

Supreme Court of India

Kettlewell Bullen And Co vs Commissioner Of Income-Tax, ... on 1 May, 1964

Equivalent citations: 1965 AIR 65, 1964 SCR (8) 97

Author: S C.

Bench: Shah, J.C.

PETITIONER:

KETTLEWELL BULLEN AND CO.

Vs.

RESPONDENT:

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 65 1964 SCR (8) 97

CITATOR INFO :

APL 1965 SC 452 (11,15)

R 1966 SC 54 (11)

R 1966 SC1325 (4,5)

R 1970 SC1811 (6)

F 1971 SC1590 (9,10)

R 1972 SC 386 (18)

RF 1973 SC1011 (25)

ACT:

Income-tax-Compensation received for surrendering managing agency-If capital or revenue-Test--Income-tax Act, 1922 (11 of 1922), ss. 2(6c), 10, 12.

HEADNOTE:

By an agreement with the Fort William Jute Company in 1925 the appellant company became its Managing Agent. The terms, inter alia, were that the appellant or its successors, unless they chose to resign, were to continue as Managing Agent until they ceased to hold certain shares in the capital of the company and were on that account removed by a resolution of the company or their tenure of office was determined by the winding up of the company. On termination of the agency, the Managing Agent was to get such reasonable

compensation as was agreed upon between the Managing Agent and the company. Besides this managing agency the appellant held five other managing agencies. In 1952, the appellant by in agreement with M/s. Mugneeram Bangur & Co., agreed to relinquished the managing agency of the Fort William Jute Co., Ltd., in their favour in consideration of M/s. Mugneeram Bangur and Co. taking over the shares held by the appellant, procuring repayment of loans advanced by the appellant to the Fort William Jute Company and further procuring that the Fort William Jute Company. will pay compensation to the appellant. The appellant intimated the members of the latter company that it would be in the best interest of the share-holders to terminate the appellant's agency which would otherwise continue till 1957 and that M/S. Mugneeram Bengur & Co. had agreed to reimburse the Fort William Jute Co. Ltd. for payment of Rs. 3,50,000 as compensation to the appellant. The arrangement with M/s. Mugneeram Bangur & Co. was accepted by the Fort William Jute Co. and the appellant tendered resignation. M/s. Mugneeram Bangur and Co.

94

became the Managing agent. The appellant received the sum of Rs. 3,50,000 and credited the sum in its profit and loss account as having been received from the Fort William Jute Co. Ltd. on account of compensation for loss of office and in calculating the net profit for the purpose of income-tax for the year 1953-54 did not include this amount in the return. The Income-tax Officer in assessment included the amount in the appellant's taxable income. The Assistant Appellate Commissioner on appeal modified the assessment holding that the sum received by the appellant as compensation for surrendering the managing agency, which was to enure for five years more and might have continued for another twenty years, was a capital receipt. The Appellate Tribunal confirmed the order of the Appellate Assistant Commissioner. At the instance of the Commissioner of Income-tax the following question was referred to the High Court:

Whether on the facts and circumstances of the case the sum of Rs. 3,50,000 received by the assessee to relinquish the managing agency was a revenue receipt assessable under the Indian Income-tax Act?.

The High Court answered the question in the affirmative.

HELD: that the answer should be in the negative. The transaction in question was not a trading transaction, but one in which the assessee parted with an asset of enduring value. The compensation received was compensation for loss of capital. It was inconsequential whether the appellant conducted the remaining agencies after the determination of the one in question.

Where payment is made as compensation for cancellation of a contract which does not affect the trading structure of the business, nor causes 'deprivation of what in substance is

source of income, and is a normal incident of the business, the compensation is revenue. But where the cancellation impairs the trading structure or results in loss of the source of income, the compensation paid for the cancellation of the agreement is normally capital receipt.

Commissioner of Income-tax Nagpur v. Rai Bahadur Jairam Yalji, 35 I.T.R. 148, referred to.

Commissioner of Income-tax v. Shaw Wallace and Co. L.R. 59 I.A. 206, explained.

Raja Bahadur Kamakshaya Narain Singh of Ramgarh v. Commissioner of Income-tax, Bihar and Orissa, L.R. 70 I.A. 180, Commissioner of Income-tax and Excess Profits Tax Madras v. South India Pictures, 29 I.T.R. 910, Peirce Leslie and Co. Ltd. v. Commissioner of Income-tax, Madras, 38 I.T.R. 356, Commissioner of Income-tax, Hyderabad-Deccan v. Vazir Sultan and Sons. 36 I.T.R. 175 and Godrej & Co. v. Commissioner of Income-tax, Bombay City, 37 I.T.R. 381, discussed.

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 226 of 1963.

Appeal from the judgment and order dated August 1, 1961, of the Calcutta High Court in Income-tax Reference No. 75 of 1956.

S. Chaudhuri, D. N. Mukherjee 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 is a public limited company. and has its registered office at Calcutta. By an agreement dated May 1, 1925, the Fort William Jute Company Ltd. appointed the appellant its managing agent upon certain terms and conditions set out therein. Under the agreement the appellant was to receive as managing agent remuneration at the rate of Rs. 3,000 per month, commission at the rate of ten per cent on the profits of the company's working, additional commission at three per cent on the cost price of all new machinery and stores purchased by the managing agent outside India on account of the company, and interest on all advances made by the managing agent to the company on the security of the company's stocks, raw materials and manufactured goods. The appellant and its successors in business, whether under the same or any other style or firm, unless they resigned their office were entitled to continue as managing agent until they ceased to hold shares in the capital of the company of the aggregate nominal value of Rs. 1,00,000 and were on that account removed by a special resolution of the company passed at an Extraordinary meeting of the company, or until the managing agent's tenure was determined by the winding up of the company. In the event of termination of agency in the contingencies specified, the managing agent was to receive such reasonable compensation for deprivation of office, as may be agreed upon between the managing

agent and the company and in case of dispute, as may be determined by two arbitrators. By cl. 8, the managing agent was at liberty at any time to resign the office of managing agent by leaving at the registered office of the company previous notice in writing of its intention in that behalf. The agreement did not specify any period for which the managing agency was to enure. Since the successors of the appellant were also to continue as agents, unless they resigned or became disqualified, the duration was in a sense unlimited. But by virtue of s. 87-A(2) of the Indian Companies Act, 1913, the appointment of the appellant as managing agent would expire on January 14, 1957, i.e. on the expiry of twenty years from the date on which the Indian Companies (Amendment) Act, 1956, was brought into operation. Section 87-A(2), however, did not prevent the managing agent from being re-appointed after the expiry of that period.

Beside the managing agency of the Fort William Jute Co. Ltd. the appellant held at all material time managing agencies of five other limited companies, viz., Fort Closter Jute Manufacturing Co. Ltd., Bowreach Cotton Mills Co. Ltd., Dunbar Mills Ltd., Mothola Co. Ltd and Joonktollee Tea Co. Ltd. The appellant had advanced Rs. 12,50,000 to the Fort William Jute Co. Ltd. on the security of the stocks, raw materials and manufactured goods of that company. The appellant held in 1952, 600 out of 14,000 ordinary shares of the face value of Rs. 100 each. and 6,920 out of 10,000 preference shares also of the face value of Rs. 100 each. On May 21, 1952, the appellant entered into an agreement with M/s Mugneeram Bangur & Co., the principal conditions of which were:

(i) M/s Mugneeram Bangur & Co. to purchase the entire holding of shares of the appellant in the Fort William Jute Co. Ltd.-ordinary shares at Rs. 400 each and preference

-,hares at Rs. 185 each, and to make an offer to all holders of the company's shares-preference and ordinary-to purchase their holdings at the same rates;

(ii) M/s Mugneeram Bangur & Co. to procure repayment on or before June 30, 1952 of all loans made by the appellant to the principal company;

(iii) M/s Mugneeram Bangur & Co. to procure that the principal company will compensate the appellant for loss of office in the sum of Rs. 3,50,000, such sum being payable to the appellant after it submitted its resignation as managing agent; and

(iv) M/s Mugneeram Bangur & Co. to reimburse the company the amount payable to the appellant.

The reasons for which the appellant agreed to relinquish the managing agency were set out in a letter dated May 28, 1952, addressed by the appellant to the members of the company intimating that M/s Mugneeram Bangur & Co. were willing to purchase the shares at the same rates at which they had agreed to purchase the share-holding of the appellant. It was recited in the letter that the installation of modern machinery in the company's factory entailed heavy capital expenditure and it was necessary to obtain a loan secured by debentures charged on the company's property; that large sums were required for renewals and replacements of machinery and it was not possible to obtain additional bank accommodation; that the appellant had made large advances to the company exceeding Rs. 12,50,000 and, having regard to its other commitments, it was doubtful if it would be

able to make available to the company additional finance; that the arrangement with M/s Mugneeram Bangur & Co., by acceptance of the terms offered by them, was the most satisfactory method of solving the company's difficulties; that it was in the best interests of the shareholders to terminate the appointment of the appellant which in the normal course would not fall due for renewal until January 14, 1957; that M/s Mugneeram Bangur & Co. had agreed to procure that the Fort William Jute Co. Ltd. will pay to the appellant Rs. 3,50,000 and that M/s Mugneeram Bangur & Co. will reimburse the company for the payment, it being anticipated that they will in due course be appointed managing agents of the company.

The arrangement with M/s Mugneeram Bangur & Co. was carried out. The appellant tendered its resignation with effect from July 1, 1952, in pursuance of the terms of the agreement and M/s Mugneeram Bangur & Co. were appointed as managing agent of the company. The sum of Rs. 3,50,000 received by the appellant from the company which it is common ground was provided by M/s Mugneeram Bangur & Co.-was credited in the profit and loss account of the appellant as received from the Fort William Jute Co. Ltd. on account of compensation for loss of office. But in arriving at the net profit in the return for income-tax for the year 1953-54 this amount was deleted. In the proceedings for assessment for the year 1953-54 the Income-tax Officer, Companies District 1V, Calcutta, included this amount in the appellant's taxable income. In appeal the Appellate Assistant Commissioner modified the assessment holding that the sum of Rs. 3,50,000 received by the appellant as compensation for surrendering the managing agency, which was to endure for five years more, and which in normal course might have continued for another term of twenty years, was a capital receipt. The Appellate Tribunal confirmed the order of the Appellate Assistant Commissioner, observing that compensation received under an agreement for "an outright sale of such an agency to a third party", not being one which a businessman enters in the normal course of business, nor being one which amounts to modification, alteration or discharge of normal incidents of such a business, was not assessable to income-tax as a revenue receipt. At the instance of the Commissioner of Income-tax, the Tribunal referred under s. 66(1) of the Income-tax Act, 1922, the following question to the High Court of Judicature at Calcutta:

"Whether on the facts and in the circumstances of the case the sum of Rs. 3,50,000 received by the assessee to relinquish the managing agency was a revenue receipt assessable under the Indian Income-tax Act?"

The High Court, for reasons which we will presently set out, answered the question in the affirmative. With certificate granted by the High Court, this appeal is preferred by the appellant.

This case raises once again the question whether compensation received by an agent for premature determination of the contract of agency is a capital or a revenue receipt. The question is not capable of solution by the application of any single test: its solution must depend on a correct appraisal in their true perspective of all the relevant facts. As observed in *Commissioner of Income-tax Nagpur v. Rai Bahadur Jairam Valji*(1) by Venkatarama Aiyar, J.,: "The question whether a receipt is capital or income has frequently come up for determination before the courts. Various rules have been enunciated as furnishing a key to the solution of the question, but as often observed by the highest authorities, it is not possible to lay down any single test as infallible or any single criterion as

decisive in the determination of the question, which must ultimately depend on the facts of the particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a decision. Vide, *Van Den Berghs Ltd. v. Clark* [(1935) 3 I.T.R. (Engl. Cas.) 17]. That, however is not to say that the question is one of fact, for as observed in *Davies (H. M. Inspector of Taxes) v. Shell Company of China Ltd.* (1952) 22 I.T.R. (Suppl.) 1) these questions between capital and income, trading profit or no trading profit, are questions which, though they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts'. " (1) [1959] SUPP. 1 S.C.R. 110, 113.

The interrelation of facts which have a bearing on the question propounded must therefore first be determined. The managing agency was not, except in the circumstances set out in cl. 2 of the agreement, liable to be determined at the instance of the company before January 14, 1957, unless the appellant by giving notice of three weeks voluntarily resigned the agency. At the date of termination the agency had five more years to run, and the Companies Act did not prohibit renewal of the agency in favour of the appellant, after the expiry of the initial period of twenty years. The appellant company was formed for the object, amongst others, (vide cl. 3(2) of the Memorandum of Association of the appellant) of carrying on the business of managing agencies. The appellant was entitled under the terms of the agreement to receive so long as the agency endured 'Len per cent of the profits of the company's working, three per cent on all purchases of stores and machinery abroad, and a monthly remuneration of Rs. 3,000. The appellant submitted its resignation in exercise of the power reserved under cl. 8 of the managing agency agreement, but that resignation was it is common ground part of the arrangement with M/s Mugneeram Bangur & Co. dated May 21, 1952. Under the terms of the managing agency agreement, the principal company was not obliged to pay any compensation to the appellant for voluntary resignation of the agency, but in consideration of the appellant parting with its shareholding and submitting resignation of the managing agency so as to facilitate the appointment of M/s Mugneeram Bangur & Co. as managing agent, the latter purchased the shareholding of the appellant, undertook to make available Rs. 3,50,000 for payment to the appellant and to discharge the debt due by the company to the appellant. Payment of Rs. 3,50,000 was therefore an integral part of an arrangement for transfer of the managing agency. A managing agency of a company is in the nature of a capital asset: that is not denied. It is true that it is not like an ordinary asset capable of being transferred from one person to another. Theoretically the power to appoint or dismiss the managing agent may lie with the directors of the company, but in practice the power lies with the person or per-

sons having a controlling interest in the share-holding of the company. M/s Mugneeram Bangur & Co. were anxious to be appointed managing agents of the principal company, and for the purpose the appellant had to be persuaded to agree to a premature termination of its agency. This was secured for a triple consideration; sale of shares held by the appellant at an agreed price, stipulation to discharge the liability of the company to repay the loans due by the company, and payment of Rs. 3,50,000 as compensation for termination of the appellant's agency.

The High Court summarised the effect of the agreement between the appellant and M/s Mugneeram Bangur & Co. as follows: The sum of Rs. 3,50,000 described as compensation for loss of office of the

managing agent was part of the whole scheme incorporated in the agreement. Each clause of the agreement was a consideration of the other clauses and payment of compensation for the alleged loss of office did not, being part of the total scheme, stand by itself. Determination of the managing agency of the appellant was not compulsory cessation of business: it was a voluntary resignation for which under the agency agreement the appellant was not entitled to any compensation, but by the device of procuring a purchaser the appellant was doing "business of selling the managing agency and getting a profit and value for it which it otherwise could not have got". The High Court stamped this transaction with the nature and character of a "trading or a business deal", because in their view the managing agency of a company-an institution peculiar to Indian business conditions--which creates a managing agent as an alter ego. of the managed company with authority to utilise the existing structure of the company's Organisation to carry on business, earn profits, and in fact, virtually to trade in every possible sphere open to the company, may. be regarded as circulating capital, where several managing agencies are conducted by an assessee. Therefore in the view of the High Court the compensation received for surrendering the agency was remuneration received on account of conducting the business, and was income. The judgment of the High Court proceeded substantially upon the following two grounds:

(1) that on the facts of the case, the managing agency held by the appellant of the Fort William Jute Co. Ltd. was stock-in-trade; and (2) that the appellant was formed with the object of acquiring managing agencies, and in fact held managing agencies of as many as six com-

panies. Earning profits by conducting the management of companies, being the business of the appellant, compensation received as consideration for surrendering the managing agency was a revenue receipt.

We are unable to agree with the High Court that the managing agency of the Fort William Jute Co. Ltd. was an asset of the character of stock-in-trade of the company. The appellant was formed with the object, among others, of acquiring managing agencies of companies and to carry on the business and to take part in the management, supervision or control of the business or operations of any other company, association, firm or person and to make profit out of it. That only authorised the appellant to acquire as a fixed asset, if a managing agency may be so described, and to exploit it for the purpose of profit. But there is no evidence that the company was formed for the purpose of acquiring and selling managing agencies and making profit by those transactions of sale and purchase. A managing agency is not an asset for which there is a market, for it depends upon the personal qualifications of the agent. Counsel appearing on behalf of the Commissioner concedes that the case that the managing agency was of the nature of stock-in- trade was not set up before the Tribunal, and he does not rely upon this part of the reasoning of the High Court in support of the plea that the compensation received by the appellant is a revenue receipt. He relies upon the alternative ground, and contends that the managing agency of the Fort William Jute Co. Ltd. was part of the framework of the business of earning profit by working as managing agent of different companies, and in the normal course, termination of employment by the principal companies of the appellant as managing agent being a normal incident of such business, compensation received by the appellant is not for loss of capital, but must be regarded as a trading receipt especially when the termination of the agency does not impair the structure of the business of the appellant. In the

present case there is a special circumstance which must first be noticed. In truth the amount of Rs. 3,50,000 was received by the appellant from M/s Mugneeram Bangur & Co. in consideration of the former agreeing to forego the agency which it held and which M/s Mugneeram Bangur & Co. were anxious to obtain. It was in a business sense a sale of such rights as the appellant possessed in the agency to M/s Mugneeram Bangur & Co. This is supported by the recitals made in cl. 2 of the agreement that if at any time within six months after the completion of such sale, M/s Mugneeram Bangur & Co. were unable to exercise the voting rights attached to the shares purchased by them the appellant will appoint any person nominated by M/s Mugneeram Bangur & Co. to attend and vote for them at any meeting of the company or the holders of any class of shares to be held within such period in such manner as M/s. Mugneeram Bangur & Co. may decide. The object underlying the agreement was therefore to transfer the managing agency to M/s Mugneeram Bangur & Co. or at least to effectuate their appointment in place of the appellant as managing agent of the Fort William Jute Co. Ltd. All the stipulations and the covenants of the agreement, viewed in the light of the surrounding circumstances, do stamp the transaction as one of surrender of the rights of the appellant in the managing agency so that corresponding rights may arise in favour of M/s. Mugneeram Bangur & Co. It would be irrelevant in considering the true nature of the transaction, to project the somewhat legalistic consideration that a managing agency is not transferable. It is because it is not directly transferable, that the arrangement incorporated in the agreement was effected. It would be difficult to regard such a transaction relating to a managing agency as a trading transaction. Counsel for the assessee contended that even assuming at the form of the transaction under which for loss of the managing agency the appellant received compensation from the principal company is decisive, or has even a dominant impact, and the ultimate source from which the compensation was provided is to be ignored, the compensation received for loss of agency by the agent must always be regarded under the Indian Income-tax Act as capital receipt. In support of that contention counsel placed strong reliance upon the judgment of the Judicial Committee in Commissioner of Income-tax v. Shaw Wallace and Co.('). In the alternative, counsel pleaded that even if the extreme proposition was not found acceptable, the right of the assessee in the managing agency of the principal company was to endure for another five years and which in the normal course would have continued for another twenty years was an enduring asset and consideration received by the appellant for extinction of that asset was a capital receipt.

On behalf of the Income-tax Department it was contended that Shaw Wallace & Co's case(') does not lay down any proposition of general application to compensation paid for determination of all agency contracts. It was further submitted that, having regard to the nature of the agreement and the voluntary resignation submitted by the assessee no enduring asset remained vested in the assessee, and none was attempted to be transferred: the compensation directly paid by the principal company (which compensation was under the terms of the contract not payable) was only a "measure of profit" which the appellant would, but for the resignation, have earned, and was therefore in the nature of revenue. It was also urged that compensation was not payable to the assessee when resignation of the managing agency was tendered under cl. 8 of the agreement, and therefore the amount sought to be brought to tax was received by the assessee in the course of a normal trading transaction of the assessee. Finally, it was urged that in any event, by the loss of the agency the framework of the business of the assessee was not at all impaired, and therefore also the compensation received must be regarded as revenue and not capital.

Whether a particular receipt is capital or income from business, has frequently engaged the attention of the court. It may be broadly stated that what is received for loss of cap-

(1) L. R. 59 I. A. 206 is a capital receipt: what is received as profit in trading transaction is taxable income. But the difficulty arises in ascertaining whether what is received in a given case is compensation for loss of a source of income, or profit in a trading transaction. Cases on the borderline give rise to vexing problems. The Act contains no real definition of income; indeed it is a term not capable of a definition in terms of a general formula. Section 2(6C) catalogues broadly certain categories of receipts which are included in income. It need hardly be said that the form in which the transaction which gives rise to income is clothed and the name which is given to it are irrelevant in assessing the exigibility of receipt arising from a transaction to tax. It is again not predicated that the income must necessarily have a recurrent quality. We are not called upon to enter upon an extensive area of enquiry as to what receipts may be regarded as income generally, but merely to consider in this case whether receipt of compensation for surrendering the managing agency may be regarded as capital or as revenue. In the absence of a statutory rule, payment made by an employer in consideration of the employee releasing him from his obligations under a service or agency agreement or a payment made voluntarily as compensation for determination of right to office arises not out of employment, but from cessation of employment and may not generally constitute income chargeable under ss. 10 and

12. It may be mentioned that this rule has been altered by the legislature by the enactment of s. 10(5A) by the Finance Act of 1955, which provides that compensation or other payment due to or received by a managing agent of an Indian company at or in connection with the termination or modification of his managing agency agreement with the company, or by a manager of an Indian company at or in connection with the termination of his office or modification of the terms and conditions relating thereto, or by any person managing the whole or substantially the whole affairs of any other company in the taxable territories at or in connection with the termination of his office or the modification of the terms and conditions relating thereto, or by any person holding an agency in the taxable territories for any part of the activities relating to the business of any other person, at or in connection with the termination of his agency or the modification of the terms and conditions relating thereto, shall be deemed to be profits and gains of a business carried on by the managing agent, manager or other person, as the case may be, and shall be liable to tax accordingly. But this amendment was made under the Finance Act, 1955, with effect from April 1, 1955, and has no application to the present case.

The Indian Income-tax Act is not in *pari materia* with the English Income-tax Statutes. But the authorities under the English Law which deal not with the interpretation of any specific provision, but on the concept of income, may not be regarded as proceeding upon any special principles peculiar to the English Acts so as to render them inapplicable in considering problems arising under the Indian Income-tax Act. It is well-settled in England that money paid to compensate for loss caused to an assessee's trade is not income. In *Short Bros. Ltd. v. The Commissioner of Inland Revenue*(1) a sum received as compensation for loss resulting from cancellation of a contract was held to be revenue in the ordinary course of the assessee's trade, and liable to excess profits duty. Similarly in *The Commissioners of Inland Revenue v. The North fleet Coal and Ballast Co. Ltd.*(2),

compensation paid by a person who had agreed to purchase a certain quantity of chalk yearly for ten years, from a company which was the owner of a quarry, in consideration of being relieved of his liability under the contract was held chargeable to excess profits duty as trading profit in the hands of the company. In *The Commissioners of Inland Revenue v. Newcastle Breweries Ltd.*⁽³⁾ compensation received under an order of the War Compensation Court, under the Indemnity Act, 1920, in addition to what was paid by the Admiralty for rum taken over in exercise of the power under the Defence of the Realm Regulations was held to be revenue.

(1) 12 T. C. 955 (3) 12 T. C. 927 (2) 12 T. C. 1102 In *Ensign Shipping Co. Ltd. v. The Commissioner of Inland Revenue*⁽¹⁾ an amount paid by the Government to a ship-owner to compensate him for loss resulting from detention of his ships during a coal-strike, and for wages etc. was held liable to excess profits duty. Again as held in *Burma Steam Ship Co. Ltd. v. Commissioners of Inland Revenue*⁽¹⁾ money received by a ship-owner from a firm of ship-builders to compensate for loss resulting from the failure by the latter to complete repairs to a ship within the stipulated period was regarded as revenue.

These cases illustrate the principle that compensation for injury to trading operations, arising from breach of contract or in consequence of exercise of sovereign rights, is revenue. These cases must, however, be distinguished from another class of cases where compensation is paid as a solatium for loss of office. Such compensation may be regarded as capital or revenue: it would be regarded as capital, if it is for loss of an asset of enduring value to the assessee, but not where payment is received in settlement of loss in a trading transaction. In *Chibbet v. Joseph Robinson & Sons*³⁾ the assessee who were ship-managers employed by a steamship company under a contract which provided that they should be paid a percentage of the company's income, were paid compensation for loss of office in anticipation of liquidation of the steamship company. It was held that payment to make up for loss resulting from cessation of profits from employment was not itself an annual profit, but was payment in respect of termination of employment and was not assessable to tax. In *Du Cros v. Ryall*⁽⁴⁾ the assessee settled a claim made by his employee for damages for wrongful dismissal and paid 57,250 as compensation for wrongful dismissal. It was held that no. part could be apportioned to salary and commission and the whole escaped assessment.

In *Duff v. Barlow*⁽¹⁾ the managing director of the appellant company who was employed for a period of ten (1) 12 T. C. 1169.

(3) 9 T. C. 48.

(2) 16 T. C. 67.

(5) 23 T. C. 631. (4) 19 T. C. 444.

years was asked by it to manage the business of one of its subsidiaries, and to receive a percentage of profits made by the subsidiary. The employment was terminated by mutual agreement two years after its commencement and 4,000 were paid as compensation to the managing director for loss of his rights of future remuneration. This was held not taxable. because it was a sum paid as

compensation for loss of a source of income and hence a capital asset. This case was followed in *Henley v. Murray*(') where the appellant employed as a managing director of a property company under a service agreement which was not determinable till March 31, 1944, was also appointed a director of a subsidiary company. At the request of the Board of directors of the property company the appellant resigned his office in the property company as well as its subsidiary and received from the property company an amount equal to the remuneration which he would, under the agreement, have been entitled to, if his appointment had not been determined. It was held by the Court of Appeal that the use of the expression "compensation for loss of office" was not the determining factor when the bargain itself stood cancelled, and the sum paid was in consideration of total abandonment of all contractual rights which the other party had. The receipt was in the circumstances not taxable. The payment was not voluntarily made; the bargain was that the appellant should resign and in consideration thereof, *In Barr, Grombie and Co. Ltd. v. Commissioners of Inland Revenue*(') the appellant company managed the ships of another company under an agreement for a period of fifteen years. The shipping company went into liquidation and a sum exceeding pound 16,000 was paid to the appellant company for the eight years which were still to run to the date of expiry of the agreement. Over a period upwards of sixteen years only two per cent of the appellant company's income was derived from other managements, and on the liquidation of the shipping company the appellant company lost its entire business except for some abnormal and temporary business. It was held by the Court of Ses-

(1) 31 T. C. 351 (2) 26 T. C. 406 sion in Scotland that the sum in question was not a trading receipt of the appellant company. Lord President Normand observed:

"In the present case virtually the whole assets of the Appellant Company consisted in this agreement. When the agreement was surrendered or abandoned practically nothing remained of the Company's business. It was forced to reduce its staff and to transfer into other premises, and it really started a new trading life. Its trading existence as practised up to that time had ceased with the liquidation of the shipping Company."

These cases establish the distinction between compensation for loss of a trading contract and solatium for loss of the source of income of the assessee.

But payment Of compensation for loss of office is not always regarded as capital receipt. Where compensation is payable under the terms of the contract, which is determined, payment is in the nature of revenue and therefore taxable. For instance in *Henry v. Foster*(') it was held that when compensation stipulated under a contract is paid for loss of office, it is taxable under Sch. 'E', and it was also held in *Dale v. De Soissons*(2) that compensation paid under an agreement to an Assistant of the managing director for premature termination of employment was held to be income. The principle on which these cases proceeded was also applied by the Court of Session in Scotland in *Kessal Parsons and Co. v. Commissioners of Inland Revenue*(3) to a case in which there was no express term for payment of compensation on termination of employment. The appellants in that case carried on business as agents on a commission basis for sale in Scotland of the products of various manufacturers, and entered into agency agreements for that purpose. At the instance of the manufacturer concerned, one of the agreements which was for a period of three years was

terminated at the end of the (1) (1931) 145 L. T. R. 225 (3) 21 T. C. 608, 520 (2) [1950] 2 All E. R 460 second year in consideration of a payment of pounds_ 1,500. It was held by the Court of Session that no capital asset of the assessee was depreciated in value, or became of less use for the purpose of the assessee's business. The sum paid was accordingly included in the calculation of the taxable profits for the year in which it was received. Lord President Normand Observed.

"We are not embarrassed here by the kind of difficulties which arise when, by agreement, a benefit extending over a tract of future years is renounced for a payment made once and for all. The sum paid in this case is really and substantially a surrogatum for one year's profits." The foundation of the distinction made in Kelsall Parsons and Co.'s case(): Henry v. Foster(): and Dale v. De Soissons(3) is to be found in the observations made by Lord Macmillan in Van Den Berchs Ltd. v. Clark(). In that case two companies which were manufacturers of ,margarine an margarine and similar products entered into an agreement with a view to end competition between them and to work in friendly alliance and to share the profits and losses in accordance with an elaborate scheme. This arrangement was terminated by mutual agreement in consideration of the payment by the Dutch company pound 450,000 to the appellant company as damages. It was held by the House of Lords that the amount was received by the appellant as payment for cancellation of the appellant company's future rights under the agreements, which constituted a capital asset of the company, and that it was a capital receipt. lord Macmillan observed.

"Now what were the Appellants giving up? They gave up their whole rights under the agreements for thirteen years ahead. These agreements are called in the States Case "pooling agreements", but that is a very inadequate description of them, for they did much more than (1) 21 T.C. 608,620 (2) [1931] 145 L.T.R.

(3) [I950] 2 All E.R. 460 (4) 19 T. C. 390, 431 merely embody a system of pooling and sharing profits. If the Appellants were merely. receiving in one sum down the aggregate of profits which they would otherwise have receiv- ed over a series of years, the lump sum might be regarded as of the same nature as the ingredients of which it was composed. But even if a payment is measured by annual receipt, it is not necessarily in itself an item of income." Cases which have lately arisen before the Courts in the United Kingdom have elaborated this distinction. In Commissioner of Inland Revenue v. Fleming and Co.(') the Court, of Session held following Kelsall Parsons & Cos' case(), that compensation paid to the assessee who carried on business as manufacturers' agent and general merchants and had acted as the sole agents since 1903 for certain products of the manufacturers for termination in 1948 of the agency at the instance of the manufacturers was regarded as revenue. In the view of Lord President Cooper the cases relating to determination of agencies, broadly speaking, fell on two sides of the line drawn in the light of the varying circumstances:

(a) "the cancellation of a contract which affects the profit-making sructure of the recipient of compensation and involves the loss of an enduring trading asset"; and

(b) "the cancellation of a contract which does not affect the recipient's trading structure nor deprive him of any enduring trading asset, but leaves him free to devote his energies and Organisation released by the cancellation of the contract to replacing the contract which has been lost by other

like contracts", and held that the case fell within the second class, and not the first.

In *Wiseburgh v. Domville*(3) the appellant had entered into an agreement in 1942 under which he acted (1) 33 T. C. 57 (3) 36 T. C. 527 (2) 21 T.C. 608, (20 as sole agent for the manufacturer. In 1948 when this agreement could have been determined by notice expiring in October 1949, the manufacturer dismissed him. The appellant received pound 4,000 as damages for breach of agreement. The appellant had several agencies from time to time as agents and it was one of the incidents of agency business that one agency may be stopped and another may come and it being a normal incident of the kind of business that the appellant was doing, that an agency should come to an end, compensation paid was regarded as income on the principle laid down in *Kelsall Parsons and Co.'s case*(').

In another case which soon followed-*Anglo French Exploration Co. Ltd. v. Clayson*(2)-the appellant company carried on business, among others, is secretary and agent for a number of other companies. A South African Company appointed the appellant company as its secretary and agent at a remuneration of pound 1,500 per annum under a contract terminable at six months' notice. Under an arrangement with the purchaser of the controlling interest of the shareholders under which the appellant company was to resign its office as secretary and agent of the South African Company, an amount of pound 20,000 received by the appellant company was held by the Court of Appeal in the nature of a trading receipt.

In *Blackburn v. Close Bros. Ltd.*(') the respondent company carried on business of merchant bankers and of a finance and issuing house and derived income in the form of allowances for performing managerial and secretarial services. Following a dispute with one 'S' for which the respondent company had agreed to provide secretarial services for three years at a remuneration of pound 8,000 per annum, the agreement was terminated within about 2-1/2 months from the date of its commencement. pound 15,000 received by the respondent company as compensation for termination of the agreement was held to be a trading receipt. *Pennycuik J.*, held that the contract was one of a number of ordinary commercial contracts for rendering (2) 36 T. C. 545 (1) 21 T.C. 608, 620 39 T.C. 164 services by the assessee in the course of carrying on its trade, and therefore the sum received on the cancellation of the agreement was a receipt of a revenue nature. It is manifest that the principle broadly stated in the earlier cases, that compensation for loss of office, or agency, must be regarded as a capital receipt, has not been approved in later cases. An exception has been engrafted upon that principle that where payment even if received for termination of an agency agreement, the agency is one of many which the assessee holds, and the termination of the agency does not impair the profit making structure, but is within the framework of the assessee's business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken, the receipt is revenue and not capital.

A case on the other side of the line may be noticed: *Sabine v. Lookers Ltd.*('). Under agreements, annually renewed with the manufacturers, the respondent company had acted for many years as their main distributors in the Manchester area of the manufacturers' products, which it bought for resale. The respondent had sunk considerable sums in fixtures and equipment specially designed for the trade of wholesale dealers and carried a large stock of spare parts mainly for wholesale sale. The

whole of the trade of the respondent was geared to the display, sale, service and repairs of the manufacturers' products. Upto 1952 inclusive,, the manufacturers had included in its agreements with distributors a standard "continuity clause, giving the distributors, on certain conditions, the option of renewal for a further year. But in 1953, the manufacturers adopted a new standard agreement, containing a new continuity clause which the respondent company regarded as giving it less security than before. As compensation for loss resulting from the alterations, the manufacturers paid to the respondent company, a sum calculated on sales to the trade during the contract period. It was held that this was a capital receipt, because, by the, modification the framework of the respondent's business was impaired. (1) 38 T. C. 120 Elaborate arguments were presented before us on the decision of the Judicial Committee in *Shaw Wallace & Co.'s Case*('). The appellant contended that *Shaw, Wallace's Case*(') laid down a principle of general application applicable to all cases of compensation received from the principal as solatium for determination of the contract of agency. Counsel for the Revenue contended that the principle should be restricted to its special facts, and cannot be extended in view of the later decisions. It is necessary to closely examine the facts which gave rise to that case. *Shaw Wallace & Company* carried on business as merchants and agents of various companies and had branch offices in different paris of India. For a number of years they acted as distributing agents in India for the *Burma Oil Company* and the *Anglo-Persian Oil Company*, but without a formal agreement with either company. The two Oil Companies having combined decided to make other arrangements for distributing their products. Each Company terminated its contract with *Shaw Wallace & Company* and paid compensation to it, which aggregated to Rs. 15,25,000. This amount, subject to certain allowances, was sought to he assessed to income-tax under ss. 10 and 12. The High Court of Calcutta held that the compensation received by the assessee was a capital receipt. In appeal to His Majesty in Council the decision of the High Court was affirmed.

The Judicial Committee declined to seek inspiration from the English decisions cited at the Bar. The Board observed that the expression "income" which is not defined in the Act connotes a periodical monetary return coming in with some sort of regularity, or expected regularity, from definite sources: the source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return, excluding anything in the nature of a mere windfall. They further observed that the income chargeable under head (iv) of s. 6 business" read with s. 10 is to be in respect of the profits and gains of any business carried on by the assessee, and therefore the sums which the Income-tax Department sought to charge could only be taxable if they were the pro- (1) L.R. 59 I.A. 206.

duce or the result of-carrying on the agencies of the Oil Companies in the year in which they were received by the assessee. But when once it was admitted that they were sums received, not for carrying on this business, but as some sort of solatium for its compulsory cessation, the answer seemed fairly plain. The Board observed that if compen- sation received for sale of the business or its goodwill was capital, the same reasoning ought to apply when the sum received was in the nature of a solatium for cessation of a part of the business, and it was a matter of no consequence that the assessee continued to pursue its other independent commercial interests, and profits from which were taxed in the ordinary course, for the sums sought to be taxed had no connection with the continuance of the assessee's other business: the profits earned by the assessee, it was observ- ed,

were "the fruit of a different tree, the crop of a different field", and if under s. 10 the compensation was not taxable, it was not taxable under s. 12 under the head "other sources" as well.

The judgment of the Board proceeds upon the ground that compensation received not for carrying on the business, but as solatium for its compulsory cessation, would be regarded as capital receipt, and for the application of this principle, existence of other independent commercial interests out of which profits were earned by the assessee was irrelevant. Two comments may be made at this stage. It cannot be said as a general rule, that what is determinative of the nature of the receipt is extinction or compulsory cessation of an agency or office. Nor can it be said that compensation received for extinction of an agency may always be equated with price received on sale of goodwill of a business. The test, applicable to contracts for termination of agencies is: what has the assessee parted with in lieu of money or money's worth received by him which is sought to be taxed? If compensation is paid for cancellation of a contract of agency, which does not affect the trading structure of the business of the recipient, or involve loss of an enduring asset, leaving the tax-payer free to carry on his trade released from the contract which is cancelled, the receipt will be a trading receipt: where the cancellation of a contract of agency impairs the trading structure, or involves loss of an enduring asset, the amount paid for compensating the loss is capital.

The view expressed by the Judicial Committee has not met with unqualified approval in later cases, Lord Wright in *Raja Bahadur Kamakshya Narain Singh of Ramgarh v. Commissioner of Income-tax, Bihar and Orissa*(¹) observed that it is incorrect to limit the true character of income, by such picturesque similes like "fruit of a different tree, or crop of a different field". Again it cannot be said generally that compensation for every transfer or determination of a contract of agency is capital receipt: *Kelsall Parsons & Co. v. Commissioner of Inland Revenue*(²): *Commissioners of Inland Revenue v. Fleming & Co.* (3): *Wiseburgh v. Domville*(⁴) and *Commissioner of Income-tax and Excess Profits Tax, Madras v. South India Pictures Ltd.*(⁵). Nor is it true to say that where an assessee holds several agency contracts, each agency contract cannot without more be regarded as independent of the other contracts, and income received from each contract cannot always be regarded as unrelated to the rest of the business continued by the assessee. The decision in *Shaw Wallace Co.'s case*(⁶) cannot therefore be read to yield the principle that compensation for loss of an agency may in all cases be regarded as capital receipt. Nor does it lay down that where the assessee has several lines of business each line must in ascertaining the character of compensation for loss of a line of business be deemed an independent source. This view is exemplified by decisions of this Court and a decision of the Madras High Court. In the *South India Pictures Ltd.'s case*(⁵) compensation received for determination of the distribution rights of films was held taxable. After the assessee had exploited partially its right of distribution of cinematographic films to which it was entitled under the terms of agreement under which he had advanced money to the producers, the agreements were cancelled and the producers paid an aggregate sum of Rs. 26,000 to the assessee towards commission. It was held by Das C. J., (1) L. R., 70 1. A. 180 (2) 21 T.C. 608, 620 (3) 33 T.C. 57 (4) 36 T.C. 527 (5) 29 1. T. R. 910 (6) L.R. 59 I.A. 206 and Venkaterama Aiyar, J., (Bhagwati J., dissenting) that the sum paid to the assessee was not compensation for not carrying on its business, but was a sum paid in the ordinary course of business to adjust the relations between the assessee and the producers, and was taxable. Similarly in *Rai Bahadur Jairam Valji's case*(⁷) a contract for the supply of limestone and dolomite was terminated when the purchaser the Bengal Iron Company

Ltd. found the rates uneconomical. A suit was then filed by the respondent for specific performance of the contract and for an injunction restraining the company from purchasing limestone and dolomite from any other person. A fresh agreement made between the respondent and the company fell through because of circumstances over which the parties to the agreement had no control. The company then agreed to pay Rs. 2,50,000 to the respondent as solatium, besides the monthly instalments of Rs. 4,000 remaining unpaid under the contract of 1940. The Income-tax Department sought to bring to tax the amount of Rs. 2,50,000 and the balance due towards the monthly instalments of Rs. 4,000. It was held by this Court that the sum of Rs. 2,50,000 was not paid to the respondent as compensation for expenses laid out for works at the quarry of a capital nature and could not be held to be a capital receipt on that account, the agreements were merely adjustments made in the ordinary course of business. There was in the view of the Court no profit-making apparatus set up by the agreement of 1941, apart from the business which was to be carried on under it and there was at no time any agreement which operated as a bar to the carrying of the business of the respondent and therefore the receipt of Rs. 2,50,000 was chargeable to tax. Venkatarama Aiyar, J., observed, in an agency contract the actual business consists of dealings between the principal and his customers, and the work of the agent is only to bring about the business: what he does is not the business itself, but something which is intimately and directly linked up with it. The agency may, therefore, be viewed as the apparatus which leads to the business rather than the business itself. Considered in this light the (1) [1959] Supp. 1 S.C.R. 110 agency right can be held to be of the nature of a capital asset invested in business. But this cannot be said of a contract entered into in the ordinary course of business. Such a contract is part of the business itself, not something outside it, and any receipt on account of such a contract can only be a trading receipt. Because compensation paid on the cancellation of a trading contract differs in character from compensation paid for cancellation of an agency contract, it should not be understood that the latter is always, and as a matter of law, to be held to be a capital receipt. An "agency contract which has the character of a capital asset in the hands of one person may assume the character of a trading receipt asset in the hands of another, as for example, when the agent is found to make a trade of acquiring agencies and dealing with them." Therefore, when the question arises whether the payment of compensation for termination of an agency is a capital or a revenue receipt, it must be considered whether the agency was in the nature of a capital asset in the hands of the agent, or whether it was only part of his stock-in-trade. The learned Judge also observed that payments made in settlement of rights under a trading contract are trading receipts and are assessable to revenue, but where a trader is prevented from doing so by external authority in exercise of a paramount power and is awarded compensation therefor, whether the receipt is a capital receipt or a revenue receipt will depend upon whether it is compensation for injury inflicted on a capital asset or on stock-in-trade. In *Pairce Leslie and Co. Ltd. v. Commissioner of Income-tax, Madras*(¹) the assessee company took up managing agencies of several plantation companies. The managing agencies were liable to termination, but the assessee was entitled to compensation by the terms of the agreement. The Talliar Estates Ltd. was one of the companies managed by the assessee. The agreement was a composite agreement about the managing agency rights and certain other rights. When the Talliar Estates Ltd. went into liquidation the assessee received Rs. 60,000 by way of compensation for loss of office and the question arose (1) 38 I. T. R. 356 whether that amount was income in the hands of the assessee. The Madras High Court held that the loss of one of several managing agencies had little effect on the structure of the assessee's business even in tea or on its profit earning apparatus as a whole and the termination of

the agreement with the Talhar Estates could well be said to have been brought about in the ordinary course of business of the assessee and therefore the amount received was a trading receipt.

In the South India Picture Ltd.'s case(): Rai Bahadur Jairam Valji's case() and Peirce Leslie Company's case() it was held that the receipt of compensation for loss of agency was in the nature of revenue. In the South India Pictures Ltd.'s case() the amount received was not compensation for not carrying on its business, but was a sum paid in the ordinary course of business to adjust the relations between the assessee and the producers; the termination of the agreements did not radically or at all affect or alter the structure of the assessee's business, and the amount received by the assessee was only so received towards commission i.e. as compensation for the loss of commission which it would have earned, had the agreements not been terminated. Therefore, the amount was not received by the assessee as the price of any capital assets sold or surrendered or destroyed, but the amount was simply received by the assessee in the course of its going distributing agency business and therefore it was an income receipt. In that case the majority of the Court held on three distinct grounds, viz., (i) that the assessee did not part with any capital asset; (ii) that the amount was received in the course of the distributing agency business which was continued, and (iii) that the termination of the agreements did not radically or at all affect or alter the structure of the assessee's business, that the sum received was revenue. Rai Bahadur Jairam Valji's case() was one of compensation received for termination of a trading contract. In Peirce Leslie and Company's case() there was termination of office, but it was held to be brought about in the ordinary course of the trading operations of the assessee.

(i) 29 I.T.R. 910 (2) [1959] Supp. I S.C.R. 110 (3)- 38 I.T.R. 356 On the other side of the line are cases of Commissioner of Income-tax, Hyderabad-Deccan v. Vazir Sultan and Sons() and Godrej and Co. v. Commissioner of Incometax, Bombay City (2). In Vazir Sultan and Son's case() the majority of the Court held that compensation paid for restricting the area in which a previous agency agreement operated was a capital receipt, not assessable to incometax. It was held that the agency agreements were not entered into by the assessee in the carrying on of their business, but formed the capital asset of the assessee's business which was exploited 'by the assessee by entering into contracts with various customers and dealers in the respective territories; it formed part of the fixed capital of the assessee's business and was not circulating capital or stock-in-trade of their business and therefore payment made by the company for determination of the contract or cancellation of the agreement was a capital receipt in the hands of the assessee.

In Godrej and Co.'s case() the managing agency agreement in favour of the assessee of a limited company which was originally for a period of thirty years and under which the assessee was entitled to a commission at certain rates was modified and remuneration payable to the managing agents was reduced. As compensation for agreeing to this reduction, the assessee received Rs. 7,50,000 which was sought to be taxed as income in the hands of the assessee. This Court held, having regard to all the attending circumstances, that the amount was paid not to make up the difference between the higher remuneration and the reduced remuneration, but in truth as compensation for releasing the company from the onerous terms as to remuneration as it was in terms expressed to be; so far as the assessee firm was concerned it was received as compensation for the deterioration or injury to the managing agency, by reason of the release of its rights to get higher remuneration and,

therefore, a capital receipts.

On an analysis of these cases which fall on two sides of the dividing line, a satisfactory measure of consistency (1) 36 I. T. R. 175 (3) 36 I.T.R. 175 (2) 37 I.T.R. 381 in principle is disclosed. Where 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.

In the present case, on a review of all the circumstances, we have no doubt that what the assessee was paid was to compensate him for loss of a capital asset. It matters little whether the assessee did continue after the determination of its agency with the Fort William Jute Co. Ltd to conduct the remaining agencies. The transaction was not in the nature of a trading transaction, but was one in which the assessee parted with an asset of an enduring value. We are, therefore, unable to agree with the High Court that the amount received by the appellant was in the nature of a revenue receipt.

We accordingly record the answer on the question submitted by the Tribunal in the negative. The appellant would be entitled to its costs in this Court.