
(1981) 09 BOM CK 0033

Bombay High Court

Case No: Income-tax Reference No. 2 of 1972

Commissioner of
Income Tax, Bombay
City-I

APPELLANT

Vs

Automobile Products of
India Ltd.

RESPONDENT

Date of Decision: Sept. 4, 1981

Acts Referred:

- Income Tax Act, 1961 - Section 4

Citation: (1983) 140 ITR 159 : (1981) 7 TAXMAN 327

Hon'ble Judges: S.K. Desai, J; D.M. Rege, J

Bench: Division Bench

Judgement

Desai, J.

In this reference the following two questions stand referred to us by the Income Tax Appellate Tribunal for our opinion:

"(1) Whether, on the facts and in the circumstances of the case, the sum of Rs. 24 lakhs, received by the assessee in terms of the agreement dated April 29, 1981, from Premier Automobiles Ltd. is a revenue receipt ?

(2) If the answer to question No. (1) is in the negative, whether the Tribunal was right in permitting the Department to raise before it for the first time the alternative contention that any capital gains arising from the receipt should be assessed ?"

2. It is stated in para. 14 of the statement of the case that question No. (2) was referred at the instance of the assessee, which had itself not filed a reference application. The decision of the Tribunal was partly against the Commissioner and partly against the assessee. The Commissioner was aggrieved by the decision of the Tribunal to the effect that the sum of Rs. 24 lakhs received by the assessee in terms of the agreement dated

April 29, 1961, between the assessee and Premier Automobiles Ltd. was a capital receipt and not a revenue receipt. He, therefore, filed a reference application and sought reference of question No. (1) However, the Tribunal had permitted the Department to raise before it the alternative contention that assuming that it was not a revenue receipt but a capital receipt, the capital gains arising from the receipt should be assessed. In its order the Tribunal directed that the matter should go back to the ITO for examination of the matter from the capital gains angle in all its aspects. It is this direction which is questioned by the assessee in question No. (2).

3. In [Commissioner of Income Tax, Kerala Vs. V. Damodaran](#), the Supreme court has opined that where the order of the Tribunal has decided the appeal partly against one party and partly against the other, the party who is aggrieved and who desires a reference to the High Court must file a reference application. The Supreme Court has gone on further to say that it is not open to an aggrieved party to make a reference application filed by the other party the basis of his claim that a question of law sought by him should be referred. The Supreme Court went on to hold that if any reference has erroneously been made to the High Court without an express application for the same by the aggrieved party, the reference to that extent must be considered void. In the circumstances, we intend to refrain from answering question No. (2).

4. We are concerned in this case with the assessment year 1962-63, for which the accounting year was the year ended on July 31, 1961. The assessee is a public limited company formed in 1949, and will hereinafter be referred to as "API" for the sake of brevity. In the beginning it carried on the business of assembling Hillman cars. This business was subsequently discontinued, and in 1953, the licence given under the Industries (Development and Regulation) Act, 1951, was cancelled. On December 9, 1955, API obtained an industrial licence to manufacture diesel engines. These engines were to be made in collaboration with Henry Meadows Ltd, of U.K. Under the said licence granted on December 9, 1955, one of the conditions put was that API should have an installed capacity for the manufacture of 3,000 Henry Meadows Diesel Engines (4 DC 330 series II). A copy of the said licence is annexed as annex. B to the statement of the case. In pursuance of this industrial licence, on March 16, 1956, API entered into a collaboration agreement with Meadows. A copy of the said agreement is annexed as annex. A to statement of case. Under one of the terms of the agreement (cl.8) API were to pay to Meadows a royalty amounting to five per cent. of the selling price of all Meadows engines, spares or component parts thereof manufactured and sold in the territory during the terms of the agreement. The collaboration agreement was entered into after being approved by the Govt. of India, which also allowed facilities to API for procuring foreign exchange.

5. From 1957 onwards API progressively set up a factory for manufacturing Meadows engines and by 1960, considerable progress appears to have been achieved in the manufacturing and introduction into the market of such engines. The sale of spares and assembled engines in the accounting year 1956-57 was about Rs. 14 1/2 lakhs and the

sales increased progressively and came to about Rs. 75 lakhs and Rs. 70 lakhs respectively in 1959-60 and 1960-61. It appears to be there agreed position (although separate accounts were not kept) that from this venture the assessee did not make a profit throughout this period. One of the reasons for the inability of API to make profits was that it was making engines only and according to the assessee the venture might have provided profitable if the makers of the engines were allowed to manufacture trucks also into which the engines could be fitted. API, however, did not have any licence to manufacture trucks. The matter were under discussion with the Govt. of India. Ultimately, the Government appears to have taken a decision that in the interest of rationalisation of the automobile industry, the same persons must manufacture engines as well as trucks. The assessee company, namely, API, was interested in obtaining a licence for manufacturing truck, but due to consideration of foreign exchange it was not possible for them to secure such a licence. Accordingly, at a meeting held on January 16, 1961, at the residence of the Hon"ble Minister for Industries, Govt. of India, certain points of agreement were arrived at between API and representative of Premier Automobiles Ltd (hereinafter referred to as "PAL" for the sake of brevity). A copy of the minutes of the meeting held before the Hon"ble Minister for Industries is annexed as annex G to the statement of case. It is in pursuance of this meeting and the minutes that API and PAL thereafter on April 29, 1961, executed an agreement for transfer of the assessee undertaking pertaining to the manufacturing of Meadows engines to PAL embodying the terms agreed to on January 16, 1961. A copy of this agreement of April 29, 1961, is annexed to the statement of case as annex. F.

6. We are concerned with art. III of the said agreement dated April 29, 1961. The agreement provides that in consideration of API having negotiated with the Govt. of India and agreed for the cancellation of the licence dated December 9, 1955, and for a termination by mutual consent of the licence granted by Meadows to API a sum of Rs. 24 lakhs in three installments as provided by the said article-Rs. 15 lakhs being payable on the execution of the agreement Rs. 3 lakhs being payable on the expiry of twelve months from the date of execution of the agreement and the final installment of Rs. 6 lakhs being payable on the expiry of twenty-four months from the dated of execution of the agreement. It may be mentioned that in the minutes of the meeting held before the Hon"ble Minister for Industries an aggregate amount of Rs. 26 1/2 lakhs was mentioned as payable by PAL to API in similar installments, which appears to have been reduced amount of Rs. 24 lakhs payable by PAL to API which is the subject matter of question No. (1).

7. The ITO held that by giving up the diesel engine manufacturing business the assessee business was not radically or at all affected. It continued to carry on its other business with no apparent mishap. According to the ITO, since the surrender of these licences had not affected the structure of the business of the assessee, he was required to hold that Rs. 24 lakhs received from PAL by the assessee was income in the hands of the assessee.

8. The assessee carried the matter further, but the AAC supported the views, of the ITO. The AAC was of the view that the machinery had been sold under the agreement much below the written down value and the sum of Rs. 24 lakhs could be said to have been paid substantially for the machinery, raw materials, etc. The AAC also approved of the footing which had found favour with the ITO and confirmed the ITO conclusion. According to the AAC, there were found effective licences involving foreign collaborations existing at the relevant time, namely:

(1) Meadows Diesel Engines 1955, M/s. Henry Meadows, U.K. (2) Lambretta Scooters 1955, M/s. Inocenti, Italy. (3) Clutch and Brake Main 1955, M/s. Automobiles and 4 others of U. S. S., Germany and Italy.

(4) Friction Materials 1954, World Beston, U.S.

9. There were other minor licences for manufacture of items, but they did not involve foreign collaboration. According to the AAC, one of these four licence had been surrendered without affecting the structure of the business as see from the subsequent performance. According to the AAC, the ITO, was, therefore, right in holding that the amount of Rs. 24 lakhs was liable to be considered as a revenue receipt and taxable as such.

10. The assessee carried the matter before the Tribunal. The Tribunal in an exhaustive, well-reasoned and well-considered order upheld in toto the contentions of the assessee.

11. In the first place, the Tribunal completely rejected the finding of the AAC that Rs. 24 lakhs represented the value of the machinery the consideration for which had been understated in the agreement between API and PAL. As Mr. Joshi has not pressed the said aspect before us, we need not advert to the various reasons set out by the Tribunal in support of its conclusion, with which we fully agree.

12. The Tribunal thereafter considered several cases and the tests laid down therein. According to the Tribunal, it was assessee business and by giving up the licence that framework was affected. The Tribunal also did not agree with the finding of the AAC that the transaction was normal incident of the assessee business,. The Tribunal was of the view that the opportunity to make profits under the collaboration agreement taken in conjunction with the industrial licence was a capital right. Ultimately the Tribunal came to the conclusion that the amount of Rs. 24 lakhs received by surrendering or giving up this right was a capital receipt.

13. It is this latter conclusion of the Tribunal which is assailed by Mr. Joshi appearing on behalf of the Commissioner.

14. Although there are a number of Supreme court decision dealing with the questions whether a particular receipts can be properly regarded as a capital receipts or a revenue receipt, it will be sufficient for our purpose to refer to a few of them only. In CIT v. Vazir

Sultan & Sons [1959] 36 between the assessee and a cigarette manufacturing company by which the assessee gave up its right to receive the sole agency discount of 2% on goods sold outside Hyderabad State. For that it was paid a sum of Rs. 2,19,343 by way of compensation. It was held by the Supreme Court (by a majority) that this compensation was held by the Supreme Court (by a majority) that this compensation paid for the loss of agency in respect of the territory outside the Hyderabad State was a capital receipt in the hands of the assessee. Mr. Dastur, appearing on behalf of the assessee-company, drew out attention to the observation to be found at p. 187 of the report, which are as follows

"In the case before us the agency agreement in respect to territory outside the Hyderabad State was a such an asset of the assessee business as the agency agreement within the Hyderabad State and though expansion of the territory of the agency in 1939 and the restriction thereof in 1950 could very well be treated as granted of additional territory in 1939 and the withdrawal thereof in 1950, both these agency agreement constituted but one employment of the assessee as the sole selling agents of the company. There is nothing on the record to show that the acquisition if such agencies constituted the assessee's business or that these agency agreement were entered into by the assessee in type carrying on of any such business. The agency agreement in fact formed a capital asset of the assessee business worked or exploited by the assessee by entering into contracts for the sale of the Charminar cigarettes manufactured by the company to the various customers and dealers in the respective territories. This assets really formed part of the fixed capital of the assessee business. It did not constitute the business of the assessee of the assessee but was the means by which the assessee entered into the business transactions by way of distributing those cigarettes within the respective territories. If really formed the profit-making apparatus of the assessee business of distribution of the cigarettes manufactured by the company. If it was then neither circulating capital nor stock-in-trade of the business carried on by the assessee, it could certainly not be anything but a capital asset of its business and any payment made by the company as and by way of compensation for terminating or canceling the same would only be a capital receipt in the hands of the assessee."

15. We were also referred to [Godrej and Co. Vs. Commissioner of Income Tax, Bombay City](#) . The Supreme Court in the said case was considering whether the payment of Rs. 7,50,000 received by the assessee in the year 1947, in pursuance of a modification of the managing agency agreement by which the commission at the rate of 20% of the net profits receivable by it was reduced to 10% was income or capital. It was observed that the questions had to be determined by a consideration of all the attending circumstances. The conclusion of the Supreme Court was that as far as the assessee-firm was concerned, the amount of Rs. 7,50,000 was a compensation for the deterioration or injury to the managing agency by reason of the release of its right to get higher remunerations and, therefore, a capital receipt. On the other hand, where an assessee carried on business in a variety of agencies and deals in diverse lines, the acquisition or giving up or transfer of agencies can conceivably be regarded as being in the normal course of

business. On that footing, the amount of compensation received by it for such extinction or transfer could be regarded in the nature of income. In [Gillanders Arbuthnot and Co., Ltd. Vs. The Commissioner of Income Tax, Calcutta](#), it was observed that there was no immutable principle that the compensation received on the cancellation of an agency must always be regarded as capital. It was further observed that compensation paid for agreeing to refrain from carrying on competitive business in the commodities in respect of the agency terminated or for loss of goodwill is prima facie of the nature of a capital receipt. It may be pointed out at this juncture that in the agreement between API and PAL there is an express provision under art. "V" that for the remaining period of the licence granted by Meadows to API under the agreement dated on March 16, 1956, that is up to March 15, 1956, API shall not engage themselves in the manufacture, assembling or selling of automotive diesel engines or industrial diesel engines or both of a horse power approximating to the horse power to horse power of Meadows Engines which were hereafter to be manufactured by PAL.

16. In [Kettlewell Bullen and Co. Vs. Commissioner of Income Tax, Calcutta](#), the principle had been explained by the Supreme Court as under (p. 276):

"It is manifest that the principle, broadly stated in the earlier cases, that compensation for loss of office, or agency, must be regarded as a capital receipt has to been approved in later cases. An exception has been engrafted upon that principle that, where payment when if received for termination of an agency agreement, but the agency is one of many which the assessee holds, and the terminations of the agency does not impair the profit-making structure but is with the framework of the assessee business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken, the receipt is revenue and not capital."

17. The question which is required to be posed is whether termination of this activity was a necessary incident of the business of the assessee or did it impair the profit-making structure. The Tribunal after considering all the circumstances appears to have come to the correct conclusion that this was not a necessary incident of the business of the assessee and that extinction and surrender of the industrial licence and the collaboration agreement did impair the profit-making structure of the assessee. If that be so, this amount of Rs. 24 lakhs paid by PAL to API as compensation must be regarded as an amount received by the assessee as a capital receipt and not as a revenue receipt. As far as questions No. (1) is concerned, we are thus fully in accord with the conclusion of the Income Tax Appellate Tribunal.

18. In the result, question No. (1) is answered in the negative and in favour of the assessee.

19. As already stated, we refrain from giving any answer to question No. (2).

20. The Revenue will pay the costs of the reference to the assessee.