

PETITIONER:
M. K. BROTHERS (P) LTD.

Vs.

RESPONDENT:
C.I.T. KANPUR

DATE OF JUDGMENT 29/08/1972

BENCH:
KHANNA, HANS RAJ
BENCH:
KHANNA, HANS RAJ
HEGDE, K.S.
REDDY, P. JAGANMOHAN

CITATION:
1973 AIR 524 1973 SCR (1)1077
1973 SCC (3) 30
CITATOR INFO :
RF 1975 SC1945 (19)

ACT:
Income-tax Act (11 of 1922)-Amount due to company from its sole selling agent-Liability undertaken by appellant to pay amount in consideration of its appointment as sole selling agent-If Capital or revenue expenditure.

HEADNOTE:

In 1955, a large amount was due to a corporation from a firm which was then its sole selling agent., As a result of an agreement between the appellant, the corporation, and the firm, the appellant undertook to discharge the liability of the firm in consideration of its being appointed the sole selling agent in place of the firm. In 1956, an indenture was executed by the corporation and the appellant relating to the appointment of the appellant as sole selling agent, and in this indenture, it was agreed that the corporation should be authorised to retain an amount equal to 1/7 of the trade discount due to the sole selling agents with a minimum of Rs. 50,000 a year, for discharging the liability, so that, the amount payable to the sole selling agents would be the amount payable as trade discount minus the aforesaid amount retained by the corporation. Clause 13 of the indenture provided that, the selling agents shall have no claim whatsoever to any such amounts retained out of the normal trade discount and adjusted in the account of the firm as 'if the amount so retained was not payable to them. For the assessment year 1956-57, out of the commission payable to the appellant as selling agents the corporation retained a sum under the contract for adjustment against the outstanding dues of the firm. The appellant, in its statement of account, credited the full amount of commission to its profit and loss account, and the sum retained by the corporation was shown as a deduction therefrom. The Department, the Appellate Tribunal and the High Court on reference, disallowed the deduction on the ground that it was a capital expenditure and not a revenue expenditure and held that the amount was liable to tax. Dismissing the appeal to this Court.
HELD : (1) The answer to the question whether the money paid

was a revenue expenditure or capital expenditure does not depend upon whether the amount paid is large or small or whether it was paid in a lumpsum or by instalments. It depends upon the purpose for which the payment had been made and the expenditure incurred. If the object of making the payment is to acquire a capital asset the payment would partake of the character of a capital payment even though it is not made in a lumpsum but by instalments over a period of time. If any such asset or advantage for the enduring benefit of the business 'is thus acquired or brought into existence it would be immaterial whether the source of the payment was capital or the income of the concern or whether the payment was made once for all or was made periodically. On the contrary, payment made in the course of and for the purpose of carrying on business or trading activity would be revenue expenditure even though the payment is of a large amount and was not to be made periodically. The aim and object

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of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. [1082 C-H]

Assam Bengal Cement Co. Ltd. v. Commissioner of Income Tax, West Bengal [1955] 27 I.T.R. (34 on p. 45) and P. B. Divecha (Deceased) and After Him His Legal Representatives and Another v. Commissioner of Income Tax, Bombay City 1 [1963] 48 I.T.R. 222, followed.,

(2) In the present case, the appellant got the sole selling agency in consideration of its agreeing to pay the amount which was then due from the firm to the corporation. If the appellant paid the amount in a lump sum in consideration of its being appointed the sole selling agent the payment would have constituted capital expenditure as it was an amount paid for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business. The fact that the amount was paid not in a lump sum but was paid in instalments through deductions out of the commission due to the appellant would not make any difference. [1082A-C]

(3) Even if under cl. 13 of the indenture the appellant could not make any claim to the amount which had been retained by the corporation it would make no material difference so far as the true nature of that amount was concerned. The amount was deducted by the corporation 'in pursuance of the agreement entered into by the appellant with the corporation and the firm, according to which, the appellant had to pay that amount in the form of deductions out of its commission in consideration of being appointed the sole selling agent. It was not a case of the application of income to discharge a liability incurred in the course of running the business but a liability undertaken for the purpose of acquiring the sole selling agency right which was an asset of a capital nature. [1083 D-F]

JUDGMENT:

CIVIL APPELLATE JURISDICTION : C.A. No. 342 of 1969.

Appeal by certificate under Article 133 of the Constitution of India from the judgment and order dated February 16, 1966 of the Allahabad High Court in Misc. Case No. 434 of 1962.

B. P. Maheshwari, for the appellant.

T. A. Ramachandran, R. N. Sachthey and S. P. Nayar, for the respondent.

The Judgment of the Court was delivered by Khanna, J. This appeal on certificate granted by the Allahabad High Court is directed against the judgment of that court

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whereby it answered the following two questions referred to it under section 66(1) of the Indian Income Tax Act, 1922 (hereinafter referred to as the Act) against the appellant and in favour of revenue :

"(1) Whether on the facts and on a true and proper interpretation of the agreement dated 31-7-1956, between the British India Corporation and the appellant company, the letters of Sri Kailash Nath Agarwal, the letters of Managing Directors, the sum of Rs. 43,333/- retained by the British India Corporation and adjusted by it to the credit of Sharma & Co. was the assessable income of the appellant company ?

(2) Whether on the facts and circumstances of the case, the sum of Rs. 43,333/- represented an expenditure under section 10 ?"

The matter relates to the assessment year 1956-57. The appellant is a private limited company and Kailash Nath Agarwal is one of its directors. As per agreement dated July 31, 1956 the appellant was appointed with effect from April 1, 1955 the sole selling agent of the Kanpur Cotton Mills for the sale of yarn and cloth manufactured by the said mills. The Kanpur Cotton Mills is owned by the British India Corporation hereinafter referred to as BIC. Prior to the appellant's appointment Sharma & Co., a partnership firm, was functioning as the sole selling agent of the Kanpur Cotton Mills. The amount due by Sharma & Co. to the Kanpur Cotton Mills as on March 21, 1955 was Rs. 8,39,350/15/6 inclusive of interest. On March 23, 1955 a letter was addressed on behalf of Sharma & Co. to the Managing Director of BIC stating that an agreement had been entered into with Kailash Nath Agarwal whereby Sharma & Co. had agreed to give up the sole selling agency of the Kanpur Cotton Mills. The Managing Director of BIC was requested to appoint Kailash Nath Agarwal or any firm or company forced by him for this purpose as the sole selling agent in place of Sharma & Co. Reference was also made in that letter to an agreement between Sharma & Co. and Kailash Nath Agarwal in the following words

"As you will notice from the agreement with Sri Kailash Nath Agarwal we are entitled to receive one seventh of the commission due to the new selling agency or to a sum of Rs. 50,000/- per annum whichever is greater, till your dues with interest are fully liquidated. We do hereby authorise you to retain this amount thus becoming due to us out of the commission payable to the agency and adjust the same to our firm's account with the Corporation."

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On the same day, i.e. March 23, 1955 Kailash Nath Agarwal addressed a letter to the Managing Director of BIC informing him of the agreement with Sharma & Co. and requesting for the grant of sole selling agency to the appellant. The letter concluded as follows :

"I hereby authorise you in case you are pleased to grant your sole selling agency to my said firm to retain one-seventh of our

commission for adjustment in the account of M/s. Sharma & Co. with minimum of Rs. 50,000/- per annum till your dues against them are cleared with interest."

The Managing Director of BIC later on that day, i.e. March 23, 1955 addressed a letter to Sharma & Co. accepting its resignation from the sole selling agency of the Kanpur Cotton Mills and about the appointment of Kailash Nath Agarwal or his nominee as the sole selling agent in succession to Sharma & Co. In regard to the liquidation of dues from Sharma & Co. the Managing Director of BIC wrote:

"As agreed between Shri Kailash Nath Agarwal and yourselves we shall deduct one seventh of the commission or Rs. 50,000/- whichever is greater out of the commission earned by the new sole selling agents and credit the same to your account with us till our dues against you standing today at Rs. 8,39,350/15/6 are completely liquidated with interest thereon at 6%."

On July 31, 1956 an indenture was executed by BIC and the appellant relating to the appointment of the appellant as the sole selling agent of the Kanpur Cotton Mills for the sale of yarn, cloth and cotton manufactures with effect from April 1, 1955. In this indenture the appellant ratified the agreement entered into by Kailash Nath Agarwal with Sharma & Co. on March 23, 1955 and authorised BIC "to give effect to the said agreement generally and in particular to retain an amount equal to one-seventh of the trade discount of 1-3/4% due to the sole selling agents with a minimum of Rs. 50,000/- per annum so that the amount payable to the sole selling agents shall be the amount payable at the rate of 11% minus the aforesaid amount retained by the corporation as payable to M/s Sharma & Co." Clauses 12 and 13 of the indenture were as under:

"Clause 12

That in the event of the dissolution of M/s Sharma & Co. before the complete repayment of their liability the sole selling agents agree that the corporation may continue to retain an amount equal to one-seventh of

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the trade discount of 1 3/4% or 50,000/- whichever is greater and adjust it towards such dues of M/s Sharma & Co. as may then be standing.

Clause 13

That the authority given above to the corporation to retain and adjust a part of the -trade discount towards the outstanding against M/s Sharma & Co. will not be revocable and will be binding on the sole selling agents, their successor, or assigns only so long as they act as the corporation's sole selling agents and will be deemed to be a condition on which the sole selling agency has been granted to the agents. The agents will have no claim whatsoever to any such amounts retained out of their normal trade discount and adjusted in the account of M/s Sharma & Co. as if the amount so retained was not payable to them."

During the year under reference, the commission as per terms of the indenture dated July 31, 1956 payable to the appellant amounted to Rs. 2,06,283. Out of this amount, Rs.

43,333 were retained by BIC under the contract for adjustment against the outstanding dues of Sharma & Co. in accordance with the terms of the indenture. In its statement of account the appellant credited the full amount of commission of Rs. 2,06,283 to its profit and loss account. The sum of Rs. 43,333 was, however, shown as a deduction therefrom. During, the, assessment proceedings, the Income Tax Officer disallowed the above deduction. The order of the Income Tax Officer in this respect was upheld by the Appellant Assistant Commissioner in appeal as well as by the Income Tax Appellate Tribunal in second appeal. On application filed by the appellant, the, Tribunal referred the questions reproduced earlier to the High Court. The High Court, as stated.. above, answered the two questions against the appellants.

In appeal Mr. Maheshwari on behalf of the appellant has argued that the amount of Rs. 43,333 was a permissible deduction and the High Court was in error in deciding this matter against the appellant-. There is, in our opinion, no force in this contention and we agree with Mr. Ram Chandran, learned counsel for the respondent, that the judgment of the High

Court should be, ,upheld. It would appear from the resume of facts given above that in March 1955 an amount of Rs. 8,39,350/15/6 was due to BIC from the firm Sharma & Co. who was the previous sole selling agent of the Kanpur Cotton Mills. As a result of agreement between the appellant, BIC and Sharma & Co. the appellant undertook to discharge the liability of Sharma & Co. in lieu of being appointed the sole selling agent of the Kanpur Cotton Mills, in place of Sharma & Co. It can, therefore, be said that

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the appellant got the sole selling agency of the Kanpur Cotton Mills in consideration of its agreeing to pay Rs. 8,39,350-15-6 which was the amount due from Sharma & Co. to BIC. It is not disputed by Mr. Maheshwari that if the amount of Rs. 8,39,350/ 1516 had been paid by the appellant in lump sum in consideration of its being appointed the sole selling agent of the Kanpur Cotton Mills, the payment would have constituted capital expenditure as it was an amount paid for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business. The fact that the amount was paid not in lump sum but was paid in instalments through deductions out of the commission due to the appellant would not, in our opinion, make any difference. The answer to the question as to whether the money paid is a revenue-expenditure or capital expenditure depends not so much upon the fact as to whether the amount paid is large or small or whether it has been' paid in lump sum or by instalments, as it does upon the purpose for which the payment has been made and expenditure incurred. It is the real nature and quality of the payment and not *the quantum or the manner of the payment which would prove decisive. If the object of making the payment is to acquire a capital asset, the payment would partake of the character of a capital payment even though it is made not in lump sum but by instalments over a period of time. On the contrary, payment made in the course of and for the purpose of carrying on business or trading activity would be revenue expenditure even though the payment is of a large amount and has not to be made periodically. As observed by this Court, in the case of Assam Bengal Cement Co. Ltd. v. Commissioner of Income Tax, West Bengal(1), if the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business it is properly attributable to capital and is of the nature of

capital expenditure. If on the other hand it is made not for the purpose of bringing into existence any such asset of advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence, it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure. The source or the manner of the payment would then be of no consequence. We may also in this connection refer to the following observations of this Court in the case of P. H. Divecha (Deceased) and After Him His Legal Representatives and Another v. Commissioner of Income Tax, Bombay City 1(2).

(1) [1955] 27 I.T.R. 34 (on p. 45).

(2) [1963] 48 I.T.R. 222.

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"It may also be stated as a general rule that the fact that the amount involved was large or that it was periodic in character have no decisive bearing upon the matter. A payment may even be described as "pay" "remuneration", etc., but that does not determine its quality, though the name by which it has been called may be relevant in determining its true nature, because this gives an indication of how the person who paid the money and the person who received it viewed it in the first instance. The periodicity of the payment does not make the payment a recurring income because periodicity may be the result of convenience and not necessarily the result of the establishment of a source expected to be productive over a certain period. These general principles have been settled firmly by this court in a large number of cases."

Although the above observations were made in the context of periodic receipts, they have a direct bearing even on cases relating to periodic payments.

Mr. Maheshwari has referred to clause 13 of the indenture reproduced above and has contended that the appellant could make no claim to the amount of Rs. 43,3.33 which had been retained by BIC, This fact.. in our opinion would make no material difference so far as the true nature of that amount was concerned, The amount was deducted by BIC in pursuance of the agreement entered into by the appellant with BIC and Sharma & Co., according to which the appellant had to pay that amount in the form of deduction out of its commission in consideration of being appointed the sole selling agent of the Kanpur Cotton Mills. The present is a case relating to the application of income to discharge a liability incurred not in the course of running the business but a liability undertaken for the purpose of acquiring the sole selling agency right which was indisputably an asset of capital nature.

The appeal consequently fails and is dismissed with costs.

V.P.S.

Appeal dismissed.

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