Seth Banarsi Das Gupta Vs Commissioner of Income Tax

Court: Allahabad High Court

Date of Decision: Sept. 3, 1970

Acts Referred: Income Tax Act, 1922 â€" Section 10(2), 12(2)

Citation: (1971) 81 ITR 170

Hon'ble Judges: V.G. Oak, C.J; H.N. Seth, J

Bench: Division Bench

Advocate: Shanti Bhushan, General, V.K. Khanna and U.S. Awasthi, for the Appellant; Brij Lal Gupta and R.R. Misra, for the Respondent

Final Decision: Disposed Of

Judgement

V.G. Oak, C.J.
This is a reference u/s 66 of the Indian Income Tax Act, 1922. The assessee is a Hindu undivided family. Seth Banarsi

Das Gupta is the karta of the joint family. The assessment year is 1953-54. The accounting period ended on June 30, 1952.

2. The assessee was the owner of a one-third share in Messrs. S. B. Sugar Mills, Bijnore. He entered into an agreement with Seth Kanshi Ram on

July 30, 1950, and obtained a lease of l/6th share in the said mills. The assessee had to pay an annual rent of Rs. 50,000 to Seth Kanshi Ram

under the lease. Subsequently, Kanshi Ram thought that the lease executed by him was against his interest. He, therefore, filed a civil suit

repudiating the lease. The parties to the suit entered into a compromise. Under the compromise, the lessee was to receive a total of Rs. 68,000

from the lessor. Accordingly, the assessee received a sum of Rs. 16,000 from Kanshi Ram. Under similar circumstances, the assessee received

another sum of Rs. 39,262 from Seth Debi Chand. The Income Tax Officer held that these receipts of Rs. 16,000 and Rs. 39,262 were liable to

be taxed as income in the hands of the assessee. This decision was upheld by the Appellate Tribunal.

3. The assessee obtained 1/6th share in S. B. Sugar Mills under a deed of exchange. The assessee claimed depreciation on machinery on account

of the assessee''s 1/6th share in S. B. Sugar Mills. The claim for depreciation was not allowed by the Income Tax authorities. This view was upheld

in appeal by the Appellate Tribunal.

4. During the accounting period the assessee paid a total sum of Rs. 1,06,039 towards interest on borrowed money. The Income Tax Officer

allowed deduction on account of this entire sum of Rs. 1,06,039. That sum included a smaller sum of Rs. 75,211 paid by the assessee towards

interest on a loan taken for the purchase of shares of Messrs. Jaswant Sugar Mills. The Appellate Assistant Commissioner thought that the

assessee was not entitled to have a deduction for that amount of Rs. 75,211. A notice was, therefore, given to the assessee to show cause why

that amount should not be disallowed. After hearing the assessee, the Appellate Assistant Commissioner confirmed his provisional finding that the

assessee was not entitled to any deduction on account of the sum of Rs. 75,211 paid as interest. When the matter went before the Appellate

Tribunal, the Tribunal disagreed with the Appellate Assistant Commissioner. The Tribunal held that the assessee was entitled to deduction on

account of the sum of Rs. 75,211 paid as interest.

5. Both the parties were dissatisfied with certain parts of the judgment of the Appellate Tribunal. The parties, therefore, applied for a reference to

the court u/s 66(1) of the Act. The Appellate Tribunal, Delhi Bench ""A"", has referred the following four questions of law to this court:

(1) Whether, on the facts and in the circumstances of the case, the sums of Rs. 16,000 and Rs. 39,262 received from Seth Kanshi Ram and Seth

Devi Chand, respectively, were assessable as income of the assessee ?

(2) Whether, on the facts and circumstances of the case, what was acquired by the assessee was l/6th share of the sugar mills or merely l/6th share

of the interest which the assessee''s vendor had in the said sugar mills.

(3) Whether, on the facts and in the circumstances of the case, depreciation is allowable on the 1/6th share in S. B. Sugar Mills, Bijnore, which the

assessee had acquired from Seth Shiv Prasad ?

(4) Whether, on the facts and circumstances of the case, the assessee is entitled to a deduction of Rs. 75,211 on account of interest paid on

moneys borrowed and used in acquiring the shares of Jaswant Sugar Mills Ltd. ?

6. Question No. 1.

7. This question relates to the agreement dated July 13, 1950. Annexure ""C"" to the statement of the case is a copy of the lease executed by Seth

Kanshi Ram in favour of Seth Banarsi Das. 1/6th share in Seth Sheo Prasad Banarsi Das Sugar Mills was covered by the lease. The lessee had to

pay an annual rent of Rs. 50,000.

8. Annexure ""E"" is a copy of the compromise arrived at between Seth Kanshi Ram and Seth Banarsi Das in the subsequent suit (No. 52 of 1951).

The compromise provided that Seth Kanshi Ram should pay the defendant a total sum of Rs. 68,000. The item of Rs. 16,000, which is mentioned

under question No. 1 is a part of this total sum of Rs. 68,000. The question for consideration is whether this receipt of Rs. 16,000 by the assessee

is to be treated as its income.

9. In Commissioner of Income Tax, Assam etc. Vs. The Panbari Tea Co. Ltd., by a lease dated March 31, 1950, the respondent-company leased

out two different estates along with machinery and building for a period of ten years in consideration of a sum of Rs. 2,25,000 by way of premium

and an annual rent of Rs. 54,000, Of the premium the sum of Rs. 45,000 was payable at the time of execution of the deed and the balance of Rs.

1,80,000 was, payable in 16 half-yearly installments of Rs. 11,250 commencing from January 31, 1952. The question arose whether the sum of

Rs. 11,250 received by the respondent towards premium was a revenue or a capital receipt. It was held to be capital receipt.

10. In Kettlewell Bullen and Co. Vs. Commissioner of Income Tax, Calcutta, it was explained that it cannot be said as a general rule that what is

determinative of the nature of a receipt on the cancellation of a contract of agency or office is extinction or compulsory cessation of the agency or

office. Where payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business or

deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation

leaves him free to carry on his trade, the receipt is revenue. Where by the cancellation of an agency the trading structure of the assessee is

impaired, or such cancellation results in loss of what may be regarded as the source of the assessee''s income, the payment made to compensate

for cancellation of the agency agreement is normally a capital receipt.

11. In Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons, the facts were these. In 1931 under the terms of a resolution

of the board of directors of a cigarette manufacturing company the assessees were appointed the sole selling agents and sole distributors for

Hyderabad State for cigarettes manufactured by the company and they were allowed discount of 2% on the gross selling price. In 1939 another

arrangement was arrived at between the parties whereby the assessees were given a discount of 2% not only on the goods sold in Hyderabad

State but on all goods sold in Hyderabad State and outside the State. In 1950 the parties reverted to the old arrangement confining the sole agency

of the assessee to Hyderabad State. The assessee was paid a sum of Rs. 2,19,343 by way of compensation for loss of agency for territory outside

Hyderabad State. It was held by the Supreme Court that the agency agreement in respect of territory outside Hyderabad State was as much an

asset of the assessee as the agency business within Hyderabad State. Payment made by the company by way of compensation for terminating or

cancelling the agreement was a capital receipt in the hands of the assessee.

12. In the Commentary on the Law and Practice of Income Tax by Kanga and Palkhivala, 6th edition, volume I, the learned authors have

observed, at page 139, thus:

Cases of such termination resulting in loss of employment or cessation of business, must be distinguished from cases of cancellation of contracts

which are of a trading nature or are entered into in the course of business or the exercise of a profession. Compensation paid for the cancellation or

wrongful termination of a contract which is made in the ordinary course of business or the exercise of a profession, is an income receipt . . .

13. In COMMISSIONER OF Income Tax AND EXCESS PROFITS TAX MADRAS Vs. SOUTH INDIA PICTURES LTD., the assessee ,

which carried on the business of distribution of films entered into three agreements for advancing money to certain motion picture producers. The

agreements provided that the assessee would advance certain sums of money in installments for the production of films. After the assessee had

exploited to a certain extent its right of distribution of the three films, the agreement was cancelled, and the producers paid an aggregate sum of Rs.

26,000 to the assessee towards commission. It was held by the Supreme Court that the sum so received was income receipt.

14. In GANGADHAR BAIJNATH Vs. COMMISSIONER OF Income Tax, LUCKNOW., , it was observed at page 637 :

''When the rights and advantages surrendered on cancellation are such as to destroy or materially to cripple the whole structure of the recipient''s

profit-making apparatus, involving the serious dislocation of the normal commercial organisation and resulting perhaps in the cutting down of the

staff previously required, the recipient of the compensation may properly affirm that the compensation represents the price paid for the loss or

sterilisation of a capital asset and is, therefore, a capital and not a revenue receipt....." Except where the compensation can be regarded as capital

on this basis, the normal rule is that compensation for the non-performance of a business contract is taxed on the same footing as the profits for the

loss of which the compensation is paid''.

15. In order to decide whether in the instant case the receipt of Rs. 16,000 was in the nature of capital receipt or revenue receipt, it will be useful

to examine the terms of the compromise (annexure ""E""). In the opening paragraph of annexure ""E"" it was stated that the lease dated July 13, 1950,

is valid. The plaintiff was withdrawing his plea about invalidity of the lease. Paragraph 2 of annexure ""E"" ran thus:

That in case the plaintiff pays to the defendant Rs. 68,000 (Rs. 16,000 per year about the first three years and Rs. 10.000 per year about the rest

two years) together with interest . . . The defendant will not be entitled to realise any further amount under this lease and the whole will be deemed

to have been paid off ....

16. In paragraph 5 of the compromise it was provided that the total sum of Rs. 68,000 had to be paid by the plaintiff to the defendant within three

years. Paragraph 5 concluded thus :

If in case the amount is not paid within the separated period of three years, the plaintiff will not be entitled to any concession given in paragraph 2

of this compromise.

17. Paragraph 2 of the compromise clearly indicates that the lessee expected to earn a profit after paying an annual rent of Rs. 50,000. The

estimated net profit was in the neighbourhood of Rs. 16,000 or Rs. 10,000. That was why it was provided under the compromise that the

defendant should in all receive a total sum of Rs. 68,000 from the plaintiff.

18. Annexure ""C"" shows that Seth Banarsi Das was already a holder of l/3rd share in the property before obtaining the lease (annexure ""C"").

Under the lease, the assessee decided to acquire additional interest to the extent of 1/6th share in the same property. The assessee carries on

business in the manufacture and sale of sugar. It appears that the rights obtained under annexure ""C"" were in connection with the assessee''s

business. The profit expected under the lease was obviously in the nature of income of the assessee. The substituted sum of Rs. 68,000 for the

estimated profits was of the nature of profits to be received by the defendant (sic assessee) Rs. 16,000 is a part of the total amount of Rs. 68,000.

Consequently, the sum of Rs. 16,000 received by the assessee was its income assessable to tax.

19. On the same reasoning, the sum of Rs. 39,262 received from Seth Devi Chand by the assessee was assessable as income of the assessee.

20. Question No. 2.

21. This question has been framed on the assumption that there is material difference between l/6th share in the sugar mills and l/6th interest in the

same property. This question has been unhappily framed. The question of depreciation was disposed of by the Appellate Tribunal in paragraph 15

of its judgment thus:

The assessee had acquired 1/6th share of another party in the said sugar mills. Since depreciation is allowable only on machinery, etc., and not on

the interest which the party had in a particular factory, the Appellate Assistant Commissioner is right in disallowing the assessee''s claim.

22. It is true that in that passage the Tribunal used two different words ""share"" and ""interest"". But it does not appear that the Tribunal considered

that there was any substantial difference between the two expressions. The basis of the decision of the Tribunal was that mere acquiring of some

interest in machinery would not suffice to obtain allowance for depreciation. Annexure ""G"" is a copy of the deed of exchange between Seth Sheo

Prasad and Seth Banarsi Das. It is under this document that Seth Banarsi Das acquired 1/6th share in the sugar mills from Seth Sheo Prasad. It is

clearly mentioned in the deed of exchange that the first party was conveying 1/6th share to the second party. There is, therefore, no difficulty in

holding that under the deed of exchange the second party did obtain 1/6th share of the sugar mills. Question No. 2 may, therefore, be answered in

favour of the assessee.

23. Question No. 3.

24. The question, however, remains whether the assessee is entitled to claim depreciation on the ground that it has acquired l/6th share in the S. B.

Sugar Mills. It is to be noted that the assessee does not claim to be full owner of the property. All that the assessee claims is 1/6th share in S. B.

Sugar Mills.

25. The assessee claims allowance under Clause (vi) of Sub-section (2) of Section 10 of the Indian Income Tax Act, 1922 (hereinafter referred to

as ""the Act""). Clause (vi) is :

In respect of depreciation of such buildings, machinery, plant or furniture being the property of the assessee. . . . .

26. In order to qualify for an allowance under Clause (vi), the assessee has to make out that the building, machinery, plant or furniture is the

property of the assessee. Mr. Shanti Bhushan appearing for the assessee urged that Clause (vi) is attracted even where an assessee owns a

fractional share in the machinery. On the other hand, Mr. Brij Lal Gupta appearing for the department urged that ownership of a fractional share in

machinery does not attract Clause (vi). The point is not free from difficulty. But if the interpretation suggested by Mr. Shanti Bhushan is accepted,

the result would be that several individuals would claim depreciation separately on the short ground that they have specified shares in buildings,

machinery, plant or furniture. A firm or association of persons would also claim depreciation on the ground that the building, machinery, plant or

furniture is the property of the firm or association of persons. Such separate claims for depreciation with respect to the same item of machinery are

likely to create confusion. Clause (vi) should, therefore, be construed strictly. In order to qualify for an allowance under Clause (vi), the claimant

must make out that the machinery is the property of the assessee. That test is not satisfied by the present assessee. The assessee does not claim to

be the full owner of the machinery in question. All that is claimed for the assessee is 1/6th share in the machinery. Such a fractional share will not

suffice for granting an allowance for depreciation u/s 10(2)(vi) of the Act.

27. Question No. 4.

28. In Ormerods (India) Private Ltd. Vs. Commissioner of Income Tax, Bombay City, the facts were these: In the accounting year ending

November 30, 1948, the assessee-company purchased shares to the tune of Rs. 52 1/2 lacs and for this purpose took loans to the extent of Rs.

49 1/2 lacs. During the accounting years the assessee paid certain sums as interest on capital borrowed for the purchase of shares, but there was

no income at all from those shares. The assessee claimed to set off those payments of interest against its other income in those years. It was held

by the Bombay High Court that the word ""purpose"" in the expression ""expenditure incurred solely for the purpose of making or earning such

income, profits or gains"" in Section 12(2) of the Act did not mean motive for the transaction. The investments were made for the purpose of

earning income or dividends or for making profits or gains. Consequently, interest paid by the assessee on moneys borrowed for the purchase of

shares could be set off against other income u/s 24(1) of the Act.

29. In CHHAIL BEHARI LAL Vs. COMMISSIONER OF Income Tax, U.P. and V.P., the assessees were partners in a firm. They borrowed

Rs. 2,50,000 each from the firm to purchase shares in a company. During the relevant accounting year they did not receive any dividend but had

each to pay the sum of Rs. 6,688 as interest on the money borrowed. The assessees claimed that the amount so paid by each of them was

expenditure deductible u/s 12(2) of the Act. It was held by this court that the assessees were entitled to deduct the interest paid on money

borrowed to purchase the shares from their other income in order to arrive at their taxable income.

30. The assessee in the present case claimed deduction under two separate provisions. Those provisions are contained in Clause (iii) of Sub-

section (2) of Section 10 and Sub-section (2) of Section 12 of the Act. Section 10(2)(iii) is : "" In respect of capital borrowed for the purposes of

the business, profession or vocation the amount of the interest paid. ..."" Sub-section (2) of Section 12 is :

Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure)

incurred solely for the purpose of making or earning such income, profits or gains. ...

31. In the present case we have to consider whether the amount of Rs. 75,211 paid towards interest can be allowed in favour of the assessee or

not. This was the amount paid as interest on a loan taken by the assessee for purchasing shares of Messrs. Jaswant Sugar Mills. The Appellate

Assistant Commissioner was of the view that the purchase of shares of Messrs. Jaswant Sugar Mills was not in connection with the assessee''s

business. The Tribunal has not recorded a definite finding on this point. If we proceed on the footing that the shares of Messrs. Jaswant Sugar Mills

were not purchased by the assessee in connection with its business, it may be difficult to bring the present case u/s 10(2)(iii) of the Act. But the

case will fall under Sub-section (2) of Section 12 of the Act. Facts of the present case are similar to the case of Chhail Behari Lal v. Commissioner

of Income Tax, decided by this court. The Tribunal was, therefore, right in taking the view that the assessee is entitled to deduction of Rs. 75,211

on account of interest paid on the loan taken for acquiring shares of Jaswant Sugar Mills Ltd.

32. We answer question No. 1 in the affirmative, and against the assessee. On question No. 2, we hold that the assessee acquired 1/6th share of

the sugar mills, and decide the question in favour of the assessee. Our answer to question No. 3 is in the negative, and against the assessee. We

answer question No. 4 in the affirmative, and in favour of the assessee. Parties shall bear their own costs in this reference.