1940 *Present :* **Keuneman and Nihill JJ.**

THEOBALD *v.* COMMISSIONER OF INCOME TAX.

*157—D. C. (Inty.) Income Tax.*

*Income tax—Business of growing papaw trees to extract papain—Lease of lands without rent—Agreement to reafforest or make permanent cultivation on termination of lease—Buildings erected on the land—Claim for deduction —Capital expenditure—Income Tax Ordinance, s. 10 (c) (Cap. 188.)*

The appellant carried on the business of extracting papain from the papaw fruit. For this purpose he took on lease from the Crown and from private parties lands for which no rent is paid. In the case of Crown lands he agrees to reafforest them and in the case of private lands to put on them a permanent plantation. During the period of the lease the appellant erects sheds on the land to house the drying ovens and lines to house the labourers. On the expiration of the lease it is frequently found not worth while dismantling these structures and re-erecting them elsewhere and they are left behind on the land when it is surrendered to the lessor. It was stated that in the year of assessment in question a sum of Rs. 6,512 was spent on these buildings. The appellant claimed a deduction of one-half of this sum as an outgoing or expense.

*Held,* that the expenditure incurred was of a capital nature within the meaning of section 10 (c) of the Income Tax Ordinance and was not a permissible deduction under section 9 of the Ordinance.

[1] *173 E. R. 1036*
[2] *176 E. R. 868.*
[3] *176 E. R. 869.*
[4] *174 E. R. 431.*

THIS was a case stated by the Board of Review under section 74 of the Income Tax Ordinance.

The facts are stated in the headnote.

The appellant claimed a deduction of Rs. 3,256 half the total expenditure. The appellant's claim was disallowed by the Assessor and on appeal by the Commissioner of Income Tax, the matter was then argued before the Board of Review. The Board held that the expenditure was of the nature of capital expenditure under section 10 (c), which cannot be allowed as a deduction under section 9 of the Income Tax Ordinance.

*H. V. Perera, K.C.* (with him *S. Aiyer and Renganathan*), for assessee, appellant.—The question for consideration is whether the sum of Rs. 3,256 represents capital expenditure or revenue expenditure. It is submitted that it is revenue expenditure. According to the facts mentioned in the case stated, the structures regarding which the expenditure was incurred were intended to be temporary and to serve only one set of operations and not the whole of our business. The business itself is something more than the operations carried on on a particular land; it consists in a repetition of these operations on different lands. The structures put up by the appellant on each land may be compared to those temporarily erected by an itinerating cinema or by a building contractor, and should be distinguished from the sheds, cooly lines, &c., of a rubber plantation ; the latter are not only permanent but are intended to serve the business indefinitely.

Section 9 (1) of Cap. 188 is applicable to the present case, and not section 10 (c). The expression "capital expenditure" occurs also in section 30 (4). The benifit derived from the abondoned sheds by a third party should not be taken into consideration—*Usher's Wiltshire Brewery, Ltd. v. Bruce* [1]. For the tests to decide whether an item of expenditure is capital expenditure or revenue expenditure, see *The Vallambrosa Rubber Co., Ltd. v. Farmer* [2] ; *Atherton v. The British Insulated and Helsby Cables, Ltd.* [3] ; *The Anglo-Persian Oil Co., Ltd. v. Dale* [4]. The meaning of "fixed capital" is dealt with in *Ammonia Soda Co., Ltd. v. Chamberlain* [5].

The Commissioner of Income Tax has purported to follow *Addie's Case* [6]. The decision of the Board of Review cannot be justified. We are concerned in this case with recurring, and therefore, revenue expenditure.

*H. H. Basnayake, C.C.*, for Commissioner of Income Tax, respondent.—The question is whether the expenditure on the cooly lines, &c., falls under section 9 or section 10 of Cap. 188. Section 10 (c) originally read thus : "Any capital withdrawn or any sum employed or intended to be employed as capital" ; these words were deleted subsequently and in their place were substituted "any expenditure of a capital nature".

The fact that the sheds were for temporary use does not alter the nature of the expenditure as lone as something stood in place of the money spent —*Eastmans, Ltd., v. Shaw* [7] ; *John Smith & Son v. Moore* [8]. It is true that there is no exact definition of "capital expenditure" and of "outgoings and expenses". *Mallett v. The Staveley Coal & Iron Co., Ltd.* [9] throws

[1] *L. R. (1915) A. C. 433 at 469.*
[2] *5 T. C. 529.*
[3] *L. R. (1926) A. C. 205, 10 T. C. 155.*
[4] *16 T. C. 253.*
[5] *L. R. (1918) 1 Ch. 266 at 286.*
[6] *1 T. C. 1.*
[7] *14 T. C. 218.*
[8] *12 T. C. 266 at 282.*
[9] *13 T. C. 772 at 780.*

light on the meaning of those terms. Where the expenditure is incurred for the purchase of a capital asset, it is of a capital nature—*Eastmans, Ltd. v. Shaw* (*supra*) *Smith v. The Westinghouse Brake Co.*[1]; *The Granite Supply Association, Ltd. v. Kitton*[2]; *Hyam v. The Commissioners of Inland Revenue*[3]; *The Commissioners of Inland Revenue v. Adam*[4]. The question of capital expenditure is not always confined to a trade or business; it may arise even in the case of an individual—*The Commissioners of Inland Revenue v. Fargus*[5], *Green v. Favourite Cinemas, Ltd.*[6].

*H. V. Perera, K.C.*, in reply.—The principle applicable is the one laid down in *Atherton's case* (*supra*). There is a difference between expenditure "for the enduring benefit of the business": and expenditure on a particular set of operations; the former is capital expenditure, and the latter is revenue expenditure.

*Cur. adv. vult.*

June 6, 1940. KEUNEMAN J.—

The appellant claimed to be entitled to deduct a sum of Rs. 3,256 from his assessable income for the year of assessment 1938-39 in the following circumstances which are set out in the case stated :—

"The appellant has been carrying on for some years the business of making papain from the papaw fruit, in partnership with another. The partnership take on lease from the Crown and from private parties various blocks of jungle lands and grow papaw trees on them for obtaining the milk for the making of papain, from the fruits of these trees.

"The leases were stated to be generally of a period from two to four years during which time the lessees clear the land and carry out either re-afforestation, in the case of Crown lands, or the planting of a permanent agricultural plantation, such as coconut, on private lands, in lieu of rent as the lands are leased out free of rent, because of the permanent afforestation or plantation which the lessees have to effect, whilst they carry out the planting of papaw trees and extract the papain therefrom in the course of their business. The papaw trees yield almost the whole milk that can be got from them in about two years, and on the expiration of the leases, the properties are handed back with the permanent plantation which has been established whilst the papain was being tapped from the papaw trees which have been grown.

"For the purpose of converting the milk into papain for export, the firm used a special kind of drying oven. The ovens and the sheds in which they are housed, covered with zinc sheets all round, are set up on each block of land on which the growing of papaw trees is done. In addition to that, temporary cooly lines to house the labourers employed in the business are also erected on these blocks of land. There are invariably a number of different blocks of such lands, in various places, on which the firm is carrying on its business operations.

[1] *2 T. C. 357.*
[2] *5 T. C. 168.*
[3] *14 T. C. 479.*
[4] *4 14 T. C. 34.*
[5] *10 T. C. 665.*
[6] *15 T. C. 390.*

> "On the expiration of a lease, it is frequently found not worth while dismantling these structures and re-erecting them elsewhere, so, they are generally left on the land when it is surrendered to the lessor, who sometimes pays compensation for them and sometimes does not. So that, on the opening of a new block for planting trees and tapping of papain, fresh drying sheds and lines have to be erected, more often than not".

The sum of Rs. 6,512 was claimed by the firm as having been incurred in the year in question, namely, Rs. 4,270 on the erection of papain drying sheds, and Rs. 2,242 on cooly lines. The appellant claimed a deduction of Rs. 3,256, namely, half of the total expenditure. The amount of tax payable in respect of this sum is Rs. 586.08.

The appellant's claim was disallowed by the assessor, and, on appeal, by the Commissioner of Income Tax. On July 26, 1939, the matter was argued before the Board of Review. The Board held that the expenditure was of nature of capital expenditure under section 10 (*c*), which cannot be allowed as a deduction under section 9 of the Income Tax Ordinance (Chapter 188). The assessment was accordingly affirmed.

The matter now comes before this Court on a case stated by the Board of Review, under section 74 of the Income Tax Ordinance.

Counsel for the appellant referred us in the first instance to the case of *The Vallambrosa Rubber Co., Ltd. v. Farmer.*[1] In this case, a rubber company had an estate, of which, in the year under review, one-seventh only produced rubber, the other six-sevenths being in process of cultivation for the production of rubber. Expenditure for the superintendence, weeding, &c., was incurred by the company in respect of the whole estate. It was held that in arriving at the assessable profits, the company was entitled to deduct the expenditure for superintendence, weeding, &c., on the whole estate and not one-seventh of such expenditure only. After considering and rejecting the proposition that nothing could ever be deducted as an expense unless the expense was purely and solely referable to a profit which was reaped within the year, the Lord President proceeded to give a rough definition of 'capital expenditure'—

> "I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing which is going to be spent once and for all, and income expenditure is a thing that is going to recur every year."

This definition of capital expenditure was carried a stage further in the case of *Atherton v. The British Insulated and Helsby Cables, Ltd.*[2] There, the respondent company claimed as a deduction in computing its profits for income tax purposes a lump sum of £31,784 which it had contributed irrevocably as a nucleus of a Pension Fund established by trust deed for the benefit of its clerical and technical salaried staff, that being the sum actuarially ascertained to be necessary to enable past years of service of the then existing staff to rank for pension. It was held by a majority of the House of Lords that the sum in question was not in an admissible

[1] *5 T. C. 529.*

[2] *(1926) H. L. A. C. 205, 10 T. C. 155.*

deduction. In the course of his judgment, Viscount Cave, Lord Chancellor, discusses the distinction between revenue expenditure and capital expenditure, and criticises the rough criterion set up in the *Vallambrosa case* (*supra*). He says :—

> "The criterion is not, and was obviously not intended by Lord Dunedin to be, a decisive one in every case; for it is easy to imagine many cases in which a payment, though made 'once and for all', would be properly chargeable against the receipts".

His Lordship then goes on to give instances from decided cases, and proceeds to lay down a general principle :—

> "But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or 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"..

His Lordship was satisfied that the payment in that case was "in the nature of capital expenditure".

One other case cited by the appellant must be mentioned, namely, *The Anglo-Persian Oil Co., Ltd. v. Dale*[1]. There, by agreements made in 1910 and 1914, the appellant company appointed another company as its agents in Persia and the East for a period of years, upon the terms (*inter alia*) that the agents should be remunerated by commission at specified rates. In course of time, the amounts payable to the agents increased far beyond the amounts originally contemplated by the company, and, after negotiation between the parties, the agreements were cancelled in 1922, the agent company agreeing to go into voluntary liquidation, and the company agreeing to pay to the agents £300,000 in cash. This sum was in fact paid, and it was held that this payment was an allowable deduction for the purposes of Income Tax and Corporations Profits Tax. This case was ultimately decided in the Court of Appeal.

Counsel for the appellant laid great stress on the language of Romer L.J. where he deals with the passage from Viscount Cave's judgment in the *Atherton case* (*supra*) :—

> "It should be remembered, in connection with this passage, that the expenditure is to be attributed to capital if it be made 'with a view' to bringing an asset or advantage into existence. It is also to be observed that the asset or advantage is to be for the 'enduring' benefit of the trade. I agree with Mr. Justice Rowlatt that by 'enduring' is meant 'enduring in the way that fixed capital endures'. An expenditure on acquiring floating capital is not made with a view to acquiring an asset that may be turned over in the course of trade at a comparatively early date".

Counsel for the appellant argued that the proper test to apply in this case is that laid down by Viscount Cave and explained by Lord Justice

[1] *16 T. C. 253.*

Romer. He argued further that, if that test was applied, the expenditure in the present case would be clearly not of a capital nature. I shall deal more fully with this argument later.

Counsel for the respondent has also referred us to several cases, and I shall refer to some of them. One of these cases is *Eastmans, Ltd. v. Shaw* [1], where the appellant company carried on business as butchers and meat retailers. It was the policy of the company to close or to open shops in accordance with the needs of their business as a whole, and it was advantageous to dispose of fixtures and fittings in the shop given up rather than to transfer them to a newly acquired shop. It was held that the company could not deduct the difference between the cost of new fixtures and the price obtained for old fixtures in computing the company's profits for the purpose of Income Tax and Corporation Profits Tax. This was decided finally in the House of Lords on the ground that the expenses were of a capital nature.

In this case, Rowlatt J. dealt with an interesting question which may have a bearing on the present case :—

> "Then Mr. Needham says, and this is the point: Their business was really that of travelling butchers. He said, for instance, like a circus . . . . Let us take a travelling butcher who has his stall in one town to-day, and his stall in another town to-morrow, and whose business it is to sell here to-day and there to-morrow. He may very well, I should think, charge his moving expenses . . . . as an expense of his travelling business. But this is not a travelling business. It is, if I may borrow the expression from the *Granite case* (5 *Tax Cases 168*), a 'flitting' business . . . . They substitute one shop, which, for however short a time it lasts, is permanent in its nature, for another shop, which for however short a time it has lasted, has also been in its nature of a permanent character. They are substituting shops for shops, and are not, I think, in any reasonable sense of the word travelling their business from place to place".

So also, in the case of *The Granite Supply Association, Ltd. v. Kitton* [2], where a granite company moved their business to larger premises, the expenses of carting the granite from the old to the new premises and of taking down and re-erecting two cranes were held not to be allowable deductions. *Vide* also *Smith v. The Westminghouse Brake Co.* [3] and *Hyam v. The Commissioners of Inland Revenue* [4], in which an interesting comment on *Eastman's case* (*supra*) is to be found. The Lord President says :—

> "That was the case of a multiple-shop business, in which the policy was not to carry on business in a number of permanently established premises, but to carry on . . . . a mobile trade here, there, and everywhere, so long as there was a prospect in any particular locality, however temporary, of doing profitable business . . . . It might be argued that, having regard to the mobile character of the trade and the constant change of premises which was necessarily incident to it, the cost of supplying these temporary premises with fittings was a proper revenue charge. But it was not so regarded either by the Judge of first instance or by the Court of Appeal or by the House of Lords".

[1] *14 T. C. 218.*
[2] *5 T. C. 168.*
[3] *2 T. C. 357.*
[4] *14 T. C. 479.*

Another case has also to be considered, namely *Mallett v. The Staveley Coal and Iron Co., Ltd.*[1] Here, a colliery company held the right to work certain beds of coal under mining leases for terms of sixty-three and twenty-one years respectively. The company agreed in 1923 for the surrender of a part of the seams demised. It was held that the payment for the surrender of the seams was an expenditure of capital, and not an admissible deduction from profits for income tax purposes. In this case, Lord Hanworth, Master of the Rolls, accepted the test applied by Rowlatt J. :—

> "The company do not make these payments to get rid of any annual charge against revenue in the future. They make these payments to get rid of the loss in the business or apprehended loss in the business—an entirely different matter . . . ."

Another case of interest is *John Smith & Son v. Moore*[2], which, although relating to Excess Profits Duty, has also an application to the present question. The matter that concerns us is the payment of £30,000 for the acquisition of certain unexpired contracts for the supply of coal at fixed prices. All these contracts expired at the end of the year in which they were purchased. The majority of their Lordships in the House of Lords held that this was a capital expenditure. Viscount Haldane said in this connection:—

> "In the case before us, the appellant, of course, made profit with circulating capital, by buying coal under the contracts . . . . but he was able to do this simply because he had acquired, among other assets of his business, including the goodwill, the contracts in question. It was not by selling these contracts, of limited duration though they were, it was not by parting with them to other masters, but by retaining them, that he was able to employ his circulating capital in buying under them. I am accordingly of opinion that; *although they may have been of short duration,* they were none the less part of his fixed capital".

I have stated the law so far as it appears to be relevant to the present case. It remains now to apply the law to the facts.

The business of the appellant is the making of papain from the papaw fruit. For the purposes of this business, he takes leases for periods of two to four years generally, which is the period which is profitable for the exploitation of the land for the appellant's purposes. The leases are free of money rent, but the appellant carries out an afforestation scheme in the case of Crown lands, or carries out the planting of a permanent plantation in the case of private lands. To protect the drying ovens, the appellant puts up sheds, and, to house the labourers employed in the business, he puts up temporary cooly lines. As the exploitation of each land continues for a limited period, the appellant does not put up any structure of a permanent character. At the end of each lease, these structures are generally left standing on the land when it is surrendered to the lessor. Occasionally the lessor pays compensation to the appellant but ordinarily no compensation is obtainable. It is rarely worth the while of the appellant to dismantle the structures and to re-erect them on

[1] *14 T. C. 772.*

[2] *12 T. C. 266.*

fresh blocks of land taken on lease. So, for the most part, the appellant has to utilize fresh material to erect his sheds and cooly lines on the lands to which he moves.

Does the expenditure in respect of these structures fall within the definition of Viscount Cave in *Atherton's case*, as explained by Romer L.J. in the *Anglo-Persian Oil Case*?

To begin with, is it made "once and for all"? There is no doubt that the expenditure is incurred "once and for all" in respect of each land leased, but Counsel for the appellant argues that, as far as the business is concerned, it is a constantly recurring item. I think the matter will best be argued in connection with the third element in Viscount Cave's definition.

Secondly, was the expenditure incurred "with a view to bringing into existence an asset or advantage" for the benefit of the business? I think this element is clearly satisfied in the present case.

Thirdly, is that asset or advantage "for the enduring benefit" of the business?

Now, I may point out, with all respect, that, although in other cases the words "permanent" and "relatively permanent" have been used, Viscount Cave adopted the word "enduring". How does fixed capital endure? Their Lordships of the House of Lords held in *John Smith's case* (*supra*) that the fact that it is of short duration does not prevent an asset from being regarded as fixed capital. In the case in question, it was a wasting asset. Fixed capital, I take it, may be wasting; it may also be subject to depreciation, and it may be that in the course of time its value may be practically nil. Further, I think it may be fixed capital, although it is in the contemplation of the owners that it will have to be superseded in the process of time. The asset must, however, be for the enduring benefit of the business to be regarded as fixed capital. Romer L.J. in the *Anglo-Persian Oil case* (*supra*) appears to have had in mind this distinction between fixed capital and what has been referred to in other cases as circulating capital, and which he refers to as "floating capital", namely, "an asset which may be turned over at a comparatively early date".

It has not been argued by Counsel for the appellant, nor can I myself see, that the expenditure in question in this case can be regarded in any way as circulating or floating capital. Counsel for the appellant in effect sought to compare his case to that of the travelling circus or travelling butcher mentioned by Rowlatt J. in *Eastman's case* (*supra*). He argued that this is in its nature a travelling business. He instanced the case of a building contractor who puts up his sheds for the purpose of his operations, and keeps moving from one site to another as his business requires, and on each site erects the necessary sheds. *Eastman's case*, Counsel argued is to be distinguished because it was the intention of the company in that case to maintain each shop it opened as a permanent shop, if the nature of the business in the locality was favourable.

In the present business, it must be admitted, there is a certain degree of mobility, and there is no intention of remaining on any land leased for a longer period than the two to four years necessary for the exploitation of the land. But can this business really be regarded as a travelling

business ? I think the position is not in any reasonable sense comparable with that contemplated by Rowlatt J., where the butcher has his stall in one place to-day and in another place to-morrow. In the present case, the appellant obtains the benefit of the structures for the full period for which the land can be regarded as economically exploitable for the making of papain ; and that period of time, is, in my opinion, a substantial period, or, to adopt the language of Romer L. J., the appellant has no intention of removing or abandoning the structures "at a comparatively early date". For the purposes of his exploitation of the land, expenditure on sheds and cooly lines is necessary, and he takes care to adapt his expenditure to the economic conditions.

No doubt the appellant realizes that, at the end of his exploitation, there may be no value whatever attaching to the structures. But I think the expenditure is incurred for the enduring benefit of the business, not only in relation to the particular land, but also in relation to his business generally, and is made once and for all.

It is not an easy matter to say whether a particular set of facts falls on one side of the line of division or of the other. But in this case, I am of opinion that the expenditure in question is of "a capital nature" within the meaning of section 10 (*c*) of the Income Tax Ordinance, and that it satisfies the condition laid down by Viscount Cave as set out earlier.

The assessment is confirmed and the appeal is dismissed with costs, but any deposit made by the appellant under section 74 (1) of the Income Tax Ordinance will be reckoned as part of the costs.

NIHILL J.—I agree.

*Appeal dismissed.*