BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Sir Chunilal V. Mehta & Sons

(Kotwal, C.J. V.S. Desai, J.)

01.03.1967

JUDGMENT

V.S. Desai, J.

1. The questions, which have been referred to us on this reference, relate to the taxability under section 10(5A) of a certain amount received by the assessee-company as compensation on the termination of its managing agency. The assessee is a private limited company now in voluntary liquidation. It was incorporated in June, 1945, and was formed by the conversion of an erstwhile partnership firm into a private limited company. This partnership firm had entered into a managing agency agreement with a public limited company called "The Century Spinning and Manufacturing Co. Ltd. "On the 15th June, 1933. Under the said agreement, the managing agency was to run for a period of 21 years certain and thereafter until either the managing agents resigned their office or the company removed them from the office by a resolution passed at its special meeting. It was provided under the said agreement that the managing agents were to receive a regular monthly remuneration of Rs. 6,000 and if the said remuneration was found to be less than 10 per cent. of the gross profits of the company at the close of the year, the managing agents were to be paid a further additional sum to make the total aggregate remuneration received by them equal to 10 per cent. of the gross profits of the company in that year. Provision was also made in the agreement as to what would happen in case the managing agency came to an end before the period of 21 years had run out. It was provided in clause (14) of the agreement that except for the four special cases specified in clause (15), if the managing agents were deprived of the office of the agents of the company for any reason or cause whatsoever, they would be entitled to receive from the company as compensation or liquidated damages for the loss of their office a sum equal to the aggregate amount of the monthly salary of not less than Rs. 6,000, which they would have been entitled to receive from the company for and during the whole of the then unexpired portion of the said period of 21 years. Now under the special cases specified in clause (15) of the agreement, termination of the agency before the expiry of the said period of 21 years specified in the agreement was treated as justifiable and gave no right to a claim for compensation or liquidated damages in favour of the managing agents. Those four

cases were :

(1) If the firm were to commit any wilful breach of any of the terms or conditions of the managing agency agreement;
(2) If the firm were to resign the said office and cease to continue its business in Bombay or become bankrupt;

(3) If the company were to go or be placed in liquidation in consequence of its being unable to carry on its business at profit or being unable to pay its debts, and (4) If the company were to transfer its business and assets to any other joint stock company or undertaking intending and competent to carry on such business effectively and such other company or undertaking who are willing to appoint and did appoint the firm as the agents of such company or undertaking upon terms and conditions not less favorable to them than the terms and conditions contained in the present agreement.

2. It will thus be seen that the managing agency agreement provided also for the consequence following upon a wrongful or unjustifiable termination of the managing agency agreement on the part of the managed company. As we have already pointed out earlier, the original managing agency firm was converted into a private limited company in June, 1945, in the name and style of the present assessee and it took over by a deed of assignment consented to by the managed company the managing agency and continued it on the terms and conditions contained in the original agreement. In about April, 1951, a large holding of the managed company to the extent of about 75 per cent. of the whole was acquired by a group of shareholders and the said group came to be in a position to dominate the affairs of the managed company. It appears that the relation between the assessee-company and this dominant group of shareholders of the managed company did not run smoothly and consequently the directors of the managed company passed a resolution on the 23rd of April, 1951, terminating the employment of the assessee-company as the agents of the managed company from 23rd April, 1951. Pursuant to this resolution passed by the directors of the managed company, an extraordinary general meeting of the shareholders of the managed company was convened and held on the 23rd May, 1951, and at the said meeting a resolution was passed terminating the employment of the assessee-company as the managing agents of the managed company. The assessee-company thereupon complained that the action of the managed company in terminating the managing agency agreement was illegal and unwarranted and claimed a sum of Rs. 50 lakhs as damages and called upon the managed company to pay the same within 7 days. The claim for Rs. 50 lakhs was however, denied by the managed company and they pointed out that the most that the assessee-company would be entitled to claim by way of compensation or liquidated damages for loss of their appointment would be a sum equal to the aggregate amount of the monthly salary of Rs. 6000 for the duration of the whole of the unexpired portion of the period of 21 years from the 1st July, 1933. It was pointed out that the the said unexpired period came to 3 years 2 months and 7 days and the compensation calculated at the rate of Rs. 6,000 per month for the said period together with a

sum of Rs. 4,600 as remuneration for the 23 days of the month April, 1951, would came to a sum of Rs. 2,34,000. The managed company made a without prejudice offer to the assessee-company of the said sum of Rs. 2,34,000 if the assessee-company was willing to accept it full satisfaction of their claim against the managed company for termination of the managing agency agreement. The letter containing this offer was sent by the managed company to the assessee-company on 15th September, 1951. The assessee-company did not accept the said offer and the 19th September, 1951, it filed a suit on the original side of this court claiming an amount of Rs. 50 lakhs by way of compensation or damages for the wrongful termination of its managing agency by the managed company. By an amendment made to the plaint on the 25th August, 1955, the claim in suit was reduced to a sum of Rs. 28,26,804 on the basis of 10 per cent. of the gross profits of the managed company during the unexpired period of 21 years of the managing agency period from the date of its termination. The claim of the assessee-company was resisted by the managed company which contended that the assessee-company was not entitled to any damages and at any rate it would not be entitled to anything more than Rs. 2,29,400 by way of the, suit, the managed company conceded that the termination of the managing agents in view of clause (14) of the agreement the trial of the suit, the managed company conceded that the termination of the managing agency was wrongful and gave rise to a claim for compensation in favor of the plaintiff, but contended that only a sum of Rs. 2,29,400 would be payable to the assessee-company in accordance with the agreement. They also contended that since that was the only amount which the plaintiffs could claim and since they were agreeable to pay the said amount and had offered to do so by their letter dated the 15th September, 1951, the plaintiffs' suit was thoroughly unjustified. This court held that the compensation or liquidated damages, to which the plaintiff was entitled for the deprivation of the office of the managing agents, was a sum of Rs. 2,29,400 as contended by the managed company and together with the remuneration of Rs. 4,600 which was due to the plaintiff for the 23 days of the month of April, 1951, the total amount to which the plaintiff was entitled was a sum of Rs. 2,34,000. It accordingly decreed the plaintiff's suit for Rs. 2,34,000 with interest thereon at 4 per cent. per annum from the date of the suit till judgment, costs and interest on judgment at 4 per cent.

3. The assessee-company received this amount of Rs. 5,68,738 some time in December, 1955, and included it in its profit and loss account for the accounting year which was the calendar year 1955, but in its return for the assessment year 1956-57, which was the relevant assessment year for the calendar year 1955 (which was the accounting year of the assessee-company), it showed this amount in Section D of the return on the basis that it was not liable to tax as it had accrued not in the year of account but on 23rd April, 1951, on the termination of its managing agency. Now, for the assessment year 1956-57, section 10(5A), which had been introduced by the Finance Act of 1955, had become applicable and under the said provision any compensation or other payment due stop or received by a managing agent of an Indian company at or in connection with the termination or modification of the managing agency agreement with the company was to be deemed to be deemed to be profits and gains of business carried on by the managing agent and was liable to taxed accordingly. The Income-tax Officer took the view that

since the sum of Rs. 2,68,738 had been received by the assessee in December, 1955, which was after section 10(5A) had come into operation, the said sum must be treated as the business profits of the assessee and liable to tax. He accordingly brought the amount to tax in the assessment year 1956-57. The assessee sought to contend before the Income-tax officer that the amount had accrued or arisen to the assessee in April, 1951, and since it was maintaining a mercantile system of accounting the amount, if taxable, could only be taxed in the assessment year 1952-53 relevant to the calendar year 1951. This contention of the assessee was not accepted by the Income-tax Officer, who, as we have already stated, took the view that the receipt of the amount in December, 1955, made it taxable in the assessment year 1956-57 by reason of the provision of section 10(5A). The Appellate Assistant Commissioner agreed with the view taken by the Income-tax Officer and rejected the assessee's appeal. In the further appeal taken to the Tribunal, it disagreed with the view taken by the Income-tax Officer and Appellate Assistant Commissioner and held that the provision of section 10(5A) was not attracted to the said amount of Rs. 2,68,738 and that the receipt in question could not be considered and included in the income of the calendar year 1955, and assessed as such. According to the Tribunal the termination of the managing agency of the assessee-company by the managed company was wrongful or unjustified and consequently the consequence arose as provided under clause (14) of the agreement and as soon as the managing agency was provided under clause (14) accrued to the assessee and became payable to it on that date a cause of action also accured to the assessee-company to recover the said damages. Since the assessee-company was maintaining it accounts on the mercantile basis, it the said sum, which accrued to the assessee on the 23rd April, 1951, and if it was taxable it could be taxed in the assessment year relevant to the calendar year 1951. The mere receipt of this amount, which had accrued, in a later year did not make it the income of the assessee-company in the later year because its method of accounting was mercantile. It was sought to be contended before the Tribunal that the amount of Rs. 2,68,738, which the assessee had received in the year 1955, was not the income of the old business of the managing agency for which the mercantile basis of accounting was adopted but it was the income of a new business which, by reason of the legal fiction, brought in by section 10(5A), must be deemed to be in existence in the year 1955, and since the receipt of this income was shown by the assessee in his profit and loss account for the year 1955, it must be regarded that for this new business of which the amount was an income, the assessee had not adopted the old method but a new method of accounting on receipt basis. It was also sought to be argued that under section 10(5A) the amount specified therein becomes inclusive as income either when it is due or received and since in the present case it was received in the year 1955, it became inclusive in the income of that year by reason of the provisions contained in section 10(5A) irrespective of the any method of accounting maintained or adopted by the assessee. The Tribunal negatived both these contentions. As to the former it held that section fiction, that what is not an income receipt of the business carried on by the of any other different or new business. According to the Tribunal, therefore, the receipt, even if considered as profits or gains, was profits and gains of the employed by the assessee for that business must be applicable to this item also. As to the second contentions the Tribunal pointed out that the provision of section 10(5A) only aimed at bringing

into its ambit all payments with the termination or modification of the managing agency agreement. It did not by itself provide as to which previous year the income would relate and when it would be brought to tax. According to the Tribunal, therefore, the words "due to or received by" the assessee employed in section 10(5A) were not intended to provided for the point of time as to when the amounts treated as income by the said amount could be included, regard will have to be had to the other provisions of the Act relating to the computation of the income including section 13 and consequently in cases where a person maintains a mercantile system of accounting the year in which the said item of income will be includible will be the year in which it could be said to have accrued to him. The Tribunal accordingly modified the order passed by the Income-tax Officer and confirmed in appeal by the Appellate Assistant Commissioner and directed that the amount of Rs. 2,68,738 should be brought to charge in the relevant assessment year. At the instance of the department it drew up a statement of case under section 66(1) and referred to this court the following two questions which arose out of its order :

> "1. Whether, on the facts and in the circumstances of this case, the compensation for termination of the managing agency accrued to the assessee on 23rd April, 1951 ?
> 2. Whether, on the facts and in the circumstances of this case, the compensation of Rs. 2,34,000 and interest thereon was taxable under section 10(5A) of the Income-tax Act in the assessment year 1956-57 ?"

4. On the point of law raised by the first question Mr. Joshi, learned counsel for the department, has argued that the compensation accrued to the assessee not on the 23rd April, 1951, when the managing agency agreement was terminated but on the 17th November, 1955, when in the suit filed by the assessee-company in the sum of Rs. 2,34,000 with interest thereon from date of suit and interest on judgment. Mr. Joshi argues that the termination of the managing agency gave right to the assessee to claim damages or compensation but no claim or damages could be said to have accrued to the assessee until his right was calculated and awarded in enforcement of the said right. It is argued by the learned council that the mere assertion of a claim is not sufficient to treat what is claim and the matter had to be taken into litigation and brought before the court for adjudication or damages could be said to have accrued to the assessee until his right was adjudicated upon and held to be enforceable by the court and damages were calculated and awarded in enforcement of the said right. Its argued by the learned counsel that the mere assertion of a claim is not sufficient to treat what is claimed as having accrued to the person asserting the claim. The assessee demanded compensation of over Rs. 50 lakhs, the managed company denied the said claim and the matter had to be taken into litigation and brought before the court for adjudication by the court. He has in that connection invited our attention to a decision of this court in Commissioner of Income-tax v. Associated Commercial Corporation. It was held in that case that a profit can be said to have accrued or liability or loss can be said to have been incurred only when the profit is either actually due or the liability becomes enforceable. A mere claim to a profit or to liability is not sufficient to make the profit to accrue or the liability to be incurred for the purposes of the Income-tax Act.

5. Now, it is true that a mere claim to a profit, which, if upheld, would give rise to a profit may not be sufficient to make the profit as accrued to the assessee when the claim is set up. Unliquidated damages for breach of contract, for instance, would only accrue when decreed and not when decreed and not when the claim is made. Where, however, the facts and circumstances are such that a claim to a profit not only arises but also for providing the manner and the method in which the compensation would be worked out and ascertained. In other words, in the present agreement between the parties provision was made in cases where a right would arise for the determination of the consequences of the right it self. Clause (14) of the agreement made a complete provision for determining the case in which a claim for compensation would arise and how it would be determined. That being the position, as soon as the said clause became operative, the claim was crystallized and became a claim which was immediately due and enforceable. Mr. Joshi says that the very fact that the parties went to litigation shows that the position was not crystal clear on the terms of the agreement and intervention of the court was necessary to adjudicate upon the existence the right and the compensation due in enforcement of the said right. The circumstances, however that the parties went to litigation cannot sufficient to hold that the position was not clear on the terms of the agreement and intervention of the court was necessary. It terms of agreement and intervention of the court was necessary. It some times happens that even when the position is very clear parties are not satisfied until the clarity is pronounced by the court. As is seen from the judgment of the trial judge of this court, the appellate bench has pointed out that the matter as to the right of the assessee to receive the compensation and the amount thereof was so clear under the agreement that there could not be any doubt about the same. The assessee-company was relaying on the expression "not less than Rs. 6,000 per month" mentioned in clause for the purpose of putting forward its claim to a larger amount and this court pointed out that the expression "not less than Rs. 6,000" was employed only to emphasis that the compensation that would be paid would be at the rate of Rs. 6,000 per month and not a rupee less nor a Rupees more. On the facts and circumstances of the present case, therefore, as soon as the managing agency agreement was terminated on the 23rd April, 1951, clause (14) of the agreement came into operation and determined the amount which would be due and payable to the managing agents for the deprivation of their office. There can be no doubt, therefore, that the compensation in the amount of Rs. 2,29,400 accrued to the assessee-company on the 23rd April, 1951, and since the assessee-company had worked as managing agents for the first 23 days of the month of April, 1951, and an amount of Rs. 4,6000 was due to it towards the remuneration for the said 23 days, the total amount due and payable to the assessee-company on the said date from the managed company came to Rs. 2,34,000. In our opinion, therefore, the answer to the first question referred to us must be in the affirmative.

6. Coming now to the second question as to whether the amount of Rs. 2,34,000 together with interest thereon totaling to a sum of Rs. 2,68,738, which was actually received by the assessee company on the 15th December, 1955, was taxable in the relevant assessment year 1956-57 by reason of the provisions of section 10(5A), the argument advanced by Mr. Joshi, briefly stated, is

as follows : he says that, in the first place on a plain reading of the provisions of section 10(5A), compensation or other payment due to or received by the assessee at or in connection with the termination or modification of its managing agency agreement is made taxable if it is either due to or received by the assessee after the provision came on the statute book. This, he says, is irrespective of any method of accounting adopted by the assessee. In the present case, since the payment is undoubtedly in connection with the termination of the managing agency and is received on the 15th December, 1955, which is after the provision of section 10(5A) came on the statute book, is taxable on its receipt, and, the consequently, liable to be included in the income of the assessee in the assessment year 1956-57. Secondly, he argues that section 10(5A) extends not only to deeming, what is not and income, an income, but also deeming, what is not a business, a business. Termination of managing agency business cannot be the carrying on of the managing agency business. The legal fiction, however, makes such termination itself as a business producing what is paid as compensation in respect thereof as the income of the business. The business says the learned counsel, therefore, is not the business of the new business of the managing agency but a new business and the payment received is an income of the new business. Considered in that light the income of the new business, and the payment received is an income of the new business. Considered in that light the income, which have been carried on at the point of time when the income is received in December, 1955, is therefore, an income of the said business in the year 1955, liable to be taxed in the assessment year 1956-57. He points out in this connection that in the profit and loss account of the assessee for the calendar year 1955 this amount is included. The inclusion of this amount in the profit and loss account of the business carried on by the business carried on by the assessee in the year 1955 would indicate, says Mr. Joshi, that for this new business the assessee has not adopted the mercantile system but the each system of accounting. Thirdly, Mr. Joshi argues that section 10(5A) not only makes the compensation or payment specified therein an item of income includible in the income of the assessee by using the expression "due to or received by the assessee at or in connection with the termination of the managing agency". According to Mr. Joshi, receipt of the payment is a point of time indicated in the provision with reference to which the income will be includible in the assessment of the assessee.

7. We are not able to agree with Mr. Joshi in the submission which he has made. Coming to the first and the third arguments, which he has advanced before us and which appear to us to be inter linked, the plain reading of the provision of section 10(5A) does not appear to us to yield to the meaning suggested by Mr. Joshi. The purpose of enacting the provision of section 10(5A) is to introduce a legal fiction making an income item, an item of income for the purpose of the Income-tax and its submit is to bring to tax all such items as prior to the introduction of the said fiction were not items of income. The legal fiction does not extend to anything more than this. On the other hand, as pointed out by this court, in Chidambaram Mulraj & Co. Pvt. Ltd. v. Commissioner of Income-tax :

> "The define purpose for enacting section 10(5A) is thus to bring to tax the amount

> received by way of compensation for termination of agreements as income, and that is the legitimate field within which the fiction enacted is sub-section (5A) operates.... Thus the fiction created is what has not been a revenue receipt has been made a revenue receipt by way of profits and gains of a business carried on, though, in fact, the amounts received for termination of business or an agreement cannot be termed as a receipt resulting from carrying on a business. The legislature was concerned with only providing a head under which the receipt which has been deemed to be income could be brought to tax."

8. Now the income received from business comes in for computation under the Income-tax Act according to the other provisions laid down in the Income-tax act. Those provisions include the provisions of section 13, which states :
"Income, profits and gains shall be computed, for the purpose of sections 10 and 12, in accordance with the method of accounting rarely employed by the assessee."
9. Section 10 contains the rules for computation of the income from business. Section 10(5A) having merely created a fictional item as an item of income from business has not in any further way interfered with the method of the computation of the said item but left it to be computed according to the usual provisions contained in the Act. The expression "due to or received by the assessee" is not intended to provide for a special mode or method of computation or inclusion of the income in assessment of the assessee. The expression "due to or received by the assessee" is descriptive of the item and not indicative of the point of time when the income is deemed to have been accrued or received. That is left to be determined according to the rules contained in section 13. Thus, for instance, after section 10(5A) came on the statue book, the compensation or other payment, which may be due to or received by the managing agent at the termination or in relation to the managing agency agreement brought to an end thereafter, became taxable in the case of managing agents adopting a mercantile basis of accounting on the date of accrual and in the case of those adopting the other basis, viz., the receipt basis, on the date on which it is actually received. The expression "due to or received by" is not intended to provide either two different points or two optional points of time at which the income can be deemed to be of the assessee liable for taxation. In our opinion, therefore, the argument of Mr. Joshi that on a plain reading of section 10(5A) the year of receipt could be the year in which the income can be brought to tax irrespective of the date of its accrual or irrespective of the method of accounting adopted by the assessee cannot be accepted.

10. Coming to the other contention raise by Mr. Joshi that the fiction involved in section 10(5A) creates a new source of business for which the assessee may adopt a different method of accounting, the said point, it appears to us, is conclude by the decision of this court in Chidambaram Mulraj & Co. Pvt. Ltd. v. Commissioner of Income-tax, wherein it is held that the fiction enacted is section 10(5A) is that what is not a revenue receipt is deemed to be profits and gains of a business and the legislature has not enacted further that the amount made taxable would necessarily be an income from a new source. There is nothing in section 10(5A) which will indicate that the legal fiction was intended by the legislature to creating a new and

independent source of the deemed income. It was, however, a capital receipt of the business before the introduction of section 10(5A) and now by the fiction the nature of the receipt is changed from capital to income. That is the only purpose and ambit if the fiction and it is not possible, therefore, to urge that the deemed income in the shape of compensation or payment for the termination of managing agency must be deemed to be an income from a new source. In your opinion, therefore, the amount which the assessee company received as compensation was not taxable under section 10(5A) of the Indian Income-tax Act in the assessment year 1956-57.

11. The second question as it is framed requires us to state whether the compensation of Rs. 2,34,000 and interest thereon was taxable under section 10(5A) of the Indian Income-tax Act in the assessment year 1956-57. Mr. Joshi argues that even if it is held that the compensation amount is not taxable under section 10(5A) on the ground that it had not accrued to the assessee in the year 1955, but only in 1951, the interest amount at any rate must be held to be taxable because that interest was awarded only by the decree of the court on the 17th November, 1955. He argues that on the view that we have taken, the amount which was determined by the operation of clause (14) and which could, therefore, be taken to have accrued to the assessee on the 23rd April, 1951, was the amount of compensation calculated at the rate of Rs. 6,000 per month for the unexpired period of the contract of the managing agency. There was no provision in the said clause for payment of any interest and no amount by way of interest could, therefore, be said to have accrued to the assessee on the said date. The interest, no doubt, he says, is related to the compensation payable to the assessee but this interest accrued only when it was awarded because it was in the description of the court and the court may as well have refused it.

12. It appears to us that there is substance in this argument of Mr. Joshi and the amount which the assessee has received by way of interest by the order of the court made on the 17th November, 1955, and received by the assessee on the 15th December, 1955, will be liable to be taxed in the assessment year in question. Question No. 2 will have to be answered accordingly.

13. In the result, therefore, we answer question No. 1 in the affirmative and as to question No. 2 our answer is that the amount of compensation of Rs. 2,34,000 will not be liable to tax, but the amount of interest thereon will be taxable under section 10(5A) of the Indian Income-tax Act in the assessment year 1956-57. The department will pay the cost of the assessee.

14. Question answered accordingly.