J. K. COTTON MANUFACTURERS LTD. A

v.

THE COMMISSIONER OF INCOME TAX, LUCKNOW

September 4, 1975

[H. R. KHANNA, V. R. KRISHNA IYER, A. C. GUPTA AND S. M. FAZAL ALI, JJ.] B

Income-tax Act (11 of 1922) *s.* 10(2) (*xv*)—*Scope of—Payment to managing agent of compensation for terminating managing agency—Whether capital or revenue expenditure.*

An analysis of s. 10(2)(xv) of the Income-tax Act, 1922, shows that in order to be a deductible expenditure the amount has to fulfil two conditions, (i) that it must be laid out wholly and exclusively for the purpose of the business, profession or vocation; and (ii) that it should not be an expenditure of a capital nature. C Both these conditions have to be complied with before an assessee can claim deduction under the section. [660 G]

Some of the tests that have been evolved by courts for determining when, on the facts and circumstances of a particular case, the expenses disbursed by an assessee amount to a capital expenditure or revenue receipt are :

(a) Bringing into an asset or advantage of enduring nature would lead to the inference that the expenditure is of a capital nature. The terms 'asset' or 'advantage of enduring nature' are descriptive and the question will depend D upon the facts of each case.

(b) An item of disbursement may be regarded as of a capital nature when it is relatable to a fixed asset or capital, whereas circulating capital or stock-in-trade would be revenue receipt.

John Smith & Sons v. *Moore* 12 T.C. 266, 282, referred to.

(c) Expenditure relating to frame work of the business is generally of a capital nature. E

(d) When a managing agency is terminated, if the termination is *in terrorem*, that is, if commercial expediency requires that the agency should be terminated as it had become onerous, or it was creating difficulties or the agents were guilty of negligence, etc., or if any payments were made as retrenchment compensation, or confirment of benefits on employees or for termination of other disadvantages or onerous relationship, it would be a capital expenditure, but if it is purely voluntary for obtaining substantial benefits, it would be revenue expenditure. [659E-660D]

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In the present case, the appellant agreed to employ a firm as its managing agent for 20 years and to pay them commission at 2½%. But after two years, the appellant terminated the agreement. The managing agents received Rs. 2,50,000 as compensation and executed a release deed. The appellant thereafter employed another managing agent at 2% commission. There was nothing to show that the out-going managing agents were guilty of any laches, negligence, or that they had caused any loss or disadvantage to the appellant so as to justify the sudden termination of their agency, or that they did not agree to reduce the commission. G On the other hand, the Board of Directors paid high compliments to the outgoing managing agents. By employing the new managing agents at the lesser commission, a net profit of Rs. 30,000 was made by the appellant per annum. The members of the outgoing and incoming agents, belonged to the same family as the appellants, showing, that the appellants were interested in both of them.

The appellant contended that the expenses of Rs. 2,50,000 was incurred by the appellant wholly and exclusively for carrying on the business of the company and would therefore be an allowable deduction under s. 10(2)(xv); H but the department and the Tribunal negatived the contention. On reference, the High Court held that the expenditure was incurred wholly and exclusively for the purpose of appellant's business, but, as the amount was in the nature of a capital expenditure, it was not deductible under the provision.

A Dismissing the appeal to this Court.

HELD: The High Court was right in holding that the disbursement of compensation of Rs. 2,50,000 was of a capital nature and was therefore not a deductible expenditure under s. 10(2)(xv). [661 G]

(1) Merely because the expenditure is incurred in the course of the business it could not be said that it would never be a capital expenditure. Section 37 of the 1961 Act corresponding to s. 10(2)(xv) of the 1922 Act,
B itself contemplates a contingency where, even though the expenditure is incurred wholly and exclusively for the purpose of the business, it may still be of a capital nature. But the High Court was in error in this case in holding that the expenditure was wholly and exclusively for the purpose of the business, because, the finding is not borne out by the facts and circumstances of the case. [660 H-661 A, G-H]

(2) The question whether compensation paid to the outgoing managing agents is capital or revenue expenditure depends on the facts and circumstances
C of each case. [662 A-B]

(3) The present case is covered by the decision of this Court in *Godrej Company* v. *C.I.T. Bombay City* (47 I.T.R. 381). That case has considered all the previous decisions and has laid down that in circumstances such as in the instant case the expenditure would be a capital expenditure in the hands of the payer and a capital receipt in the hands of the payee-company within the meaning of s. 10(2)(xv). The contention that the case was concerned only with the nature of the payment in the hands of the payee-company and
D that the observations regarding the nature of the payment in the hands of the payer-company would be *abiter*, is without substance. [654C, G-H]

(4)(a) The appellant has brought into existence an advantage of an enduring nature by the change in managing agency, because, the amount of Rs. 30,000 which the appellant got by way of recurring benefit per annum must be *regarded as an advantage of an enduring nature* so as to fall within its definition in *Atherton* v. *British Insulated and Helsby Cables Ltd.* (10 T.C. 671), leading to the inference that the expenditure is of a capital nature. [661 F]

E (b) It was not the case of the appellant reducing its expenditure by getting rid of the managing agency and taking over the management itself to save the middleman's profit. [653 B]

(c) In the present case, the only inference that could be drawn from the circumstances of the case is that the termination of the managing agency by the appellant was with the oblique motive of benefiting both the managing agents, in whom the appellant was interested, and not because of any com-
F mercial expediency. [661 D]

C.I.T. West Bengal, II, Calcutta v. *Coal Shipment (P) Ltd.* [1971] 3 S.C.C. 736, 740-41. *The Commissioner of Income-tax Madras* v. *M/s. Ashok Leyland* Ltd. [1973] 3 S.C.C. 201, 204 and *M. K. Brothers (P) Ltd.* v. *Commissioner of Income-tax Kanpur* [1973] 3 S.C.C. 30, 34 followed.

Anglo Persian Oil Co. (India) Ltd. v. Commissioner of Income-tax 1 I.T.R. 129, 133; *Commissioner of Income-tax* v. *Shaw Wallace and Company* L.R. 59 I.A. 206, 211; *Karam Chand Thopar and Bros.* (P) *Ltd.* v. *Commissioner of*
G *Income-tax (Central) Calcutta* 80 I.T.R. 167, 171; *Commissioner of Income-tax Calcutta* v. *Turner Morrison & Company Private Ltd.* 68 *I.T.R.* 147, 156 and *Greaves Cotton & Co. Ltd.* v. *Commissioner of Income-tax, Bombay City* 48 I.T.R. 111, 134, explained.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 2203 of 1970.

Appeal by Special Leave from the Judgment and Order dated the
H 26th September, 1969 of the Allahabad High Court in Income Tax Ref. No. 420 of 1963.

A. K. Sen and *M. M. Kshatriya*, for the appellant.

B. B. Ahuja and *S. P. Nayar*, for the respondent.

The Judgment of the Court was delivered by

FAZAL ALI, J.—This is an appeal by special leave against the order of the High Court of Allahabad dated September 26, 1969 on a reference made to it by the Income-tax Appellate Tribunal, Allahabad Bench. The facts giving rise to the present appeal may be briefly summarised as follows:

The appellant assessee is a public limited company known as 'J.K. Cotton Maunfacturers Ltd' and the matter in dispute relates to the assessment year 1944-45. The appellant entered into an agreement with the firm called Juggilal Kamlapat and employed the said firm as the Managing Agents of the Company. The agreement was executed on August 8, 1941 and the Managing Agents were to work for the Company for a period of 20 years and were to charge commission at the rate of 2½%. About two years later the appellant decided to terminate the agreement executed in favour of Juggilal Kamlapat and the said Managing Agents readily accepted the offer made by the appellant as a result of which a deed of release was executed by the Managing Agents Juggilal Kamlapat on September 28, 1943. Under the release the appellant agreed to pay a sum of Rs. 2,50,000 to the outgoing Managing Agents by way of compensation for terminating the agreement much earlier than stipulated under the original contract. The appellant, however, employed another firm, namely, J.K. Commercial Corporation as their new Managing Agents and executed an agreement in their favour on September 30, 1943. The action of the Company was approved by the Board of Directors.

The dispute in the instant case centres round the question as to whether the compensation of Rs. 2,50,000 paid to the outgoing Managing Agents was a capital or a revenue expenditure incurred by the appellant. The stand taken by the assessee before the revenue was that as the expenses were incurred wholly and exclusively for the purpose of carrying on the business of the Company it would fall under s. 10(2)(xv) of the Income-tax Act, 1922, which is the same as s. 37(1) of the Income-tax Act, 1961, and therefore an allowable deduction under the aforesaid provision. The appellant's case was negatived by the Income-tax Officer, the Appellate Assistant Commissioner and also by the Tribunal. The Tribunal also refused to make a reference to the High Court as in its opinion no point of law arose. The appellant then approached the High Court of Allahabad which directed the Tribunal to make a reference on the following four points and accordingly the Tribunal made a reference to the High Court on those points:

"1. Whether there was any material on the basis of which the Appellate Tribunal could hold that the goodwill of

Juggilal Kamlapat Cotton Manufacturers Ltd. was transferred to the J.K. Cotton Manufacturers Ltd.

2. Whether there was any material on the record for a finding that the said transfer had been for a sum of Rs. 1,00,000 or for any other sum, and

3. Whether there was any material on the record from which it could be held that the land had appreciated in value from Rs. 49,526/13/6 to Rs. 1,00,000.

4. Whether a sum of Rs. 2,50,000 paid by the assessee to the Managing Agents for the termination of their Managing Agency is an expenditure admissible under Section 10(2)(xv) of the Income-Tax Act."

When the matter was heard by the High Court, the assessee did not press any other point excepting point No. 4 which related to the question whether a sum of Rs. 2,50,000 paid by the assessee to the outgoing Managing Agents was an admissible expenditure under s. 10(2)(xv) of the Income-tax Act, 1922. The High Court by its judgment dated September 26, 1969, held that the expenditure in question was incurred wholly and exclusively for the purpose of assessee's business, but as the amount was in the nature of a capital expenditure it was not deductible under the provisions of the Income-tax Act and hence this appeal before us by special leave.

Mr. Asoke Sen learned counsel for the appellant has submitted two points before us in support of his case. In the first place it was contended that the High Court having held that the expenditure incurred was wholly and exclusively for the purpose of the business should have held that s. 10(2)(xv) applied in terms and, therefore, the expenditure was a revenue expenditure which would be deductible under s. 10(2)(xv) of the Income-tax Act; and secondly, it was submitted that the High Court was in error in not correctly applying the decision of this Court in *Godrej & Co.* v. *Commissioner of Income-tax Bombay City*(1).

The learned counsel for the appellant has adumbrated four propositions before us for consideration :

(1) Where a payment is made by the payer Company to the payee Company in lieu of termination of its agency, it does not follow that the said payment which was made for the purpose of business must *ipso facto* be considered to be capital expenditure in the hands of the payer Company.

(2) So far as the payee Company is concerned, the law is that generally any compensation received by it must be considered as capital receipt

(1) 37 I.T.R. 381.

(3) So far as the payer Company is concerned, if payment is for the purpose of business, the mere fact that it has, by virtue of the payment, increased its profits and reduced its expenses, should not be regarded as expenditure of capital nature but would be one in the course of business unless some oblique or gratuitous purpose is involved.

(4) The principles laid down in *Godrej & Co.'s case* (supra) would have to be read as laying down only a proposition that the payer company, namely, the managed company, was making a payment to the payee company as a capital contribution to the payee company and in the hands of the payee company the amount becomes a receipt of compensation for incurring losses. In other words the High Court did not correctly apply the decision of this Court in *Godrej & Company's case* (supra).

So far as propositions Nos. (1) to (3) are concerned their correctness cannot be disputed, because these propositions are covered by abundant authorities. As regards proposition No. (4) it seems to us that on a close and careful reading of the judgment of this Court in *Godrej & Company case* (supra) the contention of the learned counsel for the appellant on this point appears to be without any substance. We shall show that the facts of the present case appear to be on all fours with the ratio laid down by this Court in *Godrej & Co.'s case* (supra).

Mr. Ahuja appearing for the revenue, however, submitted that the termination of the managing agency by the appellant was made for extra-commercial reasons, the main intention being to benefit both the outgoing Managing Agents Juggilal Kamlapat and the incoming Managing Agents J.K. Commercial Corporation which belonged to the same family of Singhanias and, therefore, as the compensation paid to the outgoing Managing Agents led to a profit to the Company it would amount to acquisition of a new asset and would, therefore, be a capital expenditure.

Before dealing with the contentions raised before us by the learned counsel for the appellant, it may be necessary to mention a few facts which have been found by the Tribunal and whose correctness has not been disputed before us.

(1) That there was no suggestion nor any iota of evidence to show that the outgoing Managing Agents were in any way guilty of laches, negligence or that they had caused any loss or disadvantage to the appellant so as to justify a sudden termination of their agency after two years although it was stipulated to continue for 20 years. On the other hand the annexures filed along with the statement of the case sent by the Tribunal to the High Court clearly show that the Board of Direcors paid high compliments to the outgoing Managing Agents Juggilal Kamlapat.

(2) That although the incoming Managing Agents J.K. Commercial Corporation were prepared to serve the appellant on a commission of 2% only, there is nothing to suggest that the outgoing Managing Agents had refused to reduce their commission if that was the only ground for changing hands of the managing agency.

(3) This is not a case where the appellant reduced its expenditure by doing away with the middleman's profit, e.g. to get rid of the managing agency and taking the managing agency itself. It is only a question of substituting one Managing Agent for another.

(4) That although a compensation of Rs. 2,50,000 was paid by the appellant to the outgoing Managing Agents yet by employing the new Managing Agents a net profit of Rs. 30,000 was made by the Company which was in the nature of a recurring benefit, apart from other facilities.

(5) That constitution of the two Managing Agents, namely, outgoing and the incoming Managing Agents shows that Singhania family (the appellant) had major interest in both of them.

These facts have been clearly proved by the additional documents filed in this Court which were the annexures filed by the Tribunal in the statement of the case sent to the High Court along with the reference. Annexure 'G' at p. 69 of the Paper Book shows that at the time of terminating the agency of Juggilal Kamlapat high compliments were paid to the said Managing Agents as would appear from the minutes of the meeting held on August 24, 1943. The following observations were made in that meeting :

> "There was a frank discussion among the Directors and it was unanimously agreed that even though the present Managing Agents have been rendering very good services to the Company, and have been carrying on its affairs in a creditable manner, there was no denying of the truth that the appointment of Managing Agents of the constitution and composition of the J.K. Commercial Corporation Ltd. would give to the Company unique advantages which the present Managing Agents may perhaps be not able to impart, being a partnership firm, and further as the J.K. Commercial Corporation Ltd., has offered its services on lower terms, the company would be benefitted by a saving of above Rs. 30,000/- per annum."

The minutes quoted above would clearly show two things—(1) that very high compliments were paid to the outgoing Agents for their very good services ; and (2) that by the terms offered to the new Agents, namely, J.K. Commercial Corporation there was to be a saving of Rs. 30,000/- per annum.

Similarly the Tribunal in its order of reference to the High Court and the statement of case has found as follows : (p. 65 of the Paper Book)

> "The constitution of the two managing agents do show that the Singhania family has major interest in both of them."

The Tribunal on the basis of these facts came to the conclusion that the compensation was paid due to extra-commercial reasons and could not be regarded as expenditure incurred wholly and exclusively for the purpose of the business. The High Court differed from the reasons given by the Tribunal but affirmed its view on the ground that the expenditure incurred by the assessee Company being of a capital nature it was not deductible.

Having regard to the facts and circumstances of the present case we have no doubt that this case is wholly covered by the decision of this Court in *Godrej & Company's case* (supra). In this case, while it is true that this Court was dealing with the case of compensation in the hands of the payee Company who were the Agents, yet in view of the clear observations made by the Court there can be no manner of doubt that the expenses incurred in the present case by way of payment of compensation to the outgoing Agents would be of a capital nature. This Court in the aforesaid case observed as follows :

> "In the light of those decisions the sum of Rs. 7,50,000 was paid and received not to make up the difference between the higher remuneration and the reduced remuneration but was in reality paid and received as compensation for releasing the company from the onerous terms as to remuneration as it was in terms expressed to be. In other words, so far as the managed company was concerned, it was paid for securing immunity from the liability to pay higher remuneration to the assessee firm for the rest of the term of the managing agency and, therefore, a capital expenditure and so far as the assessee firm was concerned, it was received as compensation for the deterioration or injury to the managing agency by reason of the release of its rights to get higher remuneration and, therefore, a capital receipt within the decisions of this Court in the earlier cases referred to above."

Mr. Asoke Sen tried to distinguish this case on the ground that the Court was concerned in the *Godrej & Company's* case (supra) only with the nature of the payment in the hands of the payee company and any observations made as to what would be the nature of the payment in the hands of the payer company would be *obiter*, and, therefore, not binding on this Court. We are, however, unable to agree with this view. *Godrej & Company's case* (supra) has considered all the previous decisions and has clearly laid down that in the circumstances, such as the present, the expenditure incurred would be a capital expenditure in the hands of the payer company and a capital receipt in the hands of the payee company within the meaning of s. 10(2)(xv) of the Income-tax Act. The distinction sought to be made by the learned

A counsel for the appellant is extremely subtle and it is a distinction without any difference. Moreover, there are a number of other circumstances which clearly show that the expenditure concerned cannot, but be treated as a capital expenditure.

Mr. Asoke Sen then submitted that if the *Godrej and Company's* case (supra) is held to be an authority for the proposition that the B amount of compensation in the hands of the payer company also would be of a capital nature, then that case was wrongly decided and should be re-considered by us. We are, however, unable to agree with this argument, because apart from the principle of *starc decisis,* on the facts and circumstances of the present case, we do not find any special reasons to reconsider the decision in *Godrej & Company's* case (supra) particularly when in view of the facts and circumstances of C this case we are really of the opinion that the amount in question is undoubtedly a capital expenditure.

Reliance was placed by the learned counsel for the appellant on a decision of the Calcutta High Court in *Anglo-Persian Oil Co. (India) Ltd.* v. *Commissioner of Income-tax*(1). It is true that some observations in the aforesaid case are presumably in favour of the appellant D but the Calcutta High Court was careful to guard itself against its decision being treated as a general principle to apply to all cases and in this connection it observed as follows :

> "The case of payer and payee must be considered upon an independent statement of the relevant facts proved in his presence, there being no over-riding principle of law E that the Income Tax authorities are entitled to tax once at least on every payment."

In that case the Court proceeded on the admitted finding of fact that the expenditure incurred was wholly and exclusively for the purpose of the business. This, however, is not the case in the present case. In these circumstances, the decision in *Anglo-Persian Oil Co. (India)* F *Ltd's case*(1) does not appear to be of any assistance to the assessee.

Reliance was also placed on a decision in *Commissioner of Income-tax* v. *Shaw Wallace and Company*(2) in which case the Judicial Committee of the Privy Council merely affirmed the finding of the High Court that the sums received by the respondents were not income, profits or gains within the meaning of the Act though they gave diffe-G rent reasons for that conclusion. It may be noticed that *Shaw Wallace and Company case*(2) turned upon the facts and circumstances of the case and the nature of the payment made to the Company. While affirming the finding of the High Court their Lordships observed as follows :

> "The question was, however, re-stated by the learned H Chief Justice in more precise terms—namely, 'whether these sums are income profits or gains within the meaning of the

(1) 80 I.T.R. 129, 133. (2) L.R. 59 I.A. 206, 211.

Act at all,' and for the reasons stated in his judgment he came to the conclusion that they were not. Their Lordships think that his conclusion was right though they arrive at this result by a slightly different road."

Reliance was also placed on a decision of this Court in *Karam Chand Thapar and Bros. P. Ltd.* v. *Commissioner of Income-tax (Central), Calcutta*(1), where this Court observed as follows :

"As held by this court in *Commissioner of Income-tax* v. *Chari and Chari Ltd.* (57 I.T.R. 400), that ordinarily compensation for loss of office or agency is regarded as a capital receipt, but this rule is subject to an exception that payment received even for termination of an agency agreement would be revenue and not capital in the case where the agency was one of the many which the assessee held and its termination did not impair the profit-making structure of the assessee, but was within the framework of the business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken."

This was, however, a case where their Lordships were dealing with the question as to whether or not the amount of compensation in the hands of the payee company for loss of office or agency would be regarded as a capital receipt. *Karam Chand Thapar and Bros. P. Ltd's case* (supra) does not throw any light on the point with which we are concerned in the instant case.

Great reliance was sought to be placed on the decision of the Calcutta High Court in *Commissioner of Income-tax, Calcutta* v. *Turner Morrison & Company Private Ltd.*(2) where the High Court observed as follows :

"It is now well settled that the expression 'expenditure laid out or expended wholly and exclusively for the purpose of such business' includes expenditure voluntarily incurred for commercial expediency and in order indirectly to facilitate business. It is immaterial if a third party also benefits thereby. It is further well settled that an expenditure incurred in maintaining the efficiency of the manpower from time to time utilised in a business is also expenditure wholly or exclusively laid out for the purpose of such business. It is also well settled that the employment of, say a director, at a reasonable extra remuneration to supervise a particular business of the company, regard being had to his expert knowledge in that particular line of business, is expenditure within the meaning of section 10(2)(xv) and the revenue authorities are not justified in reducing such remuneration. The expression 'commercial expediency' is an expression of wide import and expenditure in commercial expediency includes such expenditure as a prudent man may incur for

(1) 80 I.T.R. 167, 171.

(2) 68 I.T.R. 147, 156.

> the purposes of business. An expenditure which is entirely gratuitous and has no connection with the business does not come within the meaning of section 10(2)(xv) of the Act."

This case also is distinguishable from the facts of the present case, inasmuch as in *Turner Morrison & Company's case* (supra) there was no question of termination of any managing agency but what had happened was that two directors had retired and in their place an expert director was appointed to manage the affairs of the company. On the facts of that case this Court held that the expenditure was incurred for commercial expediency in order to facilitate business. In the instant case, as we have already pointed out, termination of the managing agency of the outgoing Agents was a voluntary act not caused by any negligence, inefficiency by the outgoing managing agents. In these circumstances on the facts and circumstances we would not consider whether it was commercially expedient in order to facilitate business that the managing agency of the outgoing Agents should have been terminated.

Learned counsel for the appellant also referred us to the decision of the Bombay High Court in *Greaves Cotton & Co. Ltd.* v. *Commissioner of Income-tax, Bombay City*(1) where the Bombay High Court observed as follows :

> "We have already said that the inference drawn on the material on record is that the managing agency agreement had been terminated with the object of taking over its management by the board of directors and there is no evidence which will lead to an inference that it was done with the oblique motive or oblique purpose of securing the payment of the said amount of Rs. 17 lakhs to the managing agents.
>
> For reasons stated above, our answer to the question is in the affirmative, *i.e.* in favour of the assessee."

This was obviously a case where the Managing Agents had not changed hands at all but what happened that the managing agency was terminated and the managing agency was taken over by the Board of Directors themselves. Thus this case also does not appear to be of any assistance to the appellant.

In *C.I.T. West Bengal II, Calcutta* v. *Coal Shipment (P) Ltd.*(2) this Court indicated the various considerations which would govern the Court in deciding whether a particular amount is of a capital nature. Relying on a decision in the case of *Atherton* v. *British Insulated and Helsby Cables Ltd.*(3) this Court observed as follows :

> "The character of the payment can be determined, it was added, by looking at what is the true nature of the asset which has been acquired and not by the fact whether it is a

(1) 48 I.T.R. 111, 134.

(2) [1971]3 S.C.C. 736, 740, 741.

(3) 10 T.C. 671.

payment in a lump-sum or by instalments. It is also an accepted proposition that the words 'permanent' and 'enduring' are only relative terms and not synonymous with perpetual or ever-lasting.

There are some other tests like those of fixed capital and circulating capital for determining the nature of the expenditure. An item of disbursement can be regarded as capital expenditure when it is referable to fixed capital. It is revenue when it can be attributed to circulating capital."

Similarly in *The Commissioner of Income Tax, Madras* v. *M/s. Ashok Leyland Ltd.* (1) this Court observed as follows :

"A long line of decisions have laid down that when an expenditure is made with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

. . . .

From the facts found, it is clear that the managing agency was terminated on business considerations and as a matter of commercial expediency. There is no basis for holding that by terminating the managing agency, the company not only saved the expense that it would have had to incur in the relevant previous year but also for few more years to come. It will not be correct to say that by avoiding certain business expenditure, the company can be said to have acquired enduring benefits or acquired any income yielding asset."

It may be seen that in that case there was a finding of fact that the termination of the managing agency was purely on business considerations and as a matter of commercial expediency and that no enduring benefits were acquired by the company.

Similarly in *M. K. Brothers (P) Ltd.* v. *Commissioner of Income-tax, Kanpur*(2) my brother Khanna, J., speaking for the Court indicated the real tests to determine whether an amount is of a capital nature. In this connection the Court observed as follows :

"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

(1) [1973] S.C.C. 201, 204. (2) [1973] S. C.C. 30, 34.

> asset, the payment would partake of the character of a capital payment even though it is made not in a lump sum but by instalments over a period of time."

It would thus appear that numerous cases have laid down various tests to determine as to when on the facts and circumstances of a particular case the expenses disbursed by an assessee amount to a capital expenditure or a revenue receipt. The classic test laid down is by Viscount Cave, L.C., in *Atherton's case* (supra) where he observed at pp. 192-193 as follows:

> 'But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

Atherton's case (supra) has been followed by this Court in a large number of decisions such as in *M/s. Ashok Leyland Ltd. case* (supra) and *Coal Shipment (P) Ltd's case* (supra) and lot of other cases.

Several tests that have been evolved over the years by this Court as also the other High Courts may be briefly formulated as follows:

> (1) Bringing into an asset or advantage of enduring nature would lead to the inference that the expenditure disbursed is of a capital nature.

These terms, such as "asset" or "advantage of enduring nature" are, however, purely descriptive rather than definitive and no rule of universal application can be laid down. Ultimately the question will have to depend on the facts and circumstances of each case, namely, quality and quantum of the amount, the position of the parties, the object of the transaction which has impact on the business, the nature of trade for which the expenditure is incurred and the purpose thereof etc.

> (2) An item of disbursement may be regarded as of a capital nature when it is relatable to a fixed asset or capital, whereas the circulating capital or stock-in-trade would be treated as revenue receipt.

Lord Haldane in *John Smith & Sons* v. *Moore*(1) has aptly and adroitly explained the terms 'fixed capital' and 'circulating capital' thus:

> "Fixed capital is what the assessee turns into profit by keeping it in his own possession and circulating capital is what he makes profit of by parting with it and letting it change masters.

(1) 12 T.C. 255, 282

(3) Expenditure relating to framework of business is generally capital expenditure.

(4) Another important and safe test that may be laid down particularly in cases where the managing agency is terminated would be to find out whether the termination of the agency is *in terrorem* or purely voluntary for obtaining substantial benefits. In other words, the decisive test to determine whether or not termination of the agency is *in terrorem* would be to find out if in such case commercial expediency requires that the agency should be terminated as it had become onerous or it was creating difficulties or the Agents were guilty of negligence etc. It will also include payments for retrenchment compensation or conferment of benefits on employees or termination of other disadvantages or onerous relationships.

These are some of the instances which I have given but they are by no means exhaustive. The present case, however, falls within condition No. (4) pointed out by us above, and the termination of the agency cannot be said to be *in terrorem* but was voluntary so as to obtain an enduring or recurring benefit.

Before applying these tests to the facts of the present case, I would like to stress the important ingredients of s. 10(2)(xv) of the Income-tax Act, 1922 itself. Section 10(2)(xv) runs thus :

"10. (2) Such profits or gains shall be computed after making the following allowances, namely :—

(xv) any expenditure not being an allowance of the nature described in any of the clauses (i) to (xiv) inclusive, and not being in the nature of capital expenditure or personal expenses of the assessee laid out or expended wholly and exclusively for the purpose of such business, profession or vocation."

An analysis of this section would clearly show that in order to be deductible expense the amount in question must fulfil two essential conditions : (i) that expense must be laid out wholly and exclusively for the purpose of the business, profession or vocation; and (ii) that it should not be expense of a capital nature. Both these conditions have to be complied with before an assessee can claim deduction under s. 10(2)(xv). The High Court in this case has found that while the assessee had complied with the first condition that the expenditure was incurred for the purpose of the business, yet it has held that in the circumstances the expenditure is of a capital nature. It cannot be argued as was suggested by Mr. Asoke Sen at one time that whenever an expenditure is incurred in the course of the business it would never be a capital expenditure because s. 37 of the Income-tax Act, 1961, itself contemplates contingency where even though the expenditure may be incurred wholly and exclusively for the purpose of the business yet it may be of a capital nature.

Let us now apply the tests laid down by the Courts as specified by us to the facts of the present case. We have already given the facts found by the Tribunal which have not been disputed before us. In this connection there are two circumstances which clearly indicate that the expenses incurred by the assessee were not dictated by commercial expediency but were inspired by a profit-hunting motive :

> (1) That there was absolutely no necessity to terminate the managing agency of Juggilal Kamlapat only two years after the appellant entered into agreement with them. There was no complaint that the Agents had in any way caused any loss or damage to the appellant or to their reputation, nor was there anything to show that the outgoing agents were guilty of negligence, laches, fraud or inefficiency. In these circumstances, therefore, the only irresistible inference that could be drawn is that the assessee wanted to benefit both the firms, namely, incoming agents and the outgoing agents, which belonged to the Singhania family as found by the Tribunal and not disputed before us. The outgoing agents were benefited because an amount of Rs. 2,50,000 was paid to them and the incoming agents were benefited because they were given the managing agency of the Company and as found by the Tribunal the appellant had pledged their goods in lieu of advance.
>
> (2) That it is the admitted case of the appellant that by virtue of the fact that the incoming agents had agreed to charge only 2% commission, the appellant got a benefit of Rs. 30,000 per annum. This amount is a recurring benefit to the appellant and can safely be regarded as an advantage of an enduring nature so as to fall within the definition laid down by Viscount Cave, L.C.
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> In these circumstances, therefore, the present case is fully covered by the decision of this Court in *Godrej & Company's case* (supra).

For these reasons we are satisfied that the High Court was right in holding that the disbursement of compensation of Rs. 2,50,000 was of a capital nature and was, therefore, not deductible expenditure under s. 10(2)(xv) of the Income-tax Act, 1922. We, however, feel that the High Court was in error in giving a cryptic finding that the expenditure in question was incurred wholly and exclusively for the purpose of the business. This finding has been arrived at without considering the facts mentioned by us above and is not borne out from the facts and circumstances proved in this case. Nevertheless we uphold the order of the High Court on reasons different from those given by the High Court.

We would, however, like to make it clear that we have held that the compensation paid to the outgoing Agents in the peculiar facts of the present case amounts to capital expenditure. But we should not be understood as laying down a general rule that in all cases where compensation is paid to the Managing Agents whose agency is terminated it would amount to capital expenditure. We have already pointed out the various tests to be applied which are by no means exhaustive, nor are they of universal application. Each case has to be examined in the light of the circumstances of that case.

The appeal accordingly fails and is dismissed with costs.

V.P.S. *Appeal dismissed.*