INCOME-TAX REFERENCE

Before I. D. Dua and Daya Krishan Mahajan, JJ.

M/S THE HINDUSTAN FORESTS CO. LTD.,—*Appellant.*

versus

THE COMMISSIONER OF INCOME-TAX, PUNJAB,—*Respondent*

Income-Tax Reference No. 22 of 1962.

1964

December, 3rd.

Income-tax Act (XI of 1922)—S. 4—Assessee becoming a partner in a firm and imparting to it the technical 'know-how' of business in lieu of a fixed commission on profits—Commission so received—Whether taxable as revenue receipt.

Held, that in order to determine whether a particular sum received by an assessee is a revenue receipt or capital return, one has to ask the question: Is the transaction in dispute in substance a parting by the assessee with part of its property for a purchase price or is it a method of trading by which he acquires the particular sum of money as part of the profits and gains of the trade? This test, it is true, is easier to state than to apply to concrete cases. To put it in the form of illustrations, when a trader sells all the assets of his business, this would not give rise to a taxable profit except in so far as profit is made thereby on trading assets such as stocks etc. If, however, the operation consists of a sale of part of the assets and the trader continues his trade, a part or the whole of ~~any~~ any profits made by the sale can be taxable. Although the asset sold is capital asset, the terms of sale may disclose that it is in truth and substance a trading bargain; the receipts under such a bargain would in that event be taxable. Again, partners may sell some secret formulae or a good-will or even a trade mark in lieu of, among others, a commission on future sales and such commission might well be considered to be taxable. Finally, the sale itself may be a trading operation. When tangible assets or rights equivalent thereto are sold, the position may not present much difficulty but in the case of intangible assets or secret process, the problem may not be an easy one. It is not difficult to conceive of cases of joint receipts in exploitation as a commercial venture. Looking at the facts which are binding on us in the instant case and on a consideration of all the circumstances, it appears, to be a case of joint commercial exploitation by the partners and the payment to the assessee is for successive user even of the 'Know-How'. The sum in question is, therefore, in the nature of a revenue receipt which is assessable income.

Case referred under Section 66(2) by the Income-Tax Appellate Tribunal Delhi Bench for decision of the following question of law involved in the case—

> *"Whether on the facts and in the circumstances of the case, the sum of Rs. 1,109 received by the assessee from M/s Chenab Forest Company, Jammu, pursuant to clause 10 of the partnership deed dated 16th February, 1956, is a revenue receipt taxable under the Indian Income-Tax Act?"*

M/s S. K. Kapur, A. S. Mahajan and N. N. Gosawamy, Advocates, for the Appellant.

M/s D. N. Awasthy and Hem Raj Mahajan, Advocates, for the Respondents.

JUDGMENT

The following Judgment of the Court was delivered by :—

DUA, J.—We are called upon in this reference to answer the following question:— Dua, J.

> "Whether on the facts and in the circumstances of the case, the sum of Rs. 1,109 received by the assessee from M/s. Chenab Forest Company, Jammu, pursuant to clause 10 of the partnership-deed, dated 16th February, 1956, is a revenue receipt taxable under the Indian Income-Tax Act?"

The question apparently seems to be very simple and short, but after hearing the arguments, it does not appear to be quite so simple to answer. To understand the substance of the question, the facts may in a nut-shell be stated. The assessee-company's main business is exploiting the Siraj forests in the State of Jammu and Kashmir and the Company has taken a lease for the purpose of exploiting the forests. In this venture, it had entered into a partnership with Messrs R. B. Jodhamal and Company Ltd. The forests were to be exploited by a firm consisting of Messrs R. B. Jodhamal and Company and the assessee. Clause 10 of the partnership agreement is in the following terms:—

> "That in lieu of making the partnership privy to the Second Party's exclusive knowledge and technicalities involved in the successful accomplishment of mechanical sawing operations and the right granted to the partnership in regard to optional or permissive use of the goodwill in the trade name of the Second Party during the subsistence of this partnership in regard to the lease mentioned above, which forms the subject-matter of this partnership, a payment of 7½ per cent of the yearly net profits shall be made by the partnership to the Second Party to the debit of the profit and loss account of the partnership. In the event of there being loss in any year, nothing shall be paid to Second Party in this behalf."

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According to clause 13 the partnership was not terminable during the currency of the lease or any extended period thereof, but thereafter it was to be terminable by three months' notice on either side. The second party, it may be pointed out, is the assessee and the first party Messrs R. B. Jodhamal and Company Ltd.

The sum of Rs. 1,109, which is the subject-matter of the question referred, was paid by Messrs Chenab Forest Company to the assessee in pursuance of Clause 10 of the partnership deed and the technical "Know How" for which this amount has been paid and the special knowledge and the secrets imparted by the assessee are, according to the Appellate Assistant Commissioner's Order, stated as under:—

> "M/s. Hindustan Forests Co., was the first forest lessee to take up the mechanical sawing operations in the difficult mountaneous terrains. The equipments installed in the forests were specially designed and got fabricated by the company and the company imported a special type of portable saw mill equipment from abroad which is not normally used in this country so far."

The Hindustan Forest Co. specially designed and fabricated water-turbines to run on water power for direct couplings with the sawmill equipment. Such water turbines equipment is not used any where in this country so far. The Income-Tax Officer considered the whole of this amount as revenue receipt. The learned Appellate Assistant Commissioner has expressed his conclusion on this point thus:—

> "From Clause 10 of the partnership-deed, it is quite apparent that in respect of good-will the right granted to the partnership to use the name of the appellant company was optional or permissive during the subsistence of this partnership in regard to the lease transferred to the partnership by the appellant company. Evidently, therefore, the appellant company did not part with the good-will to the partnership named Chenab Forest Company, Jammu, but merely allowed it to use its good-will in consideration

of payment of some part of the annual net profits for the period during which the good-will was used. Such a receipt cannot be said to be of capital nature. This has been held so by the Madras High Court in *S. K. Kuppuswani* v. *C.I.T. Madras* (1). As no definite amount has been mentioned in clause 10 of the Partnership-deed as payment for the use of good-will, one-third of the amount received by the appellant is taken to be the payment received for the use of the good-will by the partnership concern. The balance amount being payment for disclosing "KNOW HOW" is a capital receipt as has been held in *Evans Medical Supplies Ltd.* v. *Moriarty Inspector of Taxes* (2)."

On this basis, a sum of Rs. 370 was held to be revenue receipt and the balance capital gains.

On appeal by the Income-tax Officer, the Appellate Tribunal restored the position adopted by the learned Income-tax Officer, holding that the amount of Rs. 1,109 to be commission paid to the assessee in addition to the one-third share of profits. The assessee, according to the Tribunal, was given not only one-third share of profits but something more because the assessee was rather more efficient and a well-known technician. The technical knowledge possessed by the assessee and the name which he had acquired was a source from which the income flowed with regular certainty. This yield was in character a revenue receipt and, therefore, taxable. The Tribunal for its view relied on *Rani Amrit Kaur* v. *C.T.V.* (3).

Before us, the learned counsel for the assessee has canvassed support for the view taken by the Appellate Assistant Commissioner; in other words, he wants us to hold that only Rs. 370 should be considered to be revenue receipt and the balance as capital gains. In support of his contention, he has drawn our attention to the following four English decisions:—

Handley Page v. *Butterworth* (4), *Evans Medical Supplies, Ltd.*, v. *Moriarty* [*H. M. Inspector of Taxes* (5)],

(1) (1954) 25, I.T.R., 349.
(2) (1957) 31, I.T.R., 466.
(3) (1946) 14, I.T.R., 561.
(4) 19, Tax cases, 328.
(5) 37, Tax cases, 540.

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Rolls Royce, Ltd., v. *Jeferey Inspector of Taxes* (6), and *Minister of National Revenue Canada* v. *Catherine Spooner* (7). It has as a last resort been urged that if there is some doubt about the amount in question being a revenue receipt, the assessee is entitled to have its benefit.

The respondent has in reply submitted that the cases of inventors selling their inventions stand on a different footing from those of partners utilising such inventions as a joint commercial venture. The cases cited on behalf of the assessee are, according to Shri Awasthy, distinguishable and the ratio of those decisions, is not attracted in the case in hand. According to the learned counsel, there is little doubt about the amount in question being income which flows in regularly and, therefore, if the assessee desires this Court to reverse the view of the appellate Tribunal and to hold it to be of the nature of capital return, then it is for him to establish his claim. It is also argued that the question depends on the circumstances of each case and, therefore, it would be more in the nature of a question of fact than of law.

It is unnecessary, in my opinion, to deal with the cited cases in detail because they all deal with their own peculiar facts. In *Handley Page's case*, Lord Hanworth, M. R. observed as follows:—

> "What is this sum—a large sum a considerable sum ? What is it paid for? There was here a dissipation of the knowledge and experience of the Applicant. It was placed at the disposal of all and sundry who were engaged in making these aeroplanes and supplying them to the Government. They were required to place their experience, their knowledge and such inventive faculties as they employed in their business, at the benefit of the other contractors. It seems to me that that was the very negation of carrying on the business of the Handley Page concern. No one in business, in his wisdom or prudence, would have so dealt with his facilities; I do not want to use the word 'property', because I am by no means sure as to whether

(6) (1962) 1, A.E.R., 801.
(7) 1933, I.T.R., 299.

> or not what was done was handing over of property; it seems to me rather that they were contributing to a common pool their experience, their knowledge and the drawings and the like, most of them, if I understand, incapable of being either registered and, in so far as they were apparently patentable articles, not capable of being patented."

Again, Slesser, L. J., observes:—

> "He had, in substance, nothing of his business left. His property was his secret process and his knowledge, and that property was, at the request or by compulsion of the Government, dissipated among all his competitors."

It is clear that the decision in the reported case proceeded on its own facts. The observations of Romer, L.J., also make the position clear. The decision in the case of *Evans Medical Supplies, Ltd.*, (5), discloses considerable divergence of judicial opinion and I must confess my inability to cull out or extract any clear-cut *ratio decidendi* from the speeches of the House of Lords, at least I do not find it easy to understand how that decision advances the assessee's claim before us. The later decision of the House of Lords in the case of *Rolls-Royce Ltd.* (6) also contains little which can be taken to lend support to the assessee's contention. The engineering "Know-How" sold in this case was regarded as a regular product of the trade and treated as more transient and less permanent than the "Know-How" related to medical supplies in the *Evans Medical Supplies Case.* The sales in the later case were apparently a part of deliberate policy. The ratio of this case—if anything—may well be held to some extent to go against the assessee. Lord Radcliffe has in his lucid judgment observed:—

> "* * * * * that, although 'know-how' is properly described as fixed capital by way of analogy, it is the kind of intangible entity that can very easily change its category according to the use to which its owner himself decides to put it."

Lord Reid has also adverted to this aspect when he observes that the method adopted in that case was merely

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one of deriving profit from the use of the assessee's technical knowledge, experience and ability.

As I look at the position, it appears that one has to ask the question : Is the transaction in dispute in substance a parting by the assessee with part of its property for a purchase price or is it a method of trading by which he acquires the particular sum of money as part of the profits and gains of the trade ? This test, it is true, is easier to state than to apply to concrete cases. To put it in the form of illustrations, when a trader sells all the assets of his business, this would not give rise to a taxable profit except in so far as profit is made thereby on trading assets such as stocks, etc. If, however, the operation consists of a sale of part of the assets and the trader continues his trade, a part or the whole of any profits made by the sale can be taxable. Although the asset sold is capital asset, the terms of sale may disclose that it is in truth and substance a trading bargain; the receipts under such a bargain would in that event be taxable. Again, partners may sell some secret formulae or a good-will or even a trade mark in lieu of, among others, a commission on future sales and such commission might well be considered to be taxable. Finally, the sale itself may be a trading operation. When tangible assets or rights equivalent thereto are sold, the position may not present much difficulty but in the case of intangible assets or secret process, the problem may not be an easy one. It is not difficult to conceive of cases of joint receipts in exploitation as a commercial venture. Looking at the facts which are binding on us in the instant case and on a consideration of all the circumstances, it appears to me to be a case of joint commercial exploitation by the partners and the payment to the assessee is for successive user even of the "Know-How". The sum in question is, therefore, in the nature of a revenue receipt which is assessable income.

We are accordingly of the view that the question referred should be answered in the affirmative and we hereby do so. The respondent will have his costs which we fix at Rs. 250.

B.R.T.