Privy Council Appeal No. 10 *of* 1948

Messrs. Mohanlal Hargovind of Jubbulpore - - - - *Appellants*

v.

The Commissioner of Income Tax, Central Provinces and Berar, Nagpur - - - - - - - - - *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT NAGPUR

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL DELIVERED THE 28TH JULY, 1949

Present at the Hearing:

LORD GREENE
LORD MORTON OF HENRYTON
SIR JOHN BEAUMONT

[*Delivered by* LORD GREENE]

This appeal raises a short question as to the application of sect. 10 (2) para. xii of the Indian Income Tax Act, 1922, as amended by the Indian Income Tax (Amendment) Act, 1939, in respect of assessments on the appellants for the years 1940-1 and 1941-2. That paragraph provides that in computing profits or gains of a business for the purpose of Income Tax an allowance is to be made for " any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly or exclusively for the purpose of such business." Certain expenditure claimed by the assessee to be a permissible deduction under this paragraph and admitted to have been made " wholly and exclusively for the purpose " of the business of the appellants was disallowed by the Income Tax officer. His order was confirmed successively by the Appellate Assistant Commissioner of Income Tax, Nagpur, and by the Income Tax Appellate Tribunal, Bombay. Application was made to that Tribunal for a reference to the High Court of Judicature, Nagpur, of the question whether the appellants were entitled to the deduction in question and the High Court (Grille, C.J. and Sen, J.) answered that question in the negative for the reasons given by them in their judgment in another case (Miscellaneous Civil Case, No. 55 of 1943).

The relevant facts are as follows. The appellants carry on business at several places in the Central Provinces of India as manufacturers and vendors of country made cigarettes which are known as *bidis*. These cigarettes are composed of tobacco contained or rolled in leaves of a tree known as tendu leaves which fulfil a corresponding function in the finished cigarette to that played by a cigarette paper. The appellants obtain the tendu leaves which they require by entering into a number of contracts with the Government and other owners of forests. Two of these contracts which were taken as typical of the rest are included in the Record, one relating to a Government forest and one to a forest belonging to the Rewa state. It is important to examine the terms of these documents. The former is dated the 5th September, 1939, and is

made between the Divisional Forest officer on behalf of the Secretary of State in Council and the appellants' representative described as the " forest contractor." Clause 1 identifies the subject matter of the contract, which is described as " the forest produce sold and purchased under the agreement," as that specified in Schedule 1 in the " contract area " therein indicated. By Clause 2 the quantity of the forest produce is defined as all the said produce " which may now exist or may come into existence in the contract area which the forest contractor may remove from the said area . . . during the period from the 5th day of September, 1939, to the 30th day of June, 1941." Schedule 1 A provides that " the contractor shall commence his work before the . . . day of . . . 193 , and shall, to the satisfaction of the office empowered to execute the contract on behalf of Government, make continuous and adequate progress throughout the term of the contract." In this provision the dates by an obvious oversight are left in blank but the date of commencement could not be later than the 31st December, 1939. In the second of the two agreements which with certain minor differences is substantially in the same form, the period of the operations is the 1st October, 1938, to 30th June, 1941, and the work is to be commenced on the 1st October, 1938. This agreement recites an application for the grant of " the contract of collecting and removing " tendu leaves. The grant is a grant of the right to collect and remove them from the area described. In the case of each contract a sum payable by instalments is fixed as the consideration for the grant. In the former contract the contractor is allowed to coppice small tendu plants a few months in advance to obtain good leaves and to pollard tendu trees a few months in advance to obtain better and bigger leaves.

It appears to their Lordships that there has been some misapprehension as to the true nature of these agreements and they wish to state at once what in their opinion is and what is not the effect of them. They are merely examples of many similar contracts entered into by the appellants wholly and exclusively for the purpose of their business, that purpose being to supply themselves with one of the raw materials of that business. The contracts grant no interest in land and no interest in the trees or plants themselves. They are simply and solely contracts giving to the grantees the right to pick and carry away leaves, which of course, implies the right to appropriate them as their own property.

The small right of cultivation given in the first of the two contracts is merely ancillary and is of no more significance than would be e.g. a right to spray a fruit tree given to the person who has bought the crop of apples. The contracts are short term contracts. The picking of the leaves under them has to start at once or practically at once and to proceed continuously. It is true that the rights under the contracts are exclusive but in such a case as this that is a matter which appears to their Lordships to be of no significance.

The question, therefore, resolves itself into the short one—is expenditure of this character made in acquiring one of the raw materials of the appellant's manufacture capital expenditure within the meaning of this Act? There is no definition of that expression which must in their Lordships' opinion be construed in a business sense save in so far as there may be rules of construction applicable to it. Their Lordships feel no doubt that in a business sense this expenditure is expenditure on revenue account and not on capital account just as much as if the tendu leaves had been bought in a shop. Under the contracts it is the tendu leaves and nothing but the tendu leaves that are acquired. It is not the right to pick the leaves or to go on to the land for the purpose—those rights are merely ancillary to the real purpose of the contracts and if not expressed would be implied by law in the sale of a growing crop.

In their Lordships' opinion the High Court has adopted an approach to the question which has diverted its view from the real point and has attached too much importance to cases decided upon quite different facts. Cases relating to the purchase or leasing of mines, quarries, deposits of brick earth, land with standing timber, &c. referred to in the judgment and

relied upon in the argument before the Board do not appear to their Lordships to be of assistance: nor do their Lordships consider that the elaborate distinction between movable and immovable property drawn in the judgment affords in such a case as the present a reliable test. The cases principally relied on in the judgment are the *Alianza Company* v. *Bell* (1904 2 K.B. 666 affirmed 1905 1 K.B. 184 and 1906 A.C. 18) and *Kauri Timber Co. Ltd.* v. *the Commissioner of Taxes* 1913 A.C. 771. The former was the case of a company whose object was treated as one to work and develop a bed containing a substance called caliche from which nitrates and iodine could be obtained by a process or manufacture. It was analogous to the purchase or leasing of a mine and was obviously capital expenditure. The claim was one equivalent to a claim to deduct the expenditure made in acquiring the land for it was a claim to deduct the amount carried year by year to a sinking fund set up to meet the exhaustion of the caliche. This case appears to their Lordships to bear no resemblance to the facts of the present case which resembles much more closely the case described and distinguished by Channell J. at p. 673 of the report in 1904 2 K.B. of the cost of material worked up in a manufactory. That, said the learned judge, is " a current expenditure and does not become a capital expenditure merely because the material is provided by something like a forward contract, under which a person for the payment of a lump sum down secures a supply of the raw material for a period extending over several years."

In the *Kauri Timber* case the company's business consisted in cutting and disposing of timber. It acquired in some cases timber bearing lands in other cases it purchased the standing timber. The leases were for 99 years. So far as the cases where the land was acquired were concerned there could have been no doubt that the expenditure made in acquiring it was capital expenditure. In the case of the purchase of the standing timber what was acquired was an interest in land. The purchasers bought the trees which they could allow to remain standing as long as they liked. As Lord Shaw said in delivering the judgment of the Board (at p. 776) " So long as the timber, at the option of the Company, remained upon the soil, it derived its sustenance and nutriment from it. The additional growths became *ipso jure* the property of the company." In the present case the trees were not acquired: nor were the leaves acquired until the appellants had reduced them into their own possession and ownership by picking them. The two cases can in their Lordships' opinion in no sense be regarded as comparable. If the tendu leaves had been stored in a merchant's go-down and the appellants 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 ground in principle or reason for differentiating the present case from that supposed.

Their Lordships will humbly advise His Majesty that this appeal should be allowed and that the respondent should be ordered to pay the costs of the appellants of and relating to the reference to the High Court. The respondent will pay the costs of this appeal.

(65821) Wt. 809—42 20[illegible] 8/49 D.L. G. 338

In the Privy Council

MESSRS. MOHANLAL HARGOVIND
OF JUBBULPORE

v.

THE COMMISSIONER OF INCOME TAX,
CENTRAL PROVINCES AND BERAR,
NAGPUR

DELIVERED BY LORD GREENE

Printed by HIS MAJESTY'S STATIONERY OFFICE PRESS,
DRURY LANE, W.C.2.

1949