
(1994) 12 BOM CK 0023
In the Bombay High Court
Case No : IT Ref. No. 220 of 1984

Blue Star Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 06-12-1994

Acts Referred:

Income Tax Act, 1961 — Section 35B, 37(1), 4

Citation : (1996) 217 ITR 514

Hon'ble Judges : S.M. Jhunjunwala, J;B.P. Saraf, J

Bench : Division Bench

Advocate : J.D. Mistry and C.B. Mehta, for the Appellant; G.S. Jetly and P.S. Jetly, instructed by Smt. S. Bhattacharya, for the Respondent

Judgement

S.M. Jhunjunwala, J.—By this reference made under S. 256(1) of the IT Act, 1961, the following questions have been referred to this Court for opinion at the instance of the assessee :

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the receipt of Rs. 5,00,000 by the assessee was a revenue receipt and not a capital receipt?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the surtax liability was not allowable as revenue expenditure?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee was not entitled to weighted deduction under S. 35B of the IT Act, 1961, on Rs. 20,607 being the expenditure in respect of insurance, freight and inspection?"

2. Learned counsel appearing for the parties state that controversy in question No. 2 as well as in question No. 3 above is covered by judgments of this Court. Learned counsel further state that the controversy in question No. 2 is covered by the judgment of this Court in the case of Lubrizol India Ltd. vs. CIT (1991)

187 ITR 25 (Bom) : TC 7R.1527 and the controversy in question No. 3 is covered by two judgments of this Court one in the case of Forbes Forbes Campbell and Co. Ltd. Vs. Commissioner of Income Tax, and the other in the case of M.H. Daryani Vs. Commissioner of Income Tax, . In view thereof, the second question as well as the third question are answered in the affirmative, that is, in favour of the Revenue and against the assessee.

3. We shall now deal with the controversy involved in question No. 1 above and narrate only such of the facts as are relevant to consider the said controversy.

The assessee is a limited company duly incorporated and registered under the provisions of the Companies Act, 1956. The relevant assessment year is 1977-78, having corresponding previous year ended on 31st Dec., 1976. During the assessment year, the assessee was engaged in manufacture of air-conditioning products and was also undertaking job contracts in air-conditioning. The assessee was also trading in electronics and engineering goods and was also exporting its products. On 10th June, 1973, the assessee entered into an agreement with a foreign trade enterprise Burmaschien Export Gmbh, Berlin (for short, hereafter referred to as "BME"), under which the assessee was appointed as the agent of BME for marketing and selling their products in India. As mentioned in the said agreement, it was, in the first instance valid upto 31st Dec., 1976, and thereafter, it was to be considered as automatically renewed for one calendar year at a time unless one or the other party thereto gave notice of its wish to terminate the same. Such a notice, as provided in the said agreement, was required to be in writing and of at least three months' duration before the current expiry date of the agreement. By a letter dt. 4th June, 1976, addressed by BME to the assessee, BME intimated to the assessee that BME was agreeable to the extension of the agreement for a further period of one year and, accordingly, with the consent of the parties, the said agreement stood renewed upto 10th June, 1977. But in the meanwhile, the Government of India sponsored a company known as "Computronics India Ltd." and on 6th Oct., 1976, BME wrote a letter to the assessee stating that since a lot of technical know-how and organisational potentialities were needed to handle the data process plan made by BME, the assessee might assign its rights under the said agreement to Computronics India Ltd. who was specialising in the particular line. BME agreed to pay to the assessee a lump sum of Rs. 5 lakhs by way of consideration for the assessee assigning its rights under the said agreement in favour of Computronics India Ltd. Accordingly, on 6th Dec., 1976, the assessee sent its invoice for the said amount which was paid to the assessee during the previous year ended on 31st Dec., 1976. Though, in fact, there was no assignment of the assessee's rights under the said agreement in favour of Computronics India Ltd., the said agreement between the assessee and BME stood terminated on payment of the said sum of Rs. 5 lakhs to the assessee. BME had, thereafter, dealt with Computronics India Ltd.

4. In the facts narrated above, a dispute arose as to whether the payment of the

said sum of Rs. 5 lakhs by BME to the assessee was a "capital receipt" or a "revenue receipt" in the hands of the assessee. The assessee had shown the said amount in its return under the head "Other income" but claimed that it was not taxable being a capital receipt. The claim of the assessee was rejected by the ITO who held that the arrangement between BME and the assessee borne out by the said agreement did not create any income apparatus and that the assessee had only a service contract with BME. It was further held by the ITO that there was no destruction of any income apparatus and that the amount received was not in respect of any loss of source of income but was only in respect of the actual loss of income itself for a period of one year. The CIT(A), on appeal, decided the issue in favour of the assessee and held that the receipt of the said amount of Rs. 5 lakhs in the hands of the assessee was a "capital receipt" and was not taxable. The Department, thereupon, filed an appeal before the Tribunal. The Tribunal held that the said sum of Rs. 5 lakhs received by the assessee was not a "capital receipt" but was a "revenue receipt". Hence, the abovementioned first question has been referred to this Court for the opinion at the instance of the assessee.

5. Mr. Mistry, learned counsel, appearing for the assessee, has submitted that the said sum of Rs. 5 lakhs was received by the assessee as consideration for cessation of the business relationship with BME which had produced an income stream for the assessee and, as such, the receipt of the said amount by the assessee was of a capital nature. Mr. Mistry has further submitted that to consider the dispute as to whether the receipt of the said amount by the assessee was of "capital" or "revenue" nature, neither the facts as to whether the said agreement was terminable or not nor the length or duration thereof is relevant. He has also submitted that the fact that no compensation was payable under the said agreement for the termination thereof is also not relevant to decide account. In the submission of Mr. Mistry, even the fact that the said agreement was in respect of one of the activities of the assessee and that as a result of termination thereof the profits of the assessee were unaffected, is not relevant in deciding whether the receipt of the said amount by the assessee on account of termination thereof was of "capital" or "revenue" nature. In support of his submission, Mr. Mistry has relied upon the judgments in the case of *The Commissioner of Income Tax, Bombay City, Bombay Vs. Asiatic Textile Co. Ltd., Bombay*, *, Commissioner of Income Tax, Hyderabad-deccan Vs. Vazir Sultan and Sons*, *, Kettlewell Bullen and Co. Vs. Commissioner of Income Tax, Calcutta*, and *Karam Chand Thapar and Bros. P. Ltd. Vs. Commissioner of Income Tax, (Central), Calcutta*, .

Mr. Jetley, learned counsel for the Revenue, has submitted that in the facts of the case, the receipt of the said sum of Rs. 5 lakhs by the assessee on termination of the said agreement could only be considered as "revenue receipt" and under no circumstances, it could be treated as "capital receipt".

6. The question whether a particular income arising from termination of a

contract is a "capital receipt" or a "revenue receipt" is undoubtedly a difficult question to be answered. Where, on a consideration of the circumstances, a payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of the recipient's business nor deprive the recipient of what in substance is the source of income, termination of contract being a normal incident of the business, and such cancellation leaves the recipient of the amount free to carry on his trade, the receipt is "revenue". However, where by cancellation of agency the trading structure of the assessee is impaired or such cancellation results in the loss of what may be regarded as the source of the assessee's income, payment made to compensate for such cancellation of agency agreement is normally a "capital receipt". In the facts of the case, we are required to consider as to whether the sum of Rs. 5 lakhs received by the assessee was received to compensate the assessee for cancellation of the said agreement with BME which did not affect the trading structure of the assessee nor deprive the assessee of what in substance was its source of income or by cancellation of the said agreement, the trading structure of the assessee was impaired or such cancellation resulted in loss of source of the assessee's income. Considering the nature of the said agreement and perusing the various clauses contained therein in our view, the said agreement culminating in a contract between the assessee and BME was in the nature of normal trading contract entered into in the ordinary course of the assessee's business. The assessee carried on widespread business activities as is evident even from the assessment order for the relevant assessment year showing the taxable income of the assessee at more than Rs. 86 lakhs. The agency agreement of the assessee with BME as borne out from the said agreement was only one of the many activities of the assessee. The widespread nature of business activities carried on by the assessee were not adversely affected by the termination of the said agreement and in the facts of the case, it cannot be said that there was cessation of business resulting in destruction of the source of income so far as the assessee is concerned. The said agency agreement was entered into by the assessee in the normal course within the framework of the normal business of the assessee and the termination thereof could be treated as a normal incident of the business. Even with the termination of the said agreement, the assessee was left free to carry on its normal trading activities. By cancellation of the agency, the trading structure of the assessee was not impaired. In the facts of the case, we hold that the compensation amount of Rs. 5 lakhs received by the assessee was not in the nature of "capital receipt". It was in the nature of "revenue receipt".

7. Though Mr. Mistry has relied upon the judgments referred to above, as observed by the Earl of Halsbury L.C. in the case of *Quinn vs. Leathem* (1901) AC 495 (HL), every judgment must be read as applicable to the particular facts proved or assumed to be proved, since the generality of the expressions which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such

expressions are found and a case is only an authority for what it actually decides.

In the case of Asiatic Textile Co. Ltd. (supra), under a managing agency agreement the managing agents of the company were employed for a period of 20 years. The agreement also cast an obligation upon the managed company to employ only the managing agents as macadam and brokers and as selling agents. Before expiration of the period, the managing agents accepted the termination of their appointment as managing agents and released their managing agency rights in consideration of the payment of a lump sum as compensation. In the facts of the case, it was held by this Court that there was surrender of a capital asset and that the amount received by the managing agents as solatium for the termination of the managing agency could not be profits arising out of their business but constituted only a capital receipt.

In the case of Vazir Sultan & Sons (supra), the assessee therein were appointed the sole selling agents and sole distributors of a cigarette manufacturing company for the then Hyderabad State for cigarettes manufactured and were allowed a discount of two per cent on the gross sale price. After about eight years of the appointment another arrangement was arrived at between the assessee and the company whereby the assessee were given a discount of two per cent not only on the goods sold in the then Hyderabad State, but on all the goods sold in and outside the Hyderabad State. Eleven years thereafter, the assessee were reverted to the original arrangement confining the sole agency of the assessee to the then Hyderabad State and the assessee were paid a sum of Rs. 2,19,343 by way of compensation for the loss of the agency for the territory outside the Hyderabad State. In the facts of the case, the Supreme Court held that the agency agreements were not entered into by the assessee in the carrying on of their business but formed capital assets of the assessee's business which were exploited by the assessee by entering into contracts with various customers and dealers in their respective territories and that the payment made by the company as and by way of compensation for terminating the sole selling agreement was a capital receipt in the hands of the assessee.

In the case of Kettlewell Bullen & Co. Ltd. (supra), the appellant-company was formed with the object, inter alia, of carrying on the business of the managing agency. The appellant-company was the managing agent of six companies including one Fort William Jute Co. The appellant after arriving at an arrangement with one Mugneeram Bangur & Co., tendered resignation of the managing agency and received a sum of Rs. 3,50,000 from Fort William Jute Co., though under the terms of the managing agency agreement, Fort William Jute Co. was not obliged to pay any compensation to the appellant for voluntary resignation of the managing agency. On the facts, it was held that the arrangement with Mugneeram Bangur & Co., was not in the nature of a trading transaction, but was one in which the appellant parted with an asset of enduring value. It was further held that what the appellant was paid was to compensate for the loss of a capital asset and, as such, it was not in the nature of a revenue

receipt.

The case of Karam Chand Thapar & Bros. Pvt. Ltd. (supra) was also a case for termination of one of several managing agencies. The managing agency was to subsist for a period of 20 years. The managing agency was terminated within a period of one year of the appellant being appointed as the managing agent. The appellant was paid compensation of Rs. 18 lakhs for early termination of the managing agency. The Supreme Court, in the facts of the case, held that the receipt of Rs. 18 lakhs was a capital receipt in the hands of the appellant. The Supreme Court, however, observed that ordinarily compensation for loss of office or agency is regarded as a capital receipt, but this rule is subject to an exception that payment received even for termination of an agency agreement would be revenue and not capital in a case where the agency was one of many which the assessee held and its termination did not impair the profit-making structure of the assessee.

The facts in the judgments on which reliance has been placed by Mr. Mistry have been different than the facts in the instant case and, as such, it is not possible to accept the submissions made by Mr. Mistry which are based on the judgments relied upon by him.

8. Accordingly, we answer the first question above in the affirmative, that is, in favour of the Revenue and against the assessee.

9. There shall be no order as to costs.