R. Vs. Lakshmiah Naidu and Co. V. Commissioner of Income-tax, Kerala and Coimbatore.

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Court : Chennai

Decided On : Mar-06-1962

Reported in : [1963]48ITR661(Mad)

Appeal No. : Tax Case No. 85 of 1959 (Ref. No. 32 of 1959)

Appellant : R.

Respondent : Lakshmiah Naidu and Co. V. Commissioner of Income-tax, Kerala and Coimbatore.

Judgement :

SRINIVASAN J. - The assessee is a firm of four partners. This partnership was appointed as the managing agents of the Kamala Mills Ltd., Coimbatore, under a managing agency agreement entered into in 1935. The terms of the managing agency agreement are not of any relevance to the question in issue in this reference. It appears that one Chidambaram Chettiar entered into an agreement with the assessee on the 8th January, 1955, whereby the assessee agreed to sell or to procure for this Chidambaram Chettiar 2,500 shares of Kamala Mills before a specified date. Another term of this agreement was that the assessee should resign its managing agency of the Kamala Mills Ltd. and that a consideration of Rs. 2,24,000 should be paid therefor to the assessee by this Chidambaram Chettiar. It is common ground that the terms of the agreement were fulfilled and

that the resignation of the assessee firm was also accepted by the board of directors of the Kamala Mills Ltd.

The previous year of the assessee had been accepted as the calendar year. In the return of the assessee for the assessment year 1955-56, the above receipts of Rs. 2,24,000 was not returned as part of the income. The Income-tax Officer applied section 10(5A) of the Act and called upon to show cause why the amount specified above should not be included in the total income of the relevant year ending on 31st March, 1955. The assessee objected contending that there was no termination of the managing agency agreement by the managed company and that the payment having been made by a third party and not by the principals, the amount was not compensation within the meaning of the Act. A further objection advanced was that since the amount was received on January 8, 1955, and since the previous year of the assessee was the calendar year, this amount could not be brought to assessment in the assessment year 1955-56. These objections were overruled. On the first of the above questions, the departmental authorities and the Tribunal as well came to the conclusion that section 10(5A) applied and that the amount was taxable. On the second question, the Income-tax Officer was of the view that the previous year for a business 'which had no books of account which were not made up to profit and loss account for any particular period' should be the official year. So that, since the amount was received in the financial year ending on the 31st March, 1955, it was in the view of the Income-tax Officer assessable in the assessment year 1955-56.

The appeal to the Tribunal on this point also failed. On the application of the assessee under section 66(1) of the Act, the Tribunal referred the following question for the determination of this court :

'Whether, on the facts and in the circumstances of the case, the sum of Rs. 2,24,000 or any portion thereof is includible in the income of the assessee, having regard to the provisions of section 10(5A) of the Income-tax Act, in the assessment for the year 1955-56.'

Section 10(5A) of the Income-tax Act was brought on to the statute book with effect from 1st April, 1955, by the Finance Act, 1955. The material part of this

provision relevant for our present purpose is extracted below :

'Any compensation or other payment due to or received by..... (a) the managing agent of an Indian company at or in connection with the termination or modification of his managing agency agreement with the company... shall be deemed to be profits and gains of a business carried on by the managing agent... and shall be liable to tax accordingly.'

The question appears to be practically answered by the plain words of the provision. That this sum of Rs. 2,24,000 was received by the managing agent at or in connection with the termination of its managing agency agreement is not capable of any answer but one. But the learned counsel for the assessee contends that, firstly, this amount does not represent compensation, and, secondly, that firstly, this amount does not represent compensation, and, secondly, that since this amount was not paid by the managed company, it cannot also be regarded as a compensation relevant to the termination of the managing agency agreement. It is argued that compensation signifies some recompense for some injury sustained by the person receiving the compensation and, if that is so, it should necessarily proceed from the party who was responsible for the injury. Here is a case, so argues Mr. Swaminathan, learned counsel for the assessee, where the assessee voluntarily resigned its managing agency and the receipt of this sum from a third party and not from the managed company clearly dissociates it from any compensation which a person who is deprived of a valuable right is entitled to receive in recompense for the loss of that right. It is true that compensation has the meaning that it is something paid to a person who has suffered a loss by another who has caused that loss, but that appears to be a secondary meaning. We have been referred to Salmond on Jurisprudence, where it is stated :

'It may be stated as a general rule, that the violation of a private right gives rise, in him whose right it is, to a sanctioning right to receive compensation for the injury so done to him. Such compensation must itself be divided into two kinds, which may be distinguished as Restitution and Penal Redress. In respect of the person injured, indeed, these two are the same in their nature and operation; but in

respect of the wrongdoer, they are very different. In restitution the defendant is compelled to give up the pecuniary value of some benefit which he has wrongfully obtained at the expense of the plaintiff; as when he who has wrongfully taken or detained anothers goods is made to pay him the pecuniary value of them or when he who has wrongfully enriched himself at anothers expense is compelled to account to him for all money so obtained.'

It seems to us that the above passage is not applicable to cases like the present. It is no doubt true that if the managed company got rid of the services of the managing agent, in violation of the agreement of the managing agency, the managing agent would be entitled to obtain compensation in respect of the right he was deprived of. While in civil actions the expression 'compensation' may have a peculiar significance, the expression as used in the Income-tax Act does not appear to us to be susceptible of only that meaning and no other. In Words and Phrases a variety of meaning is given. It is seen therefrom that the expression 'compensation', 'damages' and 'gratuity' are not synonymous. The primary significance of the word 'compensation' is 'equivalence' and the secondary or more common meaning is 'something given or obtained as an equivalent'. The large number of ways in which this expression 'compensation' has been interpreted has one common factor running through them all, that is, that compensation is regarded as an equivalent or recompense, that which makes good the lack of variation of something else. Flowing from this concept, the enlargement of the meaning of this expression takes in that which compensates for loss or privation, amends, remunerates or recompenses.

In Md. Mozaharlal Ahmad v. Md. Azimaddin, the learned judges referred to English cases and noticed that the expression 'compensation is not ordinarily used as an equivalent to damages, though it may often have to be measured by the same rule as damages in an action for the breach. They said :

'The term compensation etymologically suggests the image of balancing one thing against another; its primary signification is equivalence and the secondary and more common meaning is something given or obtained as an equivalent.'

We are not therefore prepared to agree with the contention of the learned counsel that, unless and until the amount received by the assessee can be regarded as compensation, in the light of a recompense for a right which the managed company wilfully deprived the assessee of, it cannot come within the scope of section 10(5A).

Even apart from this argument raised upon the precise significance of the expression 'compensation', the relevant section takes in both compensation or other payments. While it may be true that compensation in the special sense urged by the learned counsel will certainly come within the scope of the provision, any other payment which was received by the managing agent 'at or in connection with the termination' of his managing agency agreement is also within the mischief of the section. It is not necessary that the agency agreement should have been terminated by the managed company. If the payment is received at or in connection with the termination, that would be sufficient for the purpose of bringing it to tax under the Act. It cannot be denied by the learned counsel that it was so received. Clause 4 of the agreement entered into by the assessee with Chidambaram Chettiar reads :

'It is hereby further agreed by and between the parties that the amount of Rs. 2,24,000 agreed to be paid to Messrs. R. V. Lakshmiah Naidu and Co., by the purchaser in respect of the resignation by the said Messrs. R. V. Lakshmiah Naidu and Co. of their managing agency of the Coimbatore Kamala Mills Ltd....'

It is abundantly clear from the terms of this agreement that this payment was received by the assessee 'in respect the resignation of the managing agency. It certainly comes within the scope of the expression' at or in connection with the termination of his managing agency agreement' found in section 10(5A).

A somewhat vague argument was put forward that the Finance Act came into force on 1st April, 1955, and declared an item of receipt to be deemed to be profits and gains of a business. Learned counsel contends that this deeming provision does not apply to transactions which took place before 1st April, 1955. Our attention is invited to section 12B of the Act, where capital gains were brought to tax and the legislature specifically provided that 'any profits or gains arising from

the sale, exchange, relinquishment or transfer of a capital asset effected after the 31st day of March, 1956, shall be deemed to be income of the previous year...' We are invited to hold on the analogy of this provision that the presumed intention of the legislature in respect of compensation should also be that it should have effect in relation to amounts received on and after the 1st of April, 1955. This contention has only to be stated to be repelled. The Finance Act applies to the income of the previous year, and unless the legislature specifically excludes the operation of a taxable provision in respect of receipts prior to any specified dates, the interpretation sought to be placed on this provision on the analogy of section 12B cannot be accepted. So long as this receipt was during the previous year to which the newly introduced section would apply, the taxability of the amount cannot be questioned.

Learned counsel has referred to certain observations of the Supreme Court in Commissioner of Income-tax v. South India Pictures. That was a case where certain distribution agreements were cancelled and the producers paid an aggregate amount to the assessee towards commission. The question arose whether this sum represented a capital or a revenue receipt. This was before section 10(5A) was enacted. Their Lordships observed :

'Reference was made to section 10(5A) of the Indian Income-tax Act, 1922, and it was urged that the language of that sub-section impliedly indicated that the sum of Rs. 26,000 (Rupees twenty-six thousand) was a capital receipt. We are unable to accept this suggestion. 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 Wallaces case, to such cases. But that sub-section does not necessarily imply that if that sub-section were not there the kind of payment referred to therein would have been treated as capital receipt in all cases.'

To what purpose these observations are relied upon by the learned counsel we are at a loss to see. Apparently, the argument is that, but for this provision, there was a possibility of the receipt of this sum being treated as a capital receipt and, therefore, not taxable, and if that were so, effect to this provision should be given

only on and after the date of passing of the Finance Act. If that is the argument, we have necessarily to reject it, as the Finance Act, as we have observed, makes the provision applicable to the income of the previous year.

We are accordingly of the view that the sum of Rs. 2,24,000 was rightly held taxable.

The further question that we have to examine is whether the receipt could be brought to tax in the assessment for the assessment year 1955-56. From the statement of the case of the Tribunal, it is clear that originally the previous year adopted by the assessee was the period ending on the 15th of March. From 1938-39 assessment till 1940-41, a change was allowed in the accounting year which ended on the 31st of July. Once again in 1941-42, there was a change in the previous year and this time it was the year ending with the 31st of December. It is clear from the statement of the case that the previous year of the assessee was the calendar year. The disputed receipt was on 8th January, 1955, that is, in the calendar year 1955, relevant to the assessment year 1956-57. But the contention on behalf of the department as presented before us by the learned counsel for the department is that it is possible for each separate source of income to have a different previous year, and that the source of this receipt is not the managing agency business. If that is so, it is clear that it was rightly brought to tax in the assessment year 1955-56 as it had been received in the previous year relevant thereto ending 31st March, 1955. The question is not one which is free from difficulty. Section 2(11) defines the previous year in respect of any separate source of income, profits and gains. It is no doubt true as contended by the learned counsel that, even under a single head of income among the heads specified in section 6 of the Act, there may be different sources. For instance, a person may have more than one business and may appoint different previous years for each of such businesses which are undoubtedly different sources under the same head, and the previous year defined under section 2(11) refers to any separate source of income, profits and gains. Mr. Ranganathan, for the department, further claims that section 10(5A) itself provides that the receipt 'shall be deemed to be profits and gains of a business carried on by the managing agent'. According to the learned counsel, the use of the indefinite article 'a' in the

expression 'a business' connotes that the legislature intended to treat this item of receipt as derived from a different source. Firstly, we are unable to agree that this receipt was not derived from the managing agency itself. The main part of section 10(5A) refers to any composition or other payment received by a managing agent at or in connection with the termination of the managing agency agreement. If the managing agency was the business carried on by the assessee and its termination resulted in this receipt, we are at a loss to see why this receipt should not be related to that source, viz., the managing agency itself. It is true that it cannot be stated to be income, profits or gains of a business carried on, because it was not the carrying on of the business of the managing agency that gave rise to this receipt. But, undoubtedly, the source of this receipt was the managing agency business. If the argument of the learned counsel for the department is accepted, we have to presume that in addition to the fiction created by the section that the receipt shall be deemed to be the profits and gains of a business, there was the further implied fiction created by the section that it shall also be deemed to be the profits and gains of a business other than the managing agency business. It may be that, but for section 10(5A) of the Act, a receipt of this kind would, if held to be a revenue receipt, have to be taxed under the head 'income from other sources', because it could, in the absence of section 10(5A), be regarded as a receipt from a business that was carried on by the assessee. But where by the fiction embodied in section 10(5A) it is brought to tax as a revenue receipt and in addition is impressed with the character of the profits and gains of a business carried on by the managing agent, we see no obstacle to holding that this receipt must necessarily be correlated to the source from which it was derived, which was the managing agency business; and if that is so, the previous year relevant to this receipt cannot be a previous year different from the one relevant to the managing agency business itself. We once again emphasise that the source of this receipt was the managing agency itself, though it arose on the termination of the managing agency agreement, and it is the source that is important for determining the previous year. That during the calendar year 1955 the assessee was carrying on the business of managing agency up to the 8th January, 1955, is beyond question. During part of the year the managing agency itself was carried on and the profits and gains of that business would be assessable to tax in the

assessment year 1956-57; and since this sum of Rs. 2,24,000 was derived from that very source, the same previous year as for the business must be adopted for this receipt as well.

It has next been contended that the sum in question was received in respect of two obligations under the agreement with Chidambaram Chettiar, that is to say, it was a payment not only as compensation for resigning the managing agency but also for the obligation undertaken by the assessee to procure for Chidambaram Chettiar 2,500 shares of Kamala Mills. We are not prepared to accept this argument. We have already set out clause 4 of the agreement between the assessee and Chidambaram Chettiar where it is clearly stated that this sum was in respect of the resignation by the assessee of their managing agency. No remuneration for the other obligation of procuring 2,500 shares for Chidambaram Chettiar was contemplated or specified in the agreement. There is no material, therefore, in support of the claim that this sum was not wholly in respect of the termination of the managing agency.

In the result, we answer the question in this manner. The sum of Rs. 2,24,000 is rightly includible in the taxable income of the assessee, but that it cannot be brought to assessment in the assessment year 1955-56. There will be no order as to costs.

Order accordingly.