

Assistant Commissioner of Vs. Hinditron Services (P.) Ltd.

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Nov-25-2005

Reported in : (2006)99ITD479(Mum.)

Judge : J Bengra, Vice, D Agrawal

Appellant : Assistant Commissioner of

Respondent : Hinditron Services (P.) Ltd.

Judgement :

1. On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the disallowance of Rs. 61,807 without appreciating the facts that this expense was not for business purpose and was not covered by limits prescribed under Rule 6B. 2. On the facts and in the circumstances of the case and in law, the CIT (A) erred in directing the Assessing Officer to tax the amount of Rs. 14,00,000 received on termination of agency as capital receipt. The CIT(A) failed to appreciate the fact that by resources transfer agreement, the assessee continued the business in new set up, and the income earning apparatus remain intact. There was no unabsorbed stock to the business of the assessee as income increased next year. The loss because of loss of agency commission was a loss due to ordinary incident in the course of business (Eillanders Arbuthnot & Co. Ltd. v. CIT 53 ITR 283 and also Kattlewell Bullen Co. Ltd. v. CIT - 53 ITR 261).

3. On the facts and in the circumstances of the case and in law, the CIT(A) erred in directing the Assessing Officer to delete disallowance of Rs. 1,14,117 without

appreciating the fact that expenses on travelling are to be allowed as per limits of Rule 6D. 4. On the facts and in the circumstances of the case and in law, the CIT(A) erred in deleting the disallowance of Rs. 2,65,002 being expenses on guest house without appreciating the fact that expenses on guest house are allowable as per provisions of Section 37 of Income-tax Act, 1961.

5. On the facts and in the circumstances of the case and in law, the CIT(A) erred in directing the Assessing Officer to treat Rs. 80,288 received from M/s. Digital Equipment Corporation as capital receipt was because of realignment of business of interest of assessee-company and foreign company. The receipt was in ordinary incidence of business and as such a revenue receipt.

2. The first ground is about disallowance of a sum of Rs. 61,806 under Rule 60 spent on presentation articles etc. It was claimed that these articles though each valuing more than Rs. 50 did not carry any logo of the company. The CIT(A) has deleted the addition on the basis of the decision of Tribunal for the earlier assessment year 1979-80. We have heard the rival submissions and considered the facts and material on record. We find that the Assessing Officer has not given any finding as to whether the presentation articles, whose value exceeds Rs. 50 carried any logo of the assessee company so that they can fall under the head advertisements. The Assessing Officer disallowed the expenditure simply by taking each item above Rs. 50. This is not the intention of the legislature. As held in *Indian Rayon Corporation v. CIT* and *CIT v. Allona Sons P. Ltd.*, it is the duty of the Assessing Officer to give a finding as to whether presentation articles carried any logo of the company or not. In the absence of such finding, it is not possible to uphold the addition.

Therefore, we confirm the order of CIT-(A) on this issue. This ground of revenue is rejected.

3. The second ground relates to the deletion of an addition of Rs. 14.00 lacs by CIT(A). The Assessing Officer held it to be a revenue receipt while CIT(A) held it to be a capital receipt as offered as long term capital gains by the assessee. The facts of the case are that M/s.

Hinditron Tektronics Instruments Pvt. Ltd. (HTIPL in short) entered into an agreement with the assessee (HSPL in short) for resource transfer. The assessee was a distributor for Tektronix Inc. USA for last 22 years and was selling the products of USA company. A joint venture company HTIPL, consisting of the assessee and the US company, was formed to manufacture the products of US company in India and also to market products of the US company manufactured in US, vide agreement dated 17-8-1988 between assessee and HTIPL. It was agreed to transfer certain intangible assets like trained manpower personnel, dealing with textronics products in India and supply of detailed list of customers of Textronics products and introduce HTIPL to all the customers both in public and private sectors for sale of textronics products. In view of transfer of above intangible assets the assessee received a compensation of Rs. 14.00 lacs from HTIPL. The assessee treated this sum as a consideration for transfer of goodwill and offered for taxation as long-term capital gains and in view of CIT v. B.C.Srinivasa Shetty , it being capital receipts, and there being no cost of acquisition, it would not be liable to tax at all.

4. On the other hand, the Assessing Officer found that (i) the assessee had income from service contracts and commission from various parties; (ii) it is a compensation received on termination of managing agency and following the decision of Hon'ble Calcutta High Court in CIT v.Karamchand Thapar & Bros. (P.) Ltd. [1968] 67 ITR 705 held that the assessee was carrying on several managing agencies, it gave up only one and continued with other; the business structure of the assessee did not suffer; he was free to carry on the trade with other agencies; the cancellation and compensation therefore was merely a normal incidence of business; (iii) income of the assessee had increased in subsequent years, despite losing the agency of M/s Textronics Inc. USA. He, thus, held that the sum of Rs. 14.00 lacs is a revenue receipt and taxable accordingly.

5. The Id. CIT (A) on the other hand, quoting from the agreement dated 17-8-1988 held that by parting with the list of existing and potential clients along with the personnel, the assessee suffered a damage to its income yielding apparatus. Such damage is, therefore, relatable to capital account and not to revenue account. He upheld the view of the assessee that the receipt is on account of goodwill as his

income earning apparatus, which had come into existence over past 22 years when the assessee built up the distribution network has come to ascend.

The learned CIT (A) relied on the decision of Hon'ble Bombay High Court in CIT v. Automobile Products of India [1983] 140 ITR 159 : [1981] 7 Taxman 327. He distinguished the decision of the Hon'ble Calcutta High Court in Karamchand Thapar's case (supra) on facts saying that managing agency was acquired only a little while earlier and then terminated and compensation was received from managing company. In the present case, the assessee company has parted with a part of its apparatus, to a joint venture and for the loss so suffered by it, it had received compensation from joint venture company. He thus, directed the Assessing Officer to tax the receipt as capital receipt.

6. Before us, the learned DR submitted that (i) the nature of receipt need not be same in the hands of the recipient and in the hands of payee. He relied on the following judgments : 4. Indian Engg. and Commercial Corporation (P.) Ltd. v. C/r CIT v. Best & Co. (P.) Ltd. (ii) it is incorrect to say that there was any transfer of goodwill.

According to the assessee it transferred intangible asset in the form of list of customers and entire personnel engaged in the distribution of products of the Textronics inc., USA. It cannot be held as per learned DR, that they are 'asset', held by the assessee within the meaning of Section 2(14). The list of customers is not a property of assessee on which only assessee has absolute right of ownership. It is also not an intellectual property. The personnel cannot also be considered as property of the assessee (iii) there is no transfer within the meaning of Section 2(47) as this "asset" can remain with the assessee also. There is no exchange, relinquishment or extinguishments of any right (iv) what is given to HTIPL is also not goodwill because it is not shown in the balance sheet; there is no evaluation as to what is the value of goodwill of the assessee and how much of it has been transferred (v) since there is no goodwill in the balance-sheet, there is no evaluation, no determination as to what portion thereof, if any, was transferred. Hence, there is no transfer within meaning of Section 2(47) of Income-tax Act, 1961 (vi) what the assessee has surrendered is only one of many

agencies/distributorships. There was no stoppage of business. It continued yielding higher income in subsequent years. Loss of agency has not affected the trading structure, administratively, financially and physically. There was only a gradual transfer of the personnel (vii) para 7 of the agreement says that payment of Rs. 14.00 lakh is for termination of agency (viii) what is the assessee is providing to the joint venture is trained personnel. The receipt can also be regarded as fee for technical services, which is revenue receipt (ix) he further relied on the decisions in the case of Indian Engg, & Commercial Corporation (P.) Ltd. (supra) and A. Gasper v. CIT .

7. On the other hand, learned AR submitted that (i) as per agreement, the assessee ceased to function as a distributor of Textronics USA in India. Its income earning apparatus is transferred/closed (ii) the compensation of Rs. 14.00 lakhs is for transfer of personnel, which is to be completed within one year and (iii) supply of list of customs of Textronic products to HTIPL and (iv) to introduce HTIPL to the customers both in public and private sector for sale of Textronic products whether imported or locally manufactured (v) the joint venture HTIPL has to take care of all retirement and terminal benefits of the employees meaning thereby that a part of the asset of the assessee is transferred to HTIPL (vi) assessee has indemnified HTIPL against all claims and losses for breach of Clause 2(b)(vii) the payment of Rs. 14.00 lakhs is in consideration of Clause 2 and Clause 3 of the agreement (viii) there is a transfer of goodwill which is built up for last 22 years. This goodwill consisted of its customers and the employees who were handling Textronic products (viii) reliance is placed on the decisions in:-- 1. Asstt. CIT v. Kamesh S. Sonawala - ITA No. 4705/(Bom.) of 1991/91, ITAT, A Bench, Mumbai dated 28-5-1998.

2. CIT v. Automobile Products of India [1983] 140 ITR 1591 (Bom.) : [1981] 7 Taxman 327.

8. We have carefully considered the rival submissions and perused the material on record and the case laws cited by the parties. In order to understand the nature of receipt in the hands of assessee, let us examine the agreement entered into by the assessee with HTIPL to form a joint venture. It reads as under:-- Resource

transfer agreement.--This agreement is made the 17th day of August, 1988, between Hinditron Tektronix Instruments Private limited, a company incorporated under the Companies Act, 1956, and having its registered office at 69/AL, Jagmohandas Marg, Bombay - 400 006 (HTIPL) and (HINDITRON SERVICES PRIVATE LIMITED), a company incorporated under the Companies Act, 1956, and having its registered office at 69/AL Jagmohandas Marg, Bombay 400 006 (HSPL).

(A) Tektronix, Inc., a Company incorporated in the State of Oregon, USA, (Tektronix) manufactures oscilloscopes and other instruments in the USA and other countries.

(B) Tektronix has entered into a technical collaboration agreement with HTIPL for manufacture of certain Tektronix products.

(C) For the last 22 years, HSPL has been the distributor of Tektronix for the sale of Tektronix products in India.

(D) HSPL, as the distributor of Tektronix, has developed invaluable contacts with a large number of customers in the public and private sector, has a trained sales force, and has offices in different cities in India.

(E) HSPL has agreed with Tektronix that it will cease to function as the distributor of Tektronix in India as of the date specified in a written notice to HSPL from Tektronix (such date is hereinafter referred to as the Termination date and has agreed to transfer to HTIPL certain aspects its business that relate to its Tektronix distributorship.

(1) unless otherwise specified, each of the obligations contained in this agreement shall be performed from such date as shall be agreed upon between the parties.

(2)(a) HSPL shall undertake and use its best efforts to ensure that its staff dealing with the Tektronix products shall be transferred to HTIPL. HSPL and HTIPL shall mutually agree upon a list of all personnel to HTIPL. Immediately after the termination date, HSPL shall begin to transfer staff to HTIPL.

(b) HSPL undertakes and declares that it shall have satisfied or made full and adequate arrangements for payment of all dues and moneys owed to or on behalf of the transferred personnel as of the respective dates on which each person is transferred under Clause (a) hereof, including all retiral and terminal benefits, (c) HSPL agrees to indemnify HTIPL against claims, demands and losses arising by reason of or consequent upon the breach of the provisions of Sub-clause (b) hereof.

(a) supply a detailed list of customers of Tektronix products to HTIPL; (b) use its best efforts to introduce HTIPL to the customers, both in the public and private sectors, for sale of Tektronix products, whether imported or locally manufactured.

(4) HSPL shall pay HTIPL for services rendered by HTIPL in fulfilment of service obligations on Tektronix products for which HSPL received compensation prior to the termination date at the rates set forth in the annex to this agreement or mutually amended from time to time.

(5) HSPL shall do all acts, deeds and things which may be necessary or desirable to implement fully and effectively all of its obligation under this agreement and so as to ensure that HTIPL shall be in a position to enjoy fully the benefits of this agreement.

(6) In consideration of the obligations of HSPL under Clauses 2 & 3 on the termination date HTIPL shall pay to HSPL the sum of Rs. 14,00,000 (rupees fourteen lakhs), In witness whereof the parties hereto have executed these presents the day and year written above.

9. We also note that CIT (A) has given following finding, which has not been controverted by the assessee:-- In the present case until entering into an agreement with Hinditron Tektronix the assessee's business comprised the following income yielding activities:-- (2) Acting as distributor cum sales representative for M/s.

Tektronix USA which constituted about 30 per cent to 40 per cent of the total commission income.

(3) Acting as distributor, selling agent and maintenance agent for 15 other foreign companies in India which constituted 60-70 per cent of commission income.

(i) the assessee-company was acting as distributor/selling agent/sales representative for about 16 foreign companies including M/s. Tektronix inc., USA.

(ii) Tektronix, USA did not terminate its agency with the assessee for sales and distributorship of the Tektronix products in India and did not make any payment to the assessee.

(iii) HSPL (assessee) had agreed with Textronics, that after specified dates, it will transfer certain aspects of its business that relates to its Textronics distributorship.

(a) Personnel/staff dealing with Tektronics products; such transfer will be complete within one year from termination date: payment of all dues/money of such staff to be done by HSPL; indemnify HTIPL against claims/demands/losses arising from breach of Clause 2(b); (c) Compensation (advances) received by HSPL from customers for obligations to be fulfilled by HTIPL.

(vi) There is not bar to use the database of the customers, by the assessee in remaining business, he is carrying on.

(vii) Assessee is a partner in joint venture HTIPL and thus, will carry on the same business under the banner of HTIPL, which it was carrying earlier.

(viii) There is no effect on the business apparatus of the assessee, it continued with 15 other such distributorships of foreign companies.

(ix) Goodwill of assessee has not been evaluated. There is no value assigned to any goodwill in the "Resource Transfer Agreement". What is transferred is certain resources of the assessee. A part of it (customer database) can also be legally used by the assessee. There is no written agreement with Textronics as to how the relationship of distributorship with it was modified or continued even after formation of joint venture. The Resource Transfer Agreement is between HTIPL and HSPL. No evidence has been placed on record as to how the terms of HSPL with Textronic, USA between them are changed.

(x) Para E of the Resource transfer agreement speaks about certain agreement of the assessee with Textronics. If there is any, it is not placed on record.

Before coming to any conclusion let us consider the decisions cited by both the parties.

The question whether a particular income arising from termination of a contract is a capital receipt or revenue receipt is a difficult question to answer. Where, on a consideration of the circumstances, a payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of the recipient's business nor deprive the recipient of what in substance is the source of income, termination of the contract being a normal incident of the business, and such cancellation leaving the recipient of the amount free to carry on his trade, the receipt is revenue. However, where by cancellation of agency the trading structure of the assessee is impaired or such cancellation results in the loss of what may be regarded as the source of the assessee's income, payment made to compensate for such cancellation of agency is normally a capital receipt.

During the accounting year relevant to the assessment year 1977-78, the assessee was engaged in manufacture of air-conditioning products and was undertaking job contracts in air-conditioning, the assessee was also trading in electronics and engineering goods and was also exporting its products. On June 10, 1973, the assessee entered into an agreement with a foreign trade enterprise, BME, under which the assessee was appointed as the agent of BME for marketing and selling their products in India. The said agreement stated that it was, in the first instance, valid up to December 31, 1976, and thereafter it was to be considered as automatically renewed for one calendar year at a time unless one or the other party thereto gave notice of its wish to terminate the same. By a letter dated June 4, 1976, BME intimated to the assessee that BME was agreeable to extension of the agreement for a further period of one year and accordingly the said agreement stood renewed up to June 10, 1977. But, in the meanwhile, the Government of India sponsored a company C and on October 6, 1976, BME wrote a letter to the assessee stating that since a lot of technical know-how and organisation potentialities were needed to handle the data process plan made by

BME, the assessee might assign its rights under the said agreement to C which was specialising in the particular line. BME agreed to pay to the assessee a lump sum as consideration for the assessee assigning its rights in favour of C. The agreement between the assessee and BME stood terminated on a payment of Rs. 5 lakhs. The Income-tax Officer held that the amount was assessable and this was upheld by the Tribunal. On a reference: Held, that the agency agreement was entered into by the assessee in the normal course within the framework of the normal business of the assessee and the termination thereof could be treated as a normal incident of the business. Even with the termination of the agreement, the assessee was left free to carry on its normal trading activities. By cancellation of the agency, the trading structure of the assessee was not impaired. The compensation amount of Rs. 5 lakhs received by the assessee was not in the nature of a capital receipt. It was in the nature of a revenue receipt. In this case, the assessee was given right to distribute the films for a period of five years from the date of release of each film.

After the end of five years, a sum of Rs. 26,000 was paid to the assessee towards commission. During the relevant accounting year assessee had distribution rights in respect of these films. On this case, the Hon'ble Supreme Court held as under:-- Held (per Das C.J. and Venkatarama Ayyar J., Bhagwati J., dissenting) that the sum paid to the assessee was not compensation for not carrying on its business but was a sum paid in the ordinary course of business to adjust the relation between the assessee and the producers; the termination of the agreements did not radically or at all affect or alter the structure of the assessee's business; the amount received by the assessee was only so received "towards commission", i.e., as compensation for the loss of the commission which it would have earned had the agreements not been terminated; the amount was not received by the assessee as the price of any capital assets sold or surrendered or destroyed but the amount was simply received by the assessee in the course of its going distributing agency business from that going business; that therefore the sum was an income receipt.

Held also, that the language of Section 10(5A) of the Indian Income-tax Act did not impliedly indicate that the sum was a capital receipt. That Sub-section was

obviously introduced to prevent the abuse of managing agency agreements being terminated on payment of huge compensation and to nullify the application of the decision in Shaw Wallace's case [1932] (L.R. 59 LA. 206) to such cases. That Sub-section did not necessarily imply that if that Sub-section were not there the kind of payment referred to therein would have to be treated as capital receipt in all cases.

Per Bhagwati J. (dissenting). The films constituted capital assets of the assessee and the payment was one for cancellation of the assessee's rights under the agreements and was a capital receipt.

In this case, the assessee has got right to sale goods in Hyderabad State as well as outside Hyderabad State. However, the appellant-company took over the right to sale all goods outside Hyderabad State and paid a sum of Rs. 2,19,343 by way of compensation for the loss of agency for the territory outside the Hyderabad State. On the question whether the sum of money so received by the assessee was revenue receipt or capital receipt, the Hon'ble Supreme Court held as under :-- Held by the Court (Bhagwati and Sinha, J.J. Kapur, J. dissenting) that the agency agreement in respect of the territory outside the Hyderabad State was as much an asset of the assessee's business as the agency business within the Hyderabad State and though the expansion of the territory of the agency in 1939 and the restriction thereof in 1950 could be treated as grant of additional territory in 1939 and withdrawal thereof in 1950, both these agency agreements constituted but one employment of the assessee as the sole-selling agents of the company; the agency agreements were not entered into by the assessee in the carrying on of their business but formed the capital asset of the assessee's business which was exploited by the assessee by entering into contacts with various customers and dealers in the respective territories; it formed part of the fixed capital of the assessee's business and was not the circulating capital or stock-in-trade of their business; and the payment made by the company as and by way of compensation for terminating or cancelling the agreement was a capital receipt in the hands of the assessee. Held further the fact that the agreement was terminable at will and was not of an enduring character was immaterial, and it was also immaterial that only one of the agency agreements was cancelled by the company.

Per Kapur, J, - The restriction of the assessee's agency in 1950 did not result in the loss of any capital asset of the assessee's business; on the other hand, the true effect of the facts of the case was that in 1939 the assessee's area of distribution was increased and in 1950 it was again reduced and as a result of the contract the assessee did not lose their agency but only lost some agency commission and compensation paid for loss of this commission was revenue receipt and was assessable to income-tax.

Per Bhagwati and Sinha, JJ. - In considering whether compensation paid to an agent on the cancellation of his agency is a capital receipt or a revenue receipt, the first question to be considered is whether the agency agreement in question was a capital asset of the assessee's business and constituted its profits making apparatus and was in the nature of its fixed capital or it was a trading asset or circulating capital or stock-in-trade of its business. If it was the former compensation received would be a capital receipt; if the agency was entered into by the assessee in the ordinary course of his business and for the purpose of carrying on that business it would fall into the latter category and the compensation received would be a revenue receipt.

The assessee was the sole-selling agent in distribution of explosives. The agency was terminated and compensation was paid, which was equal to 2/5th of the commission accrued on its sales to be paid for the first three years. The question was whether the amount received by the assessee for those three years was of capital or revenue nature. On this, the Hon'ble Supreme Court held as under:-- Held, that, having regard to the vast array of business done by the appellant as agents, the acquisition of agencies was in the normal course of business and determination of individual agencies a normal incident not affecting or impairing its trading structure. The amounts received by the appellant for the cancellation of the explosives agency therefore did not represent the price paid for the loss of a capital asset: they were of the nature of income.

There is no immutable principle that compensation received on cancellation of an agency must always be regarded as capital.

Compensation paid for agreeing to refrain from carrying on competitive business in the commodities in respect of the agency terminated, or for loss of goodwill, is prima facie, of the nature of a capital receipt.

The appellant-company was a managing agent of six companies including one Fort William Jute Co. One Ambient Co. purchased entire holdings of the appellant company in Ford William Jute Co. and assessee had to resign the managing agency of that company. In return, it was paid a sum of Rs. 3,50,000. The question was whether the amount so received by the assessee to relinquish the managing agency was a revenue receipt liable to tax. The Hon'ble Supreme Court held as under :-- Held, on the facts, that the arrangement with Mugneeram Bangur and Co. was not in the nature of a trading transaction, but was one in which the appellant parted with an asset of an enduring value. What the assessee was paid was to compensate it for loss of a capital asset and was not, therefore, in the nature of a revenue receipt. It mattered little that the appellant did continue to conduct the remaining managing agencies after the determination of its agency with the Fort William Jute Co.

It cannot be said as general rule that what is determinative of the nature of a receipt on the cancellation of a contract of agency or office is extinction or compulsory cessation of the agency or office. Where payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business or deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated), the receipt is revenue; whereby the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt.

In this case, the assessee-company had agreed to negotiate with the Government for cancellation of licence and for termination by mutual consent of the licence granted by the foreign company to the assessee, PAL, with whom agreement was

made, agreed to pay a sum of Rs. 24.00 lakh. The assessee had in the process given up the diesel engine manufacturing business, though it continued to carry on other businesses without affecting the structure of the business of the company. On these facts, the Hon'ble Supreme Court held as under :-- Held, (i) that in the agreement between the assessee-company and PAL, there was an express provision that for the remaining period of the licence granted by the foreign company to the assessee-company under the agreement dated 16-3-1956, the assessee-company shall not engage themselves in the manufacture, assembling or selling of automotive diesel engines or industrial diesel engines or both of a horse power approximating to the horse power of Meadows engines which were to be manufactured by PAL.

(ii) that the termination of the activity was not a necessary incident of the business of the assessee and that the extinction and surrender of the industrial licence and the collaboration agreement impaired the profit-making structure of the assessee. Therefore, the amount of Rs. 24 lakhs paid by PAL to the assessee-company as compensation was a capital receipt.

The assessee was a sole distributor in India of certain type of tractors and agricultural machines manufactured by a Polish company.

The Polish company retained the right to terminate the agreement by giving 40 days notice though agreement was to last for five years.

Because of trouble between the two, the Polish company terminated the agreement. The matter moved to the Court, a settlement took place and the assessee was paid compensation, it was considered by the Assessing Officer that assessee has received a sum in the course of its business and by at a settlement with the Polish company, there was no damage to its profit-making apparatus. On this, the Hon'ble Bombay High Court held as under :-- Held, (i) that the arrangement arrived at between the assessee and the Polish company was regarding the tractors already in the possession of the assessee. By arriving at the arrangement with the Polish company and E and D, the assessee was able to dispose of the tractors which were its stock-in-trade. The conclusion arrived at by the income-tax authorities as well as the Tribunal that the sum of Rs. 93,450 was a

revenue receipt was correct.

As per the agreement, the assessee-company was to receive revenue for every ton of cement sold by it in addition to other terms and conditions for running the agency. During the course of business, assessee-company received a sum of Rs. 77,820 under the covenant providing for payment of 13 annas per ton of cement manufactured by the purchaser company. The question was whether that amount was taxable income : Held, on the facts, that the transaction was substantially a commercial transaction for sharing the profits of the commercial activities of the purchaser company and the amount of Rs. 77,820 was of the nature of income and not capital.

In assessing the true character of a receipt for the purpose of the Income-tax Act, inability to ascribe to the transaction, which is the source of the receipt, a definite category is of little consequence. It is not the nature of the receipt under the general law but in commerce that is material. It is often difficult to distinguish whether an agreement is for payment of a debt by instalments or for making annual payments in the nature of income.

The court has, on an appraisal of all the facts, to assess whether a transaction is commercial in character yielding income or is one in consideration of parting with property for repayment of capital in instalments. No single test of universal application can be discovered for solution of the problem. The name which the parties may give to the transaction which is the source of the receipt and the characterization of the receipt by them are of little moment, and the true nature and character of the transaction have to be ascertained from the covenants of the contract in the light of the surrounding circumstances. The decision of the question is, however, not left to the application of any arbitrary standards. There are certain broad principles which guide the determination of the character of the receipt. The distinction between a capital receipt and a revenue receipt, though fine, is real.

Where capital is repaid in instalments, it is not liable to income-tax; for instance when a person sells his property and agrees to receive the price stipulated in instalments, by whatever name such instalments are called, they are not liable to income-tax.

But where property is conveyed in consideration of what in truth is annuity payable for a definite or a definable period, the annuity is not payment on capital account and is taxable.

Again, if property is conveyed in consideration of periodical payments, the payment being a share of profits of a business or profession or a mineral royalty depending upon the quantity of minerals raised or computed on sales of manufactured articles or a percentage of gross profits made in the exploitation of a secret process is income and taxable.

The assessee was carrying on business in prospecting mines. The licences were obtained from State Government for prospecting of mines. The assessee and another corporation were trying to get mining leases in respect of it. An agreement took place between the assessee and the corporation whereby the assessee ceased its efforts to obtain lease for mining and also it handed over prospecting report to the corporation. In return, a sum was paid by corporation.

On the question whether amount so received is capital or revenue, it was held as under:-- Held, (i) that, at the time when the agreement between the assessee and the Corporation was entered into, the assessee had no rights whatever in Survey No. 30. The Corporation which had secured a mining lease with reference to Survey No. 40 was anxious to extend its activities of exploitation of fluorspar in Survey No. 30 also.

In other words, the Corporation as well as the assessee had, at the time of entering into the agreement, not succeeded in obtaining any rights over Survey No. 30 for purposes of mining fluorspar mineral therein. It was in that situation that the agreement had been entered into and, in the context of that situation in which the Corporation and the assessee found themselves, it was obvious that the parties to the agreement had merely adjusted their rights under its terms in the ordinary course of their respective businesses. The assessee had not acquired any right or interest in Survey No. 30 and, in that sense, the assessee had not acquired any asset and, therefore, the amount paid by the Corporation to the assessee could not be regarded as compensation in respect of loss of an enduring asset. Further, the assessee had already obtained licences to work mines in

Madhya Pradesh, Andhra Pradesh, Karnataka and Tamil Nadu and the parting with possession of Survey No. 30 by the assessee did not in any manner affect the trading structure of the assessee.

There was no loss of any enduring capital asset. The assessee had furnished the Corporation with the prospecting report. The report was only in the nature of a preliminary prospecting report submitted to the Government, pursuant to the prospecting licence, for the purpose of enabling the assessee and the Government to ascertain the availability of minerals in the area and could not form the basis of actual business activities of exploitation of minerals either by the Corporation or even by the assessee. Only after undertaking drilling and pitting operations and completing them, a complete and comprehensive idea could be gathered regarding the mineral potentiality of the tract and, therefore, the report could not be considered to be either a plant or a tool. The preliminary report was neither complete nor comprehensive and could not be regarded as technical know-how. The prospecting report was not a capital asset which had been given up. The amount of Rs. 3 lakhs was not a capital receipt; and (ii) that the receipt had its origin in the agreement which came into being in furtherance of the business activities of the assessee. There was nothing casual or unexpected about either the entering into of the agreement between the assessee and the Corporation or even the withdrawal of the Court proceedings initiated earlier by the assessee with reference to Survey No. 30.

The receipt arose out of the agreement which had been arrived at between the assessee and the Corporation, after considerable negotiation, deliberation and thought even as per the terms of the agreement and, in that sense, the receipt by the assessee was not on account of any chance or without design or motivation. The amount of Rs. 3 lakhs was not a casual and non-recurring receipt.

The assessee-company was carrying on business in innumerable agencies, for manufacturers both in and outside India. One out of several such agencies was terminated. The assessee was also asked not to be in confrontation with a company which henceforth will deal in that product in India and Ceylone for at least five years. In view of it, compensation was paid to the assessee-company.

The question was whether the amount so received by the assessee was a capital receipt or not. The Hon'ble Supreme Court held as under :-- Held, (i) that the compensation agreed to be paid was not only in lieu of the loss of the agency but also for the respondent accepting a restrictive covenant for a specified period; (ii) that the restrictive covenant was an independent obligation which came into operation only when the agency was terminated and that part of the compensation which was attributable to the restrictive covenant was a capital receipt and, hence, not taxable.

Beak v. Robson [1942] 25 Tax Cas. 33 and Gillanders Arbuthnot & Co.

Ltd. v. CIT followed.

(iii) That, on the facts, that part of the compensation received towards loss of the agency was a revenue receipt, as the loss of the agency was only a normal trading loss.

(iv) That, if compensation was paid in respect of two distinct matters, one taking the character of a capital receipt and the other of a revenue receipt, there was no principle which prevented its apportionment between the two matters. Difficulty in apportionment was not a ground for rejecting the claim either of the revenue or of the assessee. Therefore, apportionment had to be made of the compensation in this case on a reasonable basis between the loss of the agency in the usual course of business and the restrictive covenant.

Whether compensation received by an assessee for loss of agency is a capital or a revenue receipt depends upon the circumstances of each case. But before coming to the conclusion one way or the other, many questions have to be asked and answered: What was the scope of the earning apparatus or structure, from physical, financial, commercial and administrative standpoints? If it was a business of taking agencies, how many agencies had it, what was their nature and variety, how were they acquired, how were one or some of them lost and what was the total income they were yielding? If one of them was given up, what was the average income of the agency lost? What was its proportion in relation to the total income of the company? What was the impact of giving it up on the structure of

the entire business? Did it amount to a loss of an enduring asset causing an unabsorbed shock dislocating the entire or a part of the earning apparatus or structure? Or, was the loss an ordinary incident in the course of the business? But these questions can only be answered satisfactorily if the relevant material is available to the income-tax authorities. The evidence of witnesses in charge of the business, the relevant accounts and balance-sheets of the assessee before and after the loss, other evidence disclosing the previous history of the total business and the relative importance of the agency lost and the present position of the business after the loss of the said agency have to be scrutinised by the department.

The Supreme Court did not lay down in CIT v. Chari & Chari Ltd. that the burden on the revenue to establish that an income was taxable was immutable in the sense that it never shifted to the assessee. When sufficient evidence, either direct or circumstantial, in respect of its contention was disclosed by the revenue, an adverse inference could be drawn against the assessee if he failed to put before the department material which was in his exclusive possession.

While the income-tax authorities have to gather the relevant material to establish that the compensation given for the loss of agency was a taxable income, adverse inference could be drawn against the assessee if he had suppressed documents and evidence, which were exclusively within his knowledge or keeping.

In the determination of the question whether a receipt is capital or income, it is not possible to lay down any single test as infallible or any single criterion as decisive. The question must ultimately depend on the facts of the particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a decision. That, however, is not to say that the question is one of fact, for these questions between capital and income, trading profit or no trading profit, are questions which, though they may depend to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts.

When once it is found that a contract was entered into in the ordinary course of business, any compensation received for its termination would be a revenue

receipt, irrespective of whether its performance was to consist of a single act or a series of acts spread over a period.

There is a difference between a payment made as compensation for the termination of an agency contract and an amount paid as solatium for the cancellation of a contract entered into by a businessman in the ordinary course of business. In an agency contract, the actual business consists in the dealings between the principal and his customers, and the work of the agent is only to bring about that business. What he does is not the business itself but something which is intimately and directly linked up with it. The agency may, therefore, be viewed as the apparatus which leads to the business rather than the business itself. Considered in this light the agency right can be held to be of the nature of a capital asset invested in business. But this cannot be said of a contract entered into in the ordinary course of business. Such a contract is part of the business itself, not anything outside it as is the agency, and any receipt on account of such a contract can only be a trading receipt.

Because compensation paid on the cancellation of a trading contract differs in character from compensation paid for the cancellation of an agency contract, it should not be understood that the latter must always, and as a matter of law, be held to be a capital receipt. An agency contract which has the character of a capital asset in the hands of one person may assume the character of a trading receipt in the hands of another as, for example, when the agent is found to make a trade of acquiring agencies and dealing with them. Therefore, when the question arises whether the payment of compensation for the termination of an agency is a capital or a revenue receipt, it would have to be considered whether the agency was in the nature of a capital asset in the hands of the agent, or whether it was only part of his stock-in-trade.

Generally, payments made in settlement of rights under a trading contract are trading receipts and are assessable to revenue. But where a person who is carrying on business is prevented from doing so by external authority in exercise of a paramount power and is awarded compensation therefor, whether the receipt is a capital receipt or a revenue receipt will depend upon whether it is

compensation for injury inflicted on a capital asset or on a stock-in-trade.

11. A careful consideration of all the case laws above indicate following principles:-- 1. When a payment is made to compensate a person for cancellation of contract which does not affect the trading structure of the recipient's business nor deprive the assessee from source of income, then termination of contract is only a normal incidence of business.

2. Where trading structure of the assessee is impaired or cancellation results in loss of sources of income, payment to compensate such loss of source is capital.

3. A source of income may be a capital structure of one assessee.

But where the assessee is dealing in several such sources/assets then it becomes a stock-in-trade. Loss of one such source/asset will be a loss of capital if the assessee is dealing only in one but will be revenue if it is dealing in many such sources/assets as stock-in-trade.

4. When assessee is dealing in several agencies, loss of one such agency will be incidental to the carrying on of the business in agencies. Where there is a modification in the terms of any one of such agencies, it will against be a normal incidence of business.

5. There is no immutable principle that compensation received on cancellation of an agency must always be regarded as capital.

6. Compensation paid for agreeing to refrain from carrying on business in the commodities in respect of the agency terminated for loss of goodwill is prima facie, of the nature of capital receipt.

7. Manner of payment of compensation is not material. Whether capital is repaid in instalments or is paid in lump sum, it will not affect the basic nature of receipt in the hands of the recipient.

8. When assessee is not disposed of any asset, then amount received cannot be regarded as compensation in respect of loss of an enduring asset.

9. Payment made in settlement of trading rights under a trading contract are trading receipts, but where a person is prevented from doing business and injury is inflicted on capital asset, then the compensation will be capital and if injury is to stock-in-trade, then the compensation so received will be revenue in nature.

12. Now considering the facts of the present case, and principles laid down by different Courts including Hon'ble Supreme Court and Hon'ble Bombay High Court as referred above, we are of the considered view that the compensation so received by the assessee from HTIPL is revenue in nature and is taxable accordingly. The reasons are (i) the assessee is carrying on business of agencies/distributorship. It has lost only one. This business apparatus is not impaired. It is his business to deal in agencies. The impugned agency was not the sole bread earner for the assessee. His lost one trading item and continued with others, (ii) What has been done with HTIPL is only a business arrangement. A legal structure has been erected wherein the same business of distributorship of Tektronix products will continue but under different banner and in partnership with Textronics in a joint venture. This is no stoppage business as such. In place of deriving income from Tektronix directly, it will derive income for the same job from HTIPL as a share in joint venture. The business apparatus, if any, has been remodeled in a different form to suit the principles, ie., the Tektronix. The income flow has not been stopped from this source. So what has been done through this resource transfer agreement is only a business arrangement or business reorganisation whereby the assessee's income or source of income is not affected. (iii) What was transferred to HTIPL was not an asset, as no such asset had been acquired by the assessee. It does not figure in the balance sheet. It is claimed by learned Counsel for assessee that intangible asset has been transferred. In fact, we find that the customer data base as such is not transferred on an absolute ownership basis. The assessee is not prevented from using the same.

What is done is that HTIPL will use the same database henceforth after the termination date. No legal ownership or intellectual copyright is claimed over this database. At least no evidence is placed in support of the claim that customer database was a copyright protected or intellectual property right protected asset. The transfer of employees/staff also was merely a transfer of a resource, which

could have been otherwise also built-up. This is again a normal business arrangement and is only a condition of joint venture. Further arrangement with Tektronix was only modified vis-a-vis the assessee.

Earlier there was an arrangement of Tektronix directly with assessee.

Now it is again with assessee but in a joint venture. In commercial parlance, nothing has changed except form of relationship which is only a more suitable and convenient trade arrangement. Hence, transfer of employees and staff is not helpful to support the argument that there was a transfer of asset and hence the compensation so received was capital in nature, (iv) In fact HTIPL only received certain benefits in terms of resource transfer which would help the joint venture in running the business.

13. These resources (employees and customer database) are not the part of balance sheet. They are also not a part of definition of 'asset' as given in Section 2(14), 'property' of any kind held by an assessee....

14. As held in CIT v. National Insurance Co. Ltd. , a property is a bundle of rights, which the owner can lawfully exercise to the exclusion of all others. He is entitled to use and enjoy it as he wishes. The property can be either corporeal or incorporeal. Though it does not always mean physical property but it does mean the right, title, interest in a property. Property also includes rights such as trade marks, copyrights, patents and even intellectual rights capable of transfer or transmission. They also include beneficial rights to a thing considered as having money value especially with reference to transfer/succession and their capacity to be injured.

15. In the present case, the learned AR had sought to make employees and customer database as some sort of right. For it to be right, there should be (i) possession (ii) ownership to the exclusion of others (iii) transferability/succession (iv) some money value (v) or created by statute. We are of the considered view that "employees" cannot fall under the definition of capital asset as they do not fit under the concept of "property". Though, the customer database has been formed over the years but has not been actually transferred to HTIPL. It has been only

allowed to be used by it.

16. So far as the argument of learned Counsel for assessee that what has been received by the assessee is for "goodwill", is concerned, we are of the view that these two items alone do not form goodwill. In the case of *Evans Fraser & Co. Ltd. v. CIT*, the Hon'ble Bombay High Court explained the terms "good will" as whatever adds to the value to a business by reason of situation, name and reputation, connection, introduction to old customers and agreed absence from competition or any of these things. It is differential return of profit, "Sap and life" of the business, a cement that binds the business and its assets. In the same case, Hon'ble Bombay High Court also referred to *Whiteman Smith Motor Co. v. Chaplin* (1934) 2KB 35 describing "goodwill" zoologically as cats, dogs, rats and rabbits. It is useful to quote from *Evans Fraser & Co. Ltd.*, 's case (supra).

I understand the word (that is, 'goodwill') to include whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers, and agreed absence from competition, or any of these things.

The various descriptions which different judges have given of "goodwill" have been picturesquely catalogued by P. B. Mukharji J., who spoke for the court in *CIT v. Chunilal Prabhudas & Co.*

, as follows : Goodwill has been variously described. It has been horticultur-ally and botanically viewed as 'a seed sprouting' or an cora growing into the mighty oak of goodwill'. It has been geographically described by locality. It has been historically explained as growing and crystallising traditions in the business. It has been described in terms of a magnet as the 'attracting force'. In terms of comparative dynamics, goodwill has been described as the 'differential return of profit'. Philosophically it has been held to be intangible. Though immaterial, it is materially valued. Physically and psychologically, it is a 'habit' and sociologically it is a 'custom'. Biologically, it has been described by Lord Macnaghten in *Trego v. Hunt* [1896] AC 7, as the 'sap and life' of the business. Architecturally, it has been described as the 'cement' binding together the business and its assets as a whole and a going and developing concern. It has been zoologically explained by Rich J. in *Federal Commissioner of Taxation v. Williamson* [1943] 7 ATD 272, quoted at

pages 39-40 of the 4th Edn, of The Valuation of Company Shares and Business by Adamsan and Coorey in these terms: In Whiteman Smith Motor Company v. Chaplin [1934] 2 KB 35, the types were zoologically classified into cats, dogs, rats and rabbits. The cat prefers the old home to the person who keeps it, and stays in the old home although the person who has kept the home leaves, and so it represents the customer who goes to the old shop whoever keeps it, and provides the local goodwill. The faithful dog is attached to the person rather than the place, he will follow the outgoing owner if he does not go too far. The rat has no attachments, and is purely casual. The rabbit is attracted by mere propinquity. He comes because he happens to live close by and it would be more trouble to go elsewhere. These categories serve as a reminder that the goodwill of a business is a composite thing referable in part to its locality, in part to the way in which it is conducted, and the personality of those, who conduct it and in part to the likelihood of competition, many customers being no doubt actuated by mixed motives in conferring their custom'.

17. We find in the present case, that the assessee company is continuing to do business rather more profitably after parting some resources to the HTIPL. It is enjoying its goodwill. Its customer, its database, its situation, its name and all that which make a goodwill.

Goodwill is too specific to the business attached with its name, fame, place, approach, quality of the organisation as a whole.

18. As per Hon'ble Supreme Court in B.C. Srinivasa Setty case (supra), goodwill denotes benefit arising from some connection and reputation, various elements go into its formation. These elements, their quantity and value may vary from one business to another. The personality of the people carrying on the business, nature and character of the business, its name and reputation, its location, its impact on contemporary market, the financial base, socio-economic conditions of business, ecology, old customers, absence of competition, etc.

19. Thus, goodwill is not made up of one or two individual factors or a combination thereof. It is made up of whole lot of factors, each influencing the final make up of business. These factors and their composition varies in different trades and in

different businesses in the same trade. One element may preponderate in one business, another may dominate in another business. Its value may fluctuate from one moment to another, depending upon changes in the reputation of the business or even changes in the organisational set up of the business.

20. In the present case, it is undisputed fact that the assessee continued to do the business even after formation of joint venture in which it was a partner. It continued to do the business in the same line i.e. the distributorship of 15 other foreign companies. The business was continued in the same name at the same location by the same people with, the same old foreign companies except Tektronix with which business was re-organised as joint venture. Therefore, the assessee, in our considered view, continued to enjoy the same goodwill as it had before formation of joint venture. It is not specifically possible to say whether, after formation of joint venture the goodwill of the assessee was enhanced or eroded, but in our considered view, by entering into joint venture to produce the Textronics produces, the goodwill of the assessee, in general was enhanced, rather than eroded.

In any case, the goodwill prior to joint venture and subsequent to formation thereof, has not been evaluated so as to show that there was an erosion in the goodwill as claimed. But such erosion, if any, is normal incidence of business, due to various factors as described by the Hon'ble Supreme Court in B.C. Srinivasa Setty's case (supra). The root point is that assessee's goodwill has not come to an end so as to infer that it has been transferred to HTIPL. The goodwill is not divisible item in our considered view. It cannot be parted away partly and the assessee lives with rest of the part. It cannot be sold away and enjoyed too. Thus, we reject the argument of the learned Counsel for assessee that the assessee had received compensation for sale of 'goodwill'. We have already discussed above that what the assessee has got in terms of compensation was a normal incidence of business arising due to its re-organisation and formation of a joint venture. Thus, what the assessee has received is of revenue character and is taxable accordingly. Therefore, this ground of the revenue is allowed.

21. The third ground is about applicability of Rule 6D. We find that the issue is covered by the decision of Hon'ble Bombay High Court in the case of CIT v. Acme Mfg. Co. [2001] 249 ITR 460. It is held therein that the conveyance expenditure and traveling expenses, which are incurred by the employee on tour for conducting assessee's business cannot be considered as travel expenses covered under Rule 6D of the IT Rules 6(2). Thus, these amounts are to be excluded while computing disallowance under Rule 6D. Similar decision was taken by Hon'ble Bombay High Court in the case of CIT v. Chemet [1999] 240 ITR 624.

Following the above decisions, we confirm the order of CIT(A) and reject this ground of revenue.

22. The fourth ground is about guesthouse expenses. A sum of Rs. 2,65,002 was claimed to have been incurred on maintenance of guesthouses. The CIT(A) deleted the disallowance by following the decision in CIT v. Chase Bright Steels Ltd. . However, we find that this issue is covered against assessee by the decision of Special Bench in Eicher Tractors Ltd. v. Dy. CIT [2003] 84 ITD 49 (Delhi), in which the above decision was also considered. The guesthouse expenses as such are disallowable by virtue of Section 37(3). In view of this, this issue is required to be decided in favour of revenue. However, the learned AR submitted that a sum of Rs. 80,625 has been recovered from its employees and directors who have used the guest houses and such recovery was treated as travel expenses and considered for disallowance. Therefore, in our view, this issue has to go to Assessing Officer to verify as to how much recovery has taken place in respect of rent of guest houses or expenses incurred in guest house other than travelling to guest houses. In other words, travelling to guest houses will not be treated as recovery for staying in guest houses. Thus, the rent recovered in respect of guest house or expenditure incurred while staying in guest houses will be excluded while making disallowance out of Rs. 2,65,002. This ground of revenue is set aside to the assessing officer. It is treated as partly allowed.

23. The fifth ground is about a sum of Rs. 80,288 received by the assessee from Digital Equipment Ltd. USA (for short DEL) as capital receipt. The CIT(A) analysed the agreement executed by DEL and assessee. As per this agreement, the

assessee was required to desist from dealing or selling in products manufactured by DEL in India. The assessee was a distributor for some digital products. With a view to avoid any competition, the DEL had entered into this agreement with assessee to prevent it from manufacturing, selling, servicing in product manufactured by DEL. Thus, it was a non-competition agreement, whereby the assessee was prevented from competing with the sister concern of DEL for dealing in the same product.

24. The learned DR submitted that the issue is similar to the issue raised in ground No. 2 and hence decision therein would be applicable here also.

25. On the other hand, the learned AR supported the order of CIT(A) and relied on the decision in the case of Best and Co. Pvt. Ltd. (supra), wherein it is held that compensation received on account of restrictive covenant was a capital receipt and hence not taxable. Similar decision was given by Hon'ble Madras High Court in the case of CIT v. Saraswathi Publicities , wherein compensation was paid for agreeing to refrain from carrying different business with Hindustan Lever Ltd. till the end of year 1975. In consideration of this, a sum of Rs. 1,50,000 was paid to the assessee. It was held to be a capital receipt. In view of this, we hold that the sum of Rs. 80,288 received by the assessee on account of restraining itself from competition is a capital receipt. Accordingly, we confirm the order of CIT(A) on this ground.

26. In the result, the appeal of revenue is partly allowed. CO. No.1735/M/92 The assessee has raised following ground in this Cross objection appeal:-- 1. Without prejudice to your respondents contention that Rs. 61,807 disallowed by the Assessing Officer has correctly been allowed by CIT(A). Your respondents submit that out of Rs. 61,807, Rs. 18,809 is spent on employees of the respondents has to be allowed in full.

Further so far as is balance of Rs, 42,998 is covered. Even if its held Rule 6B is applicable at least the amount calculated at the rate of Rs. 50 articles has to be allowed by the respondents.

2. Your respondents submit that entire amount of Rs. 14,00,000 received from Hinditron Textronics is not at all taxable and the said additions ought to be deleted.

3. Without prejudice to your respondents contention that the amount of Rs. 80,258 received from M/s. Digital Equipment Corporation, USA is a capital receipt. Your respondents submit that the amount in question is not revenue receipt and ought to be taxed as capital gains and not as business income.

27. The first ground is allowed as this issue is already decided by us in departmental appeal in favour of assessee. Thus, this ground is allowed.

28. Regarding ground No. 2, a detailed discussion has been made in departmental appeal and the issue is decided in favour of revenue.

Thus, this ground of assessee is, therefore, rejected.

29. Ground No. 3 is about receipt of a sum of Rs. 80,258 from DEL. This amount is treated as capital receipt and decided in favour of assessee in departmental appeal (above). This ground of assessee is, therefore, allowed.

30. In the result, the cross objection appeal of assessee is partly allowed.

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