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MAHARAJA OF JAIPUR v. ARJUN LAL

Solicitors for the appellant: *Hy. S. L. Polak & Co.*

Solicitors for respondents Nos. 1 to 4: *Douglas Grant & Dold.*

FULL BENCH

Before Sir Shah Muhammad Sulaiman, Chief Justice, Mr. Justice Harries and Mr. Justice Bajpai

1937
July, 26

COMMISSIONER OF INCOME-TAX *v.* TIKA RAM AND SONS, LTD.*

Income-tax Act (XI of 1922), section 10(2) (ix)—Deduction from profits—"Expenditure incurred solely for the purpose of earning profits"—"Capital expenditure"—Brick-field purchased or taken on lease for taking earth for manufacture of bricks—Value of earth dug and utilised whether to be deducted in assessing profits.

Where a company carrying on the business of manufacturing bricks was the proprietor of a part, and the lessee of the remainder, of a piece of land on which it carried on the business and from which it dug up the earth for making the bricks:

Held, that the value of the earth dug up and utilised for the bricks was of the nature of "capital expenditure", and not of other "expenditure incurred solely for the purpose of earning profits", within the meaning of section 10(2)(*ix*) of the Income-tax Act and should not be deducted from the total profits for the purpose of assessment to income-tax. The position of the company was not that of one which carried on business by purchasing raw materials and converting these into marketable commodities; in purchasing and taking a lease of the land the company had not purchased so much earth as raw material but had acquired the land with the right of extracting earth from it, and the case was parallel to that of the business of working a mine or a quarry. The land therefore formed part of the fixed capital and the amount invested in acquiring it was of the nature of capital expenditure, and the company was not entitled to debit the profits account with the value of the earth extracted from the land for making the bricks.

Mr. *K. Verma*, for the applicant.

Mr. *Panna Lal*, for the opposite party.

SULAIMAN, C.J., HARRIES and BAJPAI, JJ.:—This is a reference by the Commissioner of Income-tax under

section 66(2) of the Indian Income-tax Act (XI of 1922). Tika Ram and Sons, Ltd., the assessee, is a company carrying on the business of manufacturing bricks. It owns as proprietor a part of land from which earth is taken for the manufacture of bricks and it also holds a lease of a portion of such land. It claimed that a sum of Rs.2,500 representing the value of the earth used up in the manufacture of bricks during the year in question should be deducted as depreciation of its property. Later the position taken up was that it was expenditure incurred solely for the purpose of earning profits or gains within the meaning of section 10(2)(*ix*) of the Income-tax Act. The question referred to the High Court is whether the applicant is entitled on these facts to a deduction of the amount claimed as expenditure on account of the price or value of the earth dug and utilised for manufacturing bricks from the total profits of the business or otherwise as a depreciation in the value of the land.

If the company had been purchasing merely raw materials for the purpose of manufacturing bricks, it would certainly have been entitled to a deduction of the price of such materials from the total income realised by the sale of the bricks during the year. But the position here is not that of a company which is merely carrying on the business of manufacture by purchasing raw materials and converting such materials into marketable commodities. The company is the owner and proprietor of a part of the land on which this business is carried on and has also taken a lease of the other part of the same land. The company therefore has both proprietor's and lessee's rights in the land itself and is in possession of such land and is also entitled to dig up earth out of this land and use the same for moulding bricks. In the process of manufacture, the subject of the lease is really not completely consumed or exhausted, but as earth is dug out fresh earth or clay becomes available though there may possibly be a greater

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inconvenience or difficulty in digging out earth from a lower level. But it cannot be regarded as a case where the materials are completely and wholly used up in the process of manufacture. Here fresh materials of the same kind are for all practical purposes substituted for those taken out from the ground. The company by taking this lease has not purchased so many maunds of earth for so many rupees but has acquired lessee's rights in the immovable property which includes the right to dig out earth and use it for the purpose of manufacturing bricks. The position seems to be more analogous to that of a company which is working a quarry or mine rather than to an ordinary manufacturer who purchases raw materials for the purpose of his manufacturing business. In the latter case the taxable income is the net gain or profit made by him, which necessarily is the difference between the amount realised by him and the total amount spent by him; whereas in the case of a lessee of a mine, quarry or brick-field, the property already exists and is taxed as realised property yielding a certain annual income to the owner or lessee.

No case which is directly in point has been cited before us by the learned counsel, but there are observations in several English cases which show that the value of the materials found in a brick-field is treated as capital expenditure in England and is therefore not allowed to be deducted from the total income. The leading case is that of *Alianza Company* v. *Bell* (1). That was a case where an English company was the owner of land in Chili containing deposits of caliche from which by a certain process nitrates and iodine were extracted. The process of manufacture would ultimately result in the exhaustion of the whole of the caliche available, in which event the land and the machinery and plant used for the purpose of manufacture would be practically of no value. CHANNELL, J.,

(1) [1904] 2 K.B., 666.

pointed out that the case was one of those cases in which the process necessarily exhausts the material, as the undertaking necessarily consumed in the course of its working the stock upon which it started. At page 673 the learned Judge observed: "If it is merely a manufacturing business, then the procuring of the raw material would not be a capital expenditure. But if it is like the working of a particular mine or bed of brick earth, and converting the stuff worked into a marketable commodity, then the money paid for the prime cost of the stuff so dealt with is just as much capital as the money sunk in machinery or buildings." At page 674 the learned Judge further pointed out that the position was similar to that of a mining company and it would make no difference whether the whole business was considered as consisting of two distinct businesses or of one business only, for in the former case the mining company would have to be credited with receiving the price of the raw material handed over to the manufacturing company if there were supposed to be two distinct businesses. This view was upheld by the Court of Appeal in *Alianza Company Limited* v. *Bell* (1), and was affirmed by the House of Lords in *Alianza Company Limited* v. *Bell* (2).

In the case of *John Smith and Son* v. *Moore* (3) the assessee had after the death of his father acquired a certain business and taken over the assets at a valuation, which assets included certain forward coal contracts made by his father with several colliery owners for the delivery of coal. The coal contracts had been valued at £ 30,000. The assessee claimed that in arriving at the amount of the profits of the business chargeable to Excess Profits Duty the value of the contracts should be deducted. The House of Lords by a large majority overruled this contention. At page 38 Lord SUMNER observed: "The business carried on was not that of buying and selling contracts, but of buying and selling coals, and the contracts, which enabled the seller of the

(1) [1905] 1 K.B., 184. (2) [1906] A.C., 18.
(3) [1921] 2 A.C., 13.

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coals to acquire the coals, were no more the subject of his trading as a stock in trade for sale than a lease of a brick-field would be the subject of a sale of bricks." It was further assumed that in the case of a lease of a brick-field the materials could not be treated as stock in trade for the purposes of assessment.

In the recent case of *Golden Horse Shoe (New) Limited* v. *Thurgood* (1) the assessee was a company which had been formed for the purpose of acquiring the right to take away and re-treat very large dumps of residual deposits resulting from the working of a gold mine. Lord HANWORTH, M.R., approved of the view expressed by CHANNELL, J., in the case of *Alianza Company* v. *Bell* (2) and quoted the opinion of the learned Judge at considerable length. ROMER, L.J., also pointed out the distinction that has to be drawn between fixed capital and circulating capital, and said at page 564 that if a gas manufacturer, instead of buying his coal from outside sources, purchases a coal mine and produces the coal that he requires by mining, he would not be entitled to debit his profit and loss account with the sum by which the value of his mine has depreciated in consequence of the extraction of that coal, for the mine is regarded as being fixed capital. He then observed: "If, ... instead of buying the mine, the gas manufacturer had bought a quantity of coal already extracted from the mine and stacked on the surface, the price of the coal would have been regarded as part of the circulating capital. . . . . In the former case the purchase of the mine is not a purchase of coal but a purchase of land with the right of extracting coal from it. The land is regarded merely as one of the means provided by the manufacturer for causing coal to be brought to his gas works, and therefore as much part of his fixed capital as would be any railway trucks or lorries provided by him for the same purpose." The distinction made in *John Smith's* case (3) was then quoted.

(1) [1934] 1 K.B., 548. (2) [1904] 2 K.B., 666.
(3) [1921] 2 A.C., 13.

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It therefore seems that the case of a brick-field is very similar to that of a quarry or a mine and the proprietor of the land or the lessee is not a mere purchaser of raw materials but a person who has acquired certain rights in the land and the amount invested by him must therefore be treated as capital expenditure within the meaning of section 10(2)(*ix*). The present assessee has agreed presumably to pay some premium and an annual rent for all his rights under the lease, and he or his predecessor might have paid the price of the land purchased. He has really not purchased any raw materials for cash and he cannot be allowed to claim a deduction of the supposed value of the earth taken out of the land as part of the property.

The answer to the question referred to us is therefore in the negative.

REVISIONAL CIVIL

Before Sir Shah Muhammad Sulaiman, Chief Justice, and Mr. Justice Hamilton

MITHAI LAL (APPLICANT) *v.* JAGAN AND OTHERS (OPPOSITE PARTIES)*

1937
July, 27

Civil Procedure Code, order XXXIII, rule 1, *explanation—"Pauper"—"Possessed of sufficient means to enable" payment of court-fee—Whether the subject-matter of the suit must always be left out of account—Possibility of raising money on the security of the subject-matter—Civil Procedure Code, section* 115*—Material irregularity or illegality in the exercise of jurisdiction—Mere error of law.*

It is not correct to say that in cases coming under the first category mentioned in the explanation to order XXXIII, rule 1, of the Civil Procedure Code, namely cases where a court-fee is prescribed for the plaint, the subject-matter of the suit must always and of necessity be excluded from consideration in deciding the question whether the applicant for leave to sue *in forma pauperis* is or is not possessed of sufficient means to enable him to pay the court-fee; whether it should or should not be so excluded is a matter for the consideration of the

*Civil Revision No. 345 of 1935.