Supreme Court of India
The Commissioner Of Income-Tax vs The Mysore Sugar Co., Ltd on 3 May, 1962
Equivalent citations: 1967 AIR 723, 1963 SCR (2) 976
Author: Hidayatullah
Bench: Hidayatullah, M.

PETITIONER:
THE COMMISSIONER OF INCOME-TAX

Vs.

RESPONDENT:
THE MYSORE SUGAR CO., LTD.

DATE OF JUDGMENT:
03/05/1962

BENCH:
HIDAYATULLAH, M.
BENCH:
HIDAYATULLAH, M.
DAS, S.K.
SARKAR, A.K.
DAYAL, RAGHUBAR

CITATION:
1967 AIR 723 1963 SCR (2) 976

ACT:
Income Tax--Deduction--Expenditure by way of investment and expenditure in the course of business--Distinction--Test applicable--Indian Income-Tax Act, 1922 (11 of 1922), ss. 1 (1), (2) (xi), 2 (xv).

HEADNOTE:
The assesses Company used to purchase sugarcane from the sugarcane growers to prepare sugar in its factory, in which a very large percentage of shares was owned by the Government of Mysore. As a part of its business operation it entered into written agreements with the sugarcane growers and advanced them seedlings, fertilizers, and also cash. The cane growers entered into these agreements known as "oppige" by which they agreed to sell sugarcane exclusively to the assessee company at current market rates and to have the
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advances adjusted towards the price. An account of each "Oppigedar" was opened by the company. These agreements were entered into for each crop.
In the year 1948-49 due to drought, the assessee company

could not work its mills and the "oppigedar" could not grow or deliver the sugarcane and thus the advances made in the year remainded unrecovered. The-Mysore Government realising the hardship appointed a committee to investigate the matter and make a report. The Committee recommended that the assessee company should ex-gratia forgo some of its dues, and in the year of account ending June 30, 1952, the company waived its rights in respect of Rs. 2,87,422/-. The Company claimed this as a deduction under s. 10 (2) (xi) and s. 10 (2) (xv) 'but the Income-Tax Officer declined to make the deduction and the appeal before the Appellate Assistant Commissioner also failed. The Tribunal was also of the opinion that these advances were made to ensure to steady supply of quality surgarcane and the loss, if any, must be taken to represent a capital loss and not a trading loss but the tribunal referred the. question thereby arising for the decision of the High Court. The High Court relying upon a decision of this Court in Badridas Daga v. Commissioner of Income-tax held, that the expenditure was not in the nature of a capital expenditure, but was a revenue expenditure and that this amount was deductible in computing. the profits of the business for the year in question under s. 10 (1) of the Income-tax Act.

The central point for decision in the present case, was whether the money which was given up, represented a loss of capital or must be treated as a revenue, expenditure.

Held, that s. 10 (2) does not deal exhaustively with the deductions which must be made to arrive at the true profits and gains. It mentions certain deductions in cls. (i) to (xiv) and if an expenditure comes within any of the emunerated classes of allowance the case has to be considered under the appropriate class. Clause (xv) is a general clause which allows an expenditure to be deducted, if laid out or expended wholly and exclusively for the purpose of such business, which is not in the nature of capital expenditure or personal expenses of the assessee. But the general scheme of the section is that profits or gains must be calculated after deducting outgoings reasonably attributable as business expenditure but not so as to deduct any part of a capital expenditure.

To find out whether an. expenditure is on the capital account or on revenue, one must consider the expenditure in 978

relation to the business. The questions to consider in this connection are for what was the money laid out ? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of business ? If money be lost in the first circumstance it, is a loss of capital, but it lost in the second circumstance, it is a revenue loss. In the first, it bears the character of an investment, but in the second, it bears the character of current expenses.

English Crown Spelter Co. Ltd. v. Baker, (1908) 5 T. C. 327,

Charles Marsden & Sons Ltd. v. The Commissioners of Inland Revenue, (1919) 12 T. C. 217 and Raid's Brewery Co. Ltd. v. Nale, (1691) 3 T. C. 273, applied.
Badridas Daga v. Commissioner of Income-tax (1959) S. C. R. 690 and Commissioner of Income-tax v. Chitnavis, (1932) L. R : 59 I. A. 290, referred to.
Held, in this case, there was hardly any element of investment which contemplate more than payment of advance price. The resulting loss to the assessee company was just as much a loss on the revenue side as would have been, if it had paid for the ready crop which was not delivered,

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 435 of 1961. Appeal from the order dated September 7, 1959, of the High Court of Mysore at Bangalore, in Income-tax Referred case No. 2 of 1955.

C. K. Daphtary, Solicitor General of India, N. D. Karkhanis, R. H. Dhebar, and P. D. Menon, for the appellant A.V. Viswanatha Sastri and K. B. Chaudhuri, for the respondent.

1962. May 3. The Judgment of the Court was delivered by HIDAYATULLAH, J.-This appeal by the Commissioner of Income- tax, Mysore, on a certificate granted under a. 66A of the Indian Income-tax Act, is directed against a judgment of the High Court of Mysore dated September 7, 1959, by which the following question referred by the Income-tax Appellate Tribunal, Madras Bench, was answered in favour of the respondent :

> "Whether there are materials for the tribunal to hold that the sum of Rs. 2,87,422/aforesaid represents a loss of capital."

Originally two question were referred, but with the second question we are not now concerned. The respondent is a limited liability Company called the Mysore Sugar Co. Ltd., in which a very large percentage of shares is owned by the Government of Mysore. We shall refer to the respondent as the assessee Company.

The asseesee Company purchases sugarcane from the sugarcane,growers, and crashes them in its factory to prepare sugar. As a part of its business operations, it enters into agreement with the sugarcane growers, who are known locally as "Oppigddars" and advances them sugarcane seedlings, fertilisers and also cash. The Oppigedars enter into a written agreement called the "Oppige", by which they agree to sell sugarcane exclusively to the assessee Company at current market rates and to have the advances adjusted towards the price of sugarcane, agreeing to pay interest in the meantime. For this purpose, an account of each Oppigeddar is opened. by the assessee Company. A crop of sugarcane takes about 18 months to nature, and these agreements take place at the harvest season each year, in preparation for the next crop.

In the year 1948-49 due to drought, the assessee Company could not work its sugar mills and the Oppigedars could not grow or deliver the sugarcane. The advances made in 1948-49 thus remained unrecovered, because they could only be recovered by the supply of sugarcane to the assessee Company. The Mysore Government realising the hardship appointed a Committee to investigate the matter and to make a report and recommendations. This report was made by the Committee on July 27, 1950, and the whole of the report has been printed in the record of this case. The Oppige bond is not printed, perhaps because it was in Kaunada, but the substance of the terms is given by the Committee and the above description fairly represents its nature. The Com- mittee recommended that the assessee Company should ex gratia forego some of its dues, and in the year of account*ending June 30, 1952, the Company waived its rights in respect of Rs. 2,87,422/The Company claimed this is a deduction under ss. 10 (3) (xi) and 10 (2) (xv) of the Indian Incometax Act. The Income-tax Officer declined to make the deduction, because, in his opinion this was neither a trade debt nor even a bad debt but an ex gratia payment almost like a gift. An appeal to the Appellate Assistant Commissioner also failed. Before the Income-tax Appellate Tribunal, Madras. Bench, these two arguments were again raised, but were rejected, the Tribunal holding that the payments were not with an eye to any commercial profit and could not thus be said to have been made out of commercial expediency, so as to attract s. 10 (2) (xv) of the Act. The Tribunal also held that these were not bad debts, because they were "'advances, pure and simple, not arising out of sales" and did not contribute to the profits of the business. From the order of reference, it appears that the Appellate Tribunal was also of the opinion that these advances were made to ensure a steady supply of quality sugarcane, and that the loss, if any, must be taken to represent a capital loss and not a trading loss. The Appellate Tribunal, however, referred the question for the opinion of the High Court, and the High Court held that the expenditure was not in the nature of a capital expenditure, and was deductible as a revenue expenditure. It relied upon a passage from Sempath Ayyangar's Book on the Indian Income- tax Law and on the decision of this Court in Badridas Daga v. Commissioner of Incometax (1.), to hold that this amount was deductible in computing the profits of the business for the year in question under a. 10 (1) of the Income-tax Act. The case has been argued before us both under s. 10 (1) and s. 10 (2) (xv), though it appears that the case of the assessee Company' has changed from a. 10 (1) to s. 10 (2) .(xi) and s. 10 (2) (xv) from time to time. The question, as propounded, seems to refer ss. 10 (2) (xv) and 10(1) and not to s. 10 (2) (xi), We, however, do not wish to emphasise the nature of the question posed, because, in our opinion, the central point to decide is whether the money which was given up, represented a loss of capital, or must be treated as a revenue expenditure.

The tax under the head "Business" is payable under is. 10 of the Income-tax Act. That section provides by sub-s. (1) that the tax shall be payable by an assessee under the head "Profits and gains of business, etc." in respect of the profits or gains of any business, etc. carried on by him. Under sub-s. (2), these profits or gains are computed after making certain allowances. Clause (xi) allows deduction of bad and doubtful business debts. It provides that when the assessee's accounts in respect of any part of his business are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business is deductible but not exceeding the amount actually written off as irrecoverable in the books of the assessee. Clause (1) (1959) S. C. R. 690.

(xv) allows any expenditure not included in cls. (1) to

(xiv), which ;is not in the nature of capital expenditure or personal expenses of the assessee, to be deducted, if laid out or expended wholly and exclusively for the purpose of such business, etc. The clauses expressly provide what can be deducted; but the general scheme of the section is that profits or gains must be calculated after deducting outgoings reasonably attributable as business expenditure but so as not to deduct any portion of an expenditure of a capital nature. If an expenditure comes within any of the enumerated classes of allowances, the case can be considered under the appropriate class; but there may be an expenditure which, though not exactly covered by any of the enumerated classes, may have to be considered in finding out the true assessable profits or gains. This was laid down by the Privy Council in Commissioner of Income-tax v. Chitnavis (1) and has been accepted by this Court. In other words, s. 10 (2) does not deal exhaustively with the deductions, which must be made to arrive at the true profits and gains. To find out whether an expenditure is on the capital account or on revenue, one must consider the expenditure in relation to the business. Since all payments reduce capital in the ultimate analysis, one is apt I to consider a loss as amounting to a loss of capital. But this is not true of all losses, because losses in the running of the business cannot be said to be of capital. The Questions to consider in this connection are: for that was the money laid out? Was it to acquire an asset of an enduring nature for the benefit of the business, or was it an outgoing in the doing of the business? If money be lost in the first circumstance, it is a loss of capital, but if lost in the second circumstance, it is a revenue loss. In the first, it bears the (1) (1932) L.R. 59 I.A. 290.

character of an investment, but in the second, to use a commonly understood phrase, it bears the character of current expenses.

This distinction is admirably brought out in some English cases, which were cited at the Bar. We shall refer 'Only to three of them. In English Crown Spelter Co. Ltd v. Baker

0), the English Crown Spelter Co. carried on the business of zinc smelting for which it required large quantities of 'blende'. To get supplies of blende, a new Company called the) Welsh Crown Spelter 'Company was formed, which received-assistance from the English Company in the shape of advances on loan. Later, the English Company was required to write off pound 38,000 odd. The question arose whether the advance could besaid to an investment of capital, because if theywere, the English Company would have no right to deduct the amount. If on the other hand, it was money employed for the business it could be deducted... Bray, J. who considered these questions, observed:

> "If this were an ordinary business transaction of a contrary by which the Welsh Company were to deliver certain trend, it may be at prices to be settled hereafter, and that this was really nothing more than an advance on account of the price of that blend, there "would be a great deal to be said in favour of the Appellants It is impossible to look upon this as an ordinary business transaction of an advance against goods to be delivered I can come to no other conclusion but that this was an investment of capital in the Welsh Company and was not an ordinary trade transaction of an advance against goods....."

(1) (1908) 5 T.C. 327.

The second case, Charles Marsdon & Sons. Ltd v. The Commissioners of Inland Revenue (1), is under the Excess Profits Duty in England, and the question arose in the following circumstances: an English Company carried on the business of paper-making. To arrange for supplies of wood pulp, it entered into an agreement with a Canadian Company for supply of 3000 tons per year between 1917-1927. The English Company made an advance of E. 30,000 against future deliveries to be recouped at the rate of E. I per ton delivered. The Canadian Company was to pay interest in the meantime. Later, the importation of wood pulp was stopped, and the Canadian Company (appropriately called the Ha Ha Company) neither delivered the pulp nor returned the money. Bowlatt, J. held this to be a capital expenditure not admi- ssible as a deduction. He-was of opinion that the payment was not an advance payment for goods, observing that no one pays for goods ten years in advance, and that it was a venture to establish a source and money was adventured as capital.

The last case, to which we need refer to illustrate the distinction made in such cases is Reid's Brewery Co. Ltd v. Nale (2). The Brewery Company there carried on, in addition to the business of a brewery, a business of bankers and money lenders making loans and advances to their customers. This helped the customers in pushing sales of the product of the Brewery Company. Certain sums had to be written off, and the amount was held to be deductible. Pollock, B, said:

> "of course, if it be capital invested, then it comes within the express provision of the Income Tax Act, that no deduction is to be X X made on that account"-

(1) (1919) T. T.C. 217.

(2) (1891) 3 T.C. 279.

but held that:

> " .....no person who is 'acquainted with the habits of business ,loan doubt that this is not Capital invested. What it is, is this. It is capital used by the Appellants but used only in the sense that all money which is laid out by persons who are traders, whether it be in the purchase of goods be they traders along, whether it be in the purchase of raw material be they manufacturers.- or in the case of money lenders, be they pawnbrokers or money lenders, whether it be money lent in the course of their trade, it is used and it comes out of capital, but it is not an investment in the ordinary sense of the word."

It was thus held to be a use of money in the course of the Company's business, and not an investment of capital at all. These cases illustrate the distinction between an expenditure by way of investment and an expenditure in the course of business, which we have described as current expenditure. The first may truly be regarded as on the capital side but not the second. Applying this test to this simple case, it is quite obvious which it is. The amount was an advanced against price of

one crop. The Oppigedars were to get the assistance not as an investment by the assessee company in its agriculture, but only as an advance payment of price. The amount, so far as the assessee Company was concerned., represented the current expenditure towards the purchase of sugarcane, and it makes .DO difference that the sugarcane thus purchased was grown by the Oppigedars with the seedlings, fertiliser and money taken on account from the assessee Company. In so far as the assessee Company was concerned, it was doing no more than making a forward arrangement for the next year's crop and paying an amount in advance out of the price, so that the growing of the crop may not suffer due to want of funds in the hands of the growers. There was hardly any, element of investment which contemplates more than payment of advance price. The resulting loss to the assessee Company was just as much a loss on the revenue side as would have been, if it had paid for the ready crop which was not delivered.

In our judgment, the decision of the High Court is right. The appeal fails, and is dismissed with costs. Appeal dismissed.
