BOMBAY HIGH COURT

F.E. Hardcastle & Co

Vs

Commissioner of Income-Tax

(V Desai and Y Tambe, JJ.)

24.10.1961

JUDGMENT

Y. Tambe, J.

1. The assessee is a private limited company and we are concerned with the assessment year 1956-57, the relevant previous year being the financial year 1955-56 ending with 31st March, 1956. The assessee was holding managing agencies of (1) Society General de Surveillance S. A. (foreign company doing business in the taxable territories) and of (2) General Superintendence Co. (India) Ltd., (hereinafter referred to as the principals). The managing agency agreements of these two companies held by the assessee were terminated on December 1, 1952, and the terms agreed upon between the parties were incorporated in two instruments of date 29th September, 1953. We would deal with the relevant terms of these agreements at a later stage. It is sufficient at this stage to say that compensation amounting to Rs. 96,000 and Rs. 48,000 respectively in half-yearly instalments or Rs. 6,000 and Rs. 3,000 were payable to the assessee subject to certain terms and conditions mentioned in the agreements. The payment of instalments commenced from July 1, 1953. In pursuance of these terms, the assessee received Rs. 12,000 and Rs. 6,000 respectively under these two agreements and the dispute is as to the chargeability to tax of the said amounts of Rs. 12,000 and Rs. 6,000. According to the assessee, the entire compensation amount of Rs. 96,000 and Rs. 48,000 accrued to the assessee on 29th September, 1953, the date on which the agreements were executed, and the instalments paid under the agreements subsequently in payment of these two amounts were only in the nature of a repayment of debts due from the principals. The income, thus, not having accrued in the assessment year, was not taxable. Another contention to the same effect was raised on the ground that type entire compensation money receivable and under the two agreements had been taken credit of by the assessee in its books of account for the year ended 31st March, 1954, and, therefore, what had been subsequently received by instalments was merely realisation of those book debts. These contentions of the assessee were not accepted by the income-tax authorities and it was held that

the said amount of Rs. 12,000 and Rs. 6,000 were chargeable to tax under sub-section (5A) of section 10 of the Act. The same contentions were again reiterated by the assessee before the Tribunal. On the construction of the deeds, the Tribunal held that the entire compensation amounts Rs. 96,000 and Rs. 48,000 had not accrued or become due to the assessee on 29th September, 1953, but the amounts as per instalments accorded due to the assessee on the date the instalments fell due. On these findings, the Tribunal held that the tax was properly levied on the assessee in expect of the said sums of Rs. 12,000 and Rs. 6,000 under section 10(5A) of the Act. On an application by the assessee under sub-section (1) of section 66 the Tribunal has drawn up a statement of case and has referred to as the following question of Law :

"Whether, on the facts and in the circumstances of the case, the two amounts of Rs. 12,000 and Rs. 6,000 received by the assessee from the two respective principals during the previous year under the agreements dated September 29, 1953, are taxable under section 10(5A) of the Indian Income-tax Act ?"

2. Section 10(5A) of the Act was introduced in the statute book by section 8 of the Fiance Act of 1955 with effect from 1st April, 1955. The portion material to the present case is in the following terms :

"(5A) Any compensation..... due to or received by -

(a) a managing agent of an Indian company at or in connection with the termination.... of this managing agency agreement with the company.....

(c) any person, by whatever name called, 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.....

(d) any person, by whatever name called, holdings 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......shall be deemed to be profits and gains of a business carried on by the managing agent..... and shall be liable to tax accordingly; and the tax on such compensation or other payment shall, if the assessee so elects, be computed at the average of the rates of income-tax and super-tax applicable to his total income for the three years immediately preceding the previous year in which the compensation or other payment was due or received."

3. As already stated, tax has been levied on the assessee in respect of these two sums under sub-section (5A) of section 10. The assessee was a managing agent of two companies : one was an Indian company and the other a foreign company doing business in India. The clause, therefore, in respect to the India company would be clause (a) and in respect of the foreign company would

be clause (c). There is no doubt that payment of Rs. 12,000 and Rs. 6,000 had been received by the assessee in the assessment year. The only question, therefore, that falls for consideration in this case is whether the payments were received by the assessee by way of compensation for the termination of its services or in connection with the termination of the agencies.

4. Mr. Palkhivala contends that on a proper construction of the agreements between the principals and the assessee, the entire amount of compensation of Rs. 96,000 and Rs. 48,000 became due to the assessee on September 29, 1953, there date on which these agreements were executed. The entire income this accrued to the assessee at that time and the accrual is not postponed till the dates on which the instalments became due. That, according to Mr. Palkhivala, is the true construction of the agreements and, therefore, on September 29, 1953. debts amounting to Rs. 96,000 and Rs. 48,000 became due to the assessee, though as a result of the agreements the assessee had agreed to accept the repayment of the debts by instalments. The amount paid by instalments were received by the assessee as repayment of debate and not payment of compensation for termination of its service or payment in connection with the termination of its services. On the other hand, it is the contention of Mr. Joshi that, on a true construction of the agreements, it cannot be said that the entire amount of Rs. 96,000 and Rs. 48,000 accrued due to the assessee on September 29, 1953. On the Other hand, compensation became due to the assessee on the dates the instalments fell due. The amounts received by the assessee this were amount received in connection with the compensation for termination of the managing agencies of the assessee and, therefore, liable to be taxed under section 10(5A) of the Act.

5. In our opinion, the contentions raised by Mr. Joshi are well founded. Even though there are two agreements with the two principals in respect of the termination of the managing agency of the assessee, it is not necessary to deal separately with both these agreements inasmuch as both these agreements are in material respect identically worded. We would, therefore, deal with the agreement relating to that termination of the managing agency of the assessee of General Superintendence Co. (India) Ltd. It is annexure "B" to the statement of the case. Clause (1), provides that from 1st December, 1952, the principal will cease to employ the assessee company to handle its business in Bombay and it will be taken over by the principal itself. Clause (2) (a) is in the following terms :

> "To compensate F. E. Hardcastle & Co. Ltd., Bombay, for the loss of employment mentioned in clause I, GSC(1) Bombay will (subject to observance of clauses 4, 5 and 6) pay to F. E. Hardcastle & Co. Ltd., Bombay, the sum of Rs. 48,000 (forty-eight thousand) (without interest) by sixteen equal six monthly instalments of Rs. 3,000 (three thousand rupee) each, payable on the 1st day of January and the 1st day of July in each year, beginning the first payment on the 1st July, 1953, and the next payment on the 1st

January, 1954, and so on."

6. It is not necessary to reproduce clauses (4), (5) and (6), but it would be sufficient to say that clauses (4) and (5) prohibit the assessee company, M/s. Hardcastle & Co., and Mr. Hardcastle, the managing director of the assessee company, to indulge directly or indirectly in any activity in competition with the business of the principal company for a period of 15 years. Clause (6) provides that if any orders are received by the assessee or Mr. Hardcastle from third parties, which fall within the framework of the general activity of the principal, the assessee and Mr. Hardcastle would transmit those orders immediately to the principal company. Clause (7) provides that if in violation of the aforesaid terms of the agreement either Mr. Hardcastle personally or the assessee ny engaged in competition in the legitimate business of the principal company and if after four warnings in writing the competition continues, then the assessee can company would be responsible to pay to the principal twice the value of the fees collected in respect of such business. The latter part of clause (7) is in the following terms :

> "Should this competition still continue further in respect of legitimate superintendence business of GSC (I) Bombay-SGS, then after 3 (three) further warnings the penalty will increase to 3 (three) times the amount of the fees collected. If, notwithstanding the above, deliberate competition in this business with GSC (I) Bombay-SGS continues, then the latter have the right to stop payment of all or part of the outstanding indemnities (provided) by clause (2) of the present agreement."

7. Clause (8) provides for arbitration in case of dispute and clause (9) provides that the agreement is subject to Swiss law. Having regard to these material terms of the agreement, it is difficult to hold that the entire amount of Rs. 48,000 accrued due to the assessee on the date of the agreement i.e., 29th September, 1953. The principal company has agreed to pay this amount to the assessee not unconditionally but "subject to the observance of clauses (4), (5) and (6)". In other words, the payment of Rs. 48,000 by instalments to the assessee was contingent on the assessee observing the terms and conditions mentioned in clauses (4), (5) and (6) of the agreement, which prohibit the assessee from indulging in competitive activities for a period of 15 years and requiring it to forward the order to the principal company. Clause (2) further provides for the payments to be made by six monthly instalments and by clause (7) a right is reserved to the principal to stop payment of the instalments after observing certain formalities in case the assessee does not observe the terms and conditions of clauses (4) to (6). These being the terms agreed upon between the parties, it is clear that the entire amount of Rs. 48,000 had not become due to the assessee on the date of the agreement but the respective amounts became due to the assessee on the respective dates the instalments fell due in the event of the assessee observing the conditions mentioned in clauses (4), (5) and (6) of the agreement. Further, the parties themselves

have chosen to term the unpaid amount of the instalments as outstanding indemnities and that indicates the character of the payment of instalments is payment of compensation and not payment of a debt. Had it been the true position, that the entire amount had become due to the assessee on the date of the agreement and the instalments agreed to be paid were only by way of repayment of that debt, then the agreements would not have mentioned the unpaid amount of the instalments as "outstanding indemnities".

8. Mr. Palkhivala contends that though the use of the expression "outstanding indemnities" in clause (7) indicates that the character of the instalments is payment of compensation, yet having regard to the other terms of the contract, it is nothing but repayment of a debt. According to Mr. Palkhivala, non-observance of the conditions in clauses (4), (5) and (6) only resulted in forfeiture of accrued income, which had remained to be paid to the assessee. It is difficult to put such a construction on the clause. Apart from the expression "outstanding indemnities", in the other clauses, as already stated, we have no doubt that the entire amount had not become due to the assessee on the date of the agreement. It is difficult to assume that option was given to the debtor not to pay his debt.

9. It is true that the assessee has, in its books of account, treated that the entire amount of Rs. 48,000 had accrued due to it on the date of the agreement, but to that, on the facts and in the circumstances of the case, hardly any importance could be attached.

10. In our opinion, therefore, it is not possible to hold that the Tribunal was in error in holding that the two amounts of Rs. 12,000 and Rs. 6,000 received by the assessee from the two respective principals are taxable under section 10(5A) of the Act. The answer to the question referred to us, therefore, will have to be returned in the affirmative. We answer it accordingly. The assessee shall pay the costs of the Commissioner.

11. Questions answered in the affirmative.