

“Whether the Tribunal was justified in law in upholding the disallowance as capital expenditure of the payment of Rs.62 lakhs made by the appellant to the sub-tenant inducted by it in an earlier year for resuming the sub-tenanted portion of Wallace House for its own business use and its purported findings in that behalf are arbitrary, unreasonable and perverse?”

Whether the Tribunal was justified in upholding the disallowance as capital expenditure of the payment of Rs.21.20 lakhs made by the appellant to its distributor for resuming for its own business use the portion of Wallace House which the appellant had allowed the distributor to use in the past and for setting the distributor's claim and its purported findings in that behalf are arbitrary, unreasonable and perverse?"

The reference to the appellant will include their predecessor-in-interest.

Briefly the facts are these:-

The appellant was the sub-lessee of, inter alia, the third and fourth floors of Wallace House standing on 4 and 5 Bankshal Street, Kolkata – 01. The lessee was one Joseph Issac Hyam. The head lease, according to the appellant expired on 30th June, 1984. With it all rights of the sub lessee came to end. The appellant claiming themselves as a monthly tenant, on 4th April, 1985, sub let the fourth floor to M/s Satya Sai Properties Limited. There was further sub-letting to M/s. Anam Corporation which in turn let in Allahabad Bank. The appellant says that this was done without their permission. Thereafter, legal proceedings were commenced, inter alia, by a trustee to the wakf for eviction of the appellant. In the suit filed by him, on 18th September, 1996, An order was made by this Court directing the appellant to pay a sum of Rs.32,000/- per month as occupation charges to the wakf estate as an interim measure.

The appellant contends before us that they did not have any permanent interest in the property. Even their right, title and interest as a tenant, was disputed. They filed a suit against M/s. Satya Sai Properties Limited and M/s. Anam Corporation praying for their eviction on the ground that the appellant needed the portion occupied by them, namely, the fourth floor, for their business. In those circumstances it paid Rs.62 lakhs to M/s. Satya Sai Properties Limited and M/s. Anam Corporation. Similarly, it paid Rs.21.20 lakhs to Mr. B. K. Roy (P) Ltd. to vacate the third floor of the premises.

The question which falls for consideration is whether this expenditure incurred by the company was capital or revenue in nature?

The learned Income Tax Appellate Tribunal 'B' Bench, Calcutta expressed the opinion in its order dated 31st August, 2005, that the payment of Rs. 83.20 lakhs made by the appellant to M/s. Satya Sai Properties Limited, M/s. Anam Corporation and M/s. B. K. Roy (P) Ltd. was to be treated as capital expenditure and not revenue expenditure. It affirmed the order of the Commissioner of Income Tax (Appeals).

Both Mr. Khaitan, learned senior advocate appearing for the appellant and Mr. Agarwal, learned Advocate for the Income Tax department cited various authorities in which property related expenditure was made by the assessee. In the cases cited by Mr. Khaitan those expenditures were treated as revenue expenditure whereas in those cited by Mr. Agarwal, they were held to be capital expenditure.

The principles of law and accountancy on which the differentiation has been made by the Courts between capital expenditure and revenue expenditure, must be appreciated in order to come to a conclusion in this appeal.

Under Section 37(1) of the Income Tax Act, 1961 expenses not being those described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses, laid out or expended wholly and exclusively for the purpose of the business or profession shall be allowed in computing the income tax under the head “profits and gains of business or profession”. Hence, if an expenditure is capital in nature, it is not allowable, irrespective of the fact that it was made in connection with the business.

To put it simply, any expenditure that results in formation of capital is capital expenditure. Capital is something permanent. Any property of enduring value may be called capital. Any property providing permanent benefit may also be called capital. Stock-in-trade is not capital because it is constantly used up in production or being sold in the market.

If an expenditure is an integral part of the profit earning process of a business then it is revenue expenditure but if made for possession of an asset or right of a permanent character then the expenditure is capital in nature.

(Bombay Stream Navigation Co. (1953) P. Ltd Vs. CIT (1965) 56 ITR 52).

Payment of Rs.1,15,000/- to perfect the title to a capital asset, i.e, a Mill was held to be a capital expenditure **(V. Jaganmohan Rao Vs. CIT (1970) 75 ITR 373)**. The test is whether the expenditure creates a new asset or is for furtherance of business of the assessee **(See Dalmia Jain & Co. Ltd. Vs. CIT**

(1971) 81 ITR 754). In **Chloride India Ltd. Vs. Commissioner of Income Tax, West Bengal** reported in **130 ITR page 61**, Mr. Justice Sabyasachi Mukharji delivering the judgment of a division bench of this Court, after consideration of many authorities came to the finding that Gasper and company's right to possession "which is capital" and of an "enduring nature" was acquired by the assessee, by payment of consideration. The expenses were capital in nature.

Another Division Bench of our Court headed by Mr. Justice Dipak Kumar Sen in **Mather & Platt (India) Ltd. Vs. Commissioner of Income-tax** reported in **(1987) 168 ITR 533** looked into the primary and dominant object of the assessee in incurring expenditure including legal expenses to obtain leases of properties in Delhi and Kolkata. Since, the leases were sufficiently long and resulted in enduring benefit to the assessee, the entire expense including legal expenses of Rs.15,082 was adjudged to be capital expenditure. More or less identical was the ruling of another Division Bench presided over by Mr. Justice Sen in **Gobind Sugar Mills Ltd. Vs. Commissioner of Income-tax** reported in **(1979) 117 ITR 747**. Payment of instalments by the assessee to the lessor to obtain a sub-lease was held to be a capital expenditure and not allowable deduction (See **Commissioner of Income-tax Vs. Hemraj mahabir Prosad (P.) Ltd.** reported in **(1989) 179 ITR 73**). Compensation paid by the assessee after taking on lease a factory, to evict certain unauthorised occupants of the factory was held to be capital expenditure (see **Hardiallia Chemicals Ltd. Vs. Commissioner of Income-tax** reported in **218 ITR 598**).

The above cases were cited by Mr. Agarwala, for the Income Tax department. Mr. J. P. Khaitan, learned senior advocate cited **Empire Jute Co. Ltd. Vs. Commissioner of Income -tax** reported in **124 ITR page 1**. In this case Jute Companies formed the Indian Jute Mill Association. By an agreement between themselves they restricted the number of working hours of looms per week to not more than 45 hours per week per mill. However, a mill which worked for less hours could transfer for consideration those hours to another mill. The Supreme Court reversing the judgment of the High Court held that this purchase of loom hours was revenue expenditure. No new asset was created. Purchasing loom hours resulted in increased profit. If the expenditure incurred helped in facilitating the assessee's trading operations or enabling the management to conduct the assessee's business more efficiently or profitably, while leaving the fixed capital untouched, the expenditure would be revenue, according to the Supreme Court. The test of enduring benefit was not the conclusive test.

A division bench of the Kerala High Court in Commissioner of Agricultural Income-tax, **Trivandrum Vs. Bombay Burmah Trading Corporation Ltd.** reported in **131 ITR page 154** cited by Mr. Khaitan held that when eviction of a tenant resulted in higher income for the assessee the expenditure was revenue in nature.

In **Commissioner of Income-tax Vs. Auto Distributors Ltd.** reported in **210 ITR page 222**, a division bench judgment of our Court, cited by Mr. Khaitan the assessee company was engaged in the business of taking property on

lease and letting them out on rent for the purpose of earning income. Instead of taking legal proceedings against a sub-tenant occupier of the premises, **Laxmi Textile Mills Pvt. Ltd.**, it got the company to vacate it upon payment of compensation. Thereafter, the assessee company let out the same to the bank at a much higher rate of rent. On those facts, the division bench held that the expenditure incurred by the assessee company to evict **Laxmi Textile Mills Pvt. Ltd.** was revenue in nature.

The assessee contends that it was merely in possession of the premises. Litigation was continuing in this Court. They were allowed to retain possession of the premises, by the Court, on payment of occupation charges of Rs.32,000/- per month. They say that they were not the owners, lessee or sub-lessee of the property but were only in possession thereof, claiming to be a monthly tenant. Hence, they had no permanent title or interest. Two entities M/s. Satya Sai Properties Limited and M/s. Anam Corporation also got into the subject premises, inducted by the assessee. With them the assessee struck a deal that if they vacated the premises they would be compensated, by being paid Rs.62 lakhs. The deal materialised. Another company M/s. B. K. Roy (P) Ltd. was inducted into the third floor by the assessee. They were distributing the assessee's fertiliser production on a whole sale basis. They were also removed from occupation of the premises by the assessee by payment of compensation of Rs.21.20 lakhs. Mr. Khaitan argued that since the assessee did not have any permanent right title and interest obtaining more space by evicting M/s. Satya Sai Properties, M/s.

Anam Corporation and M/s. B. K. Roy (P) Ltd. was for the business growth of the assessee. Any expenditure made in this behalf was revenue expenditure.

Note the difference in the facts of this case with **Commissioner of Income-tax Vs. Auto Distributors Ltd.** reported in **210 ITR page 222**. In that case, the assessee was engaged in the business of taking property on lease with a right to sub-let. The property was sub-let augmenting the income of the assessee. On these facts the division bench of our Court held that the expenditure was revenue. The division bench judgment of the Kerala High Court in **Commissioner of Agricultural Income-tax, Tribandrum Vs. Bombay Burmah Trading Corporation Ltd.** reported in **131 ITR page 154** can only be justified on the ground that if the effect of incurring expenditure had a direct connection with increasing the income of the assessee, then it could be said that the expense was revenue in nature.

The purchase of loom hours from others had a direct impact on the increase of income of the assessee and thus held to be revenue expenditure by the Supreme Court in **Empire Jute Co. Ltd. Vs. Commissioner of Income –tax** reported in **124 ITR page 1**.

On the other hand in **Chloride India Ltd. Vs. Commissioner of Income Tax, West Bengal** reported in **130 ITR page 61** Mr. Justice Sabyasachi Mukharji for the division bench said:

“Therefore, the nature of the transaction that was found by the Tribunal was that M/s. Gaper & Co. had the legal right to be in possession, which legal right, the assessee, in the instant case, had to obtain or had to procure and for

procuring that legal right to possession which was with M/s. Gasper & Co. by virtue of Section 108(c), being the lessee of the original landlord, there necessarily had to be the extinction of that right, that is to say, M/s. Gasper & Co.'s right to possession and that right to possession which flows from the right which M/s. Gasper & Co. obtained, was acquired by the assessee. If the right to possession be a right, which is capital, it is a capital of enduring nature, in the sense fixed capital asset endures. In that view of the matter, in our opinion, the Tribunal was right in coming to the decision that the expenditure was in the nature of capital expenditure and was not a revenue expenditure. For the aforesaid reasons, the question must be answered in the affirmative and in favour of the revenue."

We think that the principles are plain that when one is examining an expenditure in connection with property, one has to see what is the dominant purpose of making this expenditure. If it results in acquisition of any right to property, whether free hold, lease hold or a mere right to possession, having some kind of permanence and of enduring nature the expenditure is capital. But if the expenditure is pre-dominantly for expansion of business although it results in acquisition of some capital, then the business purpose of the expenditure is paramount. The expenditure has to be taken as revenue.

In the present case, it is just not established how the business of the assessee was perceived to grow out of the property acquired by them by negotiating the eviction of the said occupants. In fact, through the negotiation the assessee acquired some kind of an enduring right of possession over the

occupied area of the said premises surrendered to them by those occupants.

It had the incidents of permanence.

In those circumstances we agree with the revenue that the expenditure was capital in nature.

This 260A appeal by the assessee is dismissed by answering the questions in favour of the revenue and against the assessee on the basis of the observations made in this judgment and order.

Certified photocopy of this order, if applied for, be supplied to the parties upon compliance with all requisite formalities.

I agree.

(Amrita Sinha, J.)

(I.P. MUKERJI, J.)