* **THE HIGH COURT OF DELHI AT NEW DELHI**

Judgment Reserved on: 27.04.2011
% Judgment Delivered on:06.05.2011

\+ **ITR 38/1995**

CIT ..... APPELLANT

Vs

DALMIA DAIRY INDUSTRIES LTD. ..... RESPONDENT

Advocates who appeared in this case:

For the Appellant : Ms Prem Lata Bansal, Sr. Advocate with Mr Deepak Anand & Ms Ruchir Bhatia, Advocates
For the Defendant: Mr V.P. Gupta, Mr Basant Kumar & Ms Priya Deep, Advocates.

CORAM :-
HON'BLE MR JUSTICE SANJAY KISHAN KAUL
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes
2. To be referred to Reporters or not ? Yes
3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. The captioned reference has been preferred at the behest of the Revenue. The reference pertains to assessment year 1977-78 relevant for previous year ending on 30.09.1976. The Income Tax Appellate Tribunal (hereinafter referred to as 'Tribunal') by order dated 20.05.1994 has referred to us for adjudication the following question of law:

> *'Whether on the facts and in the circumstances of the case, the Tribunal is right in holding that surplus of Rs 58,32,100/- is not taxable in the assessee's total income?'*

2. The brief facts, in so far as they are relevant for adjudication of the aforementioned question, which are required to be noted (as gleaned from the orders passed by the authorities below), are as follows: The assessee entered into an agreement

dated 24.07.1962 (hereinafter referred to as 'Agreement') with one Mr E. Manekji of Karachi, Pakistan for sale of its two cement factories located at Karachi and at Dandot, Distt. Jhelum. The agreement envisaged that the purchaser, i.e., Mr Manekji would make the payment in cash or kind or both according to the procedure laid down.

2.1 In so far as the payment in kind was concerned the procedure laid down broadly envisaged that Mr Manekji would supply and deliver cement to the assessee in its factory in India equal to the value of the agreed purchase price. The supply of cement was to commence immediately after the receipt of instructions from the assessee for despatch of the same. The supplies had to be completed over a period of 3 years.

2.2 As is obvious the values of supplies made by Mr Manekji were required to be adjusted against the purchase price. In addition to the annual deliveries, the purchaser was also required to supply and deliver to the assessee a further quantum of cement in lieu of interest at the rate of 6% per annum on a weekly diminishing balance of the purchase price.

2.3 To secure performance of its obligations under the said agreement, the purchaser was required to furnish a bank guarantee from a scheduled bank having its office and business in India having approval of the assessee.

2.4 For the purposes of adjudication of the present reference it is not necessary to state in detail the other provisions of the agreement except to note that the purchaser did furnish a bank guarantee of the National Bank of Pakistan (in short 'NBP') for securing the supply of the agreed annual minimum quantum of cement to the assessee. The said guarantee was furnished on 30.09.1964.

2.5 It may also be noted that the benefits of the agreement, which enured in favour of Mr Manekji, were passed on to a private limited company by the name of Pakistani Progressive Cement Industries Ltd. (in short 'PPCIL') of which he was appointed the Managing Director. Consequent thereto, on the request of Mr Manekji a sale deed in respect of aforementioned factories was executed by the assessee on 30.09.1964 in favour of PPCIL.

2.6. It so happened, that the terms and conditions of the said agreement were not honoured by PPCIL. The reason being the 1965 and 1971 wars between India and Pakistan. With this the Government of Pakistan took recourse to emergency legislation, whereby amongst other prohibitive measures, not only orders were issued restraining the payment of dues to Indian nationals but also exports of cement to India was banned.

2.7 Consequently, both PPCIL and NBP refused to honour their obligation under the agreement. Being aggrieved the assessee referred its dispute for arbitration to the International Chamber of Commerce (in short 'ICC'), in terms of an arbitration clause, contained in the agreement.

2.8 Upon conclusion of the arbitration proceedings, two (2) awards dated 01.03.1971 and 03.03.1972, were passed in favour of the assessee. However, the arbitration awards were made subject matter of further legal proceedings. Proceedings were taken out both in the High Court at London as well as in the House of Lords. By virtue of the judgments passed by the High Court and the House of Lords on 04.05.1977 and 20.07.1977 respectively, the arbitration awards were upheld. The litigation on merits thus came to an end finally on 20.07.1977.

2.9. It is pertinent to note that, in the interregnum, NBP pursuant to the awards, had paid on 31.05.1976 to the assessee a total sum of £ 35,49,634/- towards sale consideration (qua the aforesaid factories), costs and interest. It may be noted that the interest paid spanned a period commencing from 01.10.1962 and ending on 03.05.1976.

3. It appears that the said sum was released to the assessee on a bank guarantee being furnished by the Barclays Bank in favour of NBP. The Barclays Bank, in turn, was secured by a counter bank guarantee furnished in its favour by the London branch of Bank of India. The assessee in order to give comfort to Bank of India kept the amount it had received from NBP, in satisfaction of the award, with the London branch of Bank of India, in the form of an interest bearing fixed deposit. The fixed deposit was made for an initial period of 18 months which ended on 11.07.1977.

3.1 It would be important to note at this stage, as recorded in the Assessing Officer's order, that by a communication dated 22.04.1980, the assessee was called upon to furnish the terms and conditions on which the said fixed deposit was made with the Bank of India. In response to the same, the assessee appears to have simply stated, vide letter dated 25.04.1980, that the fixed deposit carried an interest at the rate of 11.5% (we will presume that it is a simple rate of interest and that too per annum, as no other details are furnished), for a period of 18 months, and that if the assessee were to liquidate the fixed deposit it would be penalized. Importantly, the Assessing officer notes in his order that the actual terms and conditions of the fixed deposit were, however, not furnished by the assessee.

3.2 It is also pertinent to note that the revenue had issued show cause notice under Section 143(3) of the Income Tax Act, 1961 (in short 'I.T. Act') on 09.08.1979 which was followed by another notice on 14.09.1979, whereby it proposed to apply Rule 115 of the Income Tax Rules, 1962 (in short 'I.T. Rules'), as they stood prior to the amendment carried out on 01.11.1977, for the purposes of converting interest income received by the assessee in foreign currency from NBP. The application of the unamended rule to it, was challenged by the assessee, by way of a writ petition being CWP No. 1278/1978. By order dated 11.02.1980 this court evidently held that the revenue could not apply provisions of unamended Rule 115, to the assessee.

3.3 The Assessing Officer in the background of this development, which occurred during the course of assessment, thus applied the amended Rule 115 while, calculating the "surplus", which according to him accrued on the principal sum out of the money received from BNP, on account of fluctuation in the rate of foreign exchange. It may be noticed that in the assessment order the Assessing Officer has entered a caveat that, the amended Rule 115 was being applied subject to the revenue's right to carry the matter in appeal to the Supreme Court. At this juncture we may note that both counsels, have not been able to inform us, as to whether, as a matter of fact, the judgment of this court dated 11.02.1980 passed in CWP 1278/1978 was carried in appeal to the Supreme Court.

3.4. Be that as it may, the Assessing Officer came to the conclusion that a surplus, in the sum of Rs 58,32,100/- had accrued to the assessee which according to him had to be brought to tax. The calculation in that regard as contained in the assessment order is as follows:

> "principal amount under the Agreement dated 24.7.62 as fixed by Arbitrator: £ 18,21,721*
> Value of this amount in Indian rupees ***by applying Amended rule 115*** of the IT Rules, 1962: Rs 2,66,51,778/-
> Less principal being sale price of the two cement Factories as per books: Rs 2,08,19,678/-
> Rs 58,32,100/-"
>
> (* It may be noted that £ 18,21,721/- is the principal amount awarded out of the total sum of £ 35,49,634/- awarded to assessee by the arbitrators).

3.5. To complete the narrative, it appears that the assessee on maturity of the fixed deposit i.e., on 07.11.1977, received a sum of £ 41,65,860/-. Since the assessee was offered a better rate of interest, the said amount was once again deposited in the Bank of America and Citi Bank. The money was finally repatriated to India only on 15.11.1978.

3.6 The Assessing Officer in coming to the conclusion that the amounts were taxable inter alia returned broadly the following findings of fact :

(i) the amount received by the assessee on 03.05.1976 became its 'absolute property' subject to the assessee furnishing a bank guarantee;

(ii) the receipt of the amount could not be linked to the obligation of the assessee to furnish a bank guarantee;

(iii) the assessee was at liberty to remit the amount to India after the order of the High Court or in any case after the judgment of the House of Lords delivered on 20.07.1977;

(iv) the amounts which were initially kept in fixed deposit for a period of 18 months, on maturity, were invested once again with other banks and were finally remitted to India only on 15.11.1978;

(v). based on the above it cannot be said that the funds were kept in London out of compulsion;

(vi) furthermore, the assessee, therefore, could not link the bank guarantee furnished in favour of NBP to the money received by it. The assessee could have remitted the money to India at least immediately after a judgment was delivered by the House of lords on 20.07.1977; and

(vii) lastly, the argument of the assessee that the funds were blocked or immobilized could not be accepted.

3.6. It is pertinent to note that it is in this background that the Assessing Officer observed as follows: ***"It may be true that funds kept by assessee in London were not for any business purpose but in the light of the above discussion, it can also not be admitted that funds were kept in London on any capital account***."

3.7 In his order, the Assessing Officer also noticed another aspect, which was, that the assessee was apprehensive that if, the said money was remitted to India it may be attached by the revenue towards tax liability on account of interest accrued to it. In this respect some reference has been made to proceedings in the Calcutta High Court and the Tribunal pertaining to assessment year 1973-74. These aspects, however, do not concern us and therefore we are not elucidating upon them. Suffice it to say that the Assessing Officer thus concluded, that the surplus on account of the fluctuation in the rate of exchange, ought to be added to the income of the assessee being in the nature of revenue.

3.8. Being aggrieved, the assessee carried the matter in appeal to the Commissioner of Income Tax (Appeals) [in short 'CIT(A)']. The CIT(A) by order dated 22.05.1982 reversed the order passed by the Assessing Officer. The material observations in regard to the question in issue are made in paragraphs 21(a) to (c) and 22(a) to (b) of his order.

3.9. Against the order of the CIT(A) appeals to the Tribunal were preferred both by the revenue as well as the assessee. By the impugned judgment, the Tribunal dismissed the appeal of the revenue and partially allowed the assessee's appeal. What is relevant for our purposes is that in respect of the question at hand, the revenue's appeal was dismissed and the order of the CIT(A) in that regard was confirmed. The Tribunal has dealt with the said aspect in paragraph 52 of its judgment. Suffice it to say that the

Tribunal has affirmed the order of the CIT(A) by relying adverbatim on the observations contained in CIT(A)'s order to which reference has been made by us hereinabove. The revenue being aggrieved, as noticed above, has preferred the captioned reference.

4. Before us the arguments on behalf of revenue have been addressed by Ms Bansal, senior counsel assisted by Mr Deepak Anand, while on behalf of the assessee submissions were made by Mr V.P. Gupta.

4.1 Ms Bansal submitted that both the CIT(A) as well as the Tribunal had committed two errors. First, by holding that the principal amount £ 18,21,721/- was held in London on capital account. Second, (which according to her flowed from the first error) the application of the judgment of the Supreme Court in the case of ***Satluj Cotton Mills Ltd. vs CIT, West Bengal (1979) 116 ITR 1*** to the present case. Ms Bansal laid stress on the fact that the assessee's stand that it was forced to keep the amount in a bank account in London due to pending litigation had been found to be incorrect by the Assessing Officer. In this regard Ms Bansal relied upon the order passed by the Assessing Officer. She further submitted that the reference to the purported contradiction in the findings of the assessing officer by the CIT(A) in his order would be found to be without basis and completely erroneous if the observations of the Assessing Officer are read in continuum and in totality.

4.2 De hors the above, Ms Bansal further submitted, in the alternative, that in view of the fact that the litigation had finally culminated on 20.07.1977, i.e., on a day which fell in the subsequent assessment year (and not in the assessment year under consideration), the issue as to whether the surplus in the sum of Rs.58,32,100/- could be brought to tax ought to have taken up for consideration only in the succeeding assessment years. To this extent Ms Bansal conceded that the case may have to be remanded to the Tribunal for passing appropriate orders in the matter.

4.3. On the other hand Mr Gupta relied upon the judgment of the CIT(A) and the Tribunal to contend that no interference was called for. More specifically, Mr. Gupta submitted that both CIT (A) and the Tribunal had set aside the addition of surplus sum on

three grounds: First, that the principal sum of £ 18,21,721/- was kept on capital account i.e., was a capital asset. Second, the money lay unutilized in a fixed deposit and hence, was not used for business purposes. Third, that profit or loss would arise on account of appreciation or depreciation in the value of foreign currency only when, there was actual conversion of foreign currency. Since no such conversion took place, the surplus crystallized was a notional sum, which could not be brought to tax in the assessment year in issue. In rebuttal to the alternative submission of the learned counsel for the revenue, Mr. Gupta contended that since this court was called upon only to answer the question of law as framed, it could not issue a direction of the nature suggested by the revenue.

4.4 In support of his submissions, Mr Gupta relied upon the following judgments :-

CIT vs Tata Locomotive & Engg. Co. Ltd. (1966) 60 ITR 405; CIT vs Canara Bank Ltd (1967) 63 ITR 328; Liquidator of Mahamudabad Properties (P) Ltd vs CIT (1980) 124 ITR 31 and ***CIT vs J.V. Gupta & Sons (HUF) (2000) 241 ITR 861***.

5. Having heard the learned counsel for the parties and perused the record what emerges from the record is as follows:

5.1 The Tribunal in coming to the conclusion, which it did, has based it on deductions all of which according to us did not entirely flow from the record. The fallacy of the Tribunal in this regard is demonstrable from the following:

5.2 First, that the principal amount of £ 18,21,721/- was received by the assessee on capital account, that is, was a capital asset. Since it held so, it went on to conclude based on the principle enunciated in Satluj Cotton Mills (supra) that any appreciation or depreciation in the value of currency had to take the same colour. Therefore, the profit earned by the assessee, that is, a sum of Rs 58,32,100/- could not be brought to tax.

5.3 The second limb of its deductive reasoning was that since the principal sum remained “unutilized” in the form of a fixed deposit, in the bank, in London it was not used in the assessee’s business and hence, necessarily retained the character of a capital asset.

5.4 Lastly, the Tribunal held that since there was no conversion of foreign currency, in the assessment year in issue, notional profit could not be brought to tax.

6. In so far as the first two reasons supplied by the Tribunal are concerned, in our view, both are flawed.

6.1. As noticed above by us hereinabove, the Assessing Officer has categorically found that on receipt of money by the assessee on 03.05.1976, it was required to furnish a security to the NBP. This situation obtained evidently as a challenge had been laid to the award in the High Court of London. We may note that none of the parties have placed on record the orders, if any, of either the High Court at London or the House of Lords in that regard. Even if one were to assume that the money was released on a direction of the court, as a condition precedent, for the release of money in its favour, it cannot be said nor has it been shown that the fixed deposit was created at the behest of any direction of the English Courts. This was, as found by the Assessing Officer, perhaps a commercial call that the assessee had taken to secure the interest of the Bank of India which had furnished a counter guarantee in favour of Barclays Bank, who, in turn, as noticed by us, had furnished a guarantee in favour of NBP. Therefore, according to us, the Assessing Officer rightly found that it was not as if the monies received under the award had been blocked or immobilized and hence, could not be used for business purposes. Thus, the argument of the assessee which, found favour with the CIT(A) and the Tribunal that, since these were unutilized funds lying in fixed deposit they could not have been used for the purposes of business; does not find favour with us. It is precisely for this reason that we also find it difficult to accept the reasoning of both the Tribunal and the CIT(A) that £ 18,21,721/- was held by the assessee on capital account. If this reasoning were to fail, as it does, then the judgment of the Supreme Court in ***Satluj Cotton Mills*** *(supra)* would have no application.

6.2 The details of the transaction, as noticed above by us, based on the records of the case, would clearly establish that on furnishing a bank guarantee in favour of NBP the assessee was free to deal with the money any which way. The fact, however, remains

that there was uncertainity as to whether or not the assessee would receive any amount, i.e., whether or not the awards would be upheld and also as regards the exact extent to which the award would be sustained, i.e., the quantum of money that would be awarded to the assessee. The reasoning supplied both by the Tribunal as well as the CIT(A) that because a fixed deposit had been created with the London branch of Bank of India, the amount was held in capital account is not borne out from the evidence on record. The Assessing Officer's findings in this regard that the amount was not "immobilized" appear to be correct.

7. This brings us to the last limb of the Tribunal's reasoning: which is, that the profits, if any, could said to have arisen in favour of the assessee, only if, there was actual conversion of the monies received by the assessee is a principle with which, we agree. However, it is also been found as a fact that on the fixed deposit maturing the assessee received a sum equivalent to £ 41,65,860/- which was reinvested, and thereafter, remitted to India on 15.11.1978. Therefore, it is obvious that a conversion did take place. If that were so, whether or not profit or loss accrued to the assessee and to what extent, would depend upon whether appreciation or depreciation of foreign currency took place and to what extent. Noticeably relevant material as regards this aspect is not on record. However, what is certain is that consequent profit or loss on account of appreciation or depreciation in the value of currency could not have arisen in the assessment year in question. Thus, it would have to be found in favour of assessee that no profit arose in its favour in the assessment year in question.

7.1 It is thus obvious that the issue of taxability did not arise in the year in issue. However, whether it arose in the subsequent assessment year is an aspect which the Tribunal will have to examine and if necessary issue appropriate directions in that regard.

7.2 Mr Gupta learned counsel for the assessee when asked for details as to what happened in the subsequent assessment years, has not been able to supply us the information. In fact we had adjourned the matter on 26.04.2011 to ascertain the details with respect to the same. Mr Gupta has reported his failure to give us the necessary

information. In these circumstances we are of the view that even though we are required to answer the question of law as framed, there is no impediment in our directing the Tribunal to do the needful in the matter. Whether a court exercising powers under Section 256 of the I.T. Act, it could do so in a reference is in our view answered by the decision of this court in the case of ***Sushil Ansal vs CIT (2002) 254 ITR 42***. The matter is thus remanded to the Tribunal, to ascertain as to whether the assessee, on remittance of the proceeds to India earned any profit thereon? If so, to what extent? This direction is necessary as the question of law framed not only calls upon us to decide the principle but also the quantum. The surplus sum has been specifically indicated in the question itself. As noticed above by us, neither Mr Gupta nor Ms Bansal were able to enlighten us as to whether a special leave petition was preferred by the revenue against the order dated 11.02.1980 passed by this court in CWP 1278/1978. There are thus several imponderables. The Tribunal shall in this regard pass an appropriate orders including, if it is felt necessary, remand the matter to the Assessing Officer.

RAJIV SHAKDHER, J

SANJAY KISHAN KAUL,J

MAY 06, 2011
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