IN THE HIGH COURT OF JUDICATURE AT

Dated : **07.04.2014**

Coram

The Honourable Mrs.Justice CHITRA VENKATARAMAN
and
The Honourable Mr.Justice T.S.SIVAGNANAM

Tax Case (Appeal) No.1031 of 2007

Commissioner of Income Tax,
Tamil Nadu-III, ... Appellant

-vs-

M/s.Rane Brake Linings Ltd.,
"Maithiri" No.32, Cathedral Road,
Chennai – 600 086. ... Respondent

Tax Case (Appeal) filed under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal 'B' Bench, Chennai, dated 12.01.2007, in I.T.A.No.1953/Mds/2002.

For petitioner : Mrs.Hema Muralikrishnan

For Respondent : Mr.C.V.Rajan for
M/s.Subbaraya Aiyar Padmanabhan

ORDER

(The Order of the Court was made by
T.S.SIVAGNANAM, J.**)**

The appeal by the Revenue is directed against the order passed by the Income Tax Appellate Tribunal (Tribunal) in

I.T.A.No.1953/Mds/2002 for the assessment year 1994-95 and the appeal has been admitted on the following substantial questions of law:-

> *Whether on the facts and circumstances of the case, the Income-Tax Appellate Tribunal was right in law in holding that a lump sum of Rs.20,00,000/- paid by the assessee being lease rentals paid to Maharashtra Industrial Development Corporation is a revenue expenditure, is valid in law?*

2. The assessee is a company engaged in the manufacture of Automotive Ancillary Products and they had taken a land measuring an extent of 11,050 sq.mts., on lease from Maharashtra Industrial Development Corporation and paid a sum of Rs.20,00,000/-, pursuant to the agreement dated 29.10.1993. The assessee claimed the said amount as payment of rental in one lumpsum and therefore, a revenue expenditure. The Assessing Officer rejected the stand taken by the assessee holding that the amount paid by the assessee was for the purpose of acquiring the land for a period of 80 years, which renders enduring advantages to the assessee. The Assessing Officer also took note of the fact that the assessee had paid further amount of Rs.5.04 lakhs towards the enhancement cost to the land. Therefore, the Assessing Officer found that the expenditure to be a capital expenditure.

3. Aggrieved by the such finding, the assessee preferred an appeal to the Commissioner of Income Tax (Appeal) by contending that M/s.Indian Filter Manufacturers Pvt., Ltd., (IFML) had taken the land on lease from the Maharashtra Industrial Development Corporation (MIDC), who is the absolute owner of the land and the lease is valid upto 31.03.2077 and IFML offered the said land to the assessee for enjoyment and the assessee has paid a sum of Rs.20,00,000/-, being the consideration for the lease vide agreement dated 29.10.1993. The assessee contended that the amount paid in lumpsum represented discounted value of future lease payments and therefore, to be allowed as deduction. The first Appellate Authority confirmed the view taken by the Assessing Officer that the transfer in favour of the assessee is in effect a transfer in perpetuity and therefore, the expenditure incurred, is a capital expenditure. Accordingly, the appeal filed by the assessee was dismissed. Though there were other grounds, which were subject matter of the appeal, we are not concerned with those grounds in this appeal by the Revenue, which is confined only with regard the issue relating to the payment made by the assessee for the lease of the said land whether the same is a capital or a revenue expenditure. The assessee being

aggrieved by the order passed by the first Appellate Authority, preferred an appeal to the Tribunal.

4. The Tribunal considered the appeal along with the appeals filed by the assessee raising various issues. The Tribunal by referring to the decisions of this Court in the case of ***CIT vs. Madras Auto Services,*** reported in ***233 ITR 468*** and the decision of this Court in the case of ***CIT vs. Gemini Arts Pvt., Ltd.,*** reported in ***254 ITR 201*** held that to decide whether the expenditure is capital or revenue, one has to look at the expenditure from a commercial point of view and the fact that the payment made in lump sum for the entire duration of the lease does not alter the character of revenue expenditure. Accordingly, the appeal filed by the assessee was allowed. Aggrieved by the same, the Revenue has preferred this appeal.

5. The learned counsel appearing for the Revenue submitted that the entire amount of lease paid by the assessee, at one time or in instalments, it would be a capital expenditure and the Tribunal ought to have followed the decision of the Hon'ble Supreme Court in the case of ***A.R.Krishnamurthy vs. CIT*** reported in ***176 ITR 470***, wherein it was held that the leasehold land is only a capital asset and

relinquishment of the sale is a transfer and the value of the lease rent paid by the assessee is for the cost of acquisition of the right and hence, it is only a capital expenditure to acquire the capital, which is not allowable as a revenue expenditure. Further, the learned counsel also placed reliance on the decision of the Hon'ble Supreme Court in the case of ***R.K.Palshikar (HUF) vs. CIT, M.P., Nagpur & Bhandara*** reported in ***1988 (172) ITR 311***.

6. Mr.C.V.Rajan, learned counsel appearing for the assessee sought to sustain the order passed by the Tribunal by contending that the agreement between the assessee and the IFML was infact a lease transaction and the payment of the lease rent in one lumpsum does not alter the nature of the transaction and the payment is essentially towards the lease rental, which qualifies for being treated as a revenue expenditure. Merely because, the lease rent is paid in one lumpsum does not alter the character of the expenditure and the observation made by the Tribunal in this regard, is perfectly justified. Apart from referring to the decisions, which were relied on by the Tribunal in the case of ***Madras Auto Services,*** (supra) and ***Gemini Arts Pvt., Ltd.,*** (supra), the learned counsel also placed reliance on the decision of this Court in the case of the ***Commissioner of Income-tax v. Ucal Fuel Systems Ltd.*** reported in ***(2008) 296 ITR 702***.

7. We have heard the learned counsels appearing for the parties and perused the materials placed on record.

8. The issue involved in this case lies in a narrow campus. The assessee had entered into a transaction with IFML for the purpose of securing an asset which according to the assessee is only a transaction by which the IFML assigned the leasehold rights obtained by them from MIDC. In order to appreciate the transaction between the parties, it would be necessary to examine the terms and conditions of the assignment deed dated 29.10.1993. Under the said agreement, the assignor is IFML, who were granted a lease on 29.04.1982, by MIDC in respect of a property at the Industrial Estate in the village Bhosari, Pune District, State of Maharashtra. Under the assignment deed, IFML stated that they are no longer in need of the said property and desirous of sub-leasing the same and the assessee had approached them for absolute transfer of the right, title and interest in the said property on the terms and conditions agreed upon and reduced into writing in the form of assignment deed. The assessee agreed to pay a lumpsum upfront to IFML being the value of the additional lease rent which would have been charged by IFML in a sub-lease. The following Clauses of the assignment deed would be relevant

for the purpose of this case:-

> *1.IFML hereby transfers absolutely all the right, title and interest, it has derived under the said lease deed for all the residue now unexpired of the lease period into the Demised Premises as mentioned in the said lease deed absolutely to RBL subject to MIDC permitting RBL to hold the Demised Premises for all the residue now unexpired of the lease period and lease to RBL the Demised Premises for a further period of 80 years from the expiry of the lease period, as mentioned in the said lease deed, i.e., from 31st March 1997 to 31st March 2077, (both the days inclusive), subject henceforth to the payment of the rent reserved by and the performance and observance of the covenants on the part of RBL and the conditions contained in the said lease deed dated 29th April, 1982.*
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> *2. RBL shall pay a total sum of Rs.20 lacs to IFML, as consideration for the transfer mentioned in Clause 1 above, being the present value of the additional lease rent IFML would have charged during the lease period. Out of this amount IFML hereby acknowledge and confirms the receipt of Rs.5 lacs on 6th April 1993. The balance will be paid by the RBL as soon as the agreement is approved by the appropriate authority under the Income Tax Act 1961 and on or before the Registration of the Assignment Deed or on mutually agreed upon.*
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> *5. IFML shall handover possession of the property, on or before 3rd November, 1993. IFML further covenants that after giving over possession, subject to cancellation of this agreement due to refusal of MIDC to approve this transaction, IFML or anybody deriving any rights from IFML, shall have no further rights, interest or claims in any manner whatsoever on the scheduled mentioned property or against RBL in respect of this transaction.*

9. The nature purport and intent of the assignment deed could be culled out from the above referred clauses. It is seen that the transfer in favour of the assessee was absolute i.e., all rights, title and interest, which were derived by IFML were absolutely transferred in favour of the assessee. The period of lease was from 31.03.1997 to

31.03.2007 being the unexpired period of lease between IFML and MIDC. The conditions further stipulate that the assessee would be entitled to a further period of eighty years on the expiry of the period mentioned in the original lease dated 29.04.1982. Thus, it is evidently clear that the lease in favour of the assessee was a lease in perpetuity.

10. Coming to the consideration paid under the said agreement, it is to be noted that the asseesee paid a total sum of Rs.20,00,000/- to IFML, as a consideration for transfer as contemplated under the clause 1 of assignment deed. Apart from that, the assessee paid a sum of Rs.5,00,000/- directly to MIDC being the additional lease rent.

11. Conspicuously, the assignment deed does not speak of termination nor does it contemplate a contingency by which IFML would be entitled to cancel the assignment deed under certain contingencies nor does the assignment deed speak of any contingency by virtue of which the so called leasehold property would revert back to IFML. In terms of clause 5, the only covenant being that the assignment requires to be approved by MIDC and if that has been done, then the assignment continues and it is in perpetuity and only when MIDC refuses to approve the said transaction, then alone the

land shall revert back to MIDC and in any event not to the so called lessor of the assessee namely IFML. It is not in dispute that MIDC approved the transfer. Thus, on a cumulative reading of the conditions make it evidently clear that the nature of transaction in favour of the assessee is in perpetuity.

12. In the case of ***Madras Auto Services,*** (supra), in terms of the agreement between the assessee and the owner of the land, the assessee was entitled to spend certain amounts to construct a new building after demolishing the old building and the new building, from the inception was agreed to belong to the lessor and not to the lessee/assessee. However the assessee was granted the benefit of the existing lease in respect of the new building at an agreed rent for a period of 39 years. While considering the said facts, the Hon'ble Supreme Court observed that the assessee therein did not acquire a capital asset, but only a business advantage and the amounts spent on construction was deductible as revenue expenditure. The said judgment is clearly distinguishable on facts, as we have examined the terms and conditions of the assignment deed in the preceding paragraphs and therefore, the decision in the case of ***Madras Auto Services,*** (supra), does not render any support to the case of the assessee.

13. In the case of ***Gemini Arts Pvt., Ltd.,*** (supra), which was followed by this Court in the case of ***Commissioner of Income-tax vs. Ucal Fuel Systems Ltd*** reported in ***296 ITR 702,*** which was relied upon by the learned counsel appearing for the assessee, the nature of transaction was that the assessee therein had taken a land on lease for twenty years for setting up a new unit at an Industrial Estate at Pondicherry. The Assessing Officer in the said case treated the amount paid by the assessee as an advance in the nature of discounted value of lease amount otherwise payable over a period of twenty years and the assessee had treated the said payment as capital in its books of account in order to project a boosted profit to impress the shareholders. Consequently, the said payment was treated as a capital expenditure. Aggrieved by such order of the Assessing Officer, the assessee preferred appeal to the Commissioner of Income Tax (Appeals), who held that the entire expenditure could not be treated as revenue in nature for the purpose of deduction under the Income-Tax Act, when the assessee has treated the same as a capital in the books of account. On further appeal by the assessee to the Tribunal, the Tribunal allowed the appeal by relying upon the decision in the case of ***Gemini Arts Pvt., Ltd.,*** (supra), that this is how the appeal

arose before this Court in the case of ***Ucal Fuel Systems Ltd*** (supra). Infact in the said case, the Revenue fairly conceded that the issue covered by the decision in the case of ***Gemini Arts Pvt., Ltd.,*** (supra) which was a case relating to a leasehold agreement for 47 years and the rent was paid in lumpsum and the entire amount was claimed as deduction. After referring to the decision in the case of ***Madras Auto Services,*** (supra), it was held that to decide whether expenditure is revenue or capital one has to look at the expenditure from a commercial point of view and whatever substitutes for revenue expenditure should normally be considered as revenue expenditure. Further, it was held that merely because that the payment was made in a lumpsum for the entire duration of the lease does not alter the character of it being a revenue expenditure. Firstly, it has to be pointed out that the nature of transaction in the case of ***Ucal Fuel Systems Ltd*** (supra), was entirely different from that of the transaction in the case on hand.

14. Admittedly, it was a case of lease of a land for a period of 20 years and the assessee therein having paid the lease rent for a first year, paid the remaining amount in one lumpsum, whereas the case on hand is entirely different and we have seen that the transfer in

favour of the assessee was by IFML, who themselves were stated to be lessees under MIDC and the transfer in favour of the assessee was in perpetuity i.e., to be continued to be a period of 80 years beyond the unexpired lease period, which itself was in force till 2077. Therefore, these decisions relied on by the learned counsel for the assessee are clearly distinguishable on facts.

15. As far as the reliance was placed on the decision in the case of ***Madras Auto Services,*** (supra), is concerned, we do not find this judgment would be of any assistance to the assessee herein. While considering the lumpsum payment, whether lumpsum payment would be taken as a revenue expenditure or capital expenditure, the Apex Court referred to the decision in the case of ***Assam Bengal Cement Co. Ltd. v. CIT,*** reported in ***[1955] 27 ITR 34***, being the test distinguishable between the capital expenditure and revenue expenditure, the Apex Court summarized the test laid down in the said decision reported in ***Assam Bengal Cement Co. Ltd.*** (supra), which means being extracted hereunder:-

> *Whether by spending the money any advantage of an enduring nature has been obtained or not will depend upon the facts of each case. Moreover, as the above passage itself provides, this test would not apply if there are special circumstances pointing to the contrary. This court in the above case summarised the tests as follows :*
>
> *"1. Outlay is deemed to be capital when it is made for the initiation of a*

business, for extension of a business, or for a substantial replacement of equipment.

2. Expenditure may be treated as properly attributable to capital when it 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. . . If what is got rid of by a lump sum payment is an annual business expense chargeable against revenue, the lump sum payment should equally be regarded as a business expense, but if the lump sum payment brings in a capital asset, then that puts the business on another footing altogether.

3. Whether for the purpose of the expenditure, any capital was withdrawn, or, in other words, whether the object of incurring the expenditure was to employ what was taken in as capital of the business. Again, it is to be seen whether the expenditure incurred was part of the fixed capital of the business or part of its circulating capital." (underlining ours)

16. Referring to the test given in paragraph 2 on facts, the Apex Court held that the asset created by spending the said amounts did not belong to the assessee that the assessee got the business advantage of using modern premises at a low rent, thus saving considerable revenue expenditure for the next 39 years. Therefore, the observation of the Apex Court as to whether the expenditure or revenue expenditure or capital expenditure has to be looked at as a commercial point of view is a test, which has to be seen herein to on the facts has already been given in the preceding paragraphs as to the terms of the assignment deed, we have no hesitation in holding that even though that the expenditure in question is pure in a capital expenditure, the assessee does not deny the fact that the assignment of the lease in its favour had to be approved by the MIDC and there is

no denial of the fact that once the assignment deed does not speak anything about the state of affairs which continued on the expiry of the so called lease, it is clear from the reading of the assignment deed that once the assignment is approved by the MIDC, the vendor had no interest at all in the so called lease property.

17. The Assessing Officer pointed out that MIDC had directed the assessee to pay a further sum of Rs.5.40,000/- being enhancement of the cost of land. The fact remains that on the approval of the assignment in favour of the assessee practically the assessee is substituted in the place of its vendor which means on the adjustment of the amount, the assessee had to pay to the owner of the land-MIDC by reason of parting money to the assignor namely, IFML. We do not find any justification in bifurcating the amount paid to IFML, as a revenue expenditure and the payment of Rs.5,40,000/- to MIDC as a capital expenditure.

18. As pointed out by the Apex Court, the outlay by the assessee is for acquiring the benefit of the land for nearly 80 years with the further clause on the renewal to.

19. The Hon'ble Supreme Court in the case of ***Palshikar (HUF) vs. CIT (S.C).,*** reported in ***172 ITR 311***, considered the question

regarding a lease of plot for 99 years on payment of a premium and as to whether capital gain tax levyable in respect of the said transaction. After analyzing the scope of the transaction in question, the Hon'ble Supreme Court pointed out that the lease is for a long period namely 99 years and hence, it would appear that under the lease in question, the assessee has parted with an asset of an enduring nature, namely, the rights to possession and enjoyment of the properties leased for a period of 99 years subject to certain conditions on which the respective lease could be terminated. Further, a premium has been charged by the assessee in all the leases. In such circumstances, the Hon'ble Supreme Court held that the grant of leases in question amounts to a transfer of capital assets as contemplated under section 12B of the Income Tax Act, 1922. The said decision would squarely apply to the facts of the case on hand and we have no hesitation to hold that the nature of transaction amounts to a transfer of a capital assets**.**

20. The learned counsel appearing for the assessee submitted that the assignment deed is more in the nature of sub-lease, as such, the same is covered by the decision of the Hon'ble Supreme Court reported in ***Madras Auto Services,*** (supra), we do not find any

justification to construe the assignment deed as a sub-lease. Considering the fact that the assignment deed is of much leasehold interest, such assignment must be approved by MIDC and on approval, the assessee had admittedly paid a further sum to the Corporation. In the background of the above said facts, it is difficult for us to draw inference of the agreement in question only be treated as a sub-lease and not an assignment. Furthermore, the assignment deed itself does not say anything about the reversion of the property back to the hands of the assigner namely, IFML. On the other hand, the rights of the assignor on approval of the assignment comes to an end in toto.

24. Incidentally, we may also point out that as early as 1928 in the decision in the case of ***Archaka Sundara Raju Dikshatulu vs. Archaka Seshadri Dikshatulu*** reported in ***(1928) 54 MLJ 76***, this Court held that the lease for 99 years or for a long term in consideration of a premium paid down is as much an alienation as a sale or mortgage. This Court pointed out that the mere use of the word 'lease' or the fact that a long term is fixed would not by itself make the document in lease. In this connection, this Court followed the decision in the case of ***Rama Varma Tambaran vs. Raman Nayar*** reported in ***(1882) ILR 5 M 89***, holding that there was no real

distinction between mischief of such a transfer in perpetuity and a transfer for the long period of 96 years. Thus, this Court took a view that a permanent lease is as much an alienation as a sale. In the background of what we have narrated about and the clauses in the assignment deed, we hold that the lumpsum amount paid does not make a permanent lease any the less an alienation than a sale.

25. As far as the decision in the case of ***A.R.Krishnamurthy & Anr., vs. CIT.,*** reported in ***[1989] 176 ITR 417,*** is concerned, the Assessing Officer rightly construed the law declared in ***A.R.Krishnamurthy*** (supra), to hold that the expenditure is of capital in nature and not the revenue expenditure.

26. In the circumstances, we have no hesitation in setting aside the order of the Tribunal and allow the appeal filed by the Revenue by answering the question in its favour. No costs.

(C.V.,J) (T.S.S.,J)
07.04.2014

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Index :Yes/No
Internet:Yes/No

CHITRA VENKATARAMAN, J.
and
T.S.SIVAGNANAM, J.

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To
1.The Income Tax Appellate Tribunal Chennai Bench 'B', Chennai

2.The Commissioner of Income Tax (Appeals) – V, Chennai-34.

3.The Deputy Commissioner of Income Tax, Company Circle V(3), Chennai -34.

Tax Case (Appeal) No.1031 of 2007

07.04.2014