

# Gillanders Arbuthnot And Co., Ltd vs The Commissioner Of Income-Tax, ... on 1 May, 1964

**Equivalent citations: 1965 AIR 452, 1964 SCR (8) 121, AIR 1965 SUPREME COURT 452**

**Author: J.C. Shah**

**Bench: J.C. Shah, S.M. Sikri**

PETITIONER:  
GILLANDERS ARBUTHNOT AND CO., LTD.

Vs.

RESPONDENT:  
THE COMMISSIONER OF INCOME-TAX, CALCUTTA

DATE OF JUDGMENT:  
01/05/1964

BENCH:  
SHAH, J.C.  
BENCH:  
SHAH, J.C.  
SUBBARAO, K.  
SIKRI, S.M.

CITATION:  
1965 AIR 452                      1964 SCR (8) 121  
CITATOR INFO :  
R              1966 SC1325 (4,12)  
R              1971 SC1590 (9)

ACT:  
Income Tax-Capital or revenue-Termination of  
agency--Compensation--Business of several  
agencies--Cancellation of single agency-Nature of  
compensation.

HEADNOTE:  
The appellant company was carrying on business in diverse  
lines as managing agents of some concerns, distributing  
agents of others and a& secretaries of still other class of  
concerns. It also dealt as an ex-  
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porter and importer, shipping agent, and as buyer and dealer in diverse: commodities. A large amount of business was done by the appellant as an agent of foreign companies in respect of different kind& of goodsIn respect of explosives manufactured by the Imperial Chemical Industries (Export) Ltd., Glasgow, Scotland, the appellant was acting as the sole agent and distributor of that company. The agency agreement was terminable at the option of the principal company, and by a letter dated March 11, 1947, the latter informed the appellant that the agency would stand terminated from April 1, 1948 and that compensation would be paid for termination of the agency. The appellant was be paid an amount which was computed on the basis of the profits of the business. In the course of the proceedings for assessment to income-tax appellant claimed that the amount was received on determination of the agency being receipt of a capital nature and was not liable to be included in total income of the appellant, but the Income-tax Officer rejected the claim holding that cancellation of a single contract of agency out of a number of selling agencies held by the appellant was in the ordinary course of business and that the sum received as compensation was revenue taxable under the Indian Income-tax Act, 1922.

Held: Having regard to the vast array of business done by the appellant as agents, the acquisition of agencies was in the normal course of business and the determination of individual agencies, a normal incident, could not affect or impair the trading structure of the appellant, nor involve a loss of an enduring trading asset. and the compensation received by the appellant, therefore, did not represent the price paid for loss of a capital asset but only a payment made for the loss of profit it suffered by the cancellation of its agency and was income chargeable to the income-tax.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeals Nos. 825-828 of 1963.

Appeals from the judgment and order dated January 10, 1962, of the Calcutta High Court in Income-tax Reference No. 33 of 1957.

B. Sen, P. K. Chatterjee and D. N. Gupta, for the appellant.

K. N. Rajagopal Sastri and R. N. Sachthey, for the respondent.

May 1, 1964. The Judgment of the Court was delivered by SHAH, J.-The appellant which is a public limited company incorporated under the Indian Companies Act, 1913, has its registered office at Calcutta, and branches in Bombay, Madras, New Delhi and Kanpur. The appellant carried on

business in diverse lines, which may broadly be classified as (1) buying and selling on its own account, (2) introducing customers to principals (3) acting as managing agents, (4) acting as shipping agents, (5) acting as purchasing agents, (6) acting as sole importers and distributors on behalf of United Kingdom principals having no Organisation in India and (7) acting as secretaries. Since January 21, 1886, M/s. Gillanders Arbuthnot & Co. predecessors-in-interest of the appellant were the sole agents and distributors in India of explosives manufactured by the Imperial Chemical Industries (Export) Ltd. Glasgow, Scotland, hereinafter called 'the principal company'. There was no written agreement between the principal company and M/s Gillanders Arbuthnot & Co. incorporating the terms of the agency agreement. It is however common ground that the agency agreement was 'terminable at the option of the principal company. The appellant was incorporated for taking over the business of M/s Gillanders Arbuthnot & Co. and since it took over the distributing agency the appellant acted as the sole agent and distributor of explosives manufactured by the principal company, but without a written agreement.

In May 1945 the principal company desired to set up its own Organisation for distributing its products, and intimated the appellant that the agency of the . appellant may be cancelled after two or three years. By letter dated March, 11, 1947, the principal company informed the appellant that the agency will stand terminated from April 1, 1948, and that it desired to compensate the appellant for termination of the agency on the following basis:

(1) "For the first three post-transfer years" the principal company shall pay to the appellant two-fifths of the commission accrued on actual sales in the territory of the lattees agency taken over the principal company, such commission to be computed at the commission rates formerly paid to the appellant;

(2) That "in the third post-transfer yea" the principal company shall pay the appellant in I24 addition a sum equivalent to full commission on the sales for that year effected by the principal company in the appellant's territory calculated at the same rates. (3) That payments would be made to the appellant after the end of each year as soon as the amount due was ascertained.

Certain other matters in the letter which have a bearing on the dispute, may be reproduced:

"For the purpose of calculating the commission due to you, the post-transfer will be deemed to run as from the date of the transfer of your agency to Imperial Chemical Industries (India) Ltd., We trust that you will find these proposals acceptable.

As a condition of our paying you compensation on the basis outlined above, we would request you to be good enough to give us a formal undertaking to refrain from selling or accepting any agency for explosives or other commodities competitive with those covered by the agency agreement now being terminated.

In this connection, we are asking our Legal Department to prepare a formal agreement which we will submit to you for signature as soon as possible."

It is common ground that no formal agreement in writing, which was contemplated to be taken from the appellant, was executed: not even a draft of the agreement was submitted by the principal company to the appellant.

Pursuant to conditions (1) and (2) incorporated in the letter dated March 11, 1947, which have been set out earlier, the appellant received the following amounts from the principal company, .....125 For the previous year corresponding to the assesment year ending 31st March, 1949. Rs.1,53,471/11/- For the previous year corresponding to the assesment year ending 31st March, 1950. Rs.1,59,271/41- For the previous year corresponding to the assesment year ending 31st March, 1951 Rs.6,20,131/2/- These amounts were included in its profit & loss account by the appellant as commission received by it. But in the course of the proceedings for assesment to income-tax and Business Profits Tax, the appellant claimed that the amounts were compensation received on determination of the agency being receipts of a capital nature and were not liable to be included in the total income of the appellant. The Income- tax Officer, Companies District IV, Calcutta, rejected the contention of the appellant, holding that cancellation of a single contract of agency out of a number of selling agencies held by the appellant was in the ordinary course of business and the sums received by the appellant as compensation for Cancellation were revenue, taxable under the Indian Incometax Act, 1922. The Income-tax Officer also assessed the relevant amount of compensation to Business Profits tax for the chargeable accounting period ending March 31, 1949.

In appeal to the Appellate Assistant Commissioner, the contention of the appellant was accepted principally on the ground that the amounts received by the appellant were compensation for termination of the agency with the principal company and as consideration for agreeing to refrain from carrying on in future competitive business in explosives. The Appellate Tribunal held that the compensation received by the appellant was merely incidental to the carrying on of the business. The Tribunal negatived the contention of the appellant that the explosives agency was a separate business or that termination of that business amounted to loss of an enduring asset. The Tribunal also held that the covenant referred to in the letter dated March, 11, 1947, about the appellant agreeing to refrain from carrying on a competitive business in explosives did not form consideration for the amount paid, because although proposed in the letter dated March 11, 1947, there was no formal acceptance of the offer or an undertaking in writing given by the appellant agreeing not to carry on a competitive business. In the view of the Tribunal the offer relating to the undertaking not to carry on- a competitive business contained in the letter was not accepted, and the amounts paid by the principal company could not therefore be regarded as forming consideration partially or wholly for acceptance of that offer.

The Tribunal thereafter referred three questions under s. 66(l) of the Indian Income-tax Act, 1922 to the High Court of Judicature at Calcutta. These questions were:

- (1) Whether the assessee's agency of the Imperial Chemical Industries (Export) Ltd. was a separate business by itself, the closure of which resulted in the destruction of a capital asset of the assessee;

(2) Whether on the facts and in the circumstances of this case, the compensation sums received by the assessee from the Imperial Chemical Industries (Export) Ltd. are income chargeable in the hands of the assessee; and (3) Whether on the facts and in the circumstances of this case no part of the compensation money was received by the assessee on the condition not to carry on a competitive business in the same line of activity in explosives and as such no part of the money was in the nature of capital being exempt from Indian Income-tax levy?

The High Court recorded answers to the question as follows:

"Question 1.--The assessee's agency of the Imperial Chemical Industries (Export) Ltd. was not a separate business by itself and the closure of this business did not result in the destruction of a capital asset of the assessee. Question 2.--The amounts of compensation received by the assessee from the Imperial Chemical Industries (Export) Ltd. were income chargeable in the hands of the assessee. Question 3.--No part of the compensation money was received by the assessee on condition not to carry on a competitive business in explosives and consequently no part thereof was exempt from Indian Income-tax levy."

With certificate of fitness granted by the High Court, these appeals have been preferred by the appellant. The principal question in dispute is whether the amount received by the appellant as compensation for loss of agency are of the nature of capital or revenue. It is necessary in the first instance to eliminate two subsidiary contentions raised by the appellant. It was urged that the amounts received by the appellant were in lieu of compensation for cancellation of the agency by the principal company, for loss of goodwill of the appellant's business, and also in consideration of the appellant's agreeing not to carry on any competitive business in explosives or other commodities in which business was carried on by the appellant under the agency agreement. It cannot seriously be disputed that compensation paid for agreeing to refrain from carrying on competitive business in the commodities in respect of which the agency was terminated, or for loss of goodwill would, prima facie, be of the nature of a capital receipt. But there is no evidence that compensation was paid to the appellant as consideration for giving the undertaking not to carry on a competitive business, or as compensation for loss of goodwill.

In the letter dated March 11, 1947, it was expressly recited that as a condition of payment of compensation on the basis outlined therein the principal company had called upon the appellant to give a formal undertaking to refrain from selling or accepting any agency for explosives or other commodities competitive with those covered by the agency agreement, but no such formal undertaking was ever given. It was recited in the last paragraph of the letter that the prin-

cipal company will submit a formal agreement to the appellant for execution. But it appears that at the time of Payment of the compensation and thereafter also both sides ignored this condition. Payment of compensation was spread over a period of three years, but that will not give rise to an inference that the object behind the payment was to enforce the undertaking, for the undertaking, if any, would have operated permanently whereas full compensation was payable within three years. If

importance was attached to the undertaking the principal company would have declined to make even the first payment without insisting upon, a formal agreement incorporating the undertaking. Whether the appellant did not in fact carry on any competitive, business was never investigated, and the absence of evidence on that point may reasonably justify the inference that the appellant never attempted to establish that part of its case. Granting that an agreement to refrain from carrying on a competitive business may be implied from subsequent conduct, in the absence of any material at any stage, of the proceedings before the Revenue authorities, it would be reasonable to hold that the appellant did not place any reliance upon the case that part of the compensation was attributable to an undertaking not to engage in competitive business.

No part of the compensation may be attributed to loss of goodwill suffered by the appellant. It is true that the agency had continued in the hands of the predecessors of the appellant and thereafter with the appellant for upwards of sixty years. It was urged that an extensive market had been built up in India and the goodwill of that business was on termination of the appellant's agency; taken over by the new agents of the principal company, and compensation paid in that behalf must be regarded as capital. But this question also was never raised before the Revenue authorities, nor even before the Tribunal. The Tribunal observed that it had not been supplied with "any material regarding the basis of the value of the goodwill, nor anything to indicate as to what the written down value of the goodwill was, due to the termination of the agency".

It therefore held that the inference sought to be drawn by the appellant that compensation was referable to the loss of goodwill, was based on no evidence and the High Court agreed with that conclusion. We are unable to hold that the High Court was, in so holding in error. If it was the case of the appellant that a part of the compensation was in fact paid for loss of goodwill of the business, the appellant could have led evidence to establish that it was the intention of the parties that the loss of good will was to be compensated by payment of an amount which was included in the compensation ultimately paid by the principal company to the appellant. The business of agency had undoubtedly continued for more than sixty years, but there is no evidence about the terms of the agency agreement. There was no written agreement, and it is common ground that the agency was terminable at will. The principal company had, as early as 1945, informed the appellant that the distribution arrangement "would be terminated after two or three years". The appellant had sufficient notice of the proposed determination. Thereafter the agency was cancelled with effect from April 1, 1945, and in the correspondence which is tendered in evidence, there is not even an indirect reference to any negotiation for payment of Compensation for loss of goodwill, or any agreement in that behalf. We may now address ourselves to the question, whether compensation paid by the principal company for cancellation of the agency may be regarded as a capital or revenue receipt. We have in a recent case in *Kettlewell Dullen & Co. v. The Commissioner of Income-tax, Calcutta* (1) made a survey of the important cases which have arisen before the Courts in the United Kingdom and in India about the principles which govern the determination of the nature of compensation received on the termination of an agency. We observed in that case:

"On an analysis of these cases which fall on two sides of the dividing line, a satisfactory measure of consistency in principle is disclosed. Where (1) 1964] S.C.L. 93.

51 S.C.-9 on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of -the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue: where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt."

Examining the circumstances of the present case in the light of that principle, we agree with the High Court that what was received by the appellant was income and not capital. Compensation received by the appellant for cancellation of the agency which was terminable at will, the appellant was to be paid an amount which was to be computed on the basis of the profits of the business. Under the letter dated March 11, 1947, the appellant was to be paid "for the first three post-transfer years" two-fifths of the commission accrued on actual sales in the territory of the appellant's agency taken over by the Imperial Chemical Industries (India) Ltd., such commission to be computed at the rates of commission formerly paid to the appellant, and that in "the third post-transfer year" the principal company was to pay the appellant in addition a sum equivalent to full commission on the sales for that year effected by the Imperial Chemical Industries (India) Ltd. in the appellant's territory calculated at the same rates.

The appellant was conducting business as selling or distributing agent of numerous principals. The agency which was terminated was one of many such agencies in which the appellant functioned as distributing agent of a foreign principal. There is not even a suggestion, that by the determination of the agency held by the appellant in explosives from the principal company, the trading structure of the assessee's business was impaired. It is manifest that the agencies of the companies conducted by the appellant must have been obtained at different times. There is no evidence that these agencies were of any fixed duration. it would be reasonable to infer that some of the agencies may be cancelled and fresh agencies obtained. The list furnished by the appellant before the Tribunal analysing the different classes of business carried on by it disclosed that the business was done in many lines. The appellant acted as managing agent of some, concerns, distributing agent of others. and as secretary of still other class of concerns. Again it dealt as an exporter and importer, shipping agent, and as a buyer and dealer in diverse commodities. A large amount of business was done by the appellant as an agent of foreign companies. The appellant had obtained agencies for paints, varnishes, petroleum, kerosene oil, medicines and toilet preparations, cement, timber, stationery, metals, tea, engineering goods, air-conditioning equipment and a large number of other commodities. It may reasonably be held, having regard to the vast array of business done by the appellant as agents, that the acquisition of agencies was in the normal course of business and determination of individual agencies, a normal incident, not affecting or impairing the trading structure of the appellant. The appellant was compensated by payment to it the loss of profit it suffered by the cancellation of its agency, leaving it free to conduct its remaining business.

It was said that the appellant had employed expert officers who were accustomed to handle explosives which are a specialised commodity and the cancellation of that agency seriously affected

the organization of its trading operations. But the appellant was undoubtedly dealing in several kinds of inflammable substances, such as, petroleum, kerosene oil, imber and similar other commodities. it is true that explosives would require great care in handling. It appears, however, that eighty per cent of the staff attached to the Magazine Section was maintained not at the expense of tile appellant, but at the expense of the principal company. out of the officers who were attached to the explosives business, services of five officers were taken over by the principal company and six others were retained by the appellant and absorbed in other branches. It cannot, therefore, be said that termination of the agency resulted in impairment of the trading organisation of the appellant. One of the agencies was undoubtedly lost to the appellant, and even temporary dislocation in the Organisation of the business thereby may De assumed. There is no evidence, however, that the appellant could not in the ordinary course of business repair the dislocation. There is no evidence that it could not obtain an agency from another manufacturer of explosives. Even assuming that such an agency in explosives may not be replaced, that circumstance by itself may not justify the inference that the agency was independent of the other lines of business conducted by the appellant, or that by the cancellation of the agency an enduring asset was lost to the appellant. The circumstance that the agency was determinable at the will of the principal company which maintained a large staff at their expense justifies the inference that upon cancellation of that agency the appellant's business organization was not substantially impaired. The cancellation. it may be held, was an incident of the trading operations of the appeallant in the normal course of business. The payment received by the appellant could not, therefore, be regarded truly as compensation for not carrying on the business: it was a sum which was worked out in terms of profits which the appellant would have earned during the period of notice and paid in the ordinary course of business to adjust the relations between the appellant and the principal company. There is, in our judgment, no immutable principle that compensation received on cancellation of an agency must always be.regarded as capital. In each case the question has to be.determined in the light of the attendant circum- stances. .In the judgment in Kettlewall Bullen and Co.' case(') we have explained that the judgment of the Judicial Committee in the Commissioner of Income-tax v. Shaw [1964] 8.S.C.R. 93.

Wallace and Co.(') was not intended to, and did not lay down that in every case, cancellation of an agency resulted in loss of a source of revenue or that amounts paid to com- pensate for loss of agency must be regarded as capital loss. On a careful consideration of all the circumstances we agree with the High Court that cancellation of tile contract of agency did not affect the profit-making structure Of the appellant, nor did it involve a loss of an enduring trading asset; it merely deprived the appellant of a trading avenue, leaving him free to devote his energies after the cancellation to carry on the rest of the business, and to replace the contract lost by a similar contract. The compensation paid, therefore, did not represent the price paid for loss of a capital asset. We therefore dismiss the appeals with costs.

Appeal dismissed.