(1990) 01 CAL CK 0003

In the Calcutta High Court

Case No : IT Ref. No. 229 of 1984

COMMISSIONER OF INCOME TAX — APPELLANT

Vs

PEICO ELECTRONICS and ELECTRICALS LTD. — RESPONDENT

Date of Decision : 19-01-1990

Acts Referred:

Citation : (1992) 107 CTR 240

Hon'ble Judges : Suhas Chandra Sen, J;Bhagabati Prasad Banerjee, J

Bench : Full Bench

Judgement

BHAGABATI PRASAD BANERJEE, J. :

In this reference the Tribunal has forwarded the following questions of law under s. 256(1) of the IT Act, 1961 relating to the asst. yr. 1977-78 for which the relevant year of account ended on 31st December, 1976 :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the sum of Rs. 4,03,000 paid by the assessee company to M/s. Vulcan Industries for premature termination of the agreement between them was revenue expenditure of the assessee ?"

"(1) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 25,03,000 representing actuarially valued liability for gratuity for the year 1976 was not an allowable deduction in computing the total income of the assessee company for the asst. yr. 1977-78 ?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the commission payments of Rs. 70,667 to senior management staff were required to be taken into consideration for the purpose of s. 40A(5) of the Act ?"

2. So far as the question referred by the Department is concerned, the fact of the case is that there was an agreement by and between the assessee company and M/s. Vulcan Industries dt. 29th November, 1971. M/s. Vulcan Industries in

terms of the said agreement was to manufacture for the assessee certain goods. The assessee was lifting these goods regularly since January, 1972. But it stopped lifting the goods in March, 1975, though there was no breach of contract on the part of M/s. Vulcan Industries. The assessee company paid compensation for the breach of the contract. The reason was that the assessee company could not carry on business with M/s. Vulcan Industries and that such agreement was creating onerous burden on the assessee company. Therefore, by making a lump sum payment the assessee company wanted to get rid of this onerous burden.

3. The CIT(A) held that the amount of compensation of Rs. 4,03,000 was an expenditure of capital nature.

4. The Tribunal, on the contrary, found that the assessee by paying the amount did not get any benefit of enduring nature. The payment was made as a result of this business expediency and to cut short losses which the assessee was to incur in the event of continuation of the agreement and ultimately, the Tribunal was of the view that the assessees expenditure was revenue in nature. In his case the expenditure incurred for termination of the agreement was to avoid commercial inconveniences occurring in future. The payment that was made under the agreement was of revenue nature and after the agreement was terminated, the payment that was made, did not bring into existence any capital of enduring nature. The whole expenditure was on the revenue account. The contract was entered into in course of the usual business and the termination was made as the assessee thought it as the business prudence required it. When such a termination was made and such usual termination compensation was paid, this termination did not affect in any manner whatsoever the frame work of the business as also the pattern of the business of the assessee.

5. The Supreme Court in the case of the Commissioner of Income Tax, Madras Vs. Ashok Leyland Ltd., observed as follows :

"There is no doubt that, as a result of the termination of the services of the managing agents, the company got rid of its liability to pay office allowance as well as the commission it was required to pay under the Managing Agency Agreement not only during the accounting year but also for a few years more. The expenditure thus saved undoubtedly swelled the profits of the company. From the facts found it is clear that the managing agency was terminated on business consideration and as a matter of commercial expediency. There is no basis for holding that by terminating the managing agency, the company acquired any enduring benefit for any income yielding asset. It is true that by terminating the services of the managing agents, the company not only saved the expense that it would have had to incur in the relevant previous year but also for few more years to come. It will not be correct to say that by avoiding certain business expenditure, the company can be said to have acquired enduring benefits or acquired any income yielding asset."

The Supreme Court in that judgment noted with approval the decision of the

Court of Appeal in the case of G. Scammell & Nephew Ltd. vs. Rowles (1940) 8 ITR (Supp.) 41 as follows :

"The Court of Appeal held that the expenditure incurred for the termination of a trading relationship in order to avoid losses occurring in the future through that relationship, whether pecuniary losses or commercial inconveniences, is just as much for the purposes of the trade as the making or the carrying into effect of a trading agreement."

Accordingly, the question referred by the Department is answered in the affirmative and in favour of the assessee.

6. With regard to question No. 1 which is at the instance of the assessee, it is now concluded by a decision of the Supreme Court in the case of Shree Sajjan Mills Ltd. Vs. Commissioner of Income Tax, M.P., Bhopal and Another, . Following the said judgment of the Supreme Court, this question of law is answered in the affirmative and in favour of the Revenue.

7. With regard to question No. 2, which is at the instance of the assessee, the language of the section is quite clear and there is no room for any doubt as to the correctness of the decision of the Tribunal. We are of the view that the Tribunal has taken a correct view of the matter. Accordingly, this question is answered also in the affirmative and in favour of the Revenue.

There will be no order as to costs.

SUHAS CHANDRA SEN, J. :

I agree.