M/S. CHIDAMBARAM MULRAJ & CO. PVT. LTD. A

v.

COMMISSIONER OF INCOME TAX, BOMBAY CITY I

November 21, 1975

[V. R. KRISHNA IYER AND A. C. GUPTA, JJ.] B

Indian Income Tax Act, 1922—Sub-s. 5A of s. 10 introduced by the Finance *Act of* 1955—*Interpretation of—Compensation paid for the termination of a managing business is a payment in relation to the said business—Previous year relevant to that receipt is the same as the previous year for the managing agency business itself.*

The assessee-appellant received in October, 1953, a sum of Rs. 9,95,000/- out of Rs. 10,00,000/- compensation for the premature termination of its managing agency business, a sum of Rs. 5,000/-, having been deducted towards brokerage. The said amount was credited to the Capital Reserve Account in its books for the year ending on June 30, 1954 described as "compensation for loss of office". In the assessment year 1955-56, for which the appellant's previous year ended on June 30, 1954, the Income Tax Officer assessed the entire amount of Rs. 10,00,000/- in the hands of the appellant company under s. 10 (5A). C

The Company preferred an appeal to the Appellate Assistant Commissioner who allowed the appeal holding that (i) s. 10(5A) created a new source of income for which the previous year was not the previous year for the managing agency business ending on June 30, 1954; (ii) the compensation of Rs. 10,00,000/- which the assessee received in October, 1953 fell in the financial year 1953-54 which would be the previous year for this income for which the assessment year was 1954-55, which was before the enactment of sub-section 5A of s. 10; (iii) the fact that the appellant had entered the amount in its books for the year that ended on June 30, 1954, could not be taken as an exercise of option by the assessee, accepting the said year as the previous year in respect of the receipt; and (iv) if at all the amount was taxable in the assessment year 1955-56, the assessee was entitled to a deduction of Rs. 6,00,000/- paid for acquiring the managing agency. D E

The appeal preferred by the Department was partly allowed. The Tribunal agreed with the Appellate Assistant Commissioner that the assessee was entitled to a deduction of Rs. 6,00,000/- which the assessee had paid for acquiring the managing agency business. The Tribunal however held that Sec. 10 (5A) does not increase a fresh source of income that since the amount in question was received in the accounting year relevant to the assessment year 1955-56, it was taxable in the assessment year 1955-56. F

The High Court on a reference under s. 66(1) of the Act on the two questions namely,

(i) Whether the sum of Rs. 10 lakhs is income assessable in the year 1955-56 by virtue of Section 10(5A) ? and

(ii) If the answer is in the affirmative, whether the initial cost of acquisition of the Managing Agency of Rs. 6 lakhs and Rs. 5 thousands paid as brokerage on sale are deductible ? G

agreed with the views of the Tribunal.

On appeal by certificate under s. 66A(2) and dismissing the appeal, the Court,

HELD : (1) Since sub-section 5A of s. 10 came into force on April 1, 1955, the amount in question if received by the assessee during the previous year for the assessment year 1955-56, would be taxable under that sub-section. By H

A a legal fiction introduced by the sub-section, any amount received by a managing agent as compensation for the termination of his managing agency agreement which would otherwise have been a capital receipt is to be deemed as profits and gains of a business carried on by the managing agent. The fiction regards the capital receipt as income and does not extend to treating the termination of managing agency itself as a business. The amount received by the appellant was the payment for the termination of the managing agency business and, as such, the receipt is obviously related to that business. Though the B amount was not earned in carrying on the business of managing agency, yet the source of the receipt was the managing agency business itself, it is not therefore correct to say that the receipt was income from a new and independent source. [777B, FG]

(2) The High Court was right in holding that in enacting sub-section 5A, the Legislature was concerned only with providing a head under which the receipt which has been deemed to be income could be brought to tax and was not concerned with creating a new source for that deemed income. [777G]

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(3) The compensation paid for the termination of a managing agency business is a payment in relation to the said business and, therefore, the previous year relevant to that receipt would be the same as the previous year for the managing agency business itself. [778A]

Commissioner of Income Tax, Bombay v. *Sir Chunilal V. Mehta & Sons Private Ltd.*, (1967) 65 I.T.R. 50; and *R. V. Lakshmiah Naidu and Co.* v. *Commissioner of Income Tax, Kerala and Coimbatore*, (1963) 48 I.T.R. 661, D relied on.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 360 of 1971.

From the Judgment and Order dated the 27/29-1-1965 of the Bombay High Court in Income Tax Reference No. 75 of 1961.

S. C. Manchanda, K. J. John and *J. B. Dadachanji* for the Appel- E lant.

S. T. Desai, Girish Chandra and *M. N. Shroff* for the Respondent.

The Judgment of the Court was delivered by

GUPTA, J. The appellant is a private limited company. The assessment year is 1955-56 for which the relevant previous year ended F on June 30, 1954. The shareholders of the appellant company are Mulraj Kersondas, members of his family, allied concerns and nominees only. In 1944 the appellant purchased the managing agency of the Elphinston Spinning and Weaving Mills Ltd. for Rupees six lakhs and thereafter entered into a separate managing agency agreement with the managed company for a period of seventeen years. The appellant's only source of income was this managing agency in the G relevant year. Mulraj and his group also held among themselves 25,000 ordinary and 10,000 preference shares of the Elphinston Spinning and Weaving Mills Ltd. Mulraj entered into an agreement for sale of these shares with K. D. Jalan of Calcutta for a consideration of Rupees forty-five lakhs; one of the terms of the agreement was that Mulraj would have the managing agency of the appellant company terminated. In implementation of this agreement Mulraj wrote to H the appellant company on October 21, 1953 asking the company to give up the managing agency on receipt of a sum of Rupees ten lakhs as compensation which he promised to pay. On the same day the appellant company passed a resolution accepting Mulraj's offer and

wrote to the managed company, Elphinston Spinning and Weaving Mills Ltd., tendering resignation of its office as managing agents. The resignation was in due course accepted. The assessee received from Mulraj a sum of Rs. 9,95,000/- as compensation for premature termination of the managing agency, Rs. 5,000/- having been paid by Mulraj as brokerage to one Dhirajlal Maganlal. The amount received was credited to the Capital Reserve Account in the appellant's books for the year ending on June 30, 1954 described as "compensation for loss of office".

In the assessment year 1955-56 for which the appellant's previous year ended on June 30, 1954, the Income-tax Officer assessed the entire amount of Rupees ten lakhs in the hands of the appellant company under section 10(5A) of the Income-Tax Act, 1922. Section 10(1) of the Income-Tax Act, 1922 states that the "tax shall be payable by an assessee under the head "Profits and gains of business, profession or vocation" in respect of the profit or gains of any business, profession or vocation carried on by him." Sub-section (5A) was inserted in section 10 by the Finance Act, 1955 with effect from April 1, 1955, the relevant part of which is in these terms :

> "(5A) Any compensation or other payment due to or received by,—
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> (a) a managing agent of an Indian company at or in connection with the termination or modification of his managing agency agreement with the company;
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> (b) a manager of an Indian company at or in connection with the termination of his office or modification of the terms and conditions relating thereto;
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> (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 or the modification of the terms and conditions relating thereto;
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> (d) any person, by whatever name called, 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;
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> shall be deemed to be profits and gains of a business carried on by the managing agent, manager or other person, as the case may be, and shall be liable to tax accordingly;"

The company preferred an appeal to the Appellate Assistant Commissioner against the order of the Income-tax Officer. The Appellate Assistant Commissioner allowed the appeal holding that section 10(5A) created a new source of income for which the previous year was not the previous year for the managing agency business which ended on June 30, 1954, that the compensation of Rupees

A ten lakhs which the appellant received in October, 1953 fell in the financial year 1953-54 which would be the previous year for this income for which the assessment year was 1954-55 which was before sub-section (5A) of section 10 was enacted, and the fact that the appellant had entered the amount in its books for the year that ended on June 30, 1954 could not be taken as an exercise of option by the assessee accepting the said year as the previous year in respect of the B receipt. The Appellate Assistant Commissioner further held that if at all the amount was taxable in the assessment year 1955-56, the assessee was entitled to a deduction of Rupees six lakhs paid for acquiring the managing agency. The Department took an appeal to the Tribunal against the order of the Appellate Assistant Commissioner. The Tribunal was of opinion that section 10(5A) only regards the compensation received by the managing agent as profits and C gains of a business and does not create a fresh source therefor, and as the amount in question in this case was received in the accounting year relevant to the assessment year 1955-56, it was taxable in the assessment year 1955-56. The Tribunal however agreed with the Appellate Assistant Commissioner that the assessee was entitled to a deduction of Rupees six lakhs which the assessee had paid for acquiring the managing agency, and allowed the appeal partly holding D that the assessee was liable to pay tax on the sum of Rs. 3,95,000/-. At the instance of the parties the Tribunal referred the following two questions to the High Court under section 66(1) :

> "(i) Whether the sum of Rs. 10 lakhs is income assessable in the year 1955-56 by virtue of Section 10 (5A) ?
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> (ii) If the answer is in the affirmative, whether the initial cost of acquisition of the Managing Agency of Rs. 6 lakhs and Rs. 5000/- paid as brokerage on sale are deductible ?"

The first question was referred at the instance of the assessee and the second at the instance of the Department. The High Court overF ruled the contention of the assessee that the amount in question was income from a new source for which the previous year was 1953-54, and answered the first question in the affirmative and in favour of the revenue. As regards the second question, the High Court answered it in favour of the assessee and upheld the order of the Tribunal. In the present appeal brought on a certificate under section 66A(2), G the assessee challenges the correctness of the answer given by the High Court to the first question.

"Previous year" is defined in section 2(11) of the Income-Tax Act, 1922 and the relevant part of the definition is as follows :—

> "(11) 'Previous year' means in respect of any separate source of income, profits and gains—
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> (a) the twelve months ending on the 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have

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been made up to a date within the said twelve months in respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on the day to which his accounts have so been made up ;"

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As stated already, sub-section (5A) of section 10 came into force on April 1, 1955. Therefore, the amount in question, if received by the assessee during the previous year for the assessment year 1955-56, would be taxable under that sub-section. By a legal fiction introduced by sub-section (5A) any amount received by a managing agent as compensation for the termination of his managing agency agreement which would otherwise have been a capital receipt is to be deemed as profits and gains of a business carried on by the managing agent. The appellant contends that sub-section (5A) indicates that this deemed income is to be treated as receipt from a new source and, that being so, the relevant previous year for this income would not necessarily be the year ending on June 30, 1954 which was the previous year for the managing agency business, and the assessee should have been given an opportunity to choose the previous year in respect of the receipt in question; if the financial year 1953-54 is taken as the previous year for this income from a new source, the argument proceeds, then the amount would not be taxable in the assessment year 1955-56. It is further argued that the amount received as compensation could not be profits and gains of the managing agency business because the business itself was being terminated. The words of the sub-section, according to learned counsel for the appellant, indicate that the receipt is to be treated as income from a new and independent source. Sub-section (5A) states, *inter alia,* that any compensation or other payment received by a managing agent in connection with the termination of his managing agency agreement shall be deemed to be profits and gains of "a business" carried on by the managing agent. The use of the indefinite article before the word 'business', it is submitted, makes it plain that the income is not relatable to the managing agency business but to a new and separate source.

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We are unable to accept the contention. The fiction introduced by sub-section (5A) regards the capital receipt as income and does not extend to treating the termination of managing agency itself as a business. The amount received by the appellant was a payment for the termination of the managing agency business and, as such, the receipt is obviously related to that business. It is of course true that the amount was not earned in carrying on the business of managing agency, but it is clear that the source of the receipt was the managing agency business itself. It cannot therefore be said that the receipt was income from a new and independent source. In our opinion the High Court was right in holding that in enacting sub-section (5A) the legislature was concerned only with providing a head under which the receipt which has been deemed to be income could be brought to tax and was not concerned with creating a new source for that deemed income. Two decisions cited on behalf of the respondent, one of the Bombay High Court, *Commissioner of Income-tax, Bombay* v. *Sir*

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A *Chunilal* v. *Mehta & Sons Private Ltd.*(1) and the other of the Madras High Court, *R. V. Lakshmiah Naidu and Co.* v. *Commissioner of Income-Tax, Kerala and Coimbatore*(2), have both held that the compensation paid for the termination of a managing agency business is a payment in relation to the said business, and, therefore, the previous year relevant to that receipt would be the same as the previous year for the managing agency business itself. In our view these two deci-
B sions state the law on the point correctly.

The appeal fails and is dismissed with costs.

S.R. *Appeal dismissed.*

(1) (1967) 65 I.T.R. 50.
(2) (1963) 48 I.T.R. 661.