**inspecting Assistant Vs. Ghaziabad Engineering Co. (P.)**

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**Court** : Income Tax Appellate Tribunal ITAT Delhi

**Decided On :** Sep-30-1983

**Reported in** : (1984)7ITD289(Delhi)

**Judge** : K Srivastava, S Kapur

**Appellant** : inspecting Assistant

**Respondent** : Ghaziabad Engineering Co. (P.)

**Judgement** :

1. The departmental appeal and the cross-objection by the assessee are directed against the order of the Commissioner (Appeals) for the assessment year 1978-79.

2. The main ground in the departmental appeal relates to the deletion of Rs. 99,00,000 which had been added by the IAC. The relevant facts regarding this issue are that the assessee-company ('GEC') had been working as the sole distributor for Motor Industries Company Ltd. ('MICO') regarding sale and service of its products and in certain territories in the northern part of India including Delhi. From 1964 to February 1976, this arrangement was carried on merely some ad hoc basis. On 10-2-1967, there was an agreement in writing between the assessee-company and MICO. The main features of this agreement were as under : (i) MICO appointing GEC as the sole distributor for spark plugs manufactured by it and of other product in the territorie specified in the northern region of India and Delhi.

(ii) The products were to be purchased outright by GEC for subsequent sale in the territory allotted to it and the discount which was to be allowed by MICO to GEC was not to exceed 45 par cent of the list price. MICO, however, reserved the right to itself to fix the selling, price of the products.

(iii) GEC was not to deal in competing products, nor extend its sale and service beyond the territory allotted to it.

(iv) GEC was not to act as agent of MICO nor represent itself to others, to be so and was given no power to bind MICO in any manner.

(v) The agreement was valid for five years from 10-2-1967, unless terminated earlier after the expiry of the prescribed notice given by either side. MICO was also given option to terminate the agreement unilaterally by notice with immediate effect or without notice on the happening of certain events (which are not relevant to the enquiry here).

(vi) GEC was prohibited from assigning or transferring to any other person any of the rights or liabilities arising from the said agreement.

3. This agreement was for a period of five years but before the expiry of this agreement, the assessee-company received a letter from MICO on 28-1-1972. By this letter GEC was informed about the decision of MICO to tale over the business operations allotted to GEC regarding the sole distributorship by opening MICO's own sale house. It was stated that the intention was to take over the specified area in three phases commencing from February 1972 and the final take over was to be completed by February 1982. The areas for such phased take over were indicated and it was also indicated that Mi CO may consider appointing GEC as distributor for Delhi, Ghaziabad, etc. It was also indicated that till a final agreement, the earlier agreement dated 10-2-1967 was to be the basis of the working arrangement. The MICO -reserved ; the right to accelerate the process of take over earlier than what was indicated in the phased programme.

4. On 18-3-1972, GEC was appointed as the sole distributor of the products of MICO by an agreement on the same date. This agreement was to be effective for

5 years from 10-2-1972. The territory allotted to GEC under the agreement was reduced. One clause of the agreement stated that the GEC would not be entitled to any compensation in the event of termination of its distributorship and it was specifically laid down that the new agreement superseded and cancelled all the previous agreements between two parties prior to the date of this agreement.

5. Though, this agreement was to expire on 9-2-1977, MICO intimated GEC by letter dated 3-12-1976 that with effect from 9-2-1977 GEC would cease to be the sole distributor of MICO. On 9-2-1977 there was an agreement between the MICO and GEC which terminated the distributorship of GEC with effect from 10-2-1977. Under this agreement, MICO agreed to compensate GEC Rs. 33,00,000 per annum for a period of three years in consideration of the premature termination of the said distributorship.

While the first instalment was payable in the execution of the said agreement, the balance was to be paid over in the next two years.

According to Clause 3 of this agreement, the GEC was not precluded from carrying on the business of the services independently in its own right but Clause 6 prohibited GEC from carrying on any business in indigenous product in competition with those of MICO.6. According to the assessee, the amount of compensation was not taxable under Section 28(ii)(c) of the Income-tax Act, 1961 ('the Act') as GEC was not an agent of MICO. It was further contended that it was not chargeable to capital gain because there was no transfer of capital assets. The claim of the assessee that the amount of compensation was not taxable was not accepted by the IAC who held that the compensation was paid for the loss of profits and, therefore, it was a revenue receipt in the hands of the assessee. According to the IAC, GEC acted as the agent of MICO in the given territories. In this connection, a reference was made to the provisions of Section 28(ii)(c). It was also held in the alternative that if the amount in question was not taxable as business income, the same was taxable to capital gains tax as there was a transfer of capital asset.

7. When the matter came before the Commissioner (Appeals), he considered the general legal position regarding taxability of compensation specially having regard

to the ratio of the decision of the Privy Council in the case of CIT v. Shaw Wallace & Co. 6 ITC 178 and the decision of the Supreme Court in the case of CIT v. Vazir Sultan & Sons [1959] 36 ITR 175 and also in the case off P.H. Divecha v. CIT [1963] 48 ITR 222. He then proceeded to consider the special provision of the Act under sub-clauses (a) to (c) of Section 28(ii).

Section 28(ii)(c) has provided that any compensation or other payment due to or received by any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto is chargeable as income under the head 'Profits and gains of business or profession.

8. The plea of the assessee has been that this provision was not applicable to him as he was not holding any agency for any part of the activities relating to the business of any other person. This plea had not been accepted by the IAC who was of the opinion that the assessee being the sole distributor should also be considered as holding agency for a part of the activity of MICO. For this, the IAC had relied on the conditions under which the assessee-company was carrying on the business in a particular territory. According to the IAC, MICO exercised formidable control over the activities of the assessee-company and their relationship was not that of a principal with another principals. In other words, according to the IAC, the assessee was the sole selling agent of MICO. The Commissioner (Appeals), however, did not agree with this view. He considered the, definition of agent as given under Section 182 of the Indian Contract Act 1872, as under : An 'agent' is a person employed to do any act for another or to represent another in any dealings with third persons. The person for whom such act is done, or who is so represented, is called the 'principal'.

According to the contention of the assessee before the Commissioner (Appeals), the assessee-company was not to do any act on behalf of MICO or to represent in relation to a third person. The Commissioner (Appeals) accepted this claim and held that the relationship between the assessee-company and MICO was not that of an agent and a principal but of one principal with another principals. According

to the terms and conditions of the agreement, MICO used to sell their products to the assessee-company who had the right to further sell them in a specified area. The Commissioner (Appeals) held that the confusion had arisen as under the Companies Act, 1956 the sole distributors were considered as sole selling agent. Before the Commissioner (Appeals), reliance has been placed on the decision of the Bombay High Court in the case of Daruvala Bros. (P.) Ltd. v. CIT [1971] 80 ITR 213. The question for consideration before the High Court was regarding the taxability of compensation received on termination of sole distributorship. On considering the terms of agreement in that case, it was held that the sole distributor could not be considered to be the agent and the provisions under Section 10(5A)(d) of the Indian Income-tax Act, 1922 ('the 1922 Act') corresponding to the provisions under Section 28(ii)(c) were rot applicable. In the agreement of March 1972 there was a specific clause stating that the assessee-company was not to act as an agent of MICO. The Commissioner (Appeals), therefore, held that the above decision of the Bombay High Court was wholly applicable to the facts of the present case. He, therefore, came to the conclusion that the provisions of Section 28(ii)(c) could not re invoked to tax the compensation received by the assessee-ccmpany from the MICO.9. The Commissioner (Appeals) further considered the question whether the compensation was a capital receipt or a revenue receipt under the general law irrespective of the provisions of Section 28(ii)(c).

According to the IAC, this was a normal business profit or a receipt for the loss of profit. The amount of compensation was determined with a reference to the estimated profit of the assessee-company. However, it was contended before the Commissioner (Appeals) that the sale of MICO products involved almost the entire business of GEC and the agreements entered into in 1967 as well as 1972 represented the profit-making apparatus of the assessee. It was further contended that when the whole business of distributorship in MICO, which formed the main part of the assessee's business, was terminated prematurely, the compensation received should be considered as a capital receipt. In order to substantiate the assessee's claim, it was pointed out that the turnover of the company was reduced from Rs. 482 lakhs in the assessment year 1977-78 to Rs. 137 lakhs in the current assessment year and further came down to Rs. 11 lakhs in the assessment year

1979-80.

While accepting the above plea of the assessee, the Commissioner (Appeals) held that the fact that the payment was measured by the estimated annual yield or profit would not make the payment an income in the hands of the assessee. Reliance was placed on the decision of the Delhi High Court in the case of Lakshmi Insurance Co. (P.) Ltd. v.CIT [1971] 80 ITR 575. The Commissioner (Appeals) also referred to the restrictive covenant in the agreement and on that basis also agreed that the payment was on capital account. Regarding the question of chargeability of this amount under the capital gains, the Commissioner (Appeals) found that there has been no assessment of the amount under the capital gains and he held that the matter could not be considered from that angle. Thus, the Commissioner (Appeals) came to the conclusion that the amount of Rs. 99 lakhs could not be assessed under the general principles or the provisions of Section 28(ii)(c) and the ITO had also not established that provision of Section 2(47) read with Section 45 of the Act were attracted. The addition of Rs. 99 lakhs was, therefore, deleted.

10. The departmental representative challenged before us the order of the Commissioner (Appeals) and for explaining the position of the department, he took us through the relevant clauses of the various agreements which have been entered into in 1967 and then in 1972. He drew our attention to the letter dated 2S-1-1972, written by the MICO to the assessee-com-pany. This letter informed the assessee that the agreement for sole distributorship of MICO products with the assessee was expiring on 19-2-1972 and MICO had decided as a matter of policy to establish their own sales house in Delhi on the pattern of similar existing sales houses in other parts of the country. It was contemplated to completely take over the distribution of business by February 1982, in three phases. Till the finalisation of a fresh agreement, the present working arrangement was to continue. It was also clarified that MICO's right to accelerate the process of take over and complete phase programme earlier were reserved. It was further clarified that the contents of the letter was subject to any law on this matter. After this letter and after expiry of the agreement on 9-2-1972 another agreement was entered into between the parties for a further period of five years. Referring to the terms of this agreement, it

was submitted that the activity of the assessee was under the strict control of the MICO who could carry on inspection of the sale and servicing of its products by the assessee-company. He also drew our attention that sale agreement was enforced for five years and it could be terminated by either parties on an earlier date by giving 6 months notice. There was also a provision for immediate termination by notice in certain circumstances. These circumstances were relating to the breach of obligation of the assessee under the agreement. It was also stipulated that no compensation shall be payable to the assessee in the event of termination of the arrangement under the agreement. It has been clarified that this agreement superseded all agreements whether verbal or written subsisting between the parties before the date of this agreement. It was submitted that though the agreement stated that GEC was in no sense agents of MICO, the letter written by MICO to the managing director of the assessee-company on 7-12-1972 stated that though the assessee-company were only sole distributors and not sole selling agents of MICO, the provisions of the Companies Act relating to sole selling agents were attracted and for that purpose the appointment was to be rectified for the sake of abundant caution. The departmental representative then referred to the assessee-company's reply to the MICO on 25-8-1973 in which they had clarified that the assessee-company were not the sole selling agency of the products of MICO and the agreement was of a vendor and buyer on a principal to principal basis.

In this letter, the assessee-company had also stated that they were not placing the principals in contractual or other relationship with a third party on commission basis. It was also clarified that the assessee-company was at the most to be treated as favoured buyer and not as an agent. MICO had clarified to the assessee-company that the whole question could be considered only at the time of the renewal of the agreement in 1976 or 1977.

11. On 31-12-1976, MIC0 informed the assessee-company that the agreement in 1972 had clarified that all earlier letters stood superseded and cancelled and there was no provision for renewal of this agreement on its expiry. The assessee-company was informed that the agreement will stand automatically terminated or determined on 9-2-1977 by efflux of time and the assessee would cease to be the

sole distributor of MICO's products.

12. The deparimenta 1 representative then took us to the agreement made on 9-2-1977. It was forcefully submitted by the departmental representative that the terms of this agreement do not bring out the correct facts and sometime go contrary to the earlier arrangement or agreement between the parties. In this agreement, it was stated that MICO had decided not to wait till February 1982, for complete take over of the distribution of its products in the specified areas. The specific clauses to which our attention was drawn were clauses 6, 7, 8 and 9 in the preamble to the agreement and they are as follows : 6. GEC for the purposes and in the course of acting as such sole distributor of MICO Bosch products over the last many years established both directly and through other distributors, dealers and stockists a net work of distribution and service points throughout the territories assigned to it as aforesaid and also established and developed at considerable expenses and efforts its main distribution centre in New Delhi and has been deriving reasonable substantial profits from the business carried on by it as such sole distributor.

7. MICO for its own reasons and benefit recently expressed a desire to GEC to establish its own sale house in New Delhi with a view to replace GEC totally as from the 10-2-1977 for the distribution of MICO Bosch products in the territories assigned to it as aforesaid instead of waiting till February 1982 as stipulated and agreed upon in the aforesaid letters dated 1-9-1973 and 11-6-1976.

8. GEC initially expressed serious objection to the aforesaid proposal of MICO mainly on the ground of loss of profits for five years from 10-2-1977 but has after extensive discussion and negotiations finally accepted the said proposal of MICO on condition that MICO shall pay due compensation to GEC for the premature loss of office and the consequent loss of profit for the period aforesaid.

9. To facilitate the proper determination of the quantum of such compensation, GEC produced to MICO relevant financial statements duly certified by its auditors and MICO having examined such statements the parties hereto have agreed that MICO shall pay to the GEC compensation at the rate of Rs. 33,00,000 (Rupees thirty-three lakhs only) per annum for a period of three years and have also agreed to other terms and conditions herein after mentioned and contained.

It was contended by the departmental representative that this agreement was full of falsehood and do not give the correct description of the events which had already taken place. He submitted that there was no premature termination of the agreement which was expiring due to efflux of time as contemplated in the agreement of 1972. He also submitted that the description of any premature termination of the agreement was not correct, ft was pointed out that the compensation was being paid for the loss of profit, earned by the assessee-company from the sole distributorship of MICO products (sic). The assessee was to ceases to be the sole distributor of MICO products from 10-2-1977. GEC was not to be associated with any indigenous competition directly or indirectly with MICO products.

13. After giving the above background, the learned departmental representative submitted that the word 'agent' should be given its normal meaning and the relationship of the assessee with MICO was clearly to act as their agent and for this purpose, MICO were exercising substantial control over the activities of the assessee. The accounts of the assessee as well as the appointments in this connection were to be inspected by the MICO and some dealer could not be appointed without permission of MICO. According to the learned departmental representative, the words 'agent' and 'agency' were different words with different imports. According to his submission, the assessee was exercising the rights of agency for a part of MICO's business activities. In this connection, it was contended that the reliance of the learned Commissioner (Appeals) on the provision of the Indian Contract Act was not correct and the more relevant provision for this purpose was the Companies Act.

14. Relying on the decision of the Calcutta High Court in Shalagram Jhajharia v. National Co. Ltd. [1965] 35 Comp. Cas. 706 where it has been held that the agency includes selling agents, it was contended that the nomenclature given in the agreement was not important and the assessee was exercising the exclusive right to sell the product of MICO in the specified area.

15. The learned departmental representative further submitted that there were overriding considerations for not following the decision of the Bombay High Court

relied upon by the assessee in Daruvala Bros.

(P.) Ltd.'s case (supra).

16. The other leg of the arguments advanced by the departmental representative was that even on general principles the amount received by the assessee was taxable. Pointing out to the history of the case, he submitted that there was no premature loss of office and the agreement had come to an end and its time had expired. He submitted that the compensation was not in respect of any capital asset and it cannot be said that in the present case, the income earning apparatus of the assessee had been destroyed. It was pointed out by him that the letter dated 28-1-1972 was not a contract and even if it was considered to be a contract, it was superseded by the written agreement entered into after that date. It was further pointed out that the suggestion in the letter, dated 28-1-1972 was against the provision of the company law which did not provide for such an agreement beyond 5 years. It was, therefore contended by him that the representative of the assessee was not justified in relying upon the letter dated 28-1-1972 for the agreement for payments of compensation. Our attention was drawn to the fact that this letter of January 1972 does not find any mention in the agreement concluded in 1972. According to the departmental representative, the agreement expired due to efflux of time and, therefore, no capital asset remained with the company. The assessee was not holding any office and sole distributorship came to an end as the time stipulated for it has expired. Another point made by the departmental representative was that the receipt was not a capital receipt as it was related to the assessee's business and was paid to compensate the assessee for the loss of income in the first two years.

In another words, the amount had been received in lieu of profits and was, therefore, chargeable to tax. In this connection, he referred to Clause (8) of the agreement dated 9-2-1977 by which the objection of the assessee was shown to be based on loss of profit from 10-2-1977.

17. The departmental representative drew our attention to the provision of Section 294A(2) of the Companies Act and submitted that there was no unexpired period of agreement, for which compensation could be paid. He further drew our attention

that on the same date, i.e., 9-2-1977, the assessee-company entered into another agreement with M1CO who appointed the assessee as their technical consultant with effect from that date.

Under this agreement both the parties had taken note of the end of the sole distributorship agreement between the parties and provided that for an interim period of two years, GEC were to act as market consultant of MICO and had to render certain services in this connection. In consideration of these services to be rendered by GEC, MICO had to pay Rs. 5.50 lakhs per annum to GEC. A part from the above additional services were also to be provided by GEC to MICO and these included making available the office and certain specified numbers of staff belonging to the assessee to work on behalf of MICO. For such services, an amount of Rs. 60,000 per year was to be paid. There was further an agreement for the purchase of certain materials by MICO from GEC on certain payments. GEC were to exercise their good offices in assisting MICO in obtaining a lease from the connected parties in favour of MICO in respect of the premises where the business was being carried on.

18. According to the departmental representative, both the agreements were simultaneous and should be read together. He contended that new agreement clearly showed that there was no end to the assessee's business and only its form was changed. It was pointed out by him that GEC were co-operating with MICO and were continuing with their business relationship, though in another form. It was, therefore, submitted firstly, the amount was taxable under Section 28(ii)(c) and in the alternative it was taxable under the general principles without taking into consideration the provisions of Section 28(ii)(c).

19. The departmental representative further pointed out that the ITO had assessed the amount as business income but had made a mention of the fact that in case it was held that the amount of compensation represented capital receipts in the hands of the assessee, it would be taxable as if there was a transfer of a capital asset. In other words, the suggestion was that the same amount would have been taxable as capital gains. It was conended that the Commissioner (Appeals) has not considered this aspect raised by the ITO on the ground that the ITO had not

established that the capital gains were chargeable in this case.

According to the departmental representative, the rights of the assessee as a sole distributor were his capital asset and extinguishment of such capital asset resulted in a transfer within the meaning of Section 45. He further contended that this ground should be treated as a part of first term which related to the deletion of Rs. 99 lakhs. He further contended that such rights under the agreement must have a cost of acquisition and it may be observed for computing the capital gains. He further contended that though the consideration received in the first year was only Rs. 33 lakhs, the consideration agreed to was a total amount of Rs. 99 lakhs and only the mode of payment was distributed over a numbers of years.

20. The learned counsel for the assessee, Shri S.P. Mehta, submitted that the agreement of 1972 was entered into to implement the first phase contemplated in MICO's letter to the assessee on 28-1-1972. By this agreement, certain areas were reduced from the sole distributorship and the new agreement was to remain effective for a period of 5 years. He pointed out that though this agreement superseded all earlier agreements, it did not mean to supersede the letter written in January 1972 as that formed the basis for carrying out the plan of MICO to take over the business of the assessee. Referring to the various agreements from time to time, the learned counsel for the assessee submitted that these agreements constituted framework of the assessee's business. According to his submission, this framework itself was taken away when the business as a sole distributor came to an end.

He argued that the compensation had been worked out on the basis of loss of profit but it was only a measure to find out the quantum of compensation. He referred to the commentary on Law and Practice of Income-tax of Kanga and Palkhivala, Vol. 1, page 138 where it has been stated that all the cases which did not fall within Section 28(ii) would continue to be governed by general principles and the compensation in such cases would be on capital account. According to his submission, the whole framework of the assessee's business of sole distributorship had come to an end and the assessee was being compensated for the loss of this framework. In this connection, he strongly relied on the decision of

the Bombay High Court in the case of Daruvala Bros. (P.) Ltd. (supra). In that case also there was a receipt of compensation and under Section 10(5A) of the 1922 Act, the revenue tried to assess it. It was held that the agreement of sole distributorship was not one of agents and both the parties were dealing with each other on principal to principal basis and, therefore, it was not a compensation for termination of agency and the amount was held not to be taxable. According to the submission of the learned counsel for the assessee, the facts are similar in the present case and the decision of the High Court was the only decided case directly on this point. He submitted that the Bombay High Court had considered the provisions of the Indian Contract Act while considering the question of agency and had held that the agreement in that case did not create an agent. Referring to the specific clauses of agreement, it was pointed out that the assessee would not act on behalf of the MICO and could not bind a third party on behalf of the MICO. It was pointed out that the assessee had clarified the position before the officer making the assessment and it was stated that the assessee was dealing with MICO on principal to principal basis. Goods were purchased from the MICO who made their invoices charging sales tax as per law. Attention of the Assessing Officer was also drawn to the fact that the assessee was paying sales tax separately on all the sales made by them. It was also stated that the sales were made to different parties directly and those parties had no contractual relationship with MICO. In the case of litigation, suits were filed on the assessee-company and not on MICO.Certain cases actually decided by the Courts were cited. In these cases, it was held that the parties were dealing with each other on principal to principal basis. It had also been emphasised that the assessee was having its own staff and MICO had nothing to do with it.

The learned counsel for the assessee pointed out that a person who buys his goods from a manufacturer with a view of sale would be doing his own business and not the business of the manufacturer. Strong reliance was placed on the observation of the Supreme Court in the case of P.H.Divecha (supra). The fact that in some cases, some commission is allowed or sole distributorship is offered or that an overriding commission is paid if a direct sale is made would not mean that trading relationship is not one between principal and principal. He contended that only the place where the correct legal position can be found was the Indian

Contract Act where Section 182 and other sections are dealing with agency. Basically an 'agent' is a person employed to do any act for another or to represent another in dealing with third person. It was pointed out that in the present case, the assessee was not acting on behalf of the MICO and was not representing the MICO vis-a-vis other parties.

21. Submitting further it was stated that such a receipt was not of the revenue nature under the ordinary law. He submitted that the compensation was paid for the loss of the source of income and not to compensate for profit of an earning business. According to the submission of the learned counsel for the assessee, the compensation was worked out on the basis of loss of profit but was a compensation for the loss of the framework of business. He submitted that the agreement was coming to an end and, therefore, there was no question of making payment for premature termination. It was only a compensation for non-renewal of the agreement. According to the understanding between the parties, the long standing source of income belonging to the assessee dried up, though the assessee had no legal right to receive any compensation, MICO decided to pay to them for non-renewal of contract resulting in a loss of expected income.

22. Referring to the reference by the departmental representative to Section 294A of the Companies Act, he submitted that this section was not applicable in the present circumstances. Section 294A had prohibited payments of compensation to sole selling agents for loss of office in certain circumstances. It was also provided that the compensation, if any, was not to exceed the remuneration which the sole selling agent would have received for all the unexpired residue of his term or for three years, whichever was shorter. It was pointed out by the learned counsel for the assessee that there was no unexpired period of term and the earlier agreement had come to an end as the 5 years period was over. In the present case, the compensation had not been paid to a sole selling agent or to any such person for terminating the agreement prior to its expiry. For argument sake, the learned counsel for the assessee submitted that if the payment is considered to be against the provision of law that alone could not entitle the revenue to tax it in the hands of the assessee.

23. The learned counsel for the assessee then referred to the other agreement entered into on 9-2-1977, a reference to which has been made by the departmental representative. He contended that the two agreements were intended to serve two different purposes and they could not be considered as one agreement. It was merely a practical way of handing over of the business of distributorship. He relied on the decision of the Bombay High Court in the case of CIT v. Automobile Products of India Ltd. [1983] 140 ITR 159. In this case, it was held that the termination of an activity was not a necessary incident of business and where there is extinction and surrender of industrial licence, the amount received as compensation would be a capital receipt. He also pointed out that separate payments were contemplated for different services and considerations in the other agreement and both cannot be confused with each other.

24. In the end, the learned counsel for the assessee submitted that in case the amount was held to be taxable, only Rs. 33,00,000 was payable in this year and so that amount alone could be considered to accrue in this year. He also referred to the provisions of Section 80J of the Act and submitted that the deductions contemplated there would also then be available to the assessee.

25. Regarding the contention of the departmental representative that the capital gains is chargeable, the learned counsel for the assessee submitted that the Assessing Officer had not made out any such case. He also submitted that the agreement which came to an end could not. be considered to be a capital asset as it did not cost anything to the assessee. According to the learned counsel for the assessee, the cost of establishment would not be considered as cost of the agreement. In this connection, he referred to the example of tenancy right which does not cost the assessee anything. Reliance was placed on the decision of the Supreme Court in CIT v. B.C. Srinivasa Setty [1981] 128 ITR 294.

26. In reply, the departmental representative submitted that the framework of the assessee's business had not been destroyed and it continued even after 9-2-1977. There was no stipulation for renewal of agreement and, thus, it had to expire on the specified date. He reiterated that two agreements must be read together and such a large payment would not be in consideration of restraint of trade. He further

pointed out that the assessee has been paid separately for the framework of the business in the second agreement. It was contended by him that the MICO had considered the relationship to be one of agency and it was due to this that having regard to the provision of Section 294 of the Companies Act, the sole distributors were appointed only for 5 years at a time. According to the departmental representative, the assessee was the sole selling agent of MICO in a specified area. It was also submitted that the provisions of Section 294A have been introduced by the Companies (Amendment) Act, 1965 and had prohibited the payment of compensation to sole selling agents for the loss of office in certain cases. This provision also stipulated that the compensation payable was not to exceed 3 years' remuneration. It was due to this requirement that the payment of compensation in the present case was made for a period of 3 year's profits. In the end, he reiterated that the IAC who made the assessment had not made an addition for capital gains though he had made a specific reference to this alternative possibility in case the compensation was not considered as business income in the hands of the assessee. It was submitted that this aspect of the matter also should be gone into as this relates to the taxability of the amount of Rs. 99,00,000.

27. We have carefully considered the facts of the case and we have perused the different agreements executed from time to time. The question of taxability of the amount of Rs. 99,00,000 as business income of the assessee has to be considered from two angles. The first relates to the question of taxability of compensation specially provided in Section 28. The second aspect is the question of taxability under the general principles of taxation without any reference to the specific provisions in this regard. We may first consider the question of taxability of the amount under the specific provisions of Section 28(ii)(c). For this purpose, it has to be decided whether the payment in question was a compensation received by any person holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the assessee or the modification of the terms and conditions relating thereto. The answer to this would depend on the inference to be drawn on the question whether the assessee was holding an agency for MICO's business. In our view, the word 'agency' has a legal connotation and it can be considered with reference to the

provisions of the Indian Contract Act. ft is in this Act that there is a full chapter on 'agency' and the various legal requirements have been provided for in this chapter of the Indian Contract Act. As already noted above, an agent is a person employed to do any act for another or to represent another in dealings with third party. The essential point about an agent's position is his power of making the principals answerable to third persons. If a person is mentioned as an agent in an agreement, that alone does not create agency and if any other name is used, it does not mean that the person cannot be considered to be an agent. The true nature of the contract has to be gathered from its terms and conditions. A principal does not sell to his agent. There is a distinction between a contract of sale and contract of agency for sale.

The essence of agency to sell is the delivery of goods to a person who is to sell them not as his own property but as that of the principal who remains the owner of the goods and the agent is, therefore, liable to account for the proceeds. When a dealer sells goods of a manufacturer for his own profit he is not an agent of the manufacturer.

28. Considering the above legal position, with reference to the agreement between the assessee and MICO, the agreement entered into in 1967 and again in 1972 provided, that MICO had to sell and the assessee was to purchase the products of MICO for resale. The MICO had the right to appoint other distributors in case it was considered necessary. The assessee-company was to maintain a showroom and service station for these products and was not to deal in competing products. It has to carry out market survey, the price of goods to be sold was also fixed up to discount of 45 per cent was allowed to the assessee. The buyer could not appoint any distributor, stockist and other persons in that territory without prior approval of MICO. Clause 3(N) provided that the assessee shall not act as an agent of MICO nor represent itself to other to be an agent of MICO and shall have no power to bind the company in any manner. MICO had reseryed for themselves the right to inspect the business premises, service station, warehouses, etc., so as to ensure proper compliance with the agreement. There were certain clauses for circumstances under which the agreement could be terminated and Clause 9 provided that no compensation was payable if the termination was under those

clauses.

29. Such terms of agreement were there in 1967 as well as in 1972. From these terms it would appear that the assessee-company was not an agent of MICO and it cannot be said that it was holding an agency for any part of the activities relating to the business of MICO. Both the companies were dealing with each other on. principal to principal basis. When the agreement of sole distributorship concluded in 1972 and was to be approved by the board of directors of MICO, it was clearly stated in the explanatory statement as required under Section 173 of the Companies Act that GEC were not to be in any sense MICO's agents.

30. When in 1972 MICO wanted to raise some finances and had to keep the name of sole selling agents, MICO had written to the managing director of the assessee-company that they did not consider the assessee as their sole selling agents. However, they were advised that under Section 294 of the Companies Act, the appointment should be ratified.

It was also stated that such a ratification was by way of abundant caution. The assessee-company in their letter dated 25-8-1973 had written back that the agreement was not of sole selling agent but that was a vendor or a buyer of principal to principal basis. It was also stated that the assessee could be treated as favoured buyer and not an agent. A study of the above provision clearly shows that the assessee was not an agent of MICO, and, therefore, the provisions of Section 28(ii)(c) do not apply to this case.

31. In the case of P.H. Divecha (supra), the question arose whether a similar agreement of distributorship created agency and it was held by the Supreme Court that the agreement was not an agreement of agency.

The above decision was applied by the Bombay High Court in the case of Daruvala Bros. (P.) Ltd. (supra). In this case, the question arose regarding the assessability of compensation for termination of distributorship under Section 10(5A) of the 1922 Act. It may be mentioned that this provision was exactly the same as the provision of Section 28(ii)(c) of the Act. Daruvala Bros. (P.) Ltd. were the distributors of Ciba Pharma Ltd. Their territories extended to Western and

Central India and Hyderabad State. Following the reorganisation of the States, the company accepted the partial relinquishing of the territories of Bombay and Hyderabad State in consideration of compensation of Rs. 1,50,000 to be paid in three equal instalments of Rs. 50,000. The question arose as a result of findings given by the Tribunal that the terms of agreement was an agreement of agency and the amount of compensation was held assessable under Section 10(5A). The High Court considered the terms of agreement and found that the agreement provided for a scheme for sale of products in certain territories but the company was not to act as the agent of Ciba Pharma Ltd. It was further held that the company was selling goods not on behalf of the principals but on their own behalf. On these facts, the High Court held that this was not an agreement of agency and provisions of Section 10(5A) was not applicable.

32. As mentioned by the learned counsel, this case was almost having similar facts and the provisions of law considered was also to the same effect. No such other decision has been brought to our notice and, therefore, this appears to be a case which will have to be considered for deciding the present case. Following the ratio of the above case, it has to be held that the amount of compensation received by the assessee is not covered under Section 28(ii)(c).

33. At this stage, we may consider the contention of the revenue that for the purposes of the Act, we may consider the provisions of Section 294A of the Companies Act, as according to him, this would be more appropriate. The expression 'sole selling agent' has been used in Section 294 and certain provisions have been made regarding their appointment, their remuneration, etc. The expression 'sole selling agent' is not defined in the Companies Act but it can only mean an individual, firm or company which is given exclusive right to sale in a particular area the goods of the company concerned. We are, however, not inclined to accept this plea of the revenue as the words 'holding agency' is a general term having a legal connotation and it may include agencies for several purposes and not merely selling agency. We cannot agree that in respect of sole selling agents, the meaning of Section 294 should be taken whereas for other agencies one may go to the other Acts like the Indian Contract Act. It is true that the restriction for a period of 5 years and limitation of compensation for 3 years

apply because of the provisions of the Companies Act insofar as they relate to sole selling agencies. However, we are interpreting the provisions of Section 28(ii)(c) and we have to give it a meaning which will apply to all the situations which may arise in respect of an agency. This plea of the learned departmental representative has, therefore, to be rejected.

34. Having come to the conclusion that the amount in question was not taxable under Section 28(z7)(c), we may now turn to consider whether the amount could be taxed under the general provision of taxation law.

For deciding this one has to look to the purpose for which the compensation is paid if the purpose is to compensate an assessee for the loss of his profit in the course of his carrying on business, such compensation would be chargeable to tax. However, where the compensation is for the end of the source of income and for complete winding up of the framework of the business, such compensation would be capital in the hands of the recipient. As already stated above, the arrangement between MICO and the assessee-company existed for the last several years and written agreements were executed in 1967 and in 1972.

Each of these agreements were for a period of 5 years and so far as the language of the agreement was concerned, there was no provision for its extension in any automatic manner. When the agreement executed in 1972 expired on 9-2-1977', the whole of the period covered under the agreement had been exhausted and in that sense the description in Clause (8) of the agreement executed in 1977 that the compensation to GEC was for the premature loss of office and the consequent loss of profit for the period of 5 years, was not correct. There was nothing in the agreement of 1972 which could have given to the assessee any legal right to claim compensation from MICO for the non-renewal of the agreement in February 1977. The question then arises as to why this compensation was paid by MICO to the assessee. We have already discussed above the letters exchanged between MICO and the assessee.

The main letters in this connection was written by MICO to the assessee on 28-1-1972, a copy of this letter has been furnished to us and stand from pages 18 and 19 of the paper book. In this letter MICO had communicated to the assessee-

company that as a matter of policy, MICO wanted to establish their own sales house in Delhi but this process of take over of the sales in Delhi was to be spread over in three phases starting from 1972 and ending with February 1982. The assessee was also informed that MICO could accelerate the process of take over and complete the phase programme earlier than the time specified above, if the conditions stipulated in the new agreement was not adhered to by the assessee. It is on the basis of this understanding that the parties were functioning but when in 1977 MICO decided to accelerate the process of take over and complete the phased programme earlier than 1982, the assessee-company was bound to protest. In some of the letters also MICO had assured the assessee that they had no intention of deviating from their letter on 28-1-1982 and promised to do their utmost to persuade the financial institution to let MICO proceed on the basis agreed between the parties. When in December 1976 MICO decided to terminate the arrangement of sole distributorship, they informed the assessee that there was no provision for the renewal of its expiry on 9-2-1977. The assessee was also informed that they would cease to be the sole distributors from that date. The agreement executed on 9-2-1977 was the result of the negotiation carried on between this period while under the agreements M1CO could insist for not paying anything for compensation. The assessee-company relied more on the understanding communicated by letter dated 28-1-1972. There may be certain inaccuracy in the language of the agreement executed on 9-2-1977 under which the compensation under dispute was fixed. Clauses 7, 8 and 9 of this agreement has already been mentioned in para 12 of this order supra and a perusal of this agreement would show that this payment was made in consideration of the premature termination of the arrangement stipulated in the letter dated 28-1-1972 which has been repeated in some other letters though there was no premature termination of the agreement which had been entered into in February 1972. Clauses 3. 4 and 5 of this agreement provides as under : 3. GEC shall on close of the business on the 9-2-1977, cease to be the sole distributor of M1CO Bosch products in the territories assigned to it and in which it was acting up to the said date in pursuance of the aforesaid agreement/arrangements and thereupon MICO shall acquire the right to carry on the entire distribution and servicing of MICO Bosch products in the sole territories through its own Delhi sales house or in such

other manner as it may deem fit, provided that nothing in this clause shall affect the right of GEC to carry on the business of servicing independently in its own right.

4. Upon cessation of its sole distributorship as aforesaid GEC shall forthwith notify the same to all its distributors, dealers, stockists, service centres and others connected with its business relating to MICO Bosch products, GEC shall thereupon no longer represent or hold out as a sole distributor or agent of MICO Bosch products.

5. As from the 10-2-1977 GEC has foregone and abandoned and shall forgo and abandon its right, title or claim whatsoever to continue or not as sole distributor of MICO Bosch products in the territories assigned to it as aforesaid.

Thus, this compensation was paid as the business of GEC as sole distributor was made to come to an end though the understanding was that it may continue up to 1982. After this agreement, the business as sole distributor ended and the framework of that business as belonging to the assessee also came to an end.

35. At this stage, we may refer to the second agreement on which lot of emphasis was placed by the departmental representative. We have already given in brief, summary of this agreement. This agreement was to avoid a complete void after the end of sole distributorship of GEC. MICO wanted to use their experience in this area and appointed them as market consultants for a period of 2 years. Certain other payments were stipulated for the additional services, for the transfer of staff, etc.

This agreement was to govern the future relationship between the assessee and MICO and related to the assessee's business as market consultants of MICO for a period of 2 years. The Assessing Officer had not tried to combine the two agreements and no suggestion had been made that both these agreements related to the same matter. The plea of the departmental representative that both these agreements should be read as one cannot be accepted though we have to take into consideration the terms of both agreements to decide the issue before us. Both the agreements have been executed almost simultaneously. Whereas the

first provided for the payment of a compensation for the closure of the business as sole distributors, the second provided for some current services to be rendered by the assessee to MICO for the business of MICO in this area. The agreements have to be read as they stand and they were executed to serve two different purposes.

36. The amount of Rs. 99,00,000 was determined on the basis of Rs. 33,00,000 per annum but that was merely a measure to pay off the assessee-company for the end of their sole distributorship business. As the whole business structure as sole distributors had suffered injury by non-reaewal of the contract in 1977, the payment in question was in respect of the capital framework of the business. This payment was not to compensate the assessee for his trading loss as after this date the business as a sole distributor came to an end. Whatever income was being earned after this period was in another capacity and for other services to be rendered. It has, therefore, to be held that the amount of compensation was to pay for the end of the capital framework of the assessee's business and, therefore, this amount could not be assessed as income under the general principle of tax. It was only for this reason that the provisions were inserted in Section 10 of the 1922 Act and Section 28 of the Act. However, as we have seen, those specific provisions do not apply in the present case. We are, therefore, in agreement with the learned Commissioner (Appeals) that the amount of compensation of Rs. 99,00,000 could not be assessed under Section 28(ii)(c) and it could also not be assessed under the general principles of tax.

37. For the completeness of the argument, we may mention that the contention of the learned counsel that whole of Rs. 99,00,000 did not accrue in this year and only the amounts payable in this year should be taken to have accrued. We do not consider it necessary to go into this puestion. We may, however, mention that if the amount was found assessable, the relevant provisions of Section 80S of the Act will have to be kept in view.

38. This brings us to the alternative submissions made by the departmental representative by which he submitted that the amount in question should be considered for the purposes of computing capital gains under Section 45. As

already stated above, the Assessing Officer had clearly stated in his order that in case the compensation was not assessed as business income and was treated as a capital receipt, it would go in for consideration for the purposes of computing capital gains. The ITO did not proceed further to consider this question as he was taxing the whole amount as business income of the assessee-company.

The Commissioner (Appeals) has also not considered this question and has disposed of this matter with the following remarks : Finally, it needs to be stated here that the IAC had firmly treated, at page 30 of his order, that the provisions of capital gains are not being invoked as they were not applicable on the other conclusions drawn by him regarding the receipt. I would go with him in this regard, for he did not establish that the provisions of Section 2(47) of the Income-tax Act, 1961, were applicable to the said transaction. In view of the matter, his comments at page 31 of the assessment order that the compensation could be taken up for taxation 'under the provisions relating to taxes on transfer of capital asset under the Act' would not have the legal force to bring it to tax in that manner by any automatic process visualised by him.

Thus, it is held by me that the compensation determined as payable to GEC by MICO on the termination of its sole distributorship for the sale of the products of MICO, was a capital receipt and could not be taxed under the general principles or any specific provisions of the Income-tax Act, 1961. With this finding the addition made by the IAC of Rs. 99,00,000 in the impugned assessment is knocked off.

39. After hearing the departmental representative and the learned counsel for the assessee, we are inclined to agree with the departmental representative that this question is included in the ground of appeal taken by the department and the question of assessability of the amount of compensation or any part of it has to be considered and adjudicated. We have already held above that the payment in question was a capital receipt in the hands of the assessee. The further question whether all the requirements of Section 45 are satisfied has not been gone into either by the IAC who made the assessment or by the Commissioner (Appeals). We do not want, therefore, to deal with this question unless the authorities below applied their mind both on questions of facts and of law and determine a particular

position for the purposes of assessment. The Assessing Officer could not have computed the capital gain while he was including the amount as business income. However, as he indicated his alternative preference, we would consider it a fit case where for this limited purpose, the matter could go back to the Assessing Officer who should determine this question after hearing the assessee. The Assessing Officer will have to consider whether in the present case there has been a transfer of a capital asset and whether such transfer, if any, has resulted in a capital gain as understood in the Act. For this purpose, therefore, the matter will go back to the Assessing Officer.

40. to 50. [These paras are not reproduced here as they involve minor issues.]