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question did not arise for consideration at that stage, did not also consider any material to support their finding. In the circumstances, the only reasonable course is to leave that question open so that it may be decided in appropriate proceedings.

In the result, subject to the aforesaid observations, the appeals are dismissed but without costs.

Appeals dismissed.

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October 7.

COMMISSIONER OF INCOME-TAX, NAGPUR

v.

RAI BAHADUR JAIRAM VALJI AND OTHERS

(VENKATARAMA AIYAR, P. B. GAJENDRAGADKAR and A. K. SARKAR JJ.)

Income Tax—Capital or Revenue receipt—Compensation for premature termination of contract—Whether trading receipt—Liability to tax—Indian Income-tax Act, 1922 (XI of 1922).

The respondent had been carrying on business in the production and supply of limestone since 1920, and under an agreement entered into with the Bengal Iron Company was supplying all its requirements of limestone and dolomite. Sometime later the Indian Iron and Steel Company took over all the assets and liabilities of the former company. Subsequently differences having arisen between the respondent and the Indian Iron and Steel Company they entered into an agreement on May 9, 1940, in settlement of all the disputes between them whereby, inter alia, the respondent was to work a quarry of the company for a period of 25 years and to supply the limestone quarried therefrom to the company according to its requirements and to get from the railway authorities facilities for transporting the limestone more economically; and it was agreed that till such facilities were given, the respondent was to be paid Rs. 4000/- every month. Under the agreement the respondent had the right to work other quarries of his own and supply limestone so quarried to other purchasers. The railway authorities having declined to grant facilities, it became impossible to carry out the agreement in the manner contemplated by the parties, who, thereupon, entered into a fresh agreement on August 2, 1941, terminating

the agreement dated May 9, 1940, on certain terms. The agreement provided inter alia (1) that the Company should pay " Rs. 2,50,000/- to the sellers as solatium besides the monthly instalments of Rs. 4000/-", remaining unpaid under the contract dated May 9, 1940, (2) that the company should purchase limestone from the respondent for a period of 12 years, and (3) that the respondent was to be appointed the loading contractors of the Company for loading iron ore. On a question as to whether the the sum of Rs. 2,50,000/- was liable to tax, the respondent claimed that it was not, being a capital receipt but the income-tax authorities held that it was a trading receipt and was income chargeable to tax. The High Court however held on a reference under s. 66(1), that the income was not chargeable to tax, and hence the present appeal. In support of the appeal, the respondent contended inter alia that (1) the contract dated May 9, 1940, was for a period of 25 years of which more than 23 years had still to run at the time of the settlement, and it was therefore an asset of an enduring character, capital in character, and the compensation paid therefor was a capital receipt, and (2) that the true character of the agreement was that it brought into existence an arrangement which would enable the respondent to carry on a business and was not itself any business, and any payment made for the termination of such an agreement was a capital receipt.

Held, that the contract of May 9, 1940, was entered into by the respondent in the ordinary course of his business and that the sum of Rs. 2,50,000/- which was paid as solatium for the cancellation of that contract, was a revenue receipt and was chargeable to tax.

There is a distinction between a contract entered into in the usual course of business and an agency contract. While it may be possible to regard the latter as merely a framework for doing business, the former constitutes the business itself, and, therefore, compensation paid for the termination of the former kind of contract must be held to be revenue, whereas compensation paid for the termination of the latter might be capital in character.

It would make no difference in the character of the receipt, when it is compensation for cancellation of a trading contract, whether its performance is to consist of a single act or a series of acts spread over a period.

Case law reviewed.

Van Den Berghs Ltd. v. *Clark*, [1935] A.C. 431, distinguished.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 109 of 1954.

Appeal by special leave from the judgment and order dated April 21, 1950, of the former Nagpur High Court in Misc. Civil Case No. 135 of 1949.

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R. Ganapathy Iyer and *R. H. Dhebar*, for the appellant.

Radhavinod Pal, *J. M. Thakar* and *I. N. Shroff*, for the respondents.

1958. October 7. The Judgment of the Court was delivered by

VENKATARAMA AIYAR J.—This is an appeal against the judgment of the High Court of Nagpur in a reference under s. 66(1) of the Indian Income-tax Act (XI of 1922), hereinafter referred to as the Act, and the point that is raised for our determination is whether a sum of Rs. 2,50,000 received by the respondent on August 2, 1941, is chargeable to income-tax. While, according to the Department, the amount in question is a revenue receipt liable to be included in the chargeable income, according to the respondent it is capital receipt not liable to tax. The Appellate Tribunal held, affirming the decisions of the Income-tax Officer and the Appellate Assistant Commissioner, that the amount in question was a trading receipt, and was income liable to be assessed. On the application of the respondent, it referred the following question for the decision of the High Court:

"Whether in the circumstances of the case the sum of Rs. 2,50,000 received by the assessee as damages or compensation for the premature termination of the contract of 9th May 1940 is income assessable within the meaning of the Indian Income-tax Act."

The reference was heard by Sen and Deo, JJ., who held, disagreeing with the Tribunal, that the sum of Rs. 2,50,000 was a capital receipt in the hands of the respondent, and that it was not liable to be taxed. The appellant then filed an application under s. 66(A)(2) of the Act for a certificate to appeal to this Court, but that was dismissed, the learned judges holding that the law on the subject was well settled. The appellant thereafter applied to this Court for special leave under Art. 136, and the same was granted, and hence this appeal.

The question whether a receipt is capital or income has frequently come up for determination before the courts. Various rules have been enunciated as furnishing a key to the solution of the question, but as often observed by the highest authorities, it is not possible to lay down any single test as infallible or any single criterion as decisive in the determination of the question, which 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. Vide *Van Den Berghs Ltd.* v. *Clark* (1). That, however, is not to say that the question is one of fact, for, as observed in *Davies (H. M. Inspector of Taxes)* v. *The Shell Company of China Ltd.* (2) "these questions between capital and income, trading profit or no trading profit, are questions which, though they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts". Vide also the observations of Lord Greene, M. R. in *Rustproof Metal Window Co., Ltd.* v. *Commissioners of Inland Revenue* (3). That being so, we must first examine the facts of the present case, and then consider whether on those facts and in the light of the applicable principles, the sum of Rs. 2,50,000 received by the respondent is a capital or a revenue receipt.

The respondent is a businessman whose trading activities run in several channels. He is a railway contractor; he runs a rice mill and a sugar factory; he is a supplier of limestone and dolomite. It is with the last of these businesses that we are concerned in these proceedings. The respondent had acquired a quarry at Paraghat and had been himself working it and selling limestone quarried out of it to, among others, a Company called the Bengal Iron Company, Ltd. On January 5, 1935, the said Company entered into an agreement with the respondent for the purchase of all its requirements of limestone and dolomite from

(1) [1935] A.C. 431. (2) (1951) 32 Tax Cas. 133, 151.
(3) (1947) 29 Tax Cas. 243, 266.

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the latter at rates specified therein, and these rates were subsequently modified by another agreement between the parties dated December 21, 1935. In 1936 the Company went into liquidation, and its assets and liabilities were taken over by another Company called the Indian Iron and Steel Company, Ltd. under a scheme of amalgamation dated September 8, 1936. This Company continued to purchase limestone and dolomite from the respondent for some time, but later on, finding that the rates were uneconomic owing to increase in the railway freight, it decided to purchase its requirements from other sources, and by notice dated May 29, 1939, informed the respondent accordingly. Thereupon, the respondent filed Suit No. 211 of 1940 in the High Court of Calcutta for specific performance of the contract dated January 5, 1935, as modified on December 21, 1935, and for an injunction restraining the Indian Iron and Steel Company, Ltd. from purchasing limestone or dolomite from any person other than the plaintiff, and on March 13, 1940, an injunction in those terms was actually issued against the Company.

Thereafter, the Company and the respondent entered into an agreement in settlement of all the disputes between them, and the same was embodied in a document dated May 9, 1940. As it is this document that forms the source for the payment of Rs. 2,50,000 to the respondent, it is necessary to refer to the terms thereof in some detail. Under this agreement, the respondent was to work a quarry of the Company at a place called Gangapur for a period of 25 years and to supply the limestone quarried therefrom to the Company according to its requirements. This quarry, it should be stated, was situated near Kulti where the Company carried on its smelting operations, and obviously it would reduce the working expenses, if limestone required therefor could be got from Gangapur. There were, however, no facilities in Gangapur railway station for transporting the goods from the quarry, and so it was arranged that the authorities should be moved for permission to construct a siding at Gangapur, and that the cost thereof should be borne

by the Company. It was expected that it would take 18 months before the siding could be completed, and it was agreed that during that period the respondent was to be paid Rs. 4,000 every month. Thereafter, the respondent was to be paid at the rate of Rs. 2-9-0 per ton of limestone which might be loaded in the railway waggons to be arranged for by the Company. The working of the quarry was left entirely in the hands of the respondent. It was he that was to purchase the machinery and the appliances necessary for quarrying. He was to engage his own workmen and put up all the requisite superstructures. After the limestone was raised from the quarry, he was to get it cleaned and rendered merchantable, and it was thereafter to be loaded in the wagon. There are two clauses in the agreement to which reference might be made. Under cl. 6, the respondent agreed " to supply to the Company such other quantities of limestone, if any, as the Company may order besides Kulti requirements ". Clause 13 of the agreement enjoined that the respondent was not to engage, during the subsistence of the agreement, in any other contract business for the working of any quarry within an area of 20 miles from the Company's quarry, but this was subject to the proviso that the respondent was free to work any quarry belonging to and held by him.

To continue the narration, the railway authorities did not agree to the construction at Gangapur of a siding and a loopline to the quarry, and so it became impossible to carry out the agreement in the manner contemplated by the parties. It is in this situation that the parties came together, and on August 2, 1941, entered into a new agreement and it is with this that we are directly concerned in this appeal. The agreement recites that the Company feeling difficulty in working their mines referred to in the contract dated May 9, 1940, made a proposal for termination of the said contract on certain terms, and that was agreed to. The terms of the agreement are (1) that the Company should pay " Rs. 2,50,000 to the sellers as solatium besides the monthly instalments of Rs. 4,000 ", remaining unpaid under the contract dated May 9, 1940; (2)

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that the Company should take all the limestone required for its furnaces at Kulti from the respondent for a period of 12 years on terms and conditions set out in an agreement; (3) that the respondent was to be appointed the loading contractors of the Company for loading all iron ore at Monoharpore for a period of 12 years from January 1, 1942, on the terms and conditions specified in a separate agreement. Pursuant to this agreement, the respondent was paid a sum of Rs. 2,50,000 and the two agreements relating to the purchase of limestone and the loading of iron ore at Monoharpore were also executed. The balance due on account of monthly payment of Rs. 4,000 provided in the agreement of May 9, 1940, was also duly paid. Now, on these facts, the question is whether the sum of Rs. 2,50,000 received by the respondent was capital or revenue.

Before discussing the principles applicable to the facts as stated above, it is necessary to deal with a contention raised on the facts of the case on behalf of the respondent. Dr. Radha Binode Pal, who appeared for him, argued that for the purpose of carrying out the agreement dated January 5, 1935, the respondent had executed works of a capital nature such as construction of quarters, tenements and the like, and had incurred expenses exceeding Rs. 4 lakhs on that account, that all this had to be thrown away when the quarry at Paraghat had to be abandoned, and the sum of Rs. 2,50,000 was really a reimbursement of the amount spent by him as above and was therefore a capital receipt. If the facts were as stated by the respondent, the position in law would no doubt be as contended for by him. But have those facts been established? In his statement before the Income-tax Officer, the respondent merely stated that the amount in question was paid as consideration for the termination of the contract of 1935 and not of 1940, and it is pointed out by the Tribunal that the respondent did not substantiate even this assertion. There was no allegation that capital expenses had been incurred in the execution of the contract of 1935, and that the amount in question was paid as compensation therefor;

nor is there any evidence on that question. Indeed, when it is remembered that the quarry at Paraghat had been abandoned before the contract dated May 9, 1940, was entered into, it is difficult to imagine how any amount paid as compensation for the cancellation of that contract can have any connection with expenses incurred with reference to that quarry. We must hold that the sum of Rs. 2,50,000 was not paid as compensation for expenses thrown away and cannot be held to be a capital receipt on that account.

Now, the contention on behalf of the appellant is that the contract dated May 9, 1940, was one entered into by the respondent in the ordinary course of his business, that the sum of Rs. 2,50,000 was paid admittedly as solatium for the cancellation of that contract, that the payment really represents the profits which the respondent could have made, had the contract been performed, and that it is therefore a revenue receipt; and a number of authorities were quoted in support of this contention. We shall now refer to the more important of them. In *Short Bros. Ltd.* v. *The Commissioners of Inland Revenue* (1), the facts were that the appellant Company which was carrying on business as shipbuilders had entered into a contract to build two steamers and later on, agreed to its cancellation on receipt of a sum of £ 1,00,000. The question was whether this was a capital or revenue receipt. Rowlatt, J., held that it was merely a receipt in a going concern and was revenue, and that was affirmed by the Court of Appeal, Lord Hanworth, M.R., observing that such a contract as the one before him was liable in the ordinary course of business to be altered or terminated on terms and the payment of £ 1,00,000 in settlement of the rights under the contract was an adjustment made between the appellants and their clients in the ordinary course of business. Similar observations are to be found in the judgment of Sargant, L. J. and Lawrence, L. J. It may be noted on the facts of the present case that the agreement of January 5, 1935, was modified on December 21, 1935, and the disputes which arose with reference thereto

(1) (1927) 12 Tax Cas. 955.

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were settled by the agreement of May 9, 1940, which was, in turn, replaced by agreement dated August 2, 1941. The agreements dated May 9, 1940, and August 2, 1941, could therefore be properly said to be adjustments made in the ordinary course of business.

In *The Commissioners of Inland Revenue* v. *The Northfleet Coal and Ballast Co., Ltd.* (1), the respondent Company which was the owner of a chalk quarry had entered into a contract with a purchaser for the supply of certain quantity of chalk for a period of ten years. After some time, the purchaser wanted to be relieved from the contract, and the respondent agreed to its termination on receipt, of £ 3,000. The point for decision was whether that was a capital or a revenue receipt. In holding that it was the latter, Rowlatt, J., observed:

"If the contract had gone forward those sums would have come into profits every year and now that they are represented by a commutation, so far as that is concerned, the point seems to be concluded by *Short's case* (2)".

One of the contentions urged on behalf of the assessee was that the contract being for a term was a capital asset, that the effect of the subsequent agreement terminating it on payment of £ 3,000 was in substance to assign the unexpired portion of the contract for a consideration, and that it would be a capital receipt on the principle laid down in *John Smith & Son* v. *Moore* (3). In repelling this contention, Rowlatt, J., observed:

"These contracts are not being sold. They are not being even extinguished really for this purpose. What is happening is that the profits under them are being taken; something is being taken in respect of the profits of them. That is the position. This sum represents the profits of the Company on the contracts, treating them as contracts which notionally have earned or are going to earn a profit."

And the decision in *John Smith & Son* v. *Moore* (3), was distinguished.

(1) (1927) 12 Tax Cas. 1102. (2) (1927) 12 Tax Cas. 955.
(3) (1921) 12 Tax Cas. 266.

In *John Smith & Son* v. *Moore* (1), it may be stated that the executors sold some outstanding contracts for the supply of coal to the son of the testator for a consideration, and it was held that the payment made by the son for the purchase of the contracts was in his hands a capital expense. The payment was not given by one party to a contract to the other in cancellation of the agreement but by a stranger to the contract to one of the parties thereto for an assignment of his rights thereunder. In *Jessee Robinson & Sons* v. *The Commissioners of Inland Revenue* (2), the appellant had entered into two contracts for the sale of yarn. The purchaser cancelled the contracts and paid £ 12,500 in settlement of the claims. The contention of the appellant was that this payment was not a trading receipt or profit arising from his trade. In rejecting this contention, Rowlatt, J. observed:

"It seems to me that there is no reason why the sum received in that respect for breach of contract is not a sum which is part of the receipts of the business for which that contract was made."

Examining the facts of the present case in the light of the above decisions, the question to be considered is whether the contract dated May 9, 1940, was entered into by the respondent in the usual course of his business. If it was, then the amount paid for the termination of the contract must be held to be a trading receipt. That the respondent has been carrying on business in the production and supply of limestone is amply established. The record shows that he had been supplying limestone and dolomite to the Bengal Iron Company, Ltd., from about the year 1920 and that the contracts of 1935 were entered into only in the carrying on of that business. Vide para. 4 in the plaint in Suit No. 211 of 1940 already referred to. The contract of May 9, 1940, was made in settlement of the rights under those contracts. It is to be noted that under the agreement dated August 2, 1941, under which he received a sum of Rs. 2,50,000, he also secured a contract for the supply of limestone for a period of 12 years. On these facts, it is impossible to

(1) (1921) 12 Tax Cas. 266. (2) (1929) 12 Tax Cas. 1241.

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come to any conclusion other than that the contract in question was entered into by the respondent in the ordinary course of his business. The learned Judges in the Court below observe that the assessee was not a dealer in, though he was a supplier of, limestone. This appears to us to be a distinction without a difference. Moreover, it would be wholly immaterial for the present purpose whether the respondent was a dealer in or supplier of limestone, as, in either view, he would be carrying on business and the contract in question would be one entered into in the carrying on of that business. We should also observe that the statement that the respondent was only a supplier but not a dealer in limestone does not appear to be quite accurate on the facts. Under cl. 13 of the agreement dated May 9, 1940, the respondent had the right to work other quarries of his own, and the evidence shows that he did supply limestone so quarried to other purchasers.

In support of the judgment of the Court below, learned counsel for the respondent urged the following contentions:

(1) The contract dated May 9, 1940, was for a period of 25 years of which more than 23 years had still to run at the time of the settlement, and it was therefore an asset of an enduring character, capital in character, and the compensation paid therefor was a capital receipt.

(2) The true character of the agreement was that it brought into existence an arrangement which would enable the respondent to carry on a business and was not itself any business and any payment made for the termination of such an agreement is a capital receipt.

(3) The business which was to be carried on pursuant to the contract was of a specialised character, that there was no general market for limestone and dolomite, that the contract in question formed practically the entire business of the respondent and the compensation paid for the closure of that business would not be a revenue receipt but a capital receipt on account of sterilisation of a capital asset. It is argued by Dr. Radha Binode Pal that the features

stated above were not present in the contracts which came up for consideration in the decisions cited for the appellant, and that they are therefore distinguishable, and he relied on other authorities as applicable to the facts of this case. These contentions and the authorities cited in support thereof must now be considered.

(1) Is the receipt of Rs. 2,50,000 a capital receipt for the reason that it was compensation for the settlement of a contract which had a long life before it? The argument of the respondent is that there is in the Income-tax law a well-defined distinction between fixed capital and circulating capital (Vide *John Smith & Son* v. *Moore*) (1), that where there is a contract the performance of which is to be not once and for all but spread over a period of years, it is in the nature of a fixed capital and a payment on account of it must be held to be capital receipt. Reliance is placed in support of this contention on the decisions in *Commissioner of Income-tax* v. *Shaw Wallace & Co.* (2) and *Barr, Crombie & Co. Ltd.* v. *Commissioners of Inland Revenue* (3) and certain observations in *Kelsall Parsons & Co.* v. *Commissioners of Inland Revenue* (4) and *The Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd., Karaikudi* (5).

In *Income-tax Commissioner* v. *Shaw Wallace & Co.* (2), the respondent Company had been acting for several years as the distributing agents of two oil Companies. In 1927-28, these Companies decided to make their own distribution arrangements and accordingly terminated the agency of the respondent and paid compensation therefor. The question was whether this amount was a revenue receipt in the hands of the respondent. It was held by the Privy Council that it was a capital receipt, because it represented compensation paid for cessation of business, not profits earned in the carrying on of it. In *Barr, Crombie & Co. Ltd.* v. *Commissioners of Inland Revenue* (3), the facts were that

(1) (1921) 12 Tax Cas. 266. (2) (1932) L.R. 59 I.A. 206.
(3) (1945) 26 Tax Cas. 406. (4) (1938) 21 Tax Cas. 608.
(5) [1956] S.C.R. 223.

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under an agreement dated May 25, 1937, the appellant had been appointed manager of a shipping company for a period of 15 years, and one of the terms of the agreement was that if the company went into liquidation, the entire remuneration for the remaining period was payable forthwith. On November 5, 1942, the company went into liquidation, and a sum of £ 16,306 16s. 11d. was paid to the appellant as its remuneration for the period of about 8 years which was still to run. On a question as to whether this was taxable as a revenue receipt, it was held that as virtually the whole of the assets of the appellant company consisted of the managing agency agreement, a payment for its extinction was a capital receipt and was therefore not taxable. Distinguishing the decision in *Kelsall's case* (1) where compensation paid for the termination of an agency agreement was held to be a revenue receipt, the Lord President Normand observed: (at page 411).

"Here we are not dealing with a single payment in return for the surrender of the prospect of making profits in the final year of the agreement, but with a payment for the surrender of an agreement while there was still a substantial period—indeed, more than half of the period of the agreement—to run".

Lord Moncrieff agreeing with this conclusion observed that "so far from this being a prepayment of future remuneration for services, this was, if regard be had to 'the substance of the matter', a price paid upon the purchase and sale of the main asset of a business."

In *Kelsall's case* (1), the assessee carried on business as commission agents and acquired a number of agencies in the course of that business. One of these agencies which was for a period of three years was cancelled at the end of the second year on payment of £ 1,500 as compensation. The question was whether this was a capital or a revenue receipt. In holding that it was the latter, the Lord President, Normand observed that the business of the appellant was to acquire as many agencies as it could, that it was incidental to that agency that it should be modified, altered or discharged

(1) (1938) 21 Tax Cas. 608.

and that as the period outstanding was one year, it could not be said that the appellant was parting with an enduring asset of the business. Lord Fleming in agreeing with this conclusion stated that he attached importance to the fact that the agreement had only one year to run and that different considerations might arise if the outstanding period was considerable.

"A different case would have arisen for decision", he observed, (at p. 622) "if the agreement had been terminated when it had still, say, a period of 10 years to run. A payment made in respect of a loss to be sustained over a period of years may well have a different character from a payment made in respect of a loss to be sustained in the year in which the payment is received."

All these cases were considered by this Court in *The Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd., Karaikudi* (1). There, the assessee was carrying on business in the distribution of films, and in the course of such business entered into three contracts dated September 17, 1941, July 16, 1942, and May 5, 1945, with a company called the Jupiter Pictures, Ltd., for the production and distribution of three films for a period of 5 years. On October 31, 1945, the assessee and the Jupiter Pictures, Ltd., entered into an agreement terminating the contracts in consideration of a payment of Rs. 26,000 as compensation to the assessee. The question having been raised whether this was a capital or revenue receipt, this Court held that it was the latter and was liable to be taxed, and the decision in *Barr, Crombie & Co. Ltd.* v. *Commissioners of Inland Revenue* (2) was distinguished on the ground that there the whole trade of the assessee was built on the agreement dated May 25, 1937, that it was a fundamental asset of the assessee's business, and that the payment on account of it was a capital receipt.

Now, it is the contention of the respondent that the present case is governed by the principles laid down in the above decisions and not those enunciated in the authorities cited for the appellant, and that the

(1) [1956] S.C.R. 223. (2) (1945) 26 Tax Cas. 406.

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payment of Rs. 2,50,000 as compensation on account of the agreement dated May 9, 1940, falls within *Income-tax Commissioner* v. *Shaw Wallace & Co.* (1) and *Barr, Crombie & Co. Ltd.* v. *Commissioners of Inland Revenue* (2) rather than *Kelsall's case* (3) and *The Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd., Karaikudi* (4) because the contract dated May 9, 1940, formed practically the only business of the respondent and the contract had at the time of the settlement still a period of 23 years to run. It will be seen that the receipts, the chargeability of which was in question in the decisions cited for the respondent, were all payments made as compensation for the termination of agency contracts, whereas we are concerned with an amount paid as solatium for the cancellation of a contract entered into by a businessman in the ordinary course of his business, and that, in our judgment, makes all the difference in the character of the receipt. 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. In other words, what he does is not the business itself but something which is intimately and directly linked up with it. It is therefore possible to view the agency as the apparatus which leads to business rather than as the business itself on the analogy of the agreements in *Van Den Berghs Ltd.* v. *Clark* (5). 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.

That there is a distinction between an agency agreement and a contract made in the usual course of business will further be clear, if we have regard to one

(1) (1932) L.R. 59 I.A. 206.
(2) (1945) 26 Tax Cas. 406.
(3) (1938) 21 Tax Cas. 608.
(4) [1956] S.C.R. 223.
(5) [1935] A. C. 431.

of the reasons on which the conclusion that compensation paid for cancellation of agency rights is a capital receipt is sometimes rested. It is that, in substance, the agent assigns the agreement to the principal and the compensation is price paid therefor. Vide the observations of Lord Moncrieff in *Barr, Crombie & Co. Ltd.* v. *Commissioners of Inland Revenue* (1) at page 413 already quoted. It no doubt sounds somewhat strange that an arrangement between parties to a contract settling claims thereunder should be regarded as an assignment of the rights of one of them to the other, but it at least emphasises that the agreement is to be regarded as a capital asset of the agent, which is saleable. Such a concept will be out of place with reference to a contract entered into in the course of business. Any payment made for the non-performance or cancellation of such a contract can only be damages or compensation and cannot, in law or fact, be regarded as an assignment of the rights under the contract. A claim for damages is, in law, incapable of being transferred, though the benefit of a contract could be assigned while it is subsisting, and such assignment can only be in favour of third persons, not in favour of the other party to the contract, in which case it will be a new contract. Reference may in this connection be made to the observations of Rowlatt, J., in *The Commissioners of Inland Revenue* v. *The Northfleet Coal and Ballast Co., Ltd.* (2) already quoted, that such contracts were not sold.

If, then, contracts entered into in the course of business cannot, unlike agency contracts, be regarded as capital assets of the business, would it make any difference in their character that they are to be in operation for a period? On principle, it is difficult to see why it should. If under the terms of a contract a businessman A is to supply goods, let us say, 100 bales of yarn, on a particular day and he does that, the price received by him therefor will be a revenue receipt. And in the above case if the purchaser cancels the contract and pays damages to the seller, that would also be a revenue receipt. If under the same

(1) (1945) 26 Tax Cas. 406 (2) (1927) 12 Tax Cas. 1102.

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contract A is to deliver the bales in four quarterly instalments, and he does so and receives the price in four instalments, all the receipts would be revenue receipts. And if after one instalment is delivered, the purchaser cancels the contract as regards future instalments and pays compensation therefor to the seller, such payment will undoubtedly be a revenue receipt. If the contract is that A is to supply whatever goods are ordered by the purchaser during a certain period, let us say, 10 years, the price received for the goods ordered and delivered will be revenue receipt. Now, if the purchaser under this contract puts an end to the contract after some time, say, at the end of two years and pays compensation for the breach of the contract as regards the remaining period, does the receipt thereof become a capital receipt? It sounds illogical so to hold. How does it affect the true position, whether the contracting parties agree to carry on business in the sale and purchase of goods for a stated period on terms settled between them, or whether they enter into a succession of contracts for that purpose?

Two decisions have been quoted before us as showing that payments under a contract entered into in the ordinary course of business would be revenue receipts, even though the agreement may be for a period. In *The Commissioners of Inland Revenue* v. *The Northfleet Coal and Ballast Co., Ltd.* (1) cited above, the contract was for the supply of chalk for a period of ten years, and the compensation paid was for the cancellation of the contract for the unexpired period of four years, and it was held to be a trading receipt. In *Shove (H. M. Inspector of Taxes)* v. *Dura Manufacturing Co. Ltd.* (2), the respondent company had introduced company A to company B, as the result of which the former obtained a remunerative business with the latter. In return for this service, A agreed to pay the respondent a commission on the business so obtained. Later on, this agreement was terminated on payment of a sum of £ 1,500 by A to the respondent. The question was whether this was a revenue

(1) (1927) 12 Tax Cas. 1102. (2) (1941) 23 Tax Cas. 779, 783.

receipt. In answering it in the affirmative, Lawrence, J., observed:

"Reliance was also placed on certain dicta in the Court of Session in *Kelsall Parsons & Co.* v. *Commissioners of Inland Revenue*, at pages 620, 622 and 624, which suggest that if the contract cancelled has more than one year to run, the sum received for its cancellation may be capital. The learned Judges who expressed this view did not say that such sum must be capital. They were dealing with a contract different from the present, namely, an agency contract, which constituted a very large part of the taxpayer's business".

"In view of the decision in *Short Bros., Ltd.* v. *Commissioners of Inland Revenue* and in *Commissioners of Inland Revenue* v. *Northfleet Coal and Ballast Co. Ltd.* and the differences of facts, I do not feel that those dicta ought to be applied to the present case."

In our opinion, therefore, 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, and in this respect, it differs from an agency agreement.

In holding that compensation paid on the cancellation of a trading contract differs in character from compensation paid for cancellation of an agency contract, we should not be understood as deciding that the latter must always, and as a matter of law be held to be a capital receipt. Such a conclusion will be directly opposed to the decisions in *Kelsall's case* (1) and *The Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd., Karaikudi* (2). The fact is that 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. The principle was

(1) (1938) 21 Tax Cas. 608.

(2) [1956] S.C.R. 223.

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thus stated by Romer, L. J., in *Golden Horse Shoe (New) Ltd.* v. *Thurgood* (1):

"The determining factor must be the nature of the trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital. The land with which a dealer in real estate carries on his business is part of his circulating capital. The machinery with which a manufacturer makes the articles that he sells is part of his fixed capital. The machinery that a dealer in machinery buys and sells is part of his circulating capital, as is the coal that a coal merchant buys and sells in the course of his trade. So, too, is the coal that a manufacturer of gas buys and from which he extracts his gas."

Therefore, when a question arises whether a payment of compensation for 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 capital asset in the hands of the assessee, or whether it was only part of his stock-in-trade. Thus, in *Barr, Crombie & Son Ltd.* v. *Commissioners of Inland Revenue* (2), the agency was found to be practically the sole business of the assessee, and the receipt of compensation on account of it was accordingly held to be a capital receipt, while in *Kelsall's case* (3) the agency which was terminated was one of several agencies held by the assessee and the compensation amount received therefor was held to be a revenue receipt, and that was also the case in *The Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd., Karaikudi* (4). It is, however, unnecessary to further elaborate this point, as we are concerned in this appeal, not with an agency agreement but with a contract entered into in the ordinary course of business, and, in our judgment, compensation received on account of such a contract must be held to be a revenue receipt.

(2) The above discussion answers to a large extent the contention of the respondent that the contract

(1) (1933) 18 Tax Cas. 280, 300.
(2) (1945) 26 Tax Cas. 406.
(3) (1938) 21 Tax Cas. 608.
(4) [1956] S.C.R. 223.

dated May 9, 1940, was merely a framework of his business and not the business itself, and that a receipt on account of it must be treated as a capital receipt. The decision relied on in support of this contention is *Van Den Berghs Ltd.* v. *Clark* (1). There, two companies, one English and the other Dutch, which were engaged in the manufacture and sale of margarine entered into certain agreements, the object of which was to avoid competition and to augment their profits. An elaborate scheme was devised under which the two companies were to carry on their business independently but "in friendly alliance" and in accordance with the scheme; and the profits were to be shared between the two companies in certain proportions. The agreements were to be in operation till 1940, but differences arose between the parties in the working of the scheme and the "alliance" was terminated in 1927, the Dutch company paying to the English company a sum of £ 4,50,000 as compensation. The question was as to the character of this receipt, whether it was a capital or a revenue receipt, and it was held by the House of Lords that it was a capital receipt and not taxable.

Now, it will be seen that the contracts which were the source of the receipt in question did not in themselves constitute the business which yielded the profits to the two companies. Those profits were derived by them from the manufacture and sale of margarine, and there was nothing in the agreements providing that the companies were to join in the manufacture and sale of the margarine. The position under the agreement is thus stated by Lord Macmillan, who delivered the leading judgment:

"The three agreements which the appellants consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products, or for the engagement of agents or other employees necessary for the conduct of their business; nor were they merely agreements as to how their

(1) (1935) A.C. 431.

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trading profits when earned should be distributed as between the contracting parties. On the contrary the cancelled agreements related to the whole structure of the appellants' profit-making apparatus. They regulated the appellants' activities, defined what they might and what they might not do, and affected the whole conduct of their business."

Thus, the agreements in question were intended to ensure that the business in margarine was carried on to the best advantage, but did not, in themselves, form part of the business. They were merely collateral to it. For the reasons given in discussing the nature of agency agreements, the agreements between the two companies must be regarded as not pertaining to the trading activities, which yielded profits, and the payment on account of those agreements must be held to be a capital receipt. But these considerations would be inapplicable to the agreement, with which we are concerned. The business which the respondent was to carry on and which was to yield profits to him was the very business to which the agreement relates. It is under this very agreement that he was to be paid Rs. 2-9-0 per ton of limestone loaded by him, and the business which he had to do to earn the amount was to raise and supply limestone as provided in the agreement. There is here no profit-making apparatus set up by the agreement apart from the business which is to be carried on under it. We are accordingly unable to agree that the present case is governed by the decision in *Van Den Berghs Ltd.* v. *Clark* (1).

(3) It remains to deal with the contention of the respondent that the business which he was to have carried on under the contract dated May 9, 1950, was practically the entirety of his trading activities, and that the termination of such a contract is tantamount to stopping his doing business and the compensation paid therefor is a capital receipt. Reliance is placed in support of this argument on the decision in *The Glenboig Union Fireclay Co. Ltd.* v. *The Commissioners of Inland Revenue* (2). Now, to appreciate the

(1) (1935) A.C. 431. (2) (1922) 12 Tax Cas. 427.

true position, it is necessary to bear in mind the distinction between compensation on account of business carried on under an agreement with a third party when that is terminated, and compensation which is received on account of a business which the assessee is prevented from carrying on by a third person in exercise of an overriding power. In the former case, the payment would in general be a trading receipt referable to the business activities carried on or to be carried on under the agreement and would be taxable as a revenue receipt. There may be exceptions to this. A familiar instance is when the parties agree, as part of the contract to do business, that one of them shall not carry on similar business for a stated period after the termination of the contract, and a compensation is paid therefor. That has been held to be a capital receipt. Vide *Beak* v. *Robson* (1). The reason is that it is a payment made not on account of profits which might have been earned in the carrying on of the business but as solatium for not carrying on the business. A payment made in a similar covenant to operate during the period of the contract, however, has been held to be a revenue receipt, because it arises out of the carrying on of the business. Vide *Thompson* v. *Magnesium Elektron, Ltd.* (2). It might also happen that one of the parties to the contract might have, in the carrying out thereof, incurred expenses of a capital character and as a result of the cancellation of the contract, those expenses would have been thrown away. A payment made on account of those expenses would bear the character of a capital receipt. But apart from these and similar instances, it might, in general, be stated that 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 an external authority in exercise of a paramount power and is awarded compensation therefor, whether that 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

(1) (1942) 25 Tax Cas. 33. (2) (1943) 26 Tax Cas. 1.

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stock-in-trade. The decision in *The Glenboig Union Fireclay Co. Ltd.* v. *The Commissioners of Inland Revenue* (1) applies to this category of cases. There, the assessee was carrying on business in the manufacture of fire clay goods and had, for the performance of that business, acquired a fire clay field on lease. The Caledonian Railway which passed over the field prohibited the assessee from excavating the field within a certain distance of the rails, and paid compensation therefor in accordance with the provisions of a statute. It was held by the House of Lords that this was a capital receipt and was not taxable on the ground that the compensation was really the price paid "for sterilising the asset from which otherwise profit might have been obtained". That is say, the fire clay field was a capital asset which was to be utilised for the carrying on of the business of manufacturing fire clay goods and when the assessee was prohibited from exploiting the field, it was an injury inflicted on his capital asset. Where, however, the compensation is referable to injury inflicted on the stock-in-trade, it would be a revenue receipt. Vide *The Commissioners of Inland Revenue* v. *Newcastle Breweries Ltd.* (2). The principle of these decisions has no application where the compensation paid is in respect of rights arising under a trading contract. A payment made in settlement of that contract is an adjustment of the rights under that contract, and must be referred to the profits which could be made in the carrying out of that contract.

In the present case, the contract dated May 9, 1940, was simply an agreement to carry on business. In settlement of that contract, Rs. 2,50,000 was paid to the respondent. That was not a payment on account of any capital expenditure incurred by him in the execution of the contract. That indeed was the point sought to be raised by the respondent, but therein he has failed. It is also to be noted that at no time was he prevented from carrying on business. Clause 6 of the agreement dated May 9, 1940, contemplates that the respondent was to carry on generally the business

(1) (1922) 12 Tax Cas. 427. (2) (1927) 12 Tax Cas. 927.

of supply of limestone even apart from his work in the Gangapur quarry, and the agreement dated August 2, 1941, provides for his supplying limestone for the furnaces at Kulti for a period of 12 years and for loading iron at Monoharpore for a like period. There was therefore at no time any agreement which operated as a bar to the carrying on of business by the respondent.

On a consideration of all the facts established, we are of opinion that the receipt of Rs. 2,50,000 by the respondent is a revenue receipt and is chargeable to tax.

In the result, the appeal is allowed, the judgment of the High Court set aside and the order of the Tribunal restored. The respondent will pay the costs of the appellant throughout.

Appeal allowed.

P. KRISHNA MENON

v.

THE COMMISSIONER OF INCOME-TAX, MYSORE, TRAVANCORE-COCHIN AND COORG, BANGALORE

(VENKATARAMA AIYAR, GAJENDRAGADKAR and A. K. SARKAR, JJ.)

Income-tax—Assessee teaching Vedanta without object of making profit—If carrying on a vocation—Disciple making gift of money—Whether receipt amounts to income from vocation—Indian Income-tax Act, 1922 (XI of 1922), s. 10.

The assessee was teaching his disciples Vedanta philosophy without any motive or intention of making a profit out of such activity. One of his disciples made gifts of money to him on several occassions. It was contended by the assessee that he was not liable to tax on the amounts received as he was not carrying on any vocation and as the receipts were not profits or gains.

Held that, in teaching Vedanta the assessee was carrying on a vocation. It is not necessary for an activity to be a vocation