BOMBAY HIGH COURT

Daruvala Bros. (P) Ltd

Vs

Commissioner of Income-Tax

(K Desai, C.J. N Mody, J.)

16.01.1970

JUDGMENT

K.K. Desai, J.

1. In this reference under section 66(1) of the Indian Income-tax Act, 1922, the question referred to us for decision is as follows :

> "Whether, on the facts and in the circumstances of the case, the sum of Rs. 50,000 had been rightly taxed in the hands of the assessee under section 10(5A) of the Act ?"

2. Having regard to the language of the above section, the direct questions which arise for consideration are : (1) whether the assessee-firm was holding an agency..... relating to the business of any other person ? and (2) whether the compensation of Rs. 50,000 in respect whereof the assessee-firm has been taxed under the above section was received by it in connection with the termination of an agency or the modification of the terms and conditions of an agency ?

3. The facts appear in the statement of the case.

4. The assessee is a private limited company. By an agreement dated April 29, 1955, made between Ciba Pharma Ltd. (which company was the importer of pharmaceutical products of Ciba Ltd., Basle, Switzerland), and the assessee-firm, the latter was appointed distributor of the pharmaceutical products of Ciba Ltd. of Switzerland in the territories of Western and Central India and Hyderabad State on the terms and conditions contained in the agreement.

5. The question that arises for decision is whether this agreement is an agreement of agency. The question has arisen because under Section 10(5A), clause (d), tax is payable in respect of any compensation or other payment received by an assessee. The clause reads as follows :

"(d) ..... holding 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 or the modification of the terms and conditions relating thereto".

6. It has been held against the assessee-firm that, the agreement is an agreement of agency and the above sum of Rs. 50,000 having been paid towards compensation in connection with termination of an agency in respect of a part of the above territories, is liable to be taxed.

7. The main submission of behalf of the assessee-firm is that, on a true construction thereof, the above agreement provides for a scheme for sale of all the pharmaceutical goods of the Ciba Ltd. of Switzerland in the territories mentioned in the above agreement to the assessee-firm and authorises the assessee-firm for itself and on its own behalf to distribute, thereby, in fact meaning to resell the goods purchased by the assessee-firm to direct purchasers and also to sub-distributors who in their turn would have the authority for themselves to effect retail sales of these very goods to their customers and constituents. The submission is that for this reason the agreement cannot be considered to be an agreement of agency. The contrary submission on behalf of the revenue is that on a true construction the effect of the above agreement is that the assessee-firm has been appointed an agent for distributing pharmaceutical goods of the above Swiss company in the territories mentioned in the agreement.

8. To appreciate these rival submissions, the relevant provisions of the agreement are necessary to be noticed. It is convenient to state that in this connection emphatic reliance has been placed by both sides on the scheme of the whole of the agreement and specific reliance has been placed on behalf of the assessee-firm on clauses 9, 24, 26 and 27 of the agreement. On behalf of the revenue specific reliance has been placed on the recitals and clauses 3, 19 and 30 of the agreement.

9. Ciba Pharma Ltd, is referred to in the agreement as "Importers".

10. The relevant part of the recital in the agreement runs as follows :

> "..... it has been agreed that the importers shall appoint the distributors and the distributors shall act as distributors for the sale of all such pharmaceutical products as may be entrusted to them by the importers on the terms and conditions hereinafter mentioned...."

11. Though under clause 1 the period of agreement was one year, admittedly, the period had been extended and the agreement continued in existence in the year of assessment which is 1960-61. Under clause 3, the assessee-firm agreed to "Act as distributors in the territory for the sale within the territory... at prices from time to time fixed by the importers". Under clause 4, the assessee-firm is authorised to appoint sub-distributors. Clause 7 provides in respect of the price that the

distributors shall not sell the said goods above or below prices, from time to time fixed by the importers as the selling prices. In case of price reduction the importers shall credit the distributors with the difference of price for all stocks not sold. Under clause 8, the firm agreed to make a deposit of Rs. 3,00,000 to be utilised to cover delayed adjustments of outstanding or otherwise adjust monetary discrepancies which may arise in the accounts. Clause 9 provides that the importers' invoice shall be payable by the distributors and, inter alia, entitles the distributors to credit for 30 days and 45 days in respect of payments of the importers' invoices. Under clause 11, the distributors agreed to pay interest at the rate of 9 per cent. to the importers, in respect of amounts not paid at the delayed dates provided under clause 9. Clause 12 provides for the distributors truly, faithfully and honestly to act in the matter of the agreement so as to promote and safeguard the interests of the importers. Clause 14 provides for submission by the distributors every week of copies of their invoices and of copies of the invoices of their sub-distributors and at the beginning of every month a statement showing the sales of the said goods during the previous month in line with the invoices already submitted week by week. Under clause 15, the distributors agreed to maintain "a suitable sized and adequately staffed wholesale sales office..." Under clause 16, the distributors are authorised to appoint sub-distributors. Under clause 17, the importers agreed to supply the necessary stocks to the distributors once a month. Under clause 18, the distributors are directed to maintain sufficient stocks in order to enable them to execute all orders without delay. Clause 19 provides that "all goods which are not sold within six months from the date of invoice will be taken back and the value of the same credited to the distributors' account,.... It is of course understood that returned goods will be credited at the prices originally charged in the respective invoices less the discounts granted. The importers shall bear he goods-train freight for the goods returned. Under clause 20, the importers are authorised to take full and complete inspection and examination of the goods in the possession of the distributors. Clause 24 provides :

> "The distributors shall enter into written agreements with their sub-distributors; such agreements to incorporate;
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> (a) all the provisions of this agreement mutatis mutandis, and
>
> (b) .....
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> The agreements between the distributors and the sub-distributors are to be counter-signed by the importers .... The distributors shall be responsible to the importers for all acts, defaults and omissions of every sub-distributors so appointed, who shall be the agents of the distributors and not of the importers."

12. Clauses 26 and 27 provides :

"26. The distributors shall not enter into any contract in the name of or purporting to be on behalf of the importers nor shall the distributors by any act pledge the credit of the importers without permission in writing from the importers."

"27. If and as long as the distributors shall duly and faithfully perform all their obligations under this agreement, any supplies made shall be upon the selling prices specified by the importers....less a discount as the case may be of -10% (ten per cent.) thereon for goods sold to medical profession and dealers, or 20% (ten per cent.) thereon for certain goods sold to hospitals . . . and a discount for the distributors of 11 1/2% on the net price of the goods arrived at after deduction of such discount of 10% or 20% as the case may be.It is, however, understood that where the importers quote net prices, a discount of 11 1/2% to the distributors shall be calculated on such net prices only . . . The distributors shall produce the original order from all the parties and copies of their invoices showing the discounts allowed to the different parties".

13. Clause 30 provides :

"On the termination of this agreement whether by efflux of time or otherwise the importers shall . . . within six months from the date of such termination complete checking and take delivery of the stocks held by the distributors including stocks with sub-distributors and shall within the said period adjust the accounts between themselves and the distributors. . ."

14. Now, apparently, the parties have, as mentioned in the introductory recital, made the above agreement for appointing the assessee-firm as distributors for the sale of the pharmaceutical products entrusted to the assessee-firm. Several of the clauses in the agreement including those recited above provide for a scheme of what is mentioned in the agreement as scheme for distribution of the pharmaceutical products of the above Swiss company. In that connection, the products are agreed to be delivered to the assessee-firm. The firm undertakes and covenants to carry out work which is described as work of distribution truly, faithfully and honestly. The firm undertakes to safeguard the interests of the importers. The supplies to and sales by the firm are agreed to be made on the prices fixed by the importers. The firm is authorised to appoint sub-distributors and the provision is that agreement with sub-distributors to be made by the assessee-firm must be in writing and must incorporate all the provisions in the agreement mutatis mutandis. For the revenue, particular reliance is placed on clauses 19 and 30 wherein it is provided that goods not sold would be taken back by the importers and the value of the same would be credited to the distributors' account. All the stocks of goods not sold by the distributors would be taken back on termination of the agreement and the value of the goods returned would be credited in the accounts. Having regard to this general scheme in the agreement which is mentioned as agreement of distribution, it has been repeatedly submitted by Mr. Joshi for the

revenue that the true nature of this agreement is merely distribute pharmaceutical products of the importers. In his submission, there is no provision for sale of the goods by the importers of the assessee-firm. The work being of distribution on the fact of it, a finding should be made that it is agency work. In that connection, he repeated what is mentioned in the order dated January 20, 1962, of the Income-tax Appellate Tribunal, viz., that the fact that the assessee-firm had to pay or the invoice of the goods did not make any difference in the matter of the true nature of the agreement between the parties.

15. In connection with these submissions and before referring to the clauses on which reliance has been placed on behalf of the assessee-firm, it may at once be stated that the matter of the legal relationship which arises upon a contract of agency made between a principal and an agent has not remained ambiguous and has been crystallized in India by the provisions in sections 182 to 238 of the Indian Contract Act. Section 182 provides that an agent is a person employed to do any act for another, or to represent another in dealings with third persons. The person for whom such act is done, and who is so represented is called the "principal". The question, therefore, in the matter of the present agreement is to ascertain if the assessee-firm was employed to do any act for the importers with whom the agreement was made and/or whether the assessee-firm is under the agreement appointed to do anything as representing the importers in dealing with third persons. Under sections 191 and 192 , an agent is authorised to appoint a sub-agent; but where a sub-agent is properly appointed, the principal is, so far as regards third persons, represented by the sub-agent and is bound by and responsible for his acts, as if he were an agent originally appointed by the principal. The sections 211 to 221 deal with the agent's duty to the principal and, conversely, the sections 222 to 225 deal with the principal's duty to the agent. Under section 213, an agent is bound to render proper accounts to his principal on demand. Under section 215 :

> "If an agent deals on his own account in the business of the agency, without first obtaining the consent of his principal and acquainting him with all material circumstances.... the principal may repudiate the transaction. . ."

16. Now, these two sections have the effect of providing that in no case where under an agreement between the two parties one of them is entitled to act on his own behalf and for himself in respect of the goods entrusted to him the relationship of principal and agent can arise. In other words, where such relationship exists, the acts of the agent under the agreement, ordinarily, cannot be for himself and he should in the matter of the agreement only act as an agent and carry out his obligations as representing and for and on behalf of his principal. In this connection, the provisions of section 216 are important. The sections 226 to 236 relate to the effect of agency and contract with third persons. It would be out of place to described the true effect of all these sections in this judgment. It is sufficient to state that the scheme of these

sections clearly indicate that contracts made by an agent are enforceable in the same manner and have the same legal consequences as if the contract had been made by the principal. Under section 230, an agent cannot personally enforce contracts entered into by him on behalf of his principal nor is he personally bound by them. This provision, however, is subject to the exceptions contained in the second part of the section.

17. In connection with the true effect and construction of the above agreement and the rival contentions of the parties, the scheme of the agreement requires to be examined in the light of the provisions in the above sections 182 to 238 of the Indian Contract Act. Contrary to the submission made on behalf of the revenue, the clause 26 of the agreement specifically provides for preventing the assessee-firm from making any contracts in the name of or purporting to be on behalf of the importers. If further prevents the assessee-firm from pledging the credit of the importers. Though the general scheme of the agreement is for distribution of the goods for the importers, it is clearly indicated that the assessee-firm must carry on the business of resale of the pharmaceutical goods of the importers which come into its possession for itself and at its own risk as to costs and consequences. Though there are restrictions on the assessee-firm and the sub-distributors to be appointed by it as regards the prices to be charged, the importers are not concerned with the contracts made by the assessee-firm or by the sub-distributors with the customers and constituents and/or outside purchasers. The losses that may be suffered on resales effected by the assessee-firm cannot be visited on the importers. The whole of the work which is described as distribution in fact provided for a scheme of resale of the goods delivered to the assessee-firm by that firm for itself and on its own behalf. In this connection, we are unable to accept the submission made by Mr. Joshi that the scheme in clause 9 read with clause 27 is for payment of commission to the assessee-firm and does not involve payment of price by the assessee-firm to the importers. It is clear that under clause 9 the assessee-firm undertook an obligation to pay the prices mentioned in the invoices submitted to it by the importers upon supply of goods. The price is liable to be paid in cash though credit is agreed to be given for 30 days and 45 days as mentioned in the clause. Apparently, the importers are not concerned with and are not bound to bear the loss in respect of the goods which for any reason may not be available for return to the importers. The ownership of the goods upon supplies made to it must be held to have been transferred to the assessee-firm, and that would be so in spite of the scheme for return of goods as contained in clauses 19 and 30. Those clause have the nature of what is mentioned in Bombay markets as jangad sale and is otherwise known as sale on approval and/or consignment basis. In the scheme of the agreement the price is charged to the assessee-firm immediately upon delivery of goods which is not the case in other jangad sale and/or sale on approval basis. There is no doubt that under the scheme of the agreement all resales of goods supplied and delivered to the assessee-firm are to be made by that firm only for itself and not for and on behalf of the importers. Having regard to the law relating to legal relationship between an

agent and principal as contained in the section 182 to 238 of the Indian Contract Act, it would be impossible if the assessee was an agent of the importers to sell for itself and on its own behalf and at its own risk as to costs the goods supplied and delivered by the importers to the assessee-firm. This would be the result in law in spite of the fact that the parties described the supply and delivery of goods to the assessee-firm as mere entrustment of goods and delivered in the general scheme of the agreement for various stringent obligations against the assessee-firm to carry out the work of distribution honestly, faithfully and in the interests of the importers.

18. Now, in this connection, reference has been made to paragraph 351, at page 146, of Volume 1, Halsbury's Laws of England, 1952 edition, where the following appears :

> "..... if it is found that such agreement in substance contemplates the alleged agent acting on his own behalf, and not on behalf of a principal, then, though the alleged agent may be described as an agent in the agreement, the relation of agency will not have arisen.
>
> .... the essence of such an agent's position is that he shall be but a conduit pipe connecting two other parties. Thus an agent for sale or purchase is debarred from being himself either buyer or seller without full disclosure to the principal....."

19. Reliance also has been placed on the decisions in the case of *P. H. Divecha v. Commissioner of Income-tax and Ganesh Export and Import Co. v. Mahadeolal Nathmal.* It is sufficient to state that in both these cases questions for consideration arose in respect of an agreement which was in words stated to be an agency agreement and provided for several duties to be discharged by a selling agent. In the case of *P. H. Divecha v. Commissioner of Income-tax, t*he agreement had lasted for more than 16 years and was in respect of conduct of business in electrical goods including electric lamps. The so-called agency firm was given exclusive rights to purchase and sell electric lamps manufactured by "Philips" in certain areas. The provisions were similar to the provisions in the present agreement; but having regard to the material provisions in the agreement, the Supreme Court held that the agreement between the firm and Philips Electrical Company created a monopoly right of purchase for, and a monopoly right of sale in, certain areas. The agreement was not an agreement of agency.

20. In the second case, on the facts before the High Court of Calcutta, the court observed in connection with the an agreement which was similar to the agreement in this case that "upon a consideration of all the terms and conditions of the agreement, we come to the conclusion that the agreement in substance contemplates the so-called agent acting on his own behalf, we shall have no hesitation in holding that no relationship of agency has arisen in spite of the contrary description in the agreement".

21. Having regard to the above discussion, we are unable to accept Mr. Joshi's submission that the present agreement is merely for distribution of Ciba products through the assessee-firm. What is described as entrustment of goods and agreement for distribution really commences with the payment of price of all the goods supplied and delivered by the assessee-firm to the importers, and since the agreement authorises the assessee-firm to sell all these goods for itself, the phrase "entrustment" must beheld to be in law not correct in connection with the goods in the possession of the assessee-firm. We cannot accept the contention that what the assessee-firm earns from out of the sale of the goods to the firm is merely commission. For earning what is mentioned by Mr. Joshi as commission, in the first instance, the assessee-firm agreed to pay and paid the invoice prices of the goods delivered to it. We are unable to accept his submission that during the interval between the delivery and return of the goods under clauses 19 and 30, the assessee-firm held the goods delivered to it in trust for and on behalf of the importers.

22. Under the circumstances, it must be held that the finding made by the Tribunal that the above agreement was an agency agreement was not correct. The true fact is that the agreement made between the assessee-firm and the importers mentioned above was not an agreement of agency as was necessary for levying income-tax on the assessee-firm in respect of the sum of Rs. 50,000 mentioned in the question under section 10(5A) of the Act.

23. The answer to the question, therefore, will be in the negative. The respondent will pay costs.

24. Question answered in the negative.