

Cit Vs. M. Subramaniam

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Court : Chennai

Decided On : Dec-23-2003

Reported in : [2005]144TAXMAN728(Mad)

Appeal No. : Tax Cases Nos. 1 to 4 of 2001 23 December 2003.

Appellant : Cit

Respondent : M. Subramaniam

Advocate for Pet/Ap. : Mrs. Pushya Sitharaman, *for the Revenue* None appeared *for the Assessee*.

Judgement :

S. R. Sincharavelu J.

The question referred is as to whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that the expenditure in obtaining a right for reproduction of film songs for a specific period is royalty and allowable as revenue expenditure and not a capital expenditure, which attracts the provisions of section 35A of the Income Tax Act.

2. The assessee is an individual engaged in the production of audio cassettes with popular film songs. He carries on the business of manufacturing pre-recorded cassettes and selling the same in the name of ECHO Recording Company. In order to obtain such popular songs, the assessee enters into agreements with the

producers of the films for obtaining the right to re-produce the film songs.

3. The assessee claimed that the monies paid under those agreements were in the nature of royalty and should, therefore, be allowed as revenue expenditure in computing the assessee's income. His claim was accepted on 29-9-1996 for the assessment year 1985-86. For the assessment year 1984-85 also, the assessment was made under section 143(3) of the Income Tax Act on 19-3-1987 accepting the deduction of such expenditure. Later on, the Commissioner of Income Tax was of the view that the royalty paid for acquiring the copyright should be treated as capital expenditure, since what was obtained by the assessee was a capital asset.

4. Subsequently, the assessments for the years 1986-87 and 1987-88 were taken up. The assessee, by his letter dated 7-1-1989 pointed out that the agreements were entered into with the producers and the royalty was paid at 12.5 per cent., if the total half yearly sales was up to Rs. 2,00,000, at 13.5 per cent. between Rs. 2,00,000 and Rs. 10,00,000 and 14 per cent. for the sales exceeded Rs. 14,00,000. It was also pointed out that there was no enduring benefit, as the popularity of the film songs will hardly be for a period of six months. In the assessment made, these payments were treated as having been made for acquiring capital assets.

5. The Income Tax Appellate Tribunal went into the question in detail in the appeals filed by the assessee, and directed that the entire royalty paid should be treated as a revenue expenditure and ordered for re-computation accordingly, upon which, this reference arises.

Clause 2 of the agreement between the assessee and the producer of films reads as follows :

'The producer hereby assigns and/or agrees to assign and transfer to the company, absolutely, free from all encumbrance without any limitation for the entire world the copyright in so far as it extends to the exclusive right to make records from recordings embodied in . . . '.

6. Clause 5(v) of the agreement empowers the assessee's company to have exclusive right over the records. The assessee was also permitted to lease or issue licence, etc., and allow others to do so under such trademark and prices and upon such terms. Clause 7(a) of the agreement provides that the company shall pay to the producer an all-in-royalty in respect of all records manufactured. Clause 3 of the agreement provides that what was assigned included the right to publish and the reproduction rights thereof. Clause 7(e) of the agreement provides for payment of royalty.

7. The agreement clearly provides for assignment of the rights of the producer of the music of the movie to the assessee. The copyright so assigned is in the nature of a capital asset. The ascertained sum of Rs. 501 paid by the assessee to the producer at the time of entering into that agreement is clearly a capital expense. However, as regards the royalty payable to the assignor, that was variable and was unknown at the time the agreement was entered into. At that point of time, it was not possible to predict the volume of sale as also the price at which the cassette was to be sold, and as a result, the amount that would become due and payable to the assignor in future was not known.

8. In similar circumstances, it has been held by the courts that though the initial payment in the ascertained sum was a sum paid in the capital field, the sums paid subsequently which sums were variable and not ascertained at the time of assignment would lie in the field of revenue and not capital.

9. The Supreme Court in the case of Travancore Sugars and Chemicals Ltd. v. CIT : [1966]62ITR566(SC) , a decision rendered by a three-judge Bench, considered a case of a company which was floated to take over the assets of certain undertakings run by the Government. The agreement between the company and the Government, inter alia provided that apart from cash consideration, the Government shall be entitled to 20 per cent. of the annual net profits, subject to a specified maximum after providing for certain deductions. The question which arose for consideration was as to whether the payment made in terms of the clause in the agreement was capital or revenue expenditure. The court held that that expenditure was revenue expenditure as, (a) the payment was

for an indefinite period; (b) the payment was related to the annual profits which flowed from the trading activities of the company and had no relation to the capital value of the assets; and (c) the payment was not related to or tied up, in any way, to any fixed sum agreed between the parties as part of the purchase price of the three undertakings.

10. The reasons so given by the court were similar to those given by Lord Greene M. R. in CIT of Inland revenue v. 36149 Holdings Ltd. (1943) 25 TC 173 . The reasons that were given in that case for holding that the periodical payments made to the person from whom the capital assets had been purchased were to be treated as revenue expenditure, were-

(1) the payments were to be made in perpetuity until the right to commute was exercised;

(2) the payments were related to the turnover which were the trading activity~ and the sums paid were in that respect not dissimilar from royalties;

(3) the sums payable under the second category were not tied in any way or related in any way to any special sum whatsoever.

This court, in the case of CIT v. Sarada Binding Works : [1976]102ITR187(Mad) , has held as under (page 194) :

'But in this case though the Tribunal has held that the transaction under the agreement is one of sale, none the less that part of the consideration which is indefinite depending on the profit earned by the assessee each year will only be a revenue expenditure. We are of the view that even if the transaction in question amounts to a purchase of the business on which we express no opinion, the consideration which consists of partly a fixed annual sum and partly a periodical payment on a certain percentage of the profits earned by the assessee from the said business cannot, in entirety, be treated as a capital payment. The fixed annual sum paid towards part of the consideration will obviously be a capital payment. The periodical payments of sums which are indefinite depending upon the future profits earned cannot be treated as of capital nature. The purchase

consideration should, therefore, be taken to consist of two elements, one of a capital nature and another of an income nature. The fact that some of the elements of sale consideration are of a capital nature does not in the least bit point to the periodical payments which are indefinite depending on the profits of the company being also of a capital nature.'

The court also quoted from Wheatcroft's treatise, *The Law of Income Tax, Sur Tax and Profits Tax*, at page 1152 (page 194).

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