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**(1988) 07 CAL CK 0062**

**In the Calcutta High Court**

**Case No :** Income-tax Reference No. 54 of 1979

Commissioner of Income Tax

APPELLANT

Vs

D. Mondal

RESPONDENT

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**Date of Decision :** 19-07-1988

**Acts Referred:**

Income Tax Act, 1961 — Section 37, 37(1)

**Citation :** (1989) 79 CTR 175 : (1989) 175 ITR 440 : (1988) 41 TAXMAN 129

**Hon'ble Judges :** K.M. Yusuf, J;Ajit K. Sengupta, J

**Bench :** Division Bench

**Advocate :** A.N. Bhattacharjee, for the Appellant;

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**Judgement**

Ajit K. Sengupta, J.—At the instance of the Commissioner of Income Tax, West Bengal-II, the following question of law has been referred to this court u/s 256(2) of the Income Tax Act, 1961, for the assessment year 1962-63 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 50,000 paid as compensation was an expenditure of a revenue nature and was an allowable deduction u/s 37(1) of the Income Tax Act, 1961 ?"

2. The facts relating to this application are that the assessee, who is the owner of the collieries known as Pure Shampoor Collieries, appointed one Mr. Mehta for proper and efficient management of the said collieries by an agreement dated March 2, 1954. The agreement was effective from March 1, 1954, for a period of five years. The agreement was renewed and was operative till January 1, 1964. However, before the expiry of the second period of five years, the agreement was terminated on February 23, 1962. The managing contractor, Mr. Mehta, was paid a sum of Rs. 50,000 as compensation for the premature termination of the agreement. Clause 29 of the agreement provided for the settlement of compensation by arbitration. In pursuance of this clause, the matter was referred to two arbitrators, Sri Balaram Chakraborty, nominated by Mr. Mehta, and Shri

Nagendra Nath Mondal, nominated by the assessee. The arbitrators decided on a compensation of Rs. 50,000 in favour of Mr. Mehta. This compensation was paid in view of the unexpired period of 22 months of the agreement which should have normally come to an end only on January 1, 1964. The assessee terminated the service of the managing contractor as it was not satisfied with the manner in which he conducted the collieries. There were frequent violations of the coal mines regulations and as an owner, the assessee was repeatedly called upon to explain the remissness of the managing contractor, Shri Mehta. According to the agreement, Mr. Mehta was to run the collieries himself and pay commission on the basis of coal raised by him at a specified rate. The assessee actually received commission ranging from Rs. 33,000 to Rs. 37,000 for the assessment years 1960-61 to 1962-63. After the agreement was terminated, the assessee resumed the running of the mines and for the assessment year 1964-65, it was assessed on an income of about Rs. 38,000 from this colliery. Similarly, he was assessed on an amount of Rs. 33,000 for the assessment year 1963-64. On the above facts, the Income Tax Officer added back the sum of Rs. 50,000 in the assessment on the ground that the expenditure was on capital account. The bona fides of the transaction or the fact of the payment were not, in any manner, challenged by him.

3. The matter was taken in appeal to the Appellate Assistant Commissioner who found that the agreement was terminated on grounds of commercial expediency and that the settlement made between the two parties was a bona fide and genuine one. As for the legal issue, the Appellate Assistant Commissioner held that it was revenue expenditure. The Tribunal affirmed the findings and reasoning of the Appellate Assistant Commissioner.

4. Mr. A. N. Bhattacharjee, appearing for the Revenue, has relied on several decisions in support of his contentions that in this case an enduring benefit was received by the assessee and, accordingly, the expenditure in this case should be treated as capital expenditure. Mr. Bhattacharjee has relied on a decision of the Allahabad High Court in the case of *SWADESHI COTTON MILLS COMPANY LIMITED, KANPUR Vs. COMMISSIONER OF Income Tax, U.P. AND V.P.*, . In that case, the assessee-company which was engaged in the manufacture of cloth and had entered into contracts for the purchase of textile machinery cancelled the contracts and had to pay compensation for the cancellation of the contracts. On the question whether the compensation payments were an allowable deduction u/s 10(2)(xv), the High Court held that payments of compensation upon cancellation of contracts which involves a liability or disadvantage of a lasting character represent capitalisation of the outgoings. The assessee, by the payment of compensation, avoided a liability and also avoided future loss as the assessee found that the purchase of machinery would not be profitable. Accordingly, the payments could not be deducted as business expenditure u/s 10(2)(xv) of the old Act.

5. He has also relied on a decision of the Punjab and Haryana High Court in the

case of *Dalmia Dadri Cement Ltd. Vs. Commissioner of Income Tax*, . This case was with regard to the premature termination of a managing agency. The court held in that case that the decisions in which payment of compensation for premature termination of managing agency was held to be revenue expenditure were concerned with ad hoc solutions or solutions made under the pressure of economic or managerial crisis of the moment and not by way of planned policy for laying the foundation or the basis of future economic prosperity. The assessee in those cases had to reach decisions of far-reaching importance on matters of immediate and pressing interest. But, in the case before the Punjab and Haryana High Court, the assessee-company was not faced with any immediate or present danger to be averted ; neither did any financial problem confront the board of directors for terminating the managing agency agreement nor was any economic difficulty to be surmounted by adopting this course. On these facts, it was held that the payment of Rs. 6 lakhs for termination of managing agency was only a capital expenditure and was not a permissible deduction u/s 10(2) (xv) of the old Act.

6. Counsel for the Revenue has also relied on a decision of the Kerala High Court in the case of *CANNANORE SPINNING and WEAVING MILLS LTD. Vs. COMMISSIONER OF Income Tax*, . In that case, the assessee had appointed a firm as its managing agents in 1945 for a period of 20 years. In 1954, disputes arose as a result of the board of directors of the company passing resolutions suspending the managing agents and removing them from office, and some shareholders of whom four were also partners of the firm presented a petition in the High Court challenging the legality of the resolution. The judge who heard the petition was of the opinion that the case was eminently suited for settlement and that without a settlement there was no chance of the company carrying on any successful business in the future, and a settlement was reached between the parties whereunder the managing agents resigned their office and the company agreed to pay the firm the sum of Rs. 3 lakhs by way of compensation for premature termination of the managing agency and loss of office as managing agents for the unexpired term. Four out of the six partners of the firm alone were entitled to share the amount. There were further provisions in the settlement for the readjustment of the shareholding in the company. The question was whether the sum of Rs. 3 lakhs paid by the company to the managing agents in pursuance of the settlement was expenditure allowable u/s 10(2)(xv) of the Indian Income Tax Act. It was held that the payment of Rs. 3 lakhs was only for the termination of an arrangement which had become dangerous to the future well-being of the company and reflected a genuine and bona fide settlement, it was not actuated by generosity or any indirect or improper motive, and it was dictated solely by considerations of commercial expediency and benefit to the company, It was, therefore, an expenditure laid out wholly and exclusively for the purpose of the business and was an allowable deduction u/s 10(2)(xv).

7. It may be mentioned that this decision was relied on by the Appellate Assistant Commissioner in arriving at his conclusion.

8. In this case, the assessee appointed a managing contractor for the proper and efficient management of the colliery under an agreement dated March 2, 1954. This agreement was effective from March 1, 1954, till February 1, 1959, with option of renewal on the part of the managing contractor for a further period of five years on the expiry of the first period. After the expiry of the period of five years, a renewal of the agreement was made and this was effective till January 1, 1964, but before the expiry of the second period of five years, the agreement was terminated on February 23, 1962. The managing contractor was paid a sum of Rs. 50,000 as compensation for the premature termination of the agreement. The contract was terminated to save the property, that is, the colliery, from total destruction and also to earn more profits by taking over the mining operations from the managing contractor. No capital asset was acquired by termination of this agreement. Apart from commercial expediency, there was no other motive for entering into the said agreement and termination thereof. It was the desire to protect his own property which prompted the assessee to terminate the agreement prematurely and to pay a sum of Rs. 50,000. It has been found, as a matter of fact, by the Appellate Assistant Commissioner and the Tribunal that there was no improper or mala fide motive or intention on the part of the assessee in terminating the contract and making this payment. The Appellate Assistant Commissioner found that the managing contractor started slackening the mining operations once the contract was renewed for the second period of five years. There were repeated violations of mining regulations which endangered the very life of the colliery. Evidence was produced before the Appellate Assistant Commissioner in the form of notices received from the Regional Inspector of Mines for violation of the Coal Mines Regulations. The violation was made by the managing contractor who was actually carrying on the mining operations. The continued violation of mining regulations, in spite of the fact that the appellant had a full time representative at the colliery as per the agreement, compelled the assessee to force the issue and terminate the agreement with the managing contractor to safeguard his assets. On these facts, the agreement was terminated. A settlement was made from the business point of view to safeguard the assets of the business. It cannot be held, on the facts of this case, that the expenditure which was made by the assessee was not wholly and exclusively laid out for the purpose of business or not on grounds of commercial expediency. Where no new asset has been acquired nor any new asset been added by the expenditure and where, in essence, the expenditure was for defending the assets of the assessee, such expenditure must be held to be on revenue account. We are of the view that the primary finding of the Appellate Assistant Commissioner and the Tribunal that the settlement made between the parties was a bona fide and genuine one, that the payment was dictated solely by considerations of commercial expediency and not actuated by generosity shown to the managing contractor and that there was no indirect or improper motive having not been challenged, the Tribunal came to the right conclusion that expenditure was made wholly and exclusively for the purpose of the business.

9. For the reasons aforesaid, we answer the question in the affirmative and in favour of the assessee. There will be no order as to costs.

K.M. Yusuf, J.

10. I agree.