* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% Judgment reserved on: 09.05.2012
Judgment pronounced on: 09.07.2012

+ ITA 53/2000, ITA 251/2007, ITA 253/2007, ITA 257/2007 & ITA 223/2002

SHANKER TRADING (P) LTD. ..... Appellant

versus

THE CIT ..... Respondents

Advocates who appeared in this case:
For the Appellant : Mr Ajay Vohra and Ms Kavita Jha
For the Respondent: Mr Sanjeev Sabharwal and Ms Suruchi Aggarwal

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+ ITA 247/2002, ITA 45/2005, ITA 50/2005, ITA 1207/2005, ITA 361/2008, ITA 482/2008, ITA 731/2008, ITA 1191/2008, ITA 1183/2010, ITA 1198/2010, ITA 842/2011 and ITA 246/2005

COMMISSIONER OF INCOME TAX DEL ..... Appellant

versus

M/S SHANKAR TRADING CO. P. LTD ..... Respondent

Advocates who appeared in this case:
For the Appellant : Mr Sanjeev Sabharwal and Ms Suruchi Aggarwal
For the Respondent: Mr Ajay Vohra and Ms Kavita Jha

CORAM:
HON'BLE MR. JUSTICE BADAR DURREZ AHMED
HON'BLE MR. JUSTICE V.K.JAIN

V.K. JAIN, J.

1. M/s Shankar Trading (P) Limited (hereinafter referred to as the assessee) is engaged in the business of *Katha* and *Cutch* and had taken on lease, with effect

from 01.06.1978, a factory belonging to Mehta Charitable Prajnalay Trust (hereinafter referred to as "the Trust"), which also was engaged in the business of manufacturing of the same products. Shri Bishan Dass and Shri Raj Kumar, two of the trustees of the Trust were also the directors and shareholders of the Assessee Company. 3 out of 5 directors of the assessee company were the sons of two trustees of the Trust. It is also an admitted position that bulk of the shares of the assessee Company was held by the trustees of the Trust and their family members. Initially, the lease rent was fixed at Rs 25,000/- p.m., which was later increased first to be Rs 50,000/- p.m. and then to Rs 1,00,000/- p.m. As on 31.12.1991, the assessee was paying lease rental of Rs 1,00,000/- p.m. to the Trust, in respect of the factory taken on lease. The assessee entered into a fresh lease deed on 18.01.1992, whereby the lease rent was enhanced to Rs 6,75,000/- per month with effect from 01.01.1992.

2. The assessee, in its return of income for the assessment years 1992-93, claimed deductions for the lease rental which it had paid to the Trust.

The Assessing Officer was of the view that the assessee Company had acquired an asset of an enduring nature and accordingly disallowed the increased amount of rent on the ground that this payment was in the nature of capital expenses. In this regard, the Assessing Officer invoked the provisions of Section

40A(2) of the Income Tax Act, 1961 (hereinafter referred to as the Act). The Commissioner of Income Tax (Appeals) confirmed the assessment order. He was also of the view that the unusual increase in the rent was primarily for the purpose of reducing the tax incidence on the profits earned by the assessee Company and not for a business consideration and therefore was not allowable. The Income Tax Appellate Tribunal (hereinafter referred to as "the Tribunal") vide its order dated 16.2.1999 upheld the order of CIT (Appeals) and held that the enhanced lease rent amounting to Rs.17,25,000/- for the period from January to March, 1992 was a capital expenditure and therefore not allowable as a deductible expenditure.

ITA No. 53/2000 has been filed by the assessee company, challenging the order of the Tribunal in respect of the Assessment Year (AY) 1992-93. The following question of law in this appeal was framed by this Court on 12.4.2001.

> "Whether the Tribunal was justified in holding that the payment of rentals to the extent of Rs.17,25,000/- was capital in nature?"

3. For the Assessment Years 1994-95, 1995-96 and 1996-97, since the disallowance made in the year 1992-93 was maintained by the Assessing Officer in the AY 1993-94 onwards, the assessee preferred appeals before CIT (A) who heard the appeals of the Assessee for the year 1994-95 and 1995-96, disagreed with the view of his predecessor and deleted the addition. It would be pertinent to note here

that at the time CIT (A) allowed the appeals of the Assessee for the Assessment Years 1994-95 & 1995-96 he did not have the benefit of the order of the Tribunal dated 16.2.1999 in respect of AY 1992-93. However, for the Assessment Year 1996-97 CIT(A) did have the benefit of Tribunal's order dated 16.2.1999 passed in respect of the AY 1992-93. He was of the view since the entire payment of lease rent was paid towards acquisition of capital assets and enduring benefit, the disallowance made by the Assessing Officer should be enhanced to Rs.81 lac, which was the total lease rent paid in that year. He accordingly disallowed the entire claim of payment of lease rent of Rs.81 lac for the year 1996-97. The appeals were filed by the Revenue for the Assessment Years 1994-95 and 1995-96 and by the assessee for the year 1996-97, against the orders passed by CIT (A). The Tribunal, while deciding the appeals of the Revenue for the Assessment Years 1994-95 and 1995-96 and the appeal of the assessee for the Assessment Year 1996-97 vide order dated 25.2.2002, held that since the assessee did not have any enduring benefit by obtaining capital assets of the lessor against payment of monthly lease rent, the expenditure incurred by it was a revenue expenditure. The Tribunal however held that the provisions of Section 40A(2) of the Act had rightly been invoked, as there was a direct relationship between the trustees and directors of the assessee company. The Tribunal noted that 03 out of the 05 directors of the

assessee company were the sons of trustee No.1 Shri Bishan Das Mehta and brother of second trustee Shri Raj Kumar Mehta. It was noted by the tribunal that the maximum share holding in the assessee company was owned by the trustees and their relatives as defined in Section 2(41) of the Act. The Tribunal however accepted the contention of the assessee that since the Assessing Officer had not recorded a specific finding that the expenditure incurred by it was excessive or unreasonable having regard to (i) the market value of goods or services, (ii) the legitimate business needs, and (iii) benefits derived by the assessee thereforom, invocation of provisions of Section 40A(2) was not proper. The Tribunal held that the reasonableness of payment of lease rent should be examined afresh by the Assessing Officer, in the light of the valuation report which the assessee had submitted before it and other evidence available on record.

ITA No. 223/2002 has been filed by the Assessee, whereas ITA No. 247/2002 has been filed by the Revenue challenging the order of the Tribunal dated 25.2.2002 in respect of the Assessment Years 1994-95, 1995-96 and 1996-97. The following questions of law were framed by this Court in ITA No. 223/2002 and ITA No. 247/2002 on 11.12.2002:

> "Whether the facts and in the circumstances of the case, the Tribunal is correct in law in holding that Section 40A(2) of the Income-Tax Act, 1961 is applicable in

> respect of the lease rent paid by the assessee to M/s Mehta Charitable Prajnalaya Trust?" (ITA 223/2002)
>
> "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.6,75,000/- per month paid by the assessee to M/s Mehta Charitable Prajnalaya Trust in terms of agreement dated 18 January, 1992 was revenue expenditure?" (ITA 247/2002)

4. For the Assessment Years 1997-98, 1998-99 and 1999-2000 the Tribunal vide its order dated 26.5.2004 followed its earlier decision dated 25.2.2002. ITA No. 45/2005, 50/2005 and 246/2005 have been filed by the Revenue against the orders for assessment years 1999-2000, 1997-98 and 1998-99, whereas ITA No. 251/2007, 253/2007 and 257/2007 have been filed by the assessee against orders for assessment years 1997-98, 1998-99 and 1999-2000. The following questions of law were framed by this Court on 11.2.2005/15/02.2005/06.04.2005 and 19.3.2007 in these appeals:

> "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.7,87,000/- per month paid by the assessee to M/s Mehta Charitable Pranjnalaya Trust in terms of agreement dated 18th January, 1992 was revenue expenditure?" (ITA 45/2005)
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> "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.7,50,000/- per month paid by the Assessee to M/s Mehta Charitable Pranjnalaya Trust in

terms of agreement dated 18th January, 1992 was revenue expenditure?" (ITA 50/2005)

"Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.7,87,500/- per month paid by the assessee to M/s Mehta Charitable Pranjnalaya Trust in terms of agreement dated 18th January, 1992 was revenue expenditure?" (ITA 246/2005)

"Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal is correct in law in holding that the Section 40A(2) of the Income Tax Act, 1961 is applicable in respect of the lease rent paid by the Assessee to M/s Mehta Charitable Pranjnalaya Trust?" (ITA 251/2007, 253/2007 & 257/2007)

5. Vide order dated 22.6.2005, the Tribunal with respect to AY 1993-94, following its earlier order passed in respect of AY 1994-95, 1995-96 and 1996-97 held that the payment of lease rent to the trust was a revenue expenditure and that the provisions of Section 40A(2) of the Act were applicable. The Tribunal therefore directed that the matter should be restored to the Assessing Officer for fresh consideration. ITA No. 1207/2005 has been filed by the Revenue against that order. The following question of law was framed by this Court on 21.3.2007 in this appeal:

"Whether on the facts and in the circumstances of the case the Income Tax Appellate Tribunal was correct in law in holding that the expenditure of Rs.6,75,000/- per

> months paid by the Assessee to M/s Mehta Chairtable Prajnalaya Trust in terms of the agreement dated 18th January, 1992 was a revenue expenditure?"

6. Vide its order dated 28.9.2007, passed in respect of Assessment Year 2000-01 and 2001-02, the Tribunal deleted the entire disallowance. ITA No. 361/2008 and 482/2008 have been filed by the Revenue against orders for AY 2000-01 and 2001-02 respectively. The following question of law was framed by this Court in these cases on 20.3.2009/25.9.2008.

> "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.99,22,500/- per month paid by the assessee to M/s Mehta Charitable Prajnalaya Trust in terms of agreement dated 18.01.1992 was revenue expenditure? (ITA 361/2008)
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> "Whether on the facts and in the circumstances of the case, the Income Tax Tribunal was correct in law in holding that the expenditure of Rs.8.68,219/- per month paid by the Assessee to M/s Mehta Charitable Prajnalaya Turst in terms of Agreement dated 18.01.1992 was revenue expenditure?" (ITA 482/2008)

7. In respect of Assessment Year 2002-03, the Tribunal followed its earlier order dated 28.9.2007 in respect of AY 2000-01 and 2001-02. ITA No. 731/2008 has been filed by the Revenue against this order passed by the Tribunal dated 18.1.2008. The following question of law was framed by this Court on 2.7.2008:

> "Whether on the facts and in the circumstances of the case, the Tribunal was correct in law in holding that the expenditure of Rs.7,87,500/- per month paid by the Assessee to M/s Mehta Charitable Prajnalaya Trust in terms of Agreement dated 18.1.1992, was revenue expenditure?"

8. Vide order dated 28.3.2008 for the Assessment Year 2003-04, the Tribunal maintained the view taken by it for the Assessment Years 2001-02 and 2002-03. The following question of law was framed by this Court on 22.09.2008 in ITA No. 1191/08 which has been filed by the Revenue against the said order.

> "Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was correct in law in holding that the expenditure of Rs.9,11,630/- per month paid by the Assessee to M/s Mehta Charitable Prajnayala Trust in terms of Agreement dated 18.1.1992 was revenue expenditure?"

9. Vide order dated 31.7.2009 in respect of AY 2004-05 and 2005-06, the Tribunal again maintained its earlier orders for the AY 2001-02 to 2003-04 and ITA No. 1183/2010 and 1198/2010 have been field by the Revenue against the said order. The following question of law was framed by this Court in these appeals on 20.08.2010:

> "Whether on the facts and in the circumstances of the case, the Tribunal is correct in law in holding that Section 40A(2) of the Income Tax Act, 1961 is applicable in respect of the lease rent paid by the assessee to M/s Mehta Charitable Prajnalaya Turst?"

10. Vide order dated 15.11.2010 in respect of AY 2007-08, the Tribunal again followed its earlier decision for the year 2004-05 and 2005-06 and ITA No. 842/2011 has been filed by the Revenue against the said order. The following questions of law were framed by this Court in this appeal on 14.07.2011:

> (i) "Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was correct in law in deleting the addition made by the AO on account of lease charges amounting to Rs.1,14,86,544/-?
>
> (ii) Whether the order of the Income Tax Appellate Tribunal is perverse, as it has not appreciated the facts and circumstances of the case and that the lease charges are in the nature of capital expenditure and give the assessee benefiting of enduring nature?
>
> (iii) Whether on the facts and in the circumstances of the case, the ITAT is correct in law in not holding that Section 40A (2) of the Income Tax Act, 1961 is applicable in respect of the lease rent paid by the Assessee to M/s Mehta Charitable Prajnalaya Trust?"

11. The following three issues arise for our consideration in these appeals:- (i) whether the lease rent of Rs 6,75,000/- per month paid by the assessee to the Trust was a capital expenditure or revenue expenditure or partly capital and partly revenue expenditure; (ii) whether the payment made by the assessee to the Trust or

part of it comes within the purview of Section 40-A(2) of the Act; (iii) if issue No. 2 is decided in favour of the revenue, whether the payment made by the assessee to the Trust was excessive or unreasonable, having regard to the fair market value of the goods, services or facilities for which the payment was made or legitimate needs of the business of the assessee or the benefit derived by or accruing to it from those goods, services or facilities.

12. A perusal of the lease deed dated 18.01.1992, executed between the Trust and the assessee-company would show that the Trust had established a production unit known as 'Mahesh Udyog' in Tatehra Tehsil of District Una in Himachal Pradesh, in the year 1972 and that unit was engaged in production of *Katha* and *Cutch*. It further shows that the Trust leased whole of its production unit 'Mahesh Udyog' to the assessee-company vide Lease Deed dated 14.07.1978, which came into operation with effect from 01.06.1978, so as to generate funds to meet the expenses on its charitable activities. The lease rent was revised from Rs 25,000/- to Rs 50,000/- per month with effect from 01.04.1987 and further to Rs 1,00,000/- per month with effect from 01.04.1989. The lease deed further shows that even after selling its production unit 'Mahesh Udoyog' to the assessee, the Trust continued to be engaged in manufacturing and trade of *Katha* and *Cutch* and was making sufficient profits. Such trading by the lessor resulted in its product being in

competition with the assessee. The lease deed shows that the assessee approached the Trust to stop its commercial dealings in *Katha* and *Cutch* and agreed to compensate it for the losses, which it was likely to sustain on account of discontinuing such activities. The Trust also agreed to relinquish its rights and interest for purchase of Khair wood in Himachal Pradesh by way of commercial dealings followed by its processing for manufacture of *Katha* and *Cutch*. It also agreed not to indulge in competition for purchase of *Katha* and *Cutch* in a radius less than 1000 kms from the premises which it had leased to the assessee. The lease deed also indicates that on the request of the assessee, the Trust made considerable modernization and improvement in the plant and machinery, including enhancement of its production capacity in the year 1989-90.

13. It would thus be seen that the lease rental was enhance from Rs 1,00,000/- to Rs 6,75,000/- for the following reasons:-

(a) The Trust relinquishing its rights to purchase Khairwood in Himachal Pradesh;

(b) The Trust agreeing not to indulge in competition with the assessee in a radius of less than 1000 kms.

(c) The Trust having incurred expenditure in the year 1989-90 on modernization and improvement of the plant and machinery which it had leased to the assessee.

Yet another factor contributing to revision of lease money could be the normal appreciation in the lease rental, in line with the lease rent prevailing in the market.

14. There is no dispute that the normal lease rental in this case would be a revenue expenditure and not a capital expenditure, as the ownership of the property as well as the plant and machinery continued to vest in the trust and in any case the lease granted to the assessee company was neither a perpetual lease nor a lease for such a long term as would bring it at par with a perpetual lease.

15. There can be no dispute that enhancement of lease rental from Rs.1 lac p.m. to Rs.6,70,000/- p.m., to the extent it is attributable to the expenditure incurred by the trust in the year 1989-90 on modernization and improvement of the plant and machinery which the lessee had taken on lease, would be a revenue expenditure, since it would have the effect of enhancing the lease rent of the plant and machinery in the open market. How much of the enhancement in the lease rent is attributable to the moderation and improvement in the plant and machinery is a matter which the Assessing Officer has to decide after giving an opportunity to the assessee, to lead evidence in this regard. In particular, the Assessing Officer will have to ascertain what lease rent the modernized and improved plant and machinery would have fetched in the market, as on 1.1.1992, when the revised

lease commenced and the rent which such plant and machinery would have fetched in the open market prior to its modernization and improvement in the year 1989-90.

16. In ***Commissioner of Income Tax v. Madras Auto Services Pvt. Ltd.:*** **233 ITR 468 (SC)**, the assessee company took premises on lease for 39 years. In terms of the lease agreement, the premises taken on lease were demolished and a new building was constructed by the assessee at its own expenses. The lease deed also provided that the new construction right from the commencement of the work, was to be the property of the lessors and under no circumstances the lessee shall be entitled to any compensation on account of its putting up the new construction in place of the old. The expenditure incurred by the assessee on raising new construction was claimed as business expenditure. The Assessing Officer did not agree with the assessee but the Tribunal as well as the High Court held in its favour. Dismissing the appeal filed by the Revenue, the Supreme Court held that by incurring the aforesaid expenditure the assessee did not acquire any capital asset and the only advantage it got by spending money was lease of a new building at a low rent and, therefore, from business point of view, the assessee got benefit of reduced rent on account of such expenditure. The Court was of the view that saving in expenditure was saving in revenue expenditure in the form of rent and

whatever substitutes for revenue expenditure should normally be considered as revenue expenditure.

In the case before us, even the expenditure on improvement and modernization of plant and machinery was carried out by the Trust and not by the assessee. On determination of lease, the modernized plant and machinery was to revert back to the Trust. Hence, the case of the asseesse before us stands on a much stronger footing.

17. Similarly, if there was any appreciation in the market in the lease rentals of such properties, the enhancement in the lease rent of the property to the extent it is attributable to such normal appreciation in the lease rentals prevailing in the market, would be a revenue expenditure. Again, it would be for the Assessing Officer to determine whether there was any such appreciation in lease rentals, and if so, to what extent.

18. The distinction between capital expenditure and revenue expenditure is a vexed question of fact and law which has baffled the Courts to such an extent that even a toss has been suggested, to decide whether an expenditure is a capital expenditure or a revenue expenditure. Though broad parameters for distinguishing capital expenditure from the revenue expenditure have been laid down from time to

time, no uniform test which would provide an appropriate answer in all the cases in which such a question comes up for consideration of the Court, however, has been possible. The Courts, therefore, are required to apply the broad tests laid down in various judicial pronouncements to the facts of the case before them and try to find an answer which is broadly in consonance with those tests. It has been repeatedly emphasized that even minor variations in the facts may lead to an altogether different conclusion being reached by the Court.

19. One of the tests to determine whether the expenditure in question is revenue expenditure or a capital expenditure is to ascertain whether it had the effect of bringing in an advantage of an enduring benefit to the assessee. An enduring benefit does not mean permanent benefit but, at the same time, it certainly cannot be a short-term advantage and needs to last for a substantially long period, before it can qualify to be an advantage of an enduring nature. Moreover, even if an advantage brings about an enduring benefit that by itself would not be determinative in every case, because in certain cases even a revenue expenditure may bring about an advantage of an enduring nature to the assessee. As observed by Supreme Court in ***Empire Jute Mills*** *(infra),* what is important to see is as to whether the advantage which occurred to the assessee, was in the capital field or in the field of revenue. The whole matter has to be examined from the point of view

of a prudent businessman, applying a commercial sense and taking business necessity and expediency into consideration. If the expenditure incurred by the assessee is so intrinsically connected to the conduct of his business as to become an essential component of his profit making process and is not incurred for acquisition of an asset or right of a permanent nature, the expenditure should ordinarily be regarded as revenue expenditure.

20. In ***Empire Jute Company Ltd. v. Commissioner of Income Tax:*** **124 ITR 1**, the Supreme Court referred to the following test laid down by Lord Cave (LC) in ***Atherton v. British Insulated and Helsby Cables Ltd.*****: (1925) 10 TC 115**:-

> "..... 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."

The Court also referred to the following observations made by *Lord Radcliffe in* ***Commissioner of Taxes v. Nchanga Consolidated Copper Mines Ltd.:*** **(1965) 58 ITR 241**:-

> ".....There may be cases where expenditure, even if incurred for obtaining advantage of enduring benefit, may, none the less, be on revenue account and the test of enduring benefit may break down. It is not every

> advantage of enduring nature acquired by an assessee that brings the case within the principle laid down in this test. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of this test. If the advantage consists merely in facilitating the assessee's trading operations or enabling the management and conduct of the assessee's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future. The test of enduring benefit is, therefore, not a certain or conclusive test and it cannot be applied blindly and mechanically without regard to the particular facts and circumstances of a given case."

The Court also referred to the following observations made in ***Hallstorm's Property Ltd. v. Federal Commissioner of Taxation*** (72 CLR 634) - " What is an outgoing of capital and what is an outgoing on account of revenue depends on what the expenditure is calculated to effect from a practical and business point of view rather than upon the juristic classification of the legal rights, if any, secured, employed or exhausted in the process. The question must be viewed in the larger context of business necessity or expediency. If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit-earning process and not for acquisition of an asset or a right of a permanent character, the possession of which is a condition of the

carrying on of the business, the expenditure may be regarded as revenue expenditure."

Right to purchase Khairwood

21. In the case before us, the Trust relinquished its rights to purchase khairwood in Himachal Pradesh by way of commercial dealing, as a consideration for enhancement of the lease rent by the assessee. The assessee company is engaged in manufacturing of *Katha* which is a necessary ingredient in *pan and pan masalas. Katha* is derived from the Khair tree, the central portion of which is used for this purpose. The central portion of the Khair tree is thus a raw material for the assessee company. It appears from the lease deed dated 18.01.1992 that not everyone can purchase Khair wood in Himachal Pradesh from the Government. It also appears that the Trust possessed rights to purchase Khair wood in the State and it were those rights which were relinquished in favour of the assessee, at the time of enhancement of the lease rent. This is not the case of the revenue that the Trust held ownership or even leasehold rights in the land on which Khair wood trees stood in the State of Himachal Pradesh and those leasehold rights were surrendered in favour of the assessee. This is also not the case of the revenue that certain specified trees or specified area having Khair trees on it had been allocated to the

Trust and it had the right to cut and remove them at any time during a stated period of say 10, 20 or 30 years. We, therefore, assume that the Trust was not entitled either to any particular piece of land with Khair trees on it or to specified Khair trees with right in the further growth of those trees, for a substantially long period. Therefore, this case is not akin to a case of acquiring land with standing trees or the trees with right to cut them at any point of time, during a stated period. What we gathered during the course of arguments was that in the absence of right to purchase Khairwood from the Government, the assessee would have to purchase them from the open market and, therefore, relinquishment of the right of the Trust to purchase Khair tree resulted in better availability of material besides making it available to the assessee at a cheaper price, which, in turn, had the effect of increasing its profit. Therefore, it cannot be said that by obtaining relinquishment of the right to purchase Khair wood, the assessee had acquired the source of raw material itself. It only got a right to participate in the process of purchase of Khair wood from the Government in the State of Himachal Pradesh, which facilitated acquisition of raw material by it.

In ***Empire Jute Mills*** *(supra),* the Supreme Court, while culling out the distinction between revenue expenditure and capital expenditure, *inter alia,* held as under:-

> "Take a case where acquisition of raw material is regulated by quota system and in order to obtain more raw material, the assessee purchases quota right of another. Now it is obvious that by purchase of such quota right, the assessee would be able to acquire more raw material and that would increase the profitability of his profit making apparatus, but the amount paid for purchase of such quota right would indubitably be revenue expenditure, since it is incurred for acquiring raw material and is part of the operating cost.

The right to purchase khair wood from the Government in the State of Himachal Pradesh is not superior to acquiring a quota which enables a person to obtain the raw material. If purchase of quota right of another person does not constitute capital expenditure, it is difficult to say that relinquishment of right to purchase khair wood in the State of Himachal Pradesh by the Trust, in favour of the assessee, would constitute capital expenditure.

In ***Mohanlal Hargovind v. Commissioner of Income Tax*** **(1949) 17 ITR 473 (PC)**, the assesses were engaged in the business of manufacture and sale of country made cigarettes known as *bidis.* Tendu leaves were thus the raw materials of the business. Tendu leaves can be brought from dealers who sell tendu leaves in a large way. The firm took leases of forests with a right to pick the leaves. This right carried with it the right to coppice small tendu plants and to pollard the tendu

trees. There was, however, no right in the trees or the land and the right to go over the land was merely ancillary. The Privy Council was of the view that, looked at from the point of view of business, there was no more than a purchase of the leaves, and the leaves were needed as raw material of the business. The right of entry upon the land was also considered ancillary to the main purpose of the contract which was acquisition of tendu leaves and tendu leaves alone, and it was observed that even if this right of going on the land and plucking the leaves was not expressed in the contract, it would have been implied by law. The Privy Council, *inter alia,* concluded as under:

> "if the tendu leaves had been stored in a merchant's godown and the appellant had bought the right to go and fetch them and so reduce them into their possession and ownership it could scarcely have been suggested that the purchase price was capital expenditure. Their Lordships see no grounds in principle or reason for differentiating the present case from that supposed."

That case thus involved no right in land or trees; the licence to be on the land was merely an accessory right; the right of cultivation was insignificant. The term was short, and the collection of leaves was seasonal. Leaves once collected, the operation pro tempore was over till the fresh crop came. There was thus no acquisition of an enduring asset in the way capital endures; it was more a purchase

of crops of two or three successive years skewered on an agreement to ensure the supply of raw materials.

In the case before Privy Council the area of the forests from which tendu leaves could be plucked were limited by the Schedule but the assessee was granted no interest in the land or in the trees or plants. It was the tendu leaves and nothing but the tendu leaves that were acquired. In the case before us, the Turst did not have any right either in the land on which khair wood trees had grown nor did it have any right in specified khair wood trees. The limited right which the assessee acquired under the lease was the right to purchase khair wood trees from the Government in the State of Himachal Pradesh. The central portion of the khair wood being the raw material for manufacture of katha, the assessee company would have got a right only to purchase the raw material and not the source of raw material. Therefore, in our opinion, that part of the lease rent, which is attributable to the right to purchase Khair wood, in Himachal Pradesh would be a revenue expenditure and not a capital expenditure.

The learned Counsel for the Revenue has relied upon the decision of the Supreme Court in ***Abdul Kayoom (K.T.M.T.M.) v. Commissioner of Income Tax (1962) 44 ITR 689***. In the case before the Supreme Court, the assessee firm, which carried on business in the purchase and sale of conch (chank) shells, took on lease

from the Government "the exclusive rights, liberty and authority to fish for and take and carry all chank shells" in the sea off the coast line of a certain area specified in the lease, for a period of three years from 1.7.1944 to 30.6.1947, on a consideration of yearly rent of Rs.6,111. The assessee claimed that, in computing its annual income from the sale of chanks it was entitled to deduct the yearly rent of Rs.6,111 paid to the Government, as business expenditure under section 10(2)(xv) of the Income Tax Act. The High Court held that the expenditure was not of a capital nature and the assessee was entitled to deduct the amount claimed as business expenditure. Setting aside the decision of the High Court, the Supreme Court, inter alia, observed as under:

> "A trader may spend money to acquire his raw materials, or his stock- in-trade, and the payment may often be on revenue account but not necessarily. A person selling goods by retail may be said to be acquiring his stock-in-trade when he buys such goods from a wholesaler. But the same cannot be said of another retailer who buys a monopoly right over a long period from a producer of the expenditure to secure his stock-in-trade is not of the same character as the price he pays in the first illustration. By that payment, he secures an enduring advantages and an asset which is a capital asset of his business. In the same way, if a manufacturer buys his raw materials he makes a revenue expenditure, but when he acquires a source from which he would derive his raw materials for the enduring benefit of his business, he spends on the capital side. Thus, a manufacturer of woollen goods who buys his wool buys his raw materials, but when he buys a sheep

farm, he buys a capital asset. There is then no difference between a purchase of a factory and the purchase of the sheep farm, because both are capital assets of an enduring nature.

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We may now pass on to the facts of the case before us. The respondent carried on the business of selling chanks. It obtained its supplies from divers, from whom it purchases the chanks, and having got them, perhaps cheap, it resold them at a profits. This is one mode in which it carried on its business. In this business, it was directly buying its stock-in-trade for resale. The other method was to acquire exclusive right to fish for chanks by employing drivers and nets. The business then changed to something different. The sale was now of the product of another business, in which divers and equipment were first employed to get the shells. It thus took leases of extensive coastline with all the right to fish for chanks for some years. The shells were not the subject of the bargain at all, as were tree tendu leaves; but the bargain was about the right to fish. There can be no doubt that what it paid the divers when it bought chanks from them with the view of reselling them was expenditure laid out wholly and exclusively for the purpose of its business, which was not of a capital nature. That business was buying goods and reselling them at a profit. But a different kind of business was involved when it went in for fishing for chanks. To be able to fish for chanks in reserved waters it had to obtain the right first. It therefore, took lease of that right.

x x x x

x x x Here is an agreement to reserve a source, where the respondent hoped to find shells which, when found, became its stock- in-trade but which, in situ, were no more the firm's than a shell in the deepest part of

> the ocean beyond the reach of its divers and nets. The expenses of fishing shells were its current expenses as also the expenses incurred over the purchase of shells from the drivers. But to say that the payment of lease money for reserving an exclusive right to fish for chanks was on a par with payments of other character is to err.
>
> x x x
>
> x x x x It would be a straining of the imagination to say that the amount paid for reserving the coastline for future fishing was the price of chanks, with which the respondent did its business. That amount was paid to obtain an asset in the shape of an exclusive right to fish, and the payment was not related to the chanks, which it might or might not have brought to the surface in this speculative business. The rights were not transferable, but if they were and the firm had sold them, the gain, if any, would have been on the capital side and not a realising of the chanks as stock-in-trade, because none had been bought by the firm, and none would have been sold by it.

However, the facts of the case before us are altogether different. As already noted by us, what the assessee acquired while enhancing the lease rent was a right to purchase the raw material and not the source of the raw material. In the case, relied upon by the learned counsel for the Revenue, the assessee had acquired the source of raw material itself, when it was granted exclusive right and authority to fish for and take and carry all chanks shells in a specified area for a specified period. The case before us is akin to the case of **Mohanlal Hargovind** (supra) where the right

to pick tendu leaves was acquired by the lessee. This judgment to our mind could have been of help to the Revenue, had the trust been having rights in the land on which khairwood trees were grown and had it surrendered those rights in favour of the assessee, in consideration of enchancement of lease rent.

Elimination of Competition

22. As regards that part of the enhancement of the lease rental which is attributable to the trust agreeing not to compete with the assessee in manufacture and sale of katha and *Cutch* in a radius of less than 1000 kms from the premises which it had leased to the assessee, we find upon a perusal of the lease deed that the trust was earning sufficient profits from these activities. It further shows that both the trust as well as the assessee felt that such direct competition was prejudicial to the interest of both the parties and therefore ought to be avoided. Admittedly, it is the trustees of the Trust and their family members who owned and controlled the assessee company. Shri Bishan Dass and Shri Raj Kumar, who were the directors and shareholders of the assessee company, were also the trustees of the Trust. Three out of five directors of the assessee company were the sons of the trustees. Bulk of the shares of the assessee Company were admittedly held by the trustees and their family members. Considering the fact that the Trust as well as

the assessee Company were being controlled by the same set of persons and/or their family members, it can hardly be disputed that the assessee Company could have continued with the lease, so long as it was in the financial interest of the Company to continue with the arrangement it had with the Trust.

Considering the close connection between the assessee and the trust, resulting in common control of both the entities, it is difficult to dispute that the benefits, which accrue to the assessee company on account of elimination of competition by the trust were certainly of an enduring nature. This also becomes evident from the fact that the lease deed between the trust and the assessee which came into force from 1.6.1978 continued for more than 22 years till it was finally determined vide letter dated 29.9.2000. Even the lease deed dated 18.1.1992 whereby the lease rent was enhanced from Rs.1 lac to Rs.6,70,000/- p.m. continued for more than 8 years which clearly indicates that despite termination clause contained in the lease deed, the parties to the deed contemplated a long term relationship, which, at the option of the Directors of the assessee company, who were also the trustees of the trust, could have continued for an indefinite period. Therefore, it is difficult to dispute that elimination of competition from Mehta Charitable Trust brought benefits of an enduring nature to the assessee company.

23. In ***Assam Bengal Cement Companies Ltd. v. CIT:*** **(1995) 27 ITR 34**, the appellant company had acquired, for the purpose on manufacturer of cement, the lease of limestone quarries for a period of 20 years for consideration of payment of half- yearly rents and royalties. In addition, the appellant also agreed to pay to the lessor, a sum of Rs.5,000/- per annum as a protection fee, in consideration of which the lessor undertook not to grant to any person any lease, permit or license for limestone, without a condition that no limestone should be used for the manufacturer of cement. The appellant also agreed to pay Rs.35,000/- per annum for 05 years as a further protection fee, in consideration whereof the lessor gave an identical undertaking in respect of the whole of the district. The question which arose before the Supreme Court was as to whether the aforesaid payments were capital expenditure or revenue expenditure. It was observed that consideration of Rs.5,000/- per annum, which was to be paid to the lessor during the whole period of the lease, was to endure for the whole period of the lease. It was an enduring benefit for the benefit for the whole of the business. The Court felt that the fact that it was a recurring payment was immaterial, because one had to look into the nature of the payment, which, in turn, was determined by the nature of the asset which the company had acquired and since the asset acquired by the company was in the nature of a capital asset, the right to carry on its business, unfettered by any

competition from, outsiders within the area, it was a protection acquired by the company for its business as a whole. The Court observed that the expenditure was not a part of the working of the business but went to appreciate the whole of the capital asset and make it more profit yielding. As regards payment of protection fee of Rs.35,000/- per year, for a period of 05 years, the court was of the view that though the payment was limited to five years, the advantage which the company got as a result of the payment was to endure for its benefit for the whole of the period of the lease unless determined in the manner provided in the lease. The Court, therefore, held that this payment of Rs.35,000/- per year was not a revenue expenditure and was incurred for the purpose of acquiring an appreciated capital asset. In the course of the judgment, the Court inter alia observed as under:-

> "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."
>
> "The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure."

In ***Pitney Bowes India Pvt. Ltd. v. CIT***, ***ITA 784/2011*** decided on 13.9.2011, the assessee company which was engaged in the business of wholesale trading, selling and marketing of hi-tech documents and providing maintenance and after sale-service of its products acquired mailing business from M/s Kilburn Office Automation Limited as a going concern on a slump sale basis, pursuant to a business transfer agreement entered into between the parties. The payment made to M/s Kilburn Office Automation Limited included a sum of Rs.5.94 crores by way of non-compete fees, which was limited for a period of 05 years. Before transfer of the mailing business to the assessee company, M/s Kilburn Office Automation Limited was acting as the distributor of its products in India and Nepal. The assessee relying upon **Eicher Limited** (infra), **Madras Auto Services Pvt. Limited** (supra) and **Coal Shipment** (P) Limited (infra) contended that since it did not acquire any capital asset by making the payment of non-compete fees and merely eliminated competition for a limited period of 05 years, the expenditure could not be treated as capital in nature. This Court noted that the Special Bench of the Tribunal in the case of ***M/s Tecumesh India Private Limited v. Additional CIT*** **132 TTJ 129** had taken a view that warding off competition in business even to a rival dealer, would constitute capital expenditure and that to hold them to be capital expenditure it is not necessary that non-compete fees was paid to create monopoly

rights. The Court noted that the position in the case before it was almost identical and that is why even the learned Counsel for the assessee had conceded before the Tribunal that the matter was covered by the aforesaid Special Bench decision. This Court therefore answered question no.1 in the appeal by holding that the deduction of expenditure towards non-compete fees could not be allowed to the assessee.

In ***Blaze & Central (P.) Ltd. v. Commissioner of Income-tax*** *(1979) 120 ITR 33 (Mad)*, the assessee entered into an agreement with M/s. Saraswathi Publicities under which the latter agreed to part with its business of exhibiting film shorts and not to compete with the assessee in the business of exhibition of advertisements in four southern States for a period of 9 years in consideration of the assessee paying a sum of Rs. 1,50,000. Relying upon the decision of the Supreme Court in ***Coal Shipments P. Ltd.*** **(supra),** it was held that since the assessee had not only warded of the business rivalry but also acquired the business of the rival for a period of 9 years in a specified area, it had not only derived an advantage by eliminating the competition but also acquired the business which actually generates income. It was further held that any amount expended for acquiring a business or asset which generates income or for avoiding competition in business has to be treated as capital in nature.

We are of the considered view that elimination of competition from the Trust brought benefit of an enduring nature to the assessee-company, in the field of capital and, therefore, increase in lease rent, to the extent it is attributable to this benefit, would be a capital expenditure.

24. The learned Counsel for the assessee, in support of his contention that payment of non-compete fees for a limited period does not qualify as capital expenditure, has placed reliance upon ***Commissioner of Income Tax v. Coal Shipment Ltd.:*** **82 ITR 902 (SC).** In this case, the assessee company was amongst the exporters of coal to Burma, before the Second World War. Another exporter of coal was H.V. Low & Co. Ltd. The assessee and H.V. Low & Co. Ltd were two of the major members of an association formed to overcome difficulties in the conduct of trade. On cessation of the war when H.V. Low and Co. Ltd. learnt of the resumption of coal export to Burma, they also expressed an intention to export coal to Burma. Thereupon, the two companies came to an understanding and arrived at a mutual arrangement or agreement under which H.V. Low & Co. Ltd. agreed not to export coal to Burma during the subsistence. It further agreed to assist the assessee in procuring coal for shipment to Burma. The asseessee company, agreed to make payment of 05 annas per ton of coal shipped to Burma, to H.V. Low and Co. Ltd. The payments made to HV Low and company were

claimed to be revenue expenditure. The stand taken by the asseessee was rejected by the Assessing Officer, but upheld by the Tribunal as well as by the High Court primarily on the grounds that the arrangement was not for a fixed term but could be terminated at any time and the payments were related to actual shipment of coal and were not related to or tied up to any fixed sum agreed to between the parties. As regards payments made to H.V. Low and Co. Ltd. for assistance in procuring coal for shipment to Burma, the Supreme Court noted that it was admittedly an item of revenue expenditure. As regards that part of payment which was attributable to HV Low and Co. Ltd. agreeing not to export coal to Burma during the subsistence of the agreement, the Court accepted that since there was no certainty of the duration of the arrangement, which could be revoked at any time, the advantage could not be said to be of enduring character and therefore, the expenditure could not be held to be of a capital nature. The Court in this regard observed that although an enduring benefit need not be an ever-lasting character, it should not, at the same time be so transitory or ephemeral that it can be terminated at any time at the violation of any of the parties.

As regards payments made to eliminate competition, the Court inter alia observed as under:-

> "Although we agree that payment made to ward off competition in business to a rival dealer would constitute capital expenditure if the object of making that payment is to derive an advantage by eliminating the competition over some length of time, the same result would not follow if there is no certainty of the duration of the advantage and the same can be put to an end at any time. How long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and the facts of each individual case."

However, in the case before us, despite the termination clause contained in the lease deed, elimination of competition from the trust, on account of a common control of the trust and the assessee company, brought benefits of enduring nature to the assessee company and the intention of the parties to make it a long term arrangement is also evident from the lease continuing for more than 8 years after its renewal w.e.f. 01.01.1992. This judgment therefore does not help the assessee.

25. The learned Counsel for the assessee has also relied upon ***Commissioner of Income Tax v. Eicher Ltd. (2008) 302 ITR 249 (Delhi)***, ***Commissioner of Income Tax v. Career Launcher India Ltd. ITA No. 939/2010*** decided on 19.4.2012 and ***Commissioner of Income Tax v. Saw Pipes Ltd. 208 CTR 476 (Del.)***.

In **Eicher Ltd** (supra), a full time employee of the assessee company, who had acquired specialized knowledge of technology in the two-wheeler industry as well as of managing the dealership, etc. entered into an agreement with a company

called VCPL whereby he was to promote VCPL and collaborate with it in the manufacture of two-wheelers on his retirement from the assessee company. On coming to know of this, the assessee entered into a non-compete agreement with them and paid a sum of Rs. 4 crores in consideration that they would not carry out any business activity with regard to two wheelers. The payment was claimed as a business expenditure but was disallowed by the Assessing Officer. The Commissioner of Income Tax (Appeals) as well as the Tribunal decided in favour of the assessee. Allowing the appeal filed by the revenue, this Court inter alia observed and held as under:-

> "The assessed did not acquire any capital asset by making the payment of non-compete fee. It merely eliminated competition in the two wheeler business, for a while. From the record, it is not clear how long the restrictive covenant was to last, but it was neither permanent nor ephemeral. In that sense, the advantage was not of an enduring nature. There is also nothing to show that the amount of Rs. 4 crores was drawn out of the capital of the assessed. On a cumulative appreciation of these facts, it must be held that the CIT (A) and the Tribunal did not err in concluding that the payment of non-compete fee by the assessee was a business expenditure and not a capital expenditure."

In **Career Launcher India Limited** (supra), the Assessee had paid a non-compete fees of Rs.6,00,000/- to its faculty members Mr. Vijay Kalyan Jha and Mr. Sujit, who had agreed not enter into a business similar to business of the assessee company upto 31.12.2005. The Assessing Officer was of the view that the payment made to them was in the nature of a capital expenditure. The Tribunal on analysis of the agreement between the parties, concluded that the period involved, during which Mr. Vijay Kalyan Jha and Mr. Sujit were not to compete with the Assessee was only a short period of 12 months and, therefore, there could be no enduring benefit enduring to the Assessee and accordingly allowed the payment as Revenue Expenditure. Another reason given by the Tribunal in this regard was that the non-compete fees was to be paid in equal installments over a period of time, Mr. Vijay Kalya Jha was to be paid in 10 equal monthly installments whereas Mr. Sujit was to be paid in 05 equal monthly installments. Rejecting the appeal filed by the Revenue, this Court held that in coming to the decision holding the payments to be a revenue expenditure, the Tribunal had not ignored any relevant material or taken into account irrelevant material.

In **Sawpipes Limited** (supra), the assessee had spent about Rs.52 lac toward laying of service line but the cables belonged to Maharashtra State Electricity

Board (MSEB). It was held that the expenditure incurred by the Assessee was a revenue expenditure.

The learned counsel for the assessee also relied upon ***Alembic Chemical Works Co. Ltd. v. Commissioner of Income Tax, Gujarat*** ***177 ITR 377***, where the Supreme Court, referring to the expression "enduring benefit", *inter alia*, observed as under:-

> "The idea of 'once for all' payment and 'enduring benefit' are not to be treated as something akin to statutory conditions; nor are the notions of "capital" or "revenue" a judicial fetish. What is capital expenditure and what is revenue are not eternal varieties but must needs be flexible so as to respond to the changing economic realities of business. The expression "asset or advantage of an enduring nature" was evolved to emphasise the element of a sufficient degree of durability appropriate to the context. The words of Rich J. in Herring v. Federal Commissioner of Taxation 1946 72 CLR 543, dealing with an analogous provision in Section 51 of Income-tax Assessment Act of Australia may be re-called.
>
> "...Lord Cave L.C., in using the phrase 'enduring benefit' in British Insulated and Helsby Cables Ltd. v. Atherton, 1926 A.C. 205,213 (HL), was not thinking of advantages that are permanent. There is a difference between the lasting and the everlasting. The time over which the thing 'endures' is a matter of degree and one element only to be considered. Horses in the old days and motor trucks in these days are plant and their acquisition for the purpose of transport in business usually involves a capital

> expenditure. But the horses were not immortal any more than the trucks have proved to be...." (emphasis supplied)

Since all the judgments relied upon by the learned counsel for the assessee on this issue are clearly distinguishable on facts, they are of no help to the assessee.

The learned counsel for the assessee, placing emphasis on the fact that the lease executed by the Trust in favour of the assessee was determinable at any point of time contended that it cannot be said that any advantage of an enduring nature was acquired by the assessee on account of relinquishment of the right to purchase Khairwood, in Himachal Pradesh or eliminating direct competition from the Trust in sale and purchase of *katha* and *Cutch* in a specified radius. In support of his contention, the learned counsel for the assessee placed reliance upon ***Alembic Chemical Works*** (*supra*), ***Commissioner of Income Tax v. Madras Auto Services*** *(supra) and* **CIT vs. HMT Limited**, **203 ITR 820(Kar).** However, the facts of the case before us are quite different. As noted earlier, considering the common control of the Trust and the assessee-company, coupled with the fact that the lease had lasted for about 22 years in all, and for more than 08 years after its last renewal. Hence, in the facts and circumstances of the case, that part of the increase in lease rent, which is attributable to elimination of competition from the Trust, cannot be said to be revenue expenditure.

26. The learned Counsel for the assessee has also referred to ***CIT v. HMT Ltd. 203 ITR 820 (Kar), CIT v. Lahoty Bros. 19 ITR 425 (Cal)***, ***CIT v. Nchanga Consolidated Copper Mines Ltd.***: ***58 ITR 241 (Privy Council)***, ***V.Damodaran v. CIT Kerala 64 ITR 26(Ker.), Champion Engineering Works Ltd. v. CIT (1971) 81 ITR 273 (Bom)***, ***CIT v. Bowrisankara Stemp Ferry Co. (1973) 87 ITR 650 (AP)***, ***CIT v. Late G.D.Naidu and Ors. (1987) 165 ITR 63 (Mad)***, ***DCIT v. McDowell & Co. Ltd. 291 ITR 107 (Kar.)***, ***CIT v. Excel Industries Limited 122 ITR 995 (Bom.)***, ***Hindustan Times Ltd. v. CIT (1980) 122 ITR 977***, ***Sarabhai M. Chemicals Pvt. Ltd. v. CIT 127 ITR 74 (Guj.)***, ***CIT v. Panbari Tea Company Limited 151 ITR 726 (P&H)*** & ***CIT v. Karam Chand Prem Chand (P) Ltd. 200 ITR 281 (Guj.)***.

27. The learned counsel for the assessee contended that since elimination of competition from the Trust did not happen simultaneous with acquisition of *Katha* and *Cutch* business of the Trust, enhancement of lease rent, even to the extent it is attributable to elimination of competition from the Trust, would not constitute capital expenditure. In our view, this is not an absolute proposition of law that in order to constitute capital expenditure, the payment/compensation for elimination of competition should be coupled with acquisition of business of the rival and both the things should happen at the same time. In a given case, either the payment to

eliminate competition may be post acquisition of business of the rival or elimination of competition may not be accompanied by acquisition of business of the rival. It is very much possible for a rival to agree not to compete in a given area, while continuing with the same business in other areas. In such a case, there would be no takeover of the business of the rival. In any case, as far as the case before us is concerned, as would be seen from the lease deeds executed between the assessee and Mehta Charitable Trust, that the Trust had leased whole of its production unit 'Mahesh Udoyog', which was a profit generating unit to the assessee and not only the building, but the plant and machinery was also leased to the assessee along with all benefits, etc. As noted earlier by us, the lease continued for more than 22 years. A perusal of the schedule of fixed assets of 'Mahesh Udoyog', managed by the assessee, Shankar Trading Company, filed by the learned counsel for the assessee, would show that the fixed assets which were leased to the assessee-company and were managed by it, included machinery, shed, laboratory equipments, truck, furniture & fixtures, electricity fittings, fans, cooler, typewriter, refrigerator, water geyser, scooter, car, cooling tower, generator, boiler, transformers, water pollution equipment, Photostat machine, etc. Even the liability towards gratuity of the employees of the Trust was taken over. The Trust had also relinquished its rights to purchase khairwood from the Government in favour of the

assessee. This is not the case of the assessee that even after lease deed dated 18.01.1992, the Trust continued with the business of manufacture and trading of *Katha* and *Cutch* in areas beyond 1000 kilometres from the leased premises. Therefore, the business being carried by 'Mahesh Udyog' was practically taken over by the assessee-company for an indefinite period. The lease deed also shows that the lessee had approached the Trust that it should stop commercial dealings in *Katha* and *Cutch* and in lieu thereof it had agreed to compensate the Trust for the loss that would be caused to it by stopping such commercial dealings. Therefore, this was a case of takeover of the business, coupled with elimination of competition from the rival. It is also evident from a perusal of the lease deed dated 18.01.1992 that the previous lease deed executed between the parties was repealed simultaneous with the execution of the new lease deed on 18.01.1992. Therefore, technically speaking in this case, acquisition of assets of the trust and elimination of competition from the Trust took place simultaneously. In fact, the whole transaction between Trust and assessee was a composite transaction, without apportionment of lease rent into various components of the transaction. Therefore, from whatever point of view, we may examine, there is no escape from the conclusion that increase in lease rent, to the extent it was relatable to elimination of competition from the Trust, constitutes capital expenditure.

Applicability of Section 40A(2) of Income Tax Act

28. Coming to the second issue, Section 40A(2) of Income-tax Act reads as under:-

> "(2)(a) Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person referred to in clause (b) of this subsection, and the [Assessing] Officer is of opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction."
>
> (b) The persons referred to in clause (a) are the following, namely :—
>
> (i) where the assessee any relative of the assessee; is an individual
>
> (ii) Where the assessee is a any director of the company, company, firm, association partner of the firm, or member of of persons or Hindu undivided the association or family, or any family relative of such director, partner or member;
>
> (iii) any individual who has a substantial interest in the business or profession of the assessee, or any relative of such individual;
>
> (iv) a company, firm, association of persons or Hindu undivided family having a substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family, or any relative of such

director, partner or member;

(v) a company, firm, association of persons or Hindu undivided family of which a director, partner or member, as the case may be, has a substantial interest in the business or profession of the assessee; or any director, partner or member of such company, firm, association or family or any relative of such director, partner or member;

(vi) any person who carries on a business or profession,—

(A) where the assessee being an individual, or any relative of such assessee, has a substantial interest in the business or profession of that person; or

(B) where the assessee being a company, firm, association of persons or Hindu undivided family, or any director of such company, partner of such firm or member of the association or family, or any relative of such director, partner or member, has a substantial interest in the business or profession of that person."

Explanation.—For the purposes of this sub-section, a person shall be deemed to have a substantial interest in a business or profession, if,—

(a) in a case where the business or profession is carried on by a company, such person is, at any time during the previous year, the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without a right to participate in profits) carrying not less than twenty per cent of the voting power; and

(b) in any other case, such person is, at any time during the previous year, beneficially entitled to not less than twenty per cent of the profits of such business or profession."

29. The objective behind Section 40-A of the Act is to address evasion of tax under the cloak or guise of permissible deductions by checking payments made or benefits granted made to closely connected persons and entities ostensibly for the goods sold or services rendered by them. Admittedly, Mehta Charitable Prajnalay Trust is a charitable trust and by itself the Trust does not hold any share of the assessee-company. The Trust is not entitled to any profit out of the business being run by the assessee-company. Hence, the Trust does not have a substantial interest in the business of the assessee-company.

30. The Tribunal vide its order dated 25.02.2002 in respect of the assessment years 1994-95 and 1995-96, held that clause-v of Section 40A(2)(b) deals with this type of situation and, therefore, the payments made by the assessee-company to the Trust, if inflated or excessive, could be disallowed under the said provision. It is not in dispute that at least some of the trustees are also directors and shareholders of the assessee-company. The Tribunal vide its order dated 25.02.2002 held that the maximum shareholding in the assessee-company was owned by the trustees and their relatives as defined in Section 2(41) of the Act. However, clause (v) of Section 40A (2)(b) of the Act brings only such companies, firms, HUFs or association of persons within its purview, directors/partners/members of which have a substantial interest in the business or profession of the assessee. The

interest of the relatives of a director/partner/member of such company/firm/HUF/association of persons cannot be taken into consideration to ascertain whether the director/partner/member have substantial interest in the business of the assessee or not. The explanation provides that a person shall be deemed to have a substantial interest in a business if in a case where the business is carried on by a company, he, at any time, during the previous year, was the beneficial owner of shares carrying not less than 20% of the voting power. The Tribunal has not given any finding with respect to exact shareholding of the trustees in the assessee-company during the relevant previous years, and we have no material before us to indicate the exact shareholding of the trustees in the assessee-company during the years to which these appeals pertain.

31. Since Clause (v) of Section 40A (2) of the Income Tax Act refers to a company, firm, association of persons or Hindu Undivided Family and the Trust is not a company, firm or HUF. The only question which comes up for consideration is as to whether it is an association of persons within the meaning of clause (v) of Section 40A(2)(b) of the Income Tax Act? The term "association of persons" has not been defined in Income Tax Act, though it is mentioned in Section 2(31) of the Act which defines the expression "person" to include "an association of persons". In ***CIT v. Indira Balakrishna*: 1960 (39) ITR 546**, the Supreme Court, while

considering what constitutes an "association of persons", observed that by "association" means "to join any common purpose or to join an action". Therefore, association of persons would mean an association in which two or more persons join with a common purpose or for a common action. Though in view of the explanation inserted by Finance Act, 2002 w.e.f. 1.4.2002 to Section 2(31) such association need not be formed with the object of deriving income profit or gains, it is difficult to say that either the trustees or beneficiaries of a trust come altogether and form an association for a common purpose or to take a common action.

As observed by a Division of this Court in ***CIT v. Sae Head Office Monthly Paid Employees Welfare Trust*** **(2004) 271 ITR 159**, the beneficiaries do not set up a trust and the trustees derive their authority under the terms of the deed of the trust. Therefore neither the trustees nor the beneficiaries could be said to have come together for a common purpose. The beneficiaries merely enjoy the benefit of the trust whereas the function of the trustees is to administer the trust in terms of the provisions of the trust deed. As observed by this Court in ***Sae Head Office Monthly Paid Emplyees Welfare Trust*** *(supra)*, the mere fact that the beneficiaries or the trustees are more than one, cannot lead to a conclusion that they constituted an association of persons. This Court was of the view that in the absence of

element of volition on the part of either the trustees or beneficiaries by no stretch of imagination it cannot be considered to be an "association of persons".

In ***CIT v. Harivadan Tribhovandas*** *(1977) 106 ITR 494 (Guj.)*, Gujarat High Court was of the view that volition on the part of the members of the association is an essential ingredient and merely because a combination of individuals receives income jointly, without anything further, they cannot be regarded as an association of persons. Obviously, such volition is missing in the case of trustees as well as the beneficiaries of the trust.

In ***Murugesan (G.) & Brothers v. Commissioner of Income Tax*** *(1973) 088 ITR 0432*, Supreme Court, inter alia, observed that 'Association of Persons can be formed only when two or more individuals voluntarily combine together for a certain purpose and hence volition on the part of the members of the association is an essential ingredient.

In ***Commissioner of Income Tax v. Venu Suresh Sanjay Trust:*** *(1996) 221 ITR 649 (Madras)*, it was held that in the case of a discretionary trust, neither the trustees nor the beneficiaries can be considered as having come together with the common purpose of earning income. It was observed that the beneficiaries have not set up the trust and the trustees derive their authorities under the terms of the trust deed. Therefore, neither the trustees nor the beneficiaries come together for a

common purpose, they are merely in receipt of income. It was further held that the mere fact that the beneficiaries or the trustees, being representative-assessees, are more than one, cannot lead to the conclusion that they constitute "an association of persons".

We, therefore, hold that since Mehta Charitable Trust is not "association of persons" within the meaning of Section 40(A)(2) of Income-tax Act, the aforesaid provision is not attracted to the transaction which is the subject-matter of these appeals.

32. For the reasons stated hereinabove we answer the questions as below:

1. That part of the enhancement of lease rent, which is attributable to Mehta Charitable Trust surrendering its right to purchase khair wood in favour of the assessee company constitutes revenue expenditure,
2. That part of the enhancement of lease rent, which is attributable to improvement and modernization of plant and machinery carried out by the Trust in the year 1989-90, constitutes revenue expenditure.
3. The enhancement in lease rent, if any, which is attributable to normal appreciation, if any, in line with the lease rentals prevailing in the market constitutes revenue expenditure.

4. The enhancement in lease rent, which is attributable to Mehta Charitable Trust agreeing not to indulge in competition with the assessee within a radius less than 1000 kms from the demises property, constitutes capital expenditure.

5. Since, the trust is not an "association of persons", the provisions of Section 40A(2) of the Income Tax Act are not attracted to the transaction between the trust and the assessee company.

Consequently, we direct that the Assessing Officer will apportion the lease rental in various categories as indicated above and will pass a fresh order in terms of apportionment made by him.

The appeals stand disposed of. There shall be no order as to costs.

V.K.JAIN, J

BADAR DURREZ AHMED, J

MAY 09, 2012
bg/rb/vn/sn