# MEWAR SUGAR MILLS LTD., BHOPAL SAGAR

*v.*

# COMMISSIONER OF INCOME-TAX, RAJASTHAN, JAIPUR

*September* 26, 1972

[K. S. HEGDE, P. JAGANMOHAN REDDY, I. D. DUA AND H. R. KHANNA, JJ.]

*Income Tax Act* (11 *of* 1922), *s.* 10(2) (*xv*)—*Payment in respect of monopoly rights and licence and in respect of royalty—Whether capital or revenue expenditure.*

The grantee of a monopoly from the Government to manufacture sugar, transferred his rights, with the permission of the Government, to the appellant-company (assessee), under an agreement. Under the terms of the grant and the agreement, the assessee was liable to pay royalty at 2% on the price of sugar manufactured by the assessee and this rate was revisable, if after five years, it was found to be excessive; but no other tax was to be charged on the sugar manufactured. The assessee had to pay to the transferor and to his nominee, every year 1¼% of the net profits of its business, in lieu of the monopoly rights and licence.

For the assessment years 1950-53, the assessee claimed that, (a) The amount paid to the transferor in respect of the monopoly and licence, and (b) the royalty paid to the Government in respect of the sugar manufactured were deductible expenses but the Department, Tribunal and the High Court, on reference, held against the assessee.

Partly allowing the appeal to this Court,

HELD: The payments in respect of the monopoly rights are of a capital nature, but the royalties paid are of a revenue nature deductible under s. 10(2) (xv) of the Income-tax Act, 1922. [436 B-C]

None of the tests laid down in the various decisions for determining whether an expenditure incurred in bringing into existence an asset is of a capital or revenue nature, is either exhaustive or universal, because, it is not always easy to determine whether a particular asset belongs to one category or the other; nor does it depend in any way on what may be the nature of the asset in fact or in law. The determining factor depends largely on the nature of the trade in which the asset is employed and the quality of the payment therefor. [434 C-D, F]

In the present case, (1) no arguments were addressed regarding payments in respect of monopoly rights and licence. [433 B]

(2) As regards the royalty on the sugar manufactured. (a) the words 'no other tax will be charged' suggest that what was being charged, was intended to be a tax in some form, and (b) the payment of the royalty is directly related to the sugar manufactured by the appellant and is not for securing an enduring advantage. Therefore, the expenditure is a revenue expenditure. [433 E; 434 F-G; 435 E]

*Gotan Lime Syndicate* v. *Commissioner of I.T.* 59 I.T.R. 718 and *Associated Stone Industries (Kotah) Ltd.* v. *C.I.T.*, 82 I.T.R. 896. followed.

*R. B. Seth Moolchand Suganchand* v. *C.I.T., Delhi*, C.A. No. 2020 of 1972 decided on 19.9.1972, and *Singareni Collieries Co. Ltd.* v. *Commissioner of I.T.*, 66 I.T.R. 553, referred to.

*Assam Bengal Cement Co. Ltd.* v. *C.I.T., West Bengal*, 27 I.T.R. 34, explained.

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1596 to 1598 of 1969.

Appeals by certificate from the judgment and order dated November 27, 1967 of the Rajasthan High High Court in Income-tax Referencee No. 29 of 1962.

*S. T. Desai, A. K. Verma, J. B. Dadachanji, O. C. Mathur* and *Ravinder Narain*, for the appellant.

*S. C. Manchanda, J. Ramamurthy, B. D. Sharma* and *R. N. Sachthey*, for the respondent.

The Judgment of the Court was delivered by

JAGANMOHAN REDDY, J. These appeals are by certificate against the judgment of the Rajasthan High Court answering the questions referred to it by the Income-tax Appellate Tribunal under s. 66(1) of the Income-tax Act. 1922 (hereinafter referred to as the 'Act' partly in favour of the revenue and against the assessee. The assessee appellant is a public company on which the assessments in dispute were levied for the years 1950-51, 1951-52 and 1952-53, the corresponding previous years being the years ending 31st March 1950, 31st March 1951 and 31st March 1952 respectively. It appears from the statement of the case that the appellant carries on the business of sale of sugar and oil, that the manufacture of sugar was started in 1940 while that of oil in 1942. On April 5, 1932 the Maharana of the Udaipur State, in exercise of his sovereign power as a Ruler granted through the intervention of Pandit Ramakant Malaviya granted a licence for the manufacture of sugar to Sri Banarsiprasad Jhunjhunwala which was to be a monopoly enduring to his benefit for 32 years. Clauses (2), (3) and (5) of the terms of licence which are relevant are as under :—

"(2) No permission will be granted to any other person for starting a sugar factory for a period of 32 years from the date of this order.

(3) If they require land for sugarcane for this factory, it will be allotted out of the Khalsa uncultivated land not less than 5000 and subject to a maximum of 30,000 acres as may be available in the vicinity of Jaisamand. Mr. Banarsi Prasad Jhunjhunwala will have to acquire 5000 acres within two years of this order and the remaining should be acquired within 10

A years from the date of order if land near Jaisamund is not found suitable for cultivation of sugarcane, some other land if available in some other Pargana of Mawar may be allotted. This land will be given without Nazrana with full ownership right (Bapi) on the condition that it will not be alienated without sanction of Durbar. No land revenue will be charged for first B five years from the date of acquisition. . . . After that full land revenue will be charged. . . . the rate of land revenue will be re-fixed according to settlement rules and likewise will be done in future according to settlement rules. . . .

(5) Royalty will be charged on price of goods manufactured in the factory. If after five years the rate be found excessive for C the running of the factory, it can be considered then. On sugar manufactured in the factory on other tax will be charged."

After the grant of this monopoly, Malaviya and Jhunjhunwala floated a limited company called the "Mewar Industries Ltd." This company then took steps to set up a factory, obtain requisite machinery and instal it. After completion of the factory D production could not be started on account of financial difficulties. Thereafter, the Government gave notice to the company on March 19, 1936 that if it did not start the business, the permission granted to it would be granted to other parties for the manufacture of sugar. In view of this notice, the said Malaviya and Jhunjhunwala arranged for Bansidhar Dhandania and Lokenath E Prasad Dhandania (hereinafter referred to for convenience as 'Dhandanias') to acquire from the company all the rights and assets held by it for the unexpired period of 28 years and to run the business in consideration of the payment of 10% of the net profits of the business. On November 15, 1936 an agreement was entered into between the said Dhandhanias and Jhunjhunwala whereby the rights of monopoly available to Jhunjhunwala F and Malaviya were transferred to Dhandania. The *inter se* arrangement under the agreement which is set out in the statement of the case is not really material for the purpose of this case and is therefore not referred to here. It may however be mentioned that the Government permitted this arrangement after which the Dhandanias floated a new company known as Mewar Sugar Mills G Ltd. (hereinafter called the appellant) and on March 11, 1940 Jhunjhunwala transferred to the sugar company his rights under an agreement. It is not relevant to set out all the clauses of the agreement except to notice that under one of the clauses it was provided that the transferee shall

H "until the expiry of the period mentioned in the said licence and monopoly or in the event of the period thereof being extended whether in the name of the company or otherwise, so long as the monopoly

rights and licence continue to be in force, under such extension, pay and continue to pay to each of the transferor and to his nominee the said Pandit Ramakant Malaviya yearly and every year 1¼ per centum respectively of the net profits of the business of the company to be ascertained from the audited accounts of the company, provided however the profit payable to the transferor and the said Pandit Ramakant Malaviya shall be in respect of such business only as are provided in the said monopoly and licences."

By and under the said arrangement the appellant was carrying on the business of sugar manufacture and during the years 1950-51, 1951-52 and 1952-53 it paid to the State Government in respect of sugar Rs. 72,394, Rs. 15,724 and Rs. 50,455 and in respect of oil Rs. 24,729, Rs. 18,168 and Rs. 13,909 respectively. It also paid to Jhunjhunwala and Malaviya for the year 1950-51 Rs. 3,072 and for the year 1952-53 Rs. 2,613 in lieu of the monopoly rights and licences at the stipulated amount of 1¼ per cent. The assessee claimed that the amounts paid in respect of the monopoly and licence as also those paid to the Government in respect of the royalty for sugar and oil were deductible expenses but the Income-tax Officer disallowed them holding that the expenditure in respect of the said amounts were of a capital nature. In appeal the Appellate Assistant Commissioner confirmed the order of the Income-tax Officer. Against this order a further appeal was filed to the Tribunal which was rejected. On an application by the assessee under s. 66(1) of the Act, the following question was referred to the High Court :—

"Whether on a proper construction of Annexure 'A' and Annexure 'E' the sums paid to the respective parties are allowable as expenditure under the provisions of s. 10(1) or 10(2)(xv) ?"

It may here be mentioned that Annexure 'A' referred to in the question is the grant while Annexure 'E' is the agreement between Jhunjhunwala and the appellant. The High Court, as already stated, answered the question partly against the assessee holding that "on a proper construction of the Annexures 'A' and 'E' the sum paid by the assessee to the State Government as royalty on the sale of oil and its products is an allowable deduction under the provisions of s. 10(1) or 10(2)(xv) of the Act but the payment made by the assessee to the transferor and his nominee in terms of the agreement or the royalty paid by the assessee to the State Government in respect of sugar is not an allowable deduction" under the aforementioned provisions of the Act.

A The appeal raises two controversies, the one relates to the deduction of the payments made by the appellant for monopoly rights and the other concerns the payment to the State of the royalty on the price of sugar manufactured by the company. The learned advocate for the appellant having regard to the view of the law taken by the High Court has not pressed the question in B so far as it relates to the disallowance of payments made by the assessee in respect of the monopoly rights. The only other question which survives is, the finding of the High Court that the payment of 2% royalty on the price of sugar manufactured by the appellant is relatable to monopoly rights and is an expenditure of a capital nature. Is the finding sustainable in law is what has C to be determined. According to clause (5) the rate of 2% could be revised if after five years it was found to be excessive for the running of the factory. This clause certainly has no relationship with any payment referable to the monopoly conferred under cl. (2) of the grant. The advantages which Jhunjhunwala obtained under cls. (3) and (4) of the grant which right has been transferred to the appellant are advantages and facilities which any D Government with progressive economic policy would grant to encourage the setting up of nascent industries in the State in any region of the State. In our view the High Court has neither properly appreciated nor correctly interpreted the grant and the agreement referred to in the question. While it recognised that the words "no other tax will be charged" in cl. (5) suggest that E what was being charged was intended to be a tax in some form it seems to have been influenced by the grant conferring important benefits to the grantee such as giving of agricultural land on favourable terms, charging water rates at a concession, exemption of customs duty for the period of the grant and the benefit of monopoly rights by undertaking not to grant permission for 32 years from the date of the grant to any persons to start a sugar F factory. Referring to the several advantages set out above the High Court observed :—

> "Thus on consideration of the grant as a whole, we are unable to hold that 2 per cent royalty on the G production of sugar was only by way of tax. It was an overall payment for the enjoyment of the monopoly rights as well as for immunities from taxation. The nature of payment was hybrid in character. A royalty of this kind therefore could, taken as a whole, be regarded as a consideration for the grant of benefits to the grantee by the State Government. . . . . . . .
> H In the present case, it cannot be gainsaid that the acquisition of monopoly rights in the trade was an advantage of enduring benefit and, therefore, taken as a whole, the payment of two per cent royalty could be regarded

as capital expenditure and was consequently not an allowable deduction under s. 10 of the Act.'

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The passage extracted above shows a confusion of the principles applicable for determining what is an expenditure of a capital nature and that which is a revenue expenditure. This Court in a recent decision in *R. B. Seth Moolchand Suganchand* v. *C.I.T., Delhi*(1) to which two of us were a party (Jaganmohan Reddy and Khanna, JJ.) pointed out the difficulty which the Judges are confronted with in the application of the principles and criteria for determining the nature of the expenditure incurred in bringing into existence an asset or advantage for the enduring benefit of the trade, in which context several cases of this Court and the English Courts were examined. It is unnecessary to traverse the same ground again, except to say that none of the tests laid down in any of the cases is either exhaustive or universal because it is not always easy to determine whether a particular asset belongs to one category or the other nor does it depend in any way on what may be the nature of the asset in fact or in law. None of the tests suggested in decided cases affords a strict rule of guidance. In that case it was observed :

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"The principles enunciated for determining the nature of the expenditure have been sought to be applied to different situations arising on the facts of each case, but the difficulty in matching them with the seeming irreconciliability are perhaps explicable only on the ground that the determination in any particular case is dependant on the character of the lease or agreement, the nature of the asset, the purpose for which the expenditure was incurred and such other factors as in the facts and circumstances of that case would indicate."

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The determining factor, therefore, will depend largely on the nature of the trade in which the asset is employed and the quality of the payment therefrom. It appears to us that on the facts of each case it will have to be determined whether a particular expenditure is a capital expenditure or a revenue expenditure. In this case the payment made is directly related to the sugar manufactured by the appellant. The decision in *Assam Bengal Cement Co. Ltd.*, v. *C.I.T., West Bengal*(2) which has been relied upon by the High Court and the Tribunal has in our view been misapplied. In that case the question was, whether in computing the profits of the appellant the sum of Rs. 5,000 and Rs. 35,000 paid to the lessor by the appellant could be deducted under s. 10 (2)(xv) of the Act. This payment was in addition to the rents and royalties which were agreed to be paid by the lessee and was

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(1) Civil Appeal No. 2020/1972 decided on 19th September, 1972.

(2) 27 I.T.R. 34.

A payable for obtaining a right to acquire an asset of an enduring nature which had necessarily to be incurred for initiation of the business or trading activity. Bhagwati, J. speaking for this Court observed at page 45 :—

> "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 (or) advantage but for running the business or working it with a view to produce the profits it is a revenue expenditure."

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In *Gotan Lime Syndicate* v. *Commr. of I. T.*(1) which was a case dealing with the amount of dead rent payable per acre and the amount of royalty payable for a maund of lump lime and per maund of limestone, it was held that in the absence of material to show that any part of the royalty had to be treated as premium and referable to the acquisition of the mining lease, the royalty payment, including the dead rent, had relation only to the lime deposits to be got, and had therefore to be treated as a revenue expenditure; and although the appellant did derive an advantage—assuming that that advantage was to last at least for a period of five years—there was only an annual payment of royalty or dead rent which was not a direct payment for securing an enduring advantage but was relatable to the raw material to be obtained. It was further emphasised that the reason why royalty has to be allowed as revenue expenditure is the relation which it has to the raw materials to be excavated or extracted; that the more you take the more royalty you pay and that the minimum payment or the dead rent also has the same characteristic *i.e.*, it is an advance payment in respect of a certain amount of raw material to be excavated. In a similar case dealt with by the Andhra Pradesh High Court in *Singareni Collieries C. Ltd.* v. *Commr. of I.T.*(2) to which one of us (Jaganmohan Reddy, C.J.) was a party dead rent payable under the lease was characterised as having a direct relation to the working of the coal from the mine and so it was a revenue expenditure. In another case *Associated Stone Industries (Kotah) Ltd.* v. *C.I.T.*(3) to which one of us (Hegde, J.) was a party, the royalty was payable at a certain rate or rates on the stone excavated and an additional royalty was leviable at a certain rate on polished stone. On these facts it was held that the nature of the payment was no different from that of the minimum royalty paid and the excess royalty was not paid for getting some additional capital asset or

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(1) 59 I.T.R. 718.

(2) 66 I.T.R. 553.

(3) 82 I.T..R. 896.

even an enduring benefit but was paid on the basis of commercial expediency not of a capital expenditure.

A consideration of all these cases certainly support the contention of the appellant that on the facts and circumstances of this, the expenditure incurred *i.e.*, 2% royalty on the sugar manufactured, is a revenue expenditure. Our answer to the question therefore is that the two payments in respect of the monopoly rights for the years 1950-51 and 1952-53 are of capital nature while those paid for royalty for the three assessment years under consideration are of a revenue nature deductible under s. 10(2) (xv) of the Act. With these answers in favour of the assessee, the appeal is partly allowed with costs.

V.P.S.

*Appeal partly allowed.*