learned Judge led him to the conclusion that the payment in question was such an expenditure deductible under s. 10(2)(xv).

In considering the nature of the expenditure incurred in the discharge of an obligation under a contract or a statute or a decree or some similar binding covenant, one must avoid being caught in the maze of judicial decisions rendered on different facts and which always present distinguishing features for a comparison with the facts and circumstances of the case in hand. Nor would it be conducive for clarity or for reaching a logical result if we were to concentrate on the facts of the decided cases with a view to match the colour of that case with that of the case which requires determination. The surer way of arriving at a just con- clusion would be to first ascertain by reference to the document under which the obligation for incurring the expenditure is created and thereafter to apply the principle embalmed in the decisions of those facts. Judicial statements on the facts of a particular case can never assist courts in the construction of an agreement or a statute which was not considered in those judgments or to ascertain what the intention of the legislature was. What we must look at is the contract or the statute or the decree, in relation to its terms, the obligation imposed and the purpose for which the transaction was entered into. The terms of the contract have already been set out. Under those terms, a new company has to be formed and when it is formed the Government undertook to transfer the assets of all its three undertakings at a certain valuation in order to enable it to earn profits subject to the further stipulation that it should be paid 20% profits for an unlimited duration i.e. as long as the company is working, that under cl. 4(b) the company must further get the present licence of the distillery transferred to it and the Government is required to recognise such transfer and also grant a fresh licence as soon as the present licence is terminated. By cl 4(d) it is incumbent upon the company to sell its products of the distillery to the Government at prices to be fixed by it and the duty payable by the Government should be at the rate fixed by the Madras Government. Under cl. 5(b) the Government shall buy medical products at prices not exceeding cost plus 1501. Under cl. 7 the Government shall be entitled to 20% of the net profits computed on the gross income less expenditure, depreciation and remuneration to the

Secretaries and treasurers and under cl, 10 the Government is to have a director nominated who would not interfere with the normal management.

It is contended that the assessee company was created for the specific purpose of taking over the assets burdened with the obligations set out above, that it had no volition in the matter and ha to take over the assets subject to the aforesaid enforceable obligations before it came into existence. It is therefore submitted that it was an enforceable obligation at source by which part of the revenues of the business activities of the company were diverted with, the result that the part so diverted did not become its income at all. The case of Pondicherry Rly. Co. v. Income-tax Commissioner(1) was sought to be distinguished because it is said in that case the company was already in existence, that the venture was a joint venture between the English company and the French company, that the French company merely contributed to some share of the capital by the grant of a subsidy and land free of charge and that the work in fact was done by the South Indian Railway which was to pay gross receipts less working expenses to the Pondicherry company which divided the net profits after deduction of rates and taxes etc. half and half between it and the Pondicherry company. On these facts Lord Macmillan who delivered the judgment observed at p. 251 :-

> "A payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits. It assumes that profits have first come into existence. But profits on their coming into existence attract tax at that point, and the revenue is not concerned with the subsequent application of the profits."

These observations were subsequently explained by the same learned Law Lord in The Union Cold Storage Co. Ltd. v. Adam- son (H.M. Inspector of Taxes) (2) when they were sought to be made applicable to the facts in that case. Lord Macmillan said:

> "The obligation was conceived in language entirely different from the language which your Lordships have been considering in the present appeal, where there is a common form obligation in the lease to pay rent. When, (1) 58 I. A. 239.
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> (2) 16 T.C. 292 at 331 therefore, in the passage referred to by the Attorney General in the Pondicherry case I said that "a payment out of profits and conditional on profits being earned cannot accurately be described as a payment made to earn profits", I was dealing with a case in which the obligation was, first of all, to ascertain the profits in a prescribed manner, after providing for all outlays incurred in earning them, and then to divide them. Here the question is whether or not a deduction for rent has to be made in ascertaining the profits, and the question is not one of the distribution of profits at all."

In Indian Radio Etc. Co. Ltd. v. Commissioner of Income-tax Bombay(1) Lord Maugham delivering the opinion of their Lord- ships of the Privy Council observed at p. 278 :-

> "The sum is in truth made payable as part of the consideration in respect of a number of different advantages which the appellants derive from the agreement and not all of them can be shown to be of a purely temporary character. The agreement as a whole is much more like one for a joint adventure for a term of years between the appellant company and the Communications Company than one for a lease for that period."

In that view it was held that the deduction was not allowable. The Privy Council in order to avoid any misconception was careful enough while arriving at that conclusion to say that they have not taken the view that the case is governed by the decision in Pondicherry case though that case no doubt throws light on the nature of the problem which has to be solved in the case before them, and they further added that a sentence in the judgment in that case has been explained, if explanation was necessary, by Lord Macmillan in the subsequent case of W.H.E. Adamson v. Union Cold Storage Company (see pages 278-279). The Indian Radio case was under S. 10(2) (ix). In British Sugar Manufacturers Ltd. v. Harris(1) which the Tribunal said on the facts was nearest to the case before us, the company was carrying on business as manufacturers of beat sugar, had agreed to pay to two bodies in each of four years for division between them as they mutually agreed upon 20% of the net profits of the company in consideration of their giving to the company the full benefit of their technical and financial knowledge and experience, and giving to the company and its directors advice to the best of their ability respectively on all questions of or relating to manufacture and finance and disposal of the company's products. It was held, reversing the decision of Finalay J., that in ascertaining the profits or gains of the (1) 5 I.T.R. 270.

(2) 7 I.T.R. 101-[1938]2 K.B. 220.

company for any year assessable to income-tax the sum payable, to the two bodies under this agreement out of the earnings of the company should be allowed as a deduction as being money wholly or exclusively laid out or expended for the purposes of the trade. Sir Wilfrid Green M.R. said at pp. 233-234:-

> "Now bearing all those things in mind, the question arises : On which side of the line does the case fall-? I quite accept the proposition that there is a line between a contract for payment of a share of profits simpliciter and a payment of remuneration which is deductible in truth before the profits divisible are ascertained, and that line in some cases may be very difficult to draw."

It appears to us that the amount to be paid by reference to profits can either be that it is paid after the profits become divisible or distributable or that the amount is payable prior to such distribution or division to be computed by a reference to notional or as in some decisions what is termed as apparent net profits. In the former instance it will certainly be a distribution of profits and not deductible as an expenditure incurred in running the business but in the latter it may, on the facts and circumstances of the case, and the agreement or the nature of the obligation tinder the particular instrument, which governs the obligation be an expenditure 'incurred as a contribution to the profit earning apparatus or, as it is said, incurred at the inception and deductible as an over-riding charge of the profit-making apparatus or is one laid out and expended wholly and exclusively

for purposes of such business. It is true that sub-section(1) of Section 10 of the Indian Income-tax Act, 1922 imposes a charge on the profits and gains of a business which accrue to the assessee while sub-section (2) of the said Section enumerates various items which are admissible as deduction. Where income which accrues to the assessee is not his income the question of admissible deductions would not arise. Therefore, where income is diverted at source so that when it accrues it is really not his income but is somebody else's income the question as to whether that income falls under sub-section (2) of Section 10 does not arise. Again, income can be said to be diverted only when it is diverted at source so that when it accrues it is really not the income of the assessee but is somebody else's income. It is thus clear that where by the obligation income is diverted before it reaches the assessee, it is deductible. But where the income is required to be applied to discharge an obligation after such income reaches the assessee it is merely a case of application of income to satisfy an obligation. of payment and is therefore not deductible.

On a construction of the terms of the contract in this case and the obligations arising therefrom we cannot say that the conclusions of the Kerala High Court are unsustainable. The assessee had no choice at the time of inception, as a condition of its coming into existence to agree to the several terms stipulated by the Government for transferring the profit earning assets' No doubt as the learned advocate for the Revenue said, the company paid the Government in full for the value of the assets and the company had therefore no obligation to the Government on that account. This may be true to some extent but then there are the other obligations which are interlinked with the transfer of assets notwithstanding the fact that the company paid a price fixed for the transfer of the assets which may not in all cases, as in this case it is not, be the true value of the assets which are subject matter of the transaction. The Government has established businesses and they were willing to part with them at a certain price plus certain stipulation to which we have referred which form the conditions of transfer. It may be mentioned that under the contract the company had to engage only the Travancore labour and staff, that it had to take apprentices recommended by the Government and train them and that there was no limitation as to the period the company had to pay 20% or as the later agreement revised it to 10% of the net profits, nationally computed for that purpose after deduction of certain items mentioned in cl. 7. AR this appears to us to be a stipulation for payment of an amount for a concession granted to it and is therefore deductible at its inception. Viewing it from any point of view, whether as a revenue expenditure or as an overriding charge of the profit-making apparatus or as laid out and expended wholly and exclusively for purpose of trade, the answer must be in the affirmative and against the Revenue. The appeal is accordingly dismissed with costs both here and in the High Court.

S.B.W. Appeal dismissed.
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