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August 4.

MESSRS. GODREJ & COMPANY, BOMBAY

v.

COMMISSIONER OF INCOME-TAX, BOMBAY

(S. R. DAS, C.J., N. H. BHAGWATI and M. HIDAYATULLAH, JJ.)

Income-tax—Capital or revenue receipt—Remuneration of the managing agent—Variation of terms of agreement—Compensation for reduction of the scale of remuneration for the subsequent period of agency—Capital expenditure.

Under an agreement dated December 8, 1933, the appellant firm was appointed managing agent of a limited company for a period of thirty years from November 9, 1933. Clause 2 of the agreement provided for the remuneration of the managing agent. Some of the shareholders and directors of the company having felt that the scale of remuneration paid to the managing agent was extraordinarily excessive and unusual, negotiations were started for a reduction of the remuneration, and as a result the appellant and the company entered into a Supplementary Agreement on March 24, 1948, whereby in consideration of the company paying a sum of Rs. 7,50,000 "as compensation for releasing the company from the onerous term as to remuneration" contained in the original agreement, the managing agent agreed to accept as remuneration as from September 1, 1946, for the remaining term of the managing agency ten per cent. of the net annual profits of the company as defined in s. 87C, sub-s. (3) of the Indian Companies Act, 1913. The sum of Rs. 7,50,000 was paid by the company to the appellant in 1947. For the assessment year 1948-49 the Income-tax Officer treated the aforesaid sum as a revenue receipt in the hands of the appellant and taxed it as such. The appellant claimed that the sum was a payment made by the company wholly in discharge of its contingent liability to pay the higher remuneration and it was, therefore, a capital expenditure incurred by the company and received by the appellant as a capital receipt and was, as such, not liable to tax. The income-tax authorities maintained (1) that though the payment of Rs. 7,50,000 had been described as compensation, the real object and consideration for the payment was the reduction of remuneration, (2) that it was a lump sum payment in consideration of the variation of the terms of employment and was, therefore, not a capital receipt but was a revenue receipt, and (3) that there was, in fact, no break in service and the payment was made in the course of the continuation of the service and, therefore, represented a revenue receipt of the managing agency business of the appellant.

Held, that the sum of Rs. 7,50,000 was paid by the company for securing immunity from the liability to pay higher remuneration to the appellant for the rest of the term of the managing

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agency and was, therefore, a capital expenditure; and, so far as the appellant was concerned, it was received as compensation for the deterioration or injury to the managing agency by reason of the release of its rights to get higher remuneration and was, therefore, a capital receipt.

The Commissioner of Income-tax v. *Vazir Sultan and Sons*, [1959] 36 I.T.R. 175; *Hunter* v. *Dewhurst*, (1932) 16 Tax Cas. 605 and *Glenboig Union Fireclay Co. Ltd.* v. *The Commissioners of Inland Revenue*, (1922) 12 Tax Cas. 427, relied on.

Assam Bengal Cement Co. Ltd. v. *Commissioner of Income-tax*, [1955] 1 S.C.R. 972; *The Commissioner of Income-tax and Excess Profits Tax* v. *The South India Pictures Ltd.*, [1956] S.C.R. 223; *The Commissioner of Income-tax* v. *Jairam Valji*, [1959] S.C.R. (Suppl.) 110 and *The Commissioner of Income-tax* v. *Shaw Wallace and Co.* (1932) L.R. 59 I.A. 206, considered.

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 183 of 1956.

Appeal from the judgment and order dated September 11, 1953, of the Bombay High Court, in Income-tax Reference No. 23 of 1953.

A. V. Viswanatha Sastri, *S. N. Andley* and *J. B. Dadachanji*, for the appellants.

M. C. Setalvad, *Attorney-General for India*, *K. N. Rajagopal Sastri*, and *D. Gupta*, for the respondent.

1959. August 4. The Judgment of the Court was delivered by

Das C. J.

DAS C. J.—This is an appeal from the judgment and order of the High Court of Bombay delivered on September 11, 1953, on a reference made by the Income-tax Appellate Tribunal under s. 66(1) of the Indian Income-tax Act, whereby the High Court answered the referred question in the affirmative and directed the appellant to pay the costs of the respondent.

The appellant, which is a registered firm and is hereinafter referred to as "the assessee firm", was appointed the managing agent of Godrej Soaps Limited (hereinafter called the "managed company"). It has been working as such managing agent since October 1928 upon the terms and conditions recorded originally in an agreement dated October 28, 1928,

which was subsequently substituted by another agreement dated December 8, 1933, (hereinafter referred to as "the Principal Agreement"). Under the Principal Agreement the assessee firm was appointed Managing Agent for a period of thirty years from November 9, 1933. Clause 2 of that Agreement provided as follows:—

"The Company shall during the subsistence of this agreement pay to the said firm and the said firm shall receive from the company the following remuneration, that is to say:

(a) A commission during every year at the rate of twenty per cent. on the net profits of the said company after providing for interest on loans, advances and debentures (if any), working expenses, repairs, outgoings and depreciation but without any deduction being made for income-tax and super-tax and for expenditure on capital account or on account of any sum which may be set aside in each year out of profits as reserved fund.

(b) In case such net profits of the Company after providing for interest on loans, advances and debentures (if any), working expenses, depreciation, repairs and outgoings and after deduction therefrom the commission provided for by sub-clause (a) shall during any year exceed a sum of rupees one lac the amount of such excess over rupees one lac up to a limit of rupees twenty four thousand.

(c) In case such net profits of the Company after providing for interest on loans, advances and debentures (if any), working expenses, depreciation, repairs and outgoings and after also deducting therefrom the commission provided for by sub-clause (a) shall during any year exceed a sum of rupees one lac and twenty four thousand one half of such excess over rupees one lac and twenty four thousand shall be paid to the firm and the other half to the shareholders."

Some of the shareholders and directors of the managed company felt that the scale of remuneration paid to the assessee firm under cl. (2) of the Principal Agreement was extraordinarily excessive and unusual and

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should be modified. Accordingly negotiation were started for a reduction of the remuneration and, after some discussion, the assessee firm and the managed company arrived at certain agreed modifications which were eventually recorded in a apecial resolution passed at the extraordinary general meeting of the managed company held on October 22, 1946. That resolution was in the following terms:—

"Resolved that the agreement arrived at between the managing agents on the one hand and the directors of your Company on the other hand, that the managing agents, in consideration of the Company paying Rs. 7,50,000 as compensation, for releasing the Company from the onerous term as to remuneration contained in the present managing agency agreement should accept as remnneration for the remaining term of their managing agency ten per cent. of the net annual profits of the Company as defined in S. 87C, Sub-s. (3) of the Indian Companies Act in lieu of the higher remuneration to which they are now entitled under the provisions of the existing managing agency agreement be and the same is hereby approved and confirmed.

Resolved that the Company and the managing agents do execute the necessary document modifying the terms of the original managing agency agreement in accordance with the above agreement arrived at between them. Such document be prepared by the Company's solicitors and approved by the managing agents and the directors shall carry the same into effect with or without modification as they shall think fit."

The agreed modifications were thereafter embodied in a Supplementary Agreement made between the assessee firm and managed company on March 24, 1948. After reciting the appointment of the assessee firm as the Managing Agent upon terms contained in the Principal Agreement and further reciting the agreement arrived at between the parties and the resolution referred to above, it was agreed and declared as follows:

"1. That the remuneration of the Managing Agents as from the 1st day of September 1946 shall be ten per cent. of the net annual profits of the Company as defined in s. 87C, sub-s. (3) of the Indian Companies Act, 1913, in lieu of the higher remuneration as provided in the above recited cl. (2) of the Principal Agreement.

2. Subject only to the variations herein contained and such other alterations as may be necessary to make the Principal Agreement consistent with these presents the principal agreement shall remain in full force and effect and shall be read and construed and be enforceable as if the terms of these presents were inserted therein by way of substitution."

The sum of Rs. 7,50,000 was paid by the managed company and received by the assessee firm in the calendar year 1947 which was the accounting year for the assessment year 1948-49.

In the course of the assessment proceedings for the assessment year 1948-49, it was contended by the departmental representative, (i) that though the payment of Rs. 7,50,000 had been described as compensation, the real object and consideration for the payment was the reduction of remuneration, (ii) that that being the character of payment, it was a lump sum payment in consideration of the variation of the terms of employment and was, therefore, not a capital receipt but was a revenue receipt, and (iii) that there was, in fact, no break in service and the payment was made in course of the continuation of the service and, therefore, represented a revenue receipt of the managing agency business of the assessee firm. The assessee firm, on the other hand, maintained that the sum of Rs. 7,50,000 was a payment made by the managed company to the assessee firm wholly in discharge of its contingent liability to pay the higher remuneration and in order to discharge itself of an onerous contingent obligation to pay higher remuneration and it was, therefore, a capital expenditure incurred by the managed company and a capital receipt obtained by the assessee firm and was as such not liable to tax.

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The Income-tax Officer treated the sum of Rs. 7,50,000 as a revenue receipt in the hands of the assessee firm and taxed it as such. On appeal this decision was confirmed by the Appellate Assistant Commissioner and thereafter, on further appeal, was upheld by the Tribunal by its order dated July 23, 1952. At the instance of the assessee-firm the Tribunal, under s. 66(1) of the Act, made a reference to the High Court raising the following question of law:—

> "Whether on the facts and in the circumstances of the case the sum of Rs. 7,50,000 is a revenue receipt liable to tax."

The said reference was heard by the High Court and by its judgment, pronounced on September 11, 1953, the High Court answered the referred question in the affirmative and directed the assessee-firm to pay the costs of the reference. The High Court, however, gave to the assessee-firm a certificate of fitness for appeal to this Court and that is how the appeal has come before us.

As has been said by this Court in *Commissioner of Income-tax and Excess Profits Tax, Madras* v. *The South India Pictures Ltd.*(1), "it is not always easy to decide whether a particular payment received by a person is his income or whether it is to be regarded as his capital receipt". Eminent Judges have observed that "income" is a word of the broadest connotation and that it is difficult, and perhaps impossible, to define it by any precise general formula. Though in general the distinction between an income and a capital receipt is well recognised, cases do arise where the item lies on the borderline and the problem has to be solved on the particular facts of each case. No infallible criterion or test has been or can be laid down and the decided cases are only helpful in that they indicate the kind of consideration which may relevantly be borne in mind in approaching the problem. The character of payment received may vary according to the circumstances. Thus, the amount received as consideration for the sale of a plot of land may ordinarily be capital; but if the business of the recipient is to

(1) [1956] S.C.R. 223, 228.

buy and sell lands, it may well be his income. It is, therefore, necessary to approach the problem keeping in view the particular facts and circumstances in which it has arisen.

There can be no doubt that by paying this sum of Rs. 7,50,000 the managed company has secured for itself a release from the obligation to pay a higher remuneration to the assesee firm for the rest of the period of managing agency covered by the Principal Agreement. *Prima facie*, this release from liability to pay a higher remuneration for over 17 years must be an advantage gained by the managed company for the benefit of its business and the immunity thus obtained by the managed company may well be regarded as the acquisition of an asset of enduring value by means of a capital outlay which will be a capital expenditure according to the test laid down by Viscount Cave, L.C., in *Atherton* v. *British Insulated and Helsby Cables Limited* (1) referred to in the judgment of this Court in *Assam Bengal Cement Co. Ltd.* v. *Commissioner of Income-tax* (2). If the sum of Rs. 7,50,000 represented a capital expenditure incurred by the managed company, it should, according to learned counsel for the assessee firm, be a capital receipt in the hands of the assessee firm, for the intrinsic characteristics of capital sums and revenue items respectively are essentially the same for receipts as for expenditure. (See Simon's Income-tax, II Edn., Vol. I, para. 44, p. 31). But, as pointed out by the learned author in that very paragraph, this cannot be an invariable proposition, for there is always the possibility of a particular sum changing its quality according as the circumstances of the payer or the recipient are in question. Accordingly, the learned Attorney-General appearing for the respondent contends that we are not concerned in this appeal with the problem, whether, from the point of view of the managed company, the sum represented a capital expenditure or not but that we are called upon to determine whether this sum represented a capital receipt in the hands of the assessee firm.

(1) (1925) 10 Tax Cas. 155. (2) [1955] 1 S.C.R. 972.

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In the Resolution adopted by the managed company as well as in the recitals set out in the Supplementary Agreement this sum has been stated to be a payment "as compensation for releasing the company from the onerous term as to remuneration contained" in the Principal Agreement. It is true, as said by the High Court and as reiterated by the learned Attorney-General, that the language used in the document is not decisive and the question has to be determined by a consideration of all the attending circumstances; nevertheless, the language cannot be ignored altogether but must be taken into consideration along with other relevant circumstances.

This sum of Rs. 7,50,000 has undoubtedly not been paid as compensation for the termination or cancellation of an ordinary business contract which is a part of the stock-in-trade of the assessee and cannot, therefore, be regarded as income, as the amounts received by the assessee in *The Commissioner of Income-tax and Excess Profits Tax* v. *The South India Pictures Ltd.* (1) and in *The Commissioner of Income-tax, Nagpur* v. *Rai Bahadur Jairam Valji* (2) had been held to be. Nor can this amount be said to have been paid as compensation for the cancellation or cessation of the managing agency of the assessee firm, for the managing agency continued and, therefore, the decision of the Judicial Committee of the Privy Council in *The Commissioner of Income-tax* v. *Shaw Wallace and Co.*(1) cannot be invoked. It is, however, urged that for the purpose of rendering the sum paid as compensation to be regarded as a capital receipt, it is not necessary that the entire managing agency should be acquired. If the amount was paid as the price for the sterilisation of even a part of a capital asset which is the framework or entire structure of the assessee's profit making apparatus, then the amount must also be regarded as a capital receipt, for, as said by Lord Wrenbury in *Glenboig Union Fireclay Co. Ltd.* v. *The Commissioners of Inland Revenue* (4), "what is true of the whole must be equally true of part"—a principle which has been adopted by

(1) [1956] S.C.R. 223, 228.
(2) [1959] 35 I.T.R. 148; [1959] S.C.R. Supp. 110.
(3) (1932) L.R. 59 I.A. 206.
(4) [1922] 12 Tax Cas. 427.

this Court in *The Commissioner of Income-tax, Hyderabad-Deccan* v. *Messrs. Vazir Sultan and Sons*(1). The learned Attorney-General, however, contends that this case is not governed by the decisions in *Shaw Wallace's case* (2) or *Messrs. Vazir Sultan and Sons' case* (1) because in the present case there was no acquisition of the entire managing agency business or sterilisation of any part of the capital asset and the business structure or the profit-making apparatus, namely, the managing agency, remains unaffected. There is no destruction or sterilisation of any part of the business structure. The amount in question was paid in condsideration of the assessee firm agreeing to continue to serve as the managing agent on a reduced remuneration and, therefore, it bears the same character as that of remuneration and, therefore, a revenue receipt. We do not accept this contention. If this argument were correct, then, on a parity of reasoning, our decision in *Messrs. Vazir Sultan and Sons' case* (1) would have been different, for, there also the agency continued as before except that the territories were reduced to their original extent. In that case also the agent agreed to continue to serve with the extent of his field of activity limited to the State of Hyderabad only. To regard such an agreement as a mere variation in the terms of remuneration is only to take a superficial view of the matter and to ignore the effect of such variation on what has been called the profit-making apparatus. A managing agency yielding a remuneration calculated at the rate of 20 per cent. of the profits is not the same thing as a managing agency yielding a remuneration calculated at 10 per cent. of the profits. There is a distinct deterioration in the character and quality of the managing agency viewed as a profit-making apparatus and this deterioration is of an enduring kind. The reduced remuneration having been separately provided, the sum of Rs. 7,50,000 must be regarded as having been paid as compensation for this injury to or deterioration of the managing agency just as the amounts paid in *Glenboig's case* (3)

(1) Civil Appeal No. 346 of 1957, decided on March 20, 1959 ; [1959] 36 I.T.R. 175.
(2) (1932) L.R. 59 I.A. 206.
(3) (1922) 12 Tax Cas. 427.

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or *Messrs. Vazir Sultan's case*(1) were held to be. This is also very nearly covered by the majority decision of the English House of Lords in *Hunter* v. *Dewhurst*(2). It is true that in the later English cases of *Prendergast* v. *Cameron*(3) and *Wales Tilley*(4), the decision in *Hunter* v. *Dewhurst*(2) was distinguished as being of an exceptional and special nature but those later decisions turned on the words used in r. 1 of Sch. E. to the English Act. Further, they were cases of continuation of personal service on reduced remuneration simpliciter and not of acquisition, wholly or in part, of any managing agency viewed as a profit-making apparatus and consequently the effect of the agreements in question under which the payment was made upon the profit-making apparatus, did not come under consideration at all. On a construction of the agreements it was held that the payments made were simply remuneration paid in advance representing the difference between the higher rate of remuneration and the reduced remuneration and as such a revenue receipt. The question of the character of the payment made for compensation for the acquisition, wholly or in part, of any managing agency or injury to or deterioration of the managing agency as a profit-making apparatus is covered by our decisions hereinbefore referred to. In the light of those decisions the sum of Rs. 7,50,000 was paid and received not to make up the difference between the higher remuneration and the reduced remuneration but was in reality paid and received as compensation for releasing the company from the onerous terms as to remuneration as it was in terms expressed to be. In other words, so far as the managed company was concerned, it was paid for securing immunity from the liability to pay higher remuneration to the assessee firm for the rest of the term of the managing agency and, therefore, a capital expenditure and so far as the assessee firm was concerned, it was received as compensation for the deterioration or injury to the managing agency by reason of the release of its rights to get higher remuneration and, therefore, a capital receipt

(1) Civil Appeal No. 346 of 1957, decided on March 20, 1959; [1959] 36 I.T.R. 175.
(2) (1932) 16 Tax Cas. 605.
(3) (1940) 23 Tax Cas. 122.
(4) (1943) 25 Tax Cas. 136.

within the decisions of this Court in the earlier cases referred to above.

In the light of the above discussion it follows, therefore, that the answer to the referred question should by in the negative. The result, therefore, is that this appeal is allowed, the answer given by the High Court to the question is set aside and the question is answered in the negative. The appellant must get the costs of the reference in the High Court and in this Court.

Appeal allowed.

THE STATE OF SAURASHTRA

v.

MEMON HAJI ISMAIL HAJI

(S. R. DAS, C.J., N. H. BHAGWATI and M. HIDAYATULLAH, JJ.)

Act of State—Taking over of administration of Junagadh State by Dominion of India—Resumption of property by Administrator before completion of such act—If an act of State not justiciable in municipal Courts.

The suit, out of which the present appeal arose, was one originally brought by the respondent against the State of Junagadh, later on substituted by the State of Saurashtra, for a declaration that the Administrator's order dated October 1, 1948, resuming the immoveable property in suit was illegal, unjust and against all canons of natural justice. The suit was decreed by the Civil Judge and the decree was affirmed by the High Court in appeal. The only point for determination in this appeal was whether the act of resumption by the Administrator was an act of State performed on behalf of the Government of India and involved an alien outside the State and was not, therefore, justiciable in the municipal Courts. With the passing of the Indian Independence Act 1947, and lapse of paramountcy by reason of s. 7 thereof, the Nawab of Junagadh became sovereign, but instead of acceding to the new Dominion he left for Pakistan. It appeared from the White Paper on Indian States that the Government of India took over the administration of the State on November 9, 1947, at the request of the Nawab's Council, but did not formally annex it till January 20, 1949, and during that period the Administrator maintained law and order and carried on the administration.

Held, that there could be no doubt that the act of the Dominion of India in assuming the administration of Junagadh State was an act of State pure and simple and the resumption in