

IN THE PUNJAB & HARYANA HIGH COURT
AT CHANDIGARH

Date of Decision: 24.01.2013

ITA No.366 of 2008

The Commissioner of Income Tax, Patiala ...Appellant

Versus

M/s Groz Beckert Asia Limited ...Respondent

CORAM: HON'BLE MR. JUSTICE HEMANT GUPTA
HON'BLE MS. JUSTICE RITU BAHRI
HON'BLE MR. JUSTICE GURMEET SINGH SANDHAWALIA

Present: Ms. Savita Saxena, Advocate,
for the appellant.

Mr. C.S.Aggarwal, Senior Advocate, with
Ms. Radhika Suri, Advocate, for the respondent.

HEMANT GUPTA, J.

1. A Division Bench of this Court vide its order dated 31.10.2012 referred the following Question No.5.1 to the Larger Bench in view of the doubt expressed about the correctness of the view of a Division Bench of this Court in ITA No.448 of 2007 titled "**Commissioner of Income Tax – I, Ludhiana Vs. M/s Majestic Auto Limited, Ludhiana**" decided on 11.09.2008:

"5.1 Whether on the facts and in the circumstances of the case, the ITAT was right in law in not sustaining the addition of Rs.6,16,945/- on account of corporate membership fee paid to Golf Club as a capital expenditure?"

2. The said question of law arises out of the fact that the assessee obtained corporate membership of Golf Club, Chandigarh on payment of Rs.6 lacs. Rs.16,945/- was paid towards services and facilities used during the relevant assessment year. The Assessing Officer declined such expenses for the

reason that the same are personal expenses of the Managing Director and other employees and, thus, added back to the income of the assessee. In appeal before the Commissioner of Income Tax (Appeals), the said disallowance was set aside holding that club membership is in the nature of an advantage in the commercial sense and not in the capital field. The Commissioner of Income Tax (Appeals) also considered the remand report dated 17.11.2005, wherein it was observed that the payment is for acquisition of Club Membership, therefore, it is a capital expenditure. The learned Income Tax Appellate Tribunal, Chandigarh Bench – A, (for short ‘the Tribunal’) affirmed the findings recorded by the Commissioner of Income Tax (Appeals) by observing to the following effect:

“5. We have considered the rival submissions. Ostensibly, the membership of the club has been acquired by the assessee for the use of its personnel. The CIT(A) has accepted the plea of the assessee that the membership of club was obtained for business purposes in as much as it facilitated interaction with business associates etc. The decision of the CIT(A), in our view is in consonance with the judgment of the Hon’ble Bombay High Court in the case of Otis Elevator Company (I) Limited (supra). The plea of the Revenue that the membership of the club provides an enduring benefit and therefore the expenditure incurred is of capital nature, in our view, is unsustainable. No doubt, payment of membership fee results in obtaining of club membership for a period beyond the year of payment but the benefit remains in the revenue field and not in the capital field. Resultantly, the expenditure incurred on acquiring an enduring benefit in the revenue field is liable to be treated as a revenue expenditure. A gainful reference can be made to the judgment of the apex court in the case of Empire Jute Co. Ltd. 124 ITR 1 (SC) in this regard. Further, the Hon’ble High Court of Gujarat in the case of Gujarat State Export Corporation (supra) has held that the acquisition of club membership results in an advantage in the commercial sense and not in the capital field. On the basis of the aforesaid discussion, we do not find any justifiable reason to interfere with the decision of the CIT(A) on this issue. Accordingly, this ground of appeal of the Revenue is dismissed.”

3. In **M/s Majestic Auto Limited’s case (supra)**, a Division Bench of this Court has dissented with the judgment of Bombay High Court in **OTIS Elevator Company (India) Limited Vs. Commissioner of Income Tax (1992) 195 ITR 682** and agreed with the judgment of Kerala High Court in **Framatone**

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294 ITR 559 to hold that the expenditure of the assessee company on the corporate membership of the Delhi Golf Club was in the nature of capital expenditure as the same is properly attributable not to revenue but to capital. It is the said view with which the Division Bench expressed reservation and referred the matter to the Larger Bench. In these circumstances, the matter is placed before this Bench.

4. Learned counsel for the Revenue relied upon the judgment of Kerala High Court in **Framatone Connector OEN Limited's case (supra)**, to contend that the corporate membership is a capital expenditure. Such membership has long term advantage to the assessee and, therefore, such expenditure is to the capital field and not to the revenue field.

5. On the other hand, learned counsel for the assessee relied upon **Assam Bengal Cement Co. Ltd. Vs. Commissioner of Income Tax, West Bengal (1955) 27 ITR 34**, **Empire Jute Co. Ltd. Vs. Commissioner of Income Tax 124 ITR 1**, **Commissioner of Income Tax, Bombay City-I Vs. Associated Cement Companies Ltd. (1988) 172 ITR 257 (S.C)**, **Commissioner of Income Tax Vs. Madras Auto Service (P) Ltd. (1998) 233 ITR 468** apart from the judgments of Delhi High Court in **Commissioner of Income Tax Vs. Engineers India Ltd. (1999) 239 ITR 237** and of Bombay High Court in **Otis Elevator Co. (India) Ltd. Vs. Commissioner of Income Tax (1992) 195 ITR 682**.

6. Having heard learned counsel for the parties, we find that the judgment of this court in **M/s Majestic Auto Limited's case (supra)** is not a correct law for the reasons recorded herein after.

7. Section 37 of the Income Tax Act, 1961 provides that "Any expenditure (not being expenditure of the nature described in Sections 30 to 36) and not being in the nature of capital expenditure or personal expenses of the assessee, laid out or expended wholly and exclusively for the purposes of the

business or profession shall be allowed in computing the income chargeable under the head 'Profits and gains of business or profession'. The expression 'capital expenditure' has been interpreted by the various judgments, starting from **Assam Bengal Cement Co. Ltd. case (supra)**, wherein the Supreme Court approved the opinion of the Full Bench of Lahore High Court in **Benarsidas Jagannath (1947) 15 ITR 185** and held that it is not easy to define the term 'capital expenditure' in the abstract or to lay down any general and satisfactory test to discriminate between a capital and a revenue expenditure. Some of the broad principles deduced were that, 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 and; 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 as asset or an advantage for the enduring benefit of a trade. The expression 'enduring benefit' or 'of a permanent character' were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset. The Court observed to the following effect:

“This synthesis attempted by the Full Bench of the Lahore High Court truly enunciates the principles which emerge from the authorities. In cases where the expenditure is made for the initial outlay or for extension of a business or a substantial replacement of the equipment, there is no doubt that it is capital expenditure. A capital asset of the business is either acquired or extended or substantially replaced and that outlay whatever be its source whether it is drawn from the capital or the income of the concern is certainly in the nature of capital expenditure. The question however arises for consideration where expenditure is incurred while the business is going on and is not incurred either for extension of the business or for the substantial replacement of its equipment. Such expenditure can be looked at either from the point of view of what is acquired or from the point of view of what is the source from which the expenditure is incurred. 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. If any such asset or advantage for the enduring benefit of the business is thus acquired or brought into existence it would be immaterial whether the source of the payment was the capital or the income of the concern or whether the payment was made once and for all or was made periodically. The aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or a revenue expenditure....”

8. The Court culled down the following tests to determine the nature of expenditure:

“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: vide Lord Sands in IRC v. Granite City Steamship Co. (1927) 13 Tax Cases 1 at p. 14. In City of London Contract Corporation v. Styles (1887) 2 Tax Cases 239 at p. 243, Bowen L.J. observed as to the capital expenditure as follows:

You do not use it 'for the purpose of your concern, which means, for the purpose of carrying on your concern, but you use it to acquire the concern.

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 : vide Viscount Cave, L.C., in Atherton v. British Insulated & Helsby Cables Ltd. (1920) 10 Tax Cases 155. 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. Thus, if labour saving machinery was acquired, the cost of such acquisition cannot be deducted out of the profits by claiming that it relieves the annual labour bill, the business has acquired a new asset, that is, machinery.

The expressions 'enduring benefit' or 'of a permanent character' were introduced to make it clear that the asset or the right acquired must have enough durability to justify its being treated as a capital asset.

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. Fixed capital is what the owner turns to profit by keeping it in his own possession. Circulating or floating capital is what he makes profit of by parting with it or letting it change masters. Circulating capital is capital which is turned over and in the process of being turned over yields profit or loss. Fixed capital, on the other hand, is not involved directly in that process and remains unaffected by it.”

9. In **Empire Jute Co. Ltd. case (supra)**, the Supreme Court was examining the consequences of a time agreement in which the Mills shall be entitled to work their looms. The agreement in question was transfer of allotment of hours of work per week, commonly referred to as sale of loom hours by one member to another. The question examined was; whether the sum paid by the assessee to purchase loom hours represents capital expenditure or revenue expenditure. It was observed that whether it is capital expenditure or revenue expenditure would have to be determined having regard to the nature of the transaction and other relevant factors. It was observed as under:

“....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. But even if this test were applied in the present case, it does not yield a conclusion in favour of the revenue. Here, by purchase of loom hours no new asset has been created. There is no addition to or expansion of the profit-making apparatus of the assessee. The income-earning machine remains what it was prior to the purchase of loom hours. The

assessee is merely enabled to operate the profit making structure for a longer number of hours. And this advantage is clearly not of an enduring nature....”

10. In **Associated Cement Companies Ltd. case (supra)**, the assessee under an agreement undertook to supply water and to put up a high tension electric transmission line as well as to supply electricity for the street lighting of a town. The assessee was to undertake and complete at its own cost the water supply scheme for the town involving laying of the main water pipelines. The Supreme Court negated the argument that the water pipelines were laid which could be regarded as capital assets; therefore, the expenditure could only be regarded as capital expenditure. It was observed as under:

“....It is true that certain water supply lines did come to be laid as a result of the expenditure incurred, but the facts on record which we have referred to above, clearly show that these water pipelines on which the expenditure in question was incurred were not assets of the assessee, but assets of the Shahabad Municipality and hence it was not as if the expenditure resulted in bringing into existence any capital asset for the company. The only advantage derived by the assessee by incurring the expenditure was that it obtained an absolution or immunity, under normal conditions, from levy of certain municipal rates and taxes and charges....”

11. In **Madras Auto Service (P) Ltd. case (supra)**, the Supreme Court observed that in order to decide; whether the expenditure is a revenue or a capital, one has to look at the expenditure from a commercial point of view. In the said case, the assessee had a lease of 39 years and also right to demolish the existing premises and construct a new building thereon to suit the purpose of their business. The lessee was not entitled to any compensation whatsoever on account of its putting up new construction in the place of the old. It was held that the expenditure was made in order to secure a long lease of new and more suitable business premises at a lower rent. The saving in expenditure was a saving in revenue expenditure in the form of rent and that assessee did not get any capital asset by spending such amounts. Quoting from Assam Bengal

Cement Co. Ltd. case (supra) and in respect of second test of “*any advantage of an enduring nature*”, the Court held that by spending money on the construction of new building, the assessee did not acquire any capital asset. The only advantage by spending money was of a low rent. From the business point of view, the assessee got the benefit of reduced rent, which was a business advantage and has to be treated as revenue expenditure. After considering number of judgments, the Court concluded to the following effect:

“All these cases have looked upon expenditure which did bring about some kind of an enduring benefit to the company as a revenue expenditure when the expenditure did not bring into existence any capital asset for the company. The asset which was created belonged to somebody else and the company derived an enduring business advantage by expending the amount. In all these cases, the expenses have been looked upon as having been made for the purpose of conducting the business of the assessee more profitably or more successfully. In the present case also, since the asset created by spending the said amounts did not belong to the assessee but the assessee got the business advantage of using modern premises at a low rent, thus saving considerably revenue expenditure for the next 39 years, both the Tribunal as well as the High Court have rightly come to the conclusion that the expenditure should be looked upon as revenue expenditure.”

12. Applying the principles laid down in the aforesaid judgments, the Bombay High Court in **Otis Elevator Co. (India) Ltd. case (supra)** allowed the payment of club fee as a business expenditure. Similar view was taken by the Delhi High Court in a judgment reported as **Engineers India Ltd. case (supra)** in respect of membership fee of a club. Referring to the judgment in Assam Bengal Cement Co. Ltd. case (supra), it was observed that if 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 only for running the business or working it with a view to produce the benefits, it is a revenue expenditure. It was held that payment of membership fee has to be allowed as revenue expenditure. The same view was followed later by Delhi High Court in

Commissioner of Income Tax Vs. Nestle India Ltd. (2008) 296 ITR 682 in respect of membership of a club and in Commissioner of Income Tax Vs. Samtel Color Ltd. (2010) 326 ITR 425, wherein the judgment of judgment of Kerala High Court in Framatone Connector OEN Ltd. case (supra) was dissented.

13. The Gujarat High Court in a judgment reported as Gujarat State Export Corporation Limited Vs. Commissioner of Income Tax (1994) 209 ITR 649 examined the payment of fee to the Sports Club of Gujarat Limited. It was held that if 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. But if it is made 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 view of the tests laid down, it was held that payment of entrance fee for becoming a member of the sports club cannot be termed as a capital expenditure.

14. The Kerala High Court in Framatone Connector OEN Ltd. case (supra) has referred to a judgment rendered by the Supreme Court in Punjab State Industrial Development Corporation Ltd. Vs. Commissioner of Income Tax (1997) 225 ITR 792 to return a finding that payment of membership, is a payment once and for all, resulting in an enduring benefit to the institution. None of the earlier judgments, referred to above, in respect of nature of capital expenditure were brought to the notice of the Court. The judgment in Punjab State Industrial Development Corporation Ltd. case (supra) is, in fact, in respect of expenses incurred for enhancement of capital. The assessee claimed such expenses as revenue expenditure. Since the expenses were incurred for expansion of capital base of the company, it was found to be directly related to capital expenditure. It was held that it would still retains the character of a capital expenditure. The said

judgment is in respect of ancillary expenses incurred for expansion of capital. Therefore, the said case does not support the argument in respect of membership of a club.

15. In M/s Majestic Auto Limited's case (supra), this Court has followed the judgment of Kerala High Court in Framatone Connector OEN Limited case (supra) in preference to the judgment of Bombay High Court in OTIS Elevator Company (India) Limited case (supra). None of the judgments of Supreme Court, as mentioned above, were brought to the notice of the Bench.

16. In the present case, the nature of the expenditure incurred by the assessee cannot be said to be a capital expenditure. The second test culled down in Assam Bengal Cement Co. Ltd.'s case (supra) is that expenditure should bring into existence *an asset or an advantage for the enduring benefit of a trade*.

In the present case, the corporate membership of Rs.6 lacs was for a limited period of 5 years. The corporate membership was obtained for running the business with a view to produce profit. Such membership does not bring into existence an asset or an advantage for the enduring benefit of the business. It is an expenditure incurred for the period of membership and is not long lasting. By subscribing to the membership of a club, no capital asset is created or comes into existence. By such membership, a privilege to use facilities of a club alone, are conferred on the assessee and that too for a limited period. Such expenses are for running the business with a view to produce the benefits to the assessee. Consequently, it cannot be treated as capital asset. Therefore, the reasoning given by Delhi, Bombay and Gujarat High Courts in respect of members of Clubs is based upon correct enunciations of the principles of law as delineated above in the judgments of the Supreme Court.

17. In view of the above, we find that the judgment of this Court in M/s Majestic Auto Limited's case (supra) is not a correct interpretation of expression "capital expenditure". Consequently, the said judgment is overruled.

18. Having answered the question of law, in the manner above, the matter be placed before the appropriate Bench as per roster for decision on the other questions of law.

(HEMANT GUPTA)
JUDGE

(RITU BAHRI)
JUDGE

24.01.2013
Vimal

(G. S. SANDHAWALIA)
JUDGE