THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 29.01.2013

\+ **ITA No.1286/2008**

KHANNA AND ANNADHANAM ....Appellant

versus

COMMISSIONER OF INCOME TAX ....Respondent

Advocates who appeared in this case:

For the Appellant : Mr Ajay Vohra, Ms Kavita Jha and Mr Somnath Shukla, Advocates.

For the Respondent : Mr Sanjeev Sabharwal, Sr. Standing Counsel with Mr Puneet Gupta, Jr Standing Counsel.

CORAM:-
HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE R.V.EASWAR

JUDGMENT

R.V.EASWAR, J

1. This is an appeal filed by the assessee under section 260A of the Income Tax Act, 1961. On 08.09.2010, the appeal was admitted and the following substantial question of law was framed for decision: -

> "Whether the amount of ₹1,15,70,000/- received by the appellant from DTTI in terms of release agreement with DTTI is capital receipt or revenue receipt?"

2. The assessee is a firm of chartered accountants. From the year

1983, under an informal understanding it was getting referred work from M/s Gupta Chaudhary & Ghose, Chartered Accounts of Calcutta who were doing the work in Calcutta which was referred to them by Deliotte Haskins & Sells ('DHS'), a firm of chartered accounts based outside India. The understanding between the assessee-firm and the chartered accountants firm in Calcutta was limited to the work in Delhi and surrounding areas only. It may also be added that DHS was part of the chartered accountants firm by name "Deliotte Touche Tohmatsu International", based in USA. The informal understanding between the assessee and DHS was formalised on 14.08.1992 by an agreement between them. In 1996, it transpired that DHS wanted another firm of chartered accountants by name C.C. Chokshi & Co., of Bombay to represent its work in India. Accordingly an agreement was entered into on 14.11.1996 which was called a release agreement, under which the assessee firm was to no longer represent DHS in India; thereafter DHS would not refer any work to the assessee-firm. In consideration of the termination of the services of the assessee-firm, a compensation of US$ 325000 amounting to Indian ₹1,15,70,000/- was paid by DHS to the assessee-firm. This amount was received in the previous year relevant to

the assessment year 1997-98 and the short question before us is whether the receipt was capital in nature or was professional income.

3. The assessing officer took the view that the receipt was taxable as part of the professional income of the assessee-firm; his decision was reversed by the CIT (Appeals) and on further appeal by the revenue, the Tribunal agreed with the assessing officer. Hence, the present appeal by the assessee.

4. The contention put forward on behalf of the assessee is that the amount represents compensation for the sterilisation of a source of income, namely referred work from DHS through the Calcutta firm of chartered accountants and where an amount is received for loss of a source of income it would represent capital receipt. It was contended that the amount did not represent professional income. It is emphasised that for 13 years (1983-1996) the assessee-firm was carrying out the referred work which was quite lucrative and the arrangement with DHS through the Calcutta firm constituted the source and once that source got terminated, the compensation received can only be capital in nature.

5. We think that there is a good deal of force in the contention of the

assessee. In ***Kettlewell Bullen & Co. Ltd. v. CIT*****: (1964) 53 ITR 261** the Supreme court drew a distinction between the compensation received for injury to trading operations arising from breach of contract or from the exercise of sovereign rights and compensation received as solatium for loss of office. It was held that the compensation received for loss of an asset of enduring value would be regarded as capital. After a review of the entire case law on the subject, it was ultimately held as follows: -

> "*On an analysis of these cases which fall on two sides of the dividing line, a satisfactory measure of consistency in principle is disclosed. Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue : Where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt.*
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> *In the present case, on a review of all the circumstances, we have no doubt that what the assessee was paid was to compensate him for loss of a capital asset. It matters little whether the assessee did continue after the determination of its agency with the Fort William Jute Co. Ltd. to conduct the remaining agencies. The transaction was not in the nature of a trading transaction, but was one in which the assessee parted with an asset of an enduring value. We are,*

therefore, unable to agree with the High Court that the amount received by the appellant was in the nature of a revenue receipt."

6. The ratio of the above judgment applies to the present case. The Tribunal seems to have been troubled by the fact that despite the termination arrangement with DHS the assessee did not cease to carry on the profession. This aspect of the matter has also been answered by the Supreme Court in the above judgment and it has been held that the fact that the assessee continued its business or its usual operations even after termination of the agencies was of no consequence. What appears to be the ratio of the judgment is that if the receipt represents compensation for the loss of a source of income, it would be capital and it matters little that the assessee continues to be in receipt of income from its other similar operations.

7. We may refer to one more judgment of the Supreme Court which is reported as ***<u>Oberoi Hotel Pvt. Ltd. v. CIT</u>*: (1999) 236 ITR 903**. There the assessee was operating, managing and administering several hotels across the globe such as Cairo, Colombo, Kathmandu, Singapore, etc. Its agreement with Hotel Oberoi Imperial, Singapore, which it was operating

from 02.11.1970 was terminated and the assessee received a sum of ₹29,47,500/- from the receiver of the Singapore Hotel. The Supreme Court held that the amount was received because the assessee had given up its right to purchase or operate the property and thus it was a loss of a source of income. The receipt was accordingly held to be capital in nature. It was observed, after a review of the earlier cases, that ordinarily compensation for loss of office or agency is to be regarded as a capital receipt and the only exception where the payment received for termination of an agency agreement could be treated as revenue was where the agency was one of many which the assessee held and its termination did not impair the profit-making structure of the assessee, but was within the framework of the business, it being a necessary incident of the business that existing agencies may be terminated and fresh agencies may be taken. It is somewhat difficult to conceive of a professional firm of chartered accountants entering into such arrangements with international firms of chartered accountants, as the assessee in the present case had done, with the same frequency and regularity with which companies carrying on business take agencies, simultaneously running the risk of such agencies being terminated with the strong possibility of

fresh agencies being taken. In a firm of chartered accountants there could be separate sources of professional income such as tax work, audit work, certification work, opinion work as also referred work. Under the arrangement with DHS there was a regular inflow of referred work from DHS through the Calcutta firm in respect of clients based in Delhi and nearby areas. There is no evidence that the assessee-firm had entered into similar arrangements with other international firms of chartered accountants. The arrangement with DHS was in vogue for a fairly long period of time -13 years- and had acquired a kind of permanency as a source of income. When that source was unexpectedly terminated, it amounted to the impairment of the profit-making structure or apparatus of the assessee-firm. It is for that loss of the source of income that the compensation was calculated and paid to the assessee. The compensation was thus a substitute for the source. In our opinion, the Tribunal was wrong in treating the receipt as being revenue in nature.

8. On behalf of the revenue our attention was drawn to another judgment of the Supreme Court in ***CIT v. Best & Co. (P) Ltd.*****: (1966) 60 ITR 11**. This judgment was rendered by the same bench which had earlier rendered the judgment in ***Kettlewell Bullen & Co. Ltd.*** *(supra)*.

The decision was however in favour of the revenue. The earlier judgment in ***Kettlewell Bullen & Co. Ltd.*** *(supra)* was referred to in the judgment but the Supreme Court observed that the application of the principle laid down in ***Kettlewell Bullen & Co. Ltd.*** *(supra)* must depend on the facts of each case. Their Lordships distinguished the facts and held that in the case of ***Best & Co.*** *(supra)* the assessee had innumerable agencies in different lines and it only gave up one of them and continued to do business without any apparent mishap and that the correspondence showed that the assessee gave up the agency without any protest "presumably because such termination of agencies was part of the normal course of its business". It was on account of this distinction that the ultimate decision went in favour of the revenue. The facts of the case before us, as noted earlier, are not *in pari materia* with those in ***Best & Co. (P) Ltd.*** *(supra)*. In our view the facts are more akin to the case of ***Kettlewell Bullen & Co. Ltd.*** *(supra)* and, therefore, the ratio laid down in that case is more appropriate to be applied to the present case.

9. In the result we answer the substantial question of law by holding that the amount of ₹1,15,70,000/- received by the assessee in terms of the release agreement dated 14.11.1996 represents a capital receipt, not

assessable to income tax. The appeal of the assessee is allowed with no order as to costs.

R.V.EASWAR, J

BADAR DURREZ AHMED, J

JANUARY 29, 2013
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