The Commissioner Of Income-Tax, West ... vs United Provinces Electric Supply ... on 17 April, 2000

Equivalent citations: AIRONLINE 2000 SC 170, 2000 (5) SCC 101, (2000) 244 ITR 764, (2000) 160 CUR TAX REP 248, (2000) 110 TAXMAN 134, (2000) 157 TAXATION 535, (2000) 3 SCALE 377, (2000) 4 JT 635, (2000) 3 SUPREME 384, (2000) 4 JT 635 (SC)

Bench: M.B.Shah, D.P.Wadhwa

PETITIONER:
THE COMMISSIONER OF INCOME-TAX, WEST BENGAL-I, CALCUTTA.

Vs.

RESPONDENT:
UNITED PROVINCES ELECTRIC SUPPLY COMPANY

DATE OF JUDGMENT: 17/04/2000

BENCH:
M.B.Shah, D.P.Wadhwa,

JUDGMENT:

Shah, J.

At the instance of revenue, two questions were referred to the High Court by the Income-tax Appellate Tribunal under Section 256(1) of the Income Tax Act, 1961 (herein referred to as the Act). First question for which leave to appeal was granted by this Court is as under: -

Whether, on the facts and in the circumstances of the case and on a proper interpretation of the provisions of the Indian Electricity Act, 1910, the Tribunal was right in holding that the addition of the sum of Rs.1,29,35,557/- under Section 41(2) of the Income-tax Act, 1961, in the assessment year 1965-66 was not justified?

The High Court answered the said question in favour of the assessee and against the revenue by holding that Section 41(2) of the Act does not and cannot come into play till the price is finally ascertained and in the facts of the case as the price of the undertakings of the assessee had not been finally determined and only an ad hoc payment has been made which has been accepted under protest, it was not open for the revenue to intervene and proceed to assess the assessee under Section 41(2) of the Act. Hence this appeal.

The aforesaid question arises for the assessment year 1965-66 i.e. relevant accounting year ending on 31.3.1965. Admittedly, the business of the respondent-assessee was of generating and of supply of electricity to the consumers. The assessee had two undertakings one at Allahabad and the other at Lucknow. By exercising power under Section 6 of the Indian Electricity Act, 1910, the Government of U.P. purchased both the undertakings for the UP State Electricity Board (Electricity Board for short). The possession of the undertakings was handed over to the Electricity Board w.e.f. 17.9.1964 and the Board paid Rs.62,60,668/- and Rs.41,35,398/- to the assessee as compensation for the compulsory purchase of the said undertakings respectively. Besides these payments, the Board also made certain adjustments in respect of assessees liabilities for loans and the final compensation paid to the assessee amounted to Rs.3,35,84,552/-. The assessee accepted the said amount without prejudice to its right to claim the compensation payable as provided under Section 7A of the Electricity Act, 1910. Thereafter, assessee went for arbitration for determining the compensation payable to it under the said Act. As the arbitrators failed to make any award, they referred the matter for decision to an umpire. It is alleged that Electricity Board moved the civil court at Lucknow and obtained an order of stay of the proceedings before the umpire.

The Income Tax Officer took the amount of Rs.3,35,84,552/- as sale proceeds of the depreciable assets of the assessee and as per the details given in his order computed the written down value of those assets at Rs.2,06,48,985/- and determined the profit of Rs.1,29,35,557/- under Section 41(2) of the Act and added the same to the income of the assessee. In appeal before the Appellate Assistant Commissioner, it was contended that no profit under Section 41(2) could be taxed in the assessment year under consideration because claim of the assessee for compensation was not settled during the year and that dispute was still pending before the arbitrators. The Appellate Asstt. Commissioner rejected the said contention. In further appeal, the Tribunal held as the compensation payable to the assessee was not settled and finalized, the ITO was not justified in making addition to the income of assessee under Section 41(2) in the year under consideration.

The High Court arrived at the conclusion that the assets of the assessee, namely, two undertakings had been sold within the meaning of Section 41(2) of the Act read with Section 32(1) thereof and the explanation therein. The High Court held that, hence, Section 41(2) to that extent is attracted but an assessment under Section 41(2) can only be made after the price at which the assets of the assessee had been sold is determined. As the price is not finally determined, it cannot be said that the amount which has been received by the assessee in respect of his two undertakings is a price at which the same had been sold. The Court further held that Section 41(2) does not envisage that an assessee would be assessed piece-meal as and when the amount on account of price is received. Hence the question was answered in favour of the assessee as stated above.

At the time of hearing of the appeal, Mr. K.N. Shukla, Sr. Advocate appearing for the revenue submitted that compensation amount is determined by the State and paid to the assessee, hence under Section 41(2) it would be assessable and taxable income as provided therein. It is his contention that merely because assessee has filed an application for enhancement of the compensation, it would not mean that the assessee has not received the compensation. According to his submission, it would be the income of the assessee during the relevant accounting year and, therefore, the order passed by the ITO was in accordance with the law. As against this, Mr. Joseph

Vellapally, Sr. Advocate appearing for the assessee submitted that the amount received by the assessee is not full and final payment towards the compensation. It is only ad hoc payment made by the State Government. That amount cannot be taken into consideration for the purpose of Section 41(2) of the Act. He relied upon the various decisions of the High Court in support of his contention.

For deciding the rival contention raised by the learned counsel for the parties, we would first refer to Section 41(2), which was in force at the relevant time. It reads as under: 41. Profits chargeable to tax.

(2) Where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceed the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax as income of the business or profession of the previous year in which the moneys payable for the building, machinery, plant or furniture became due:

> Explanation: For the purposes of this sub-section, the expression moneys payable and the expression sold shall have the same meanings as in sub-section (1A) of section 32.
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> Explanation to Section 32(1A) is :
>
> Explanation: For the purposes of this clause,--
>
> (i) moneys payable, in respect of any structure or work, includes
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> (a) any insurance or compensation moneys payable in respect thereof;
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> (b) where the structure or work is sold, the price for which it is sold; and
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> (ii) sold shall have the meaning assigned to it in the Explanation to clause (iii) of sub-section (1).

Explanation (2) to clause (iii) of sub-Section (1) of Section 32 gives following meaning to expression sold:

> sold includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian company;
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> Section 41 is under the heading Computation of Business Income. The entire section makes it abundantly clear that income arising as provided therein is to be considered as income of business or profession and is chargeable to income tax as income of

business or profession. Once it is held to be a business income unless provided otherwise it would be taxable in the previous year in which the same is received. Section 41(2) provides the method of calculating balancing charge. It inter alia states that where any building, machinery, plant or furniture is sold and moneys payable in respect of such building, machinery, plant of furniture exceed the written down value, so much of the excess as does not exceed the difference between actual cost and the written down value is chargeable to income tax as income of the business of the previous year in which the moneys payable became due. Explanation to the phrase moneys payable is wide enough and includes any compensation moneys payable in respect thereof. Similarly, the explanation sold includes a compulsory acquisition under any law for the time being in force. Hence, in case of acquisition of property under any law, the balancing charge under Section 41(2) is taxable to income-tax as income of the business of the previous year in which moneys payable became due. Question would be when moneys payable become due. Determination of compensation and its payment by the authority would certainly mean that moneys payable became due. Receipt of the compensation payable in respect of acquisition is a stage subsequent to its becoming due. In the present case, income has accrued and is actually received. The amount received is compensation amount in respect of acquisition of the property and is to be accounted for the purpose of income tax as income of the business of the previous year. For the market value determined by the authority if there is no difference or dispute, whatever amount is determined and paid would be compensation payable for the acquisition. That determination of the amount of compensation would mean moneys payable became due. However, in case of dispute or difference for the determination of the market value the matter is required to be determined by the arbitrator under Section 7A of the Indian Electricity Act but this would not mean that whatever the amount is determined and paid by the authority would cease to be compensation moneys payable. Pendency of proceeding for additional moneys payable would not be relevant so far as taxability of the compensation amount received is concerned. If additional amount is received in the subsequent year it would be a business income of that year. In the present case, presuming that the assessee is entitled to have additional amount than what is paid by the acquiring authority, yet for the purpose of tax, moneys payable became due and are paid and received. In case he gets any additional amount that would be taxable subsequently as profits in accordance with the provisions of the Act. This interpretation would be in-conformity with sub-sections (1) and (4) of Section 41. Sub- section (1) deals with allowance or deduction made in respect of loss, expenditure or trading liability incurred by the assessee and subsequently the assessee has obtained any amount in respect of such loss, expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him is deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year. Receipt of such amount may or may not be in the same year. It can be during more than one subsequent year. In such a case, it would be taxable in the previous year in which it is received. Similarly, sub-section (4)

provides for deduction allowed in respect of bad debt or part of debt and if the amounts of such bad debt or part thereof is subsequently recovered then it is to be taxed as profit as provided therein. This recovery of debt may not be in the same year. Further, considering the fact that this is to be deemed to be business profit, such receipt is to be taxed as income in the year in which it is received. In such situation, there is no question of piece-meal assessment as it is to be taxed when the amount on account of trading loss, bad debt or compensation is received.

The learned counsel for the assessee submitted that till the compensation amount is finally ascertained and determined, the amount received by the assessee is to be treated as ad hoc amount and after receipt of the ascertained final amount it would be taxable as a business income in the previous year in which the said amount is determined as in that year moneys payable became due. He submitted that there is a marked variation from the language of Section 10(2)(vii) of the 1922 Act. In the earlier Act, the balancing charge was chargeable in the year of sale. However, under the 1961 Act, the balancing charge is taxable only in the year of final determination of sale price. For this purpose, he referred to the Notes on Clauses to the Income Tax Bill, 1961 to contend that there is material change in the new provision. Clause 41(2) of the said Notes reads as under: This corresponds to the provisions contained in the second and fourth provisos to the existing section 10(2)(vii). The changes made here are verbal and seek to clarify that where the monies payable for sale or destruction are not determined in the year in which the sale, destruction etc. took place, the profit will be assessable in the assessment year in the previous year of which that sum is determined. The Explanation clarifies that the provisions of this sub-section will apply even if the business or profession is not in existence in the year in which the sums fall to be assessed The aforequoted object does not in any way advance the submission made by the learned counsel for the respondent. It is specifically stated that changes made are verbal and seek to clarify that in case moneys payable for sale are not determined in the year in which the sale took place, the profit will be assessable in the assessment year in the previous year of which that sum is determined. This object nowhere talks of final determination of compensation and this would not mean that as the assessee has the right to move the arbitrator for enhancement of the compensation, the compensation amount determined by the authority is not to be taken into account till the proceedings for enhancement are finalized. The moneys payable as per the explanation includes any compensation moneys payable in respect thereof. Hence, when compensation moneys payable is determined or fixed even though it is not received it would amount to moneys payable. Under the Explanation as quoted above, the expression moneys payable is defined to include compensation moneys payable in respect thereof. As discussed above, once the compensation is determined by the authority and is received by the assessee under protest and the dispute is referred to the arbitrator for its enhancement, it would not cease to be compensation moneys paid to the assessee. The amount so received by the assessee represents compensation in respect of acquisition of building, plant, machinery or furniture.

> The learned counsel for the assessee further submitted that as held by this Court in CIT, Bombay v. Bipinchandra Maganlal & Co. Ltd. [(1961) 41 ITR 291] capital receipts are taxed under the head, Profits and gains from business or profession by virtue of deeming fiction, but the receipts do not become business profits. He, therefore, submitted that notional receipt of profit is in the nature of capital receipt and as there is no provision or procedure in the Act for taxing it again after receipt of additional amount, it should be held that the amount becomes taxable only when the compensation is finally determined. In the said case, the Court dealt with similar provision Section 10 (2)(vii) of Income Tax Act, 1922 and observed that such income is notionally regarded as profit in the year in which the asset is sold and by a fiction it is regarded for the purpose of Act as income. The relevant part of the observation is as under: -

What in truth is a capital return is by a fiction regarded for the purposes of the Act as income. Because this difference between the price realized and the written down value is made chargeable to income-tax, its character is not altered, and it is not converted into the assessees business profits. It does not reach the assessee as his profits: it reaches him as part of the capital invested by him, the fiction created by section 10(2)(vii), second proviso, notwithstanding. The reason for introducing this fiction appears to be this. Where in the previous years, by the depreciation allowance, the taxable income is reduced for those years and ultimately the asset fetches on sale an amount exceeding the written down value, i.e., the original cost less depreciation allowance, the Revenue is justified in taking back what it had allowed in recoupment against wear and tear, because in fact the depreciation did not result. But the reason of the rule does not alter the real character of the receipt. Again, it is the accumulated depreciation over a number of years which is regarded as income of the year in which the asset is sold. The difference between the written down value of an asset and the price realized by sale thereof though not profit earned in the conduct of the business of the assessee is notionally regarded as profit in the year in which the asset is sold, for the purpose of taking back what had been allowed in the earlier years.

From the aforesaid observations, it is apparent that for the purpose of tax, the difference between the written down value of an asset and the price realized by sale thereof, though no profit is earned in conduct of the business of the assessee, is notionally regarded as profit in the year in which the asset is sold. Once it is held to be a business profit, then there is no question of treating it as a capital receipt and taxing it accordingly. Further, once it is a business profit as per the provision of the Act it is to be taxed on its accrual and it cannot be said that there is no provision for taxing the receipt of additional amount at a subsequent stage. As stated earlier, sub-sections (1) and (4) apparently contemplate receipt of amount as stated therein to be taxed in the year in which it is received and such recovery may be in one or more subsequent years.

Learned counsel further submitted that for the calculation of the deemed profit, it is necessary to know both the sale consideration of each asset as well as its written down value and in the year under consideration, the sale price of each individual asset is not known. Therefore, Section 41 cannot be applied by taking the overall compensation and reducing therefrom the overall written down value of depreciable assets as has been done by the I.T.O. He submitted that balancing charge

has to be calculated with respect of each individual asset. In support of his contention, he referred to the decision of this Court in C.I.T., Gujarat vs. Artex Manufacturing Co., {(1997) 6 SCC 437 : 227 ITR 278}.

In our view, in the present appeal, we are only concerned with the limited question which was referred to the High Court - whether on the facts and in the circumstances of the case and on interpretation of the provisions of the Indian Electricity Act, 1910, the provisions of section 41(2) of the Act are applicable to the receipts of the amount by the assessee towards the compensation payable to him? Therefore, additional question raised by the learned counsel for the appellant which depends upon facts, is not required to be dealt with or decided in this appeal. We also make it clear that we have not considered the effect of Section 7A of the Indian Electricity Act, 1910 as amended by the UP Act 14 of 1976 as the said question was not there before the High Court. Further, we would make it clear that it would be open to the assessee to raise these contentions before the competent authority.

Learned counsel further submitted that various High Courts have held that balancing charge can only be brought to tax in the year in which compensation is finally determined. For this purpose, he referred to Akola Electric Supply Co. Pvt. Ltd. v. Commissioner of Income Tax, Bombay City [(1978) 113 ITR 265]. In the said case, the Bombay High Court held that though taking over the possession might have vested the undertaking in the Electricity Board without a price being settled, the transaction became sale only when the price became settled and it was only after the price had been settled that it became due to the assessee; the moneys payable became due only when they were ascertained. These observations are made in the background of the fact that under the provisions of Section 7 of the Electricity Act, the property was acquired by the Bombay State Electricity Board and the possession was handed over on December 7, 1959 and as regards the payment, it was pointed out that the Board was not under obligation to make any payment till the sale value was determined. However as a measure of cooperation, Board agreed to make a provisional payment equivalent to 65 per cent of the book value on receipt of all assets. The provisional payment was made through a cheque on June 7, 1961. Ultimately by letter dated March 31, 1962, the sale value was fixed by mutual agreement. In that context, a question with regard to the taxability of balancing charge under Section 41(2) for the assessment year 1962-63 was determined by the High Court. In that case, assessee raised a contention that moneys payable became due when the vesting took place and the Board became owner of the Undertaking and its assets. Against that revenue contended that money payable became due after their determination. The Court negatived the said contention and accepted the contention of the revenue by referring to the decision rendered by the Delhi High Court in P.C. Gulati, Voluntary Liquidator, Panipat Electricity Supply Co. Ltd. v. CIT [(1972) 86 ITR 501 (Delhi)] and held that moneys payable became due when they were ascertained and not on the date of possession of the properties. In C.I.T., Delhi-II v. Rohtak Textile Mills Ltd., [(1982) 138 ITR 195 (Delhi)], the Delhi High Court followed its earlier decision and the decision rendered by the Bombay High Court.

In CIT, Karnataka v. Sheshappa Hegde [(1984) 150 ITR 164, Karnataka] the assessee had purchased two motor vehicles in 1973 and 1975. They were acquired by the Government under the Contract Carriage (Acquisition) Act, 1976 which came into force on January 30, 1976 and the vehicles were

taken over on the same day. For the assessment year 1976-77, the assessee filed a revised return claiming loss which included the cost of vehicle taken over by the Government. The Court held that the year of taxability under S. 41(2) is the year of receipt or the year in which it becomes due.

The learned counsel for the assessee further referred to the decision in Okara Electric Supply Company Ltd. v. CIT [(1985) 154 ITR 493]. In that case also, the Court followed P.C. Gulati and Akola Electricity Supply Co. cases (supra). The Court considered the fact that on January 4, 1959, Government took over all the assets of the Undertaking. A sum of Rs. 60,000/- was paid to the assessee in that regard on June 3, 1959. There was a dispute about the valuation of the assets acquired and ultimately by Memorandum dated November 18, 1963, the assets were revalued at Rs.2,02,781/-, but finally its valuation was determined in the accounting year 1966-67, i.e. between April 1, 1965 and October 26, 1965. In the light of that fact Court arrived at the conclusion that on the determination of the amount, the balancing charge would be includible in the assessment year 1966-67.

In CIT v. The Central Indian Electric Supply Co. Ltd. [(1993) 114 CTR (MP) 160], the Undertaking was taken over by the M.P. Electricity Board. The assessee was entitled to the market value of its undertaking taken over or purchased under the Act. The assessee for the accounting year in question, i.e. 1970-71 submitted a return showing its income as nil, although along with the return it had enclosed a balance-sheet showing therein the written down value of its assets acquired by the Board as also the compensation actually received by it from the Board. Revenue contended that the amount had become due for payment only when the decree in terms of the award was passed by the District Judge and the same having been passed in the relevant year, it was the case of income accruing to the assessee and could be brought to tax in the assessment year in question. The Court held that in the two expressions payable and due there is difference only of degree and time. The money is payable immediately on the date of acquisition or sale under the Act, but it becomes due for payment at some future date, if there is a dispute about the price. In the event of dispute about the price, quantification of the price is done only through the award of the arbitrator. The Court thereafter observed: -

the price due for payment to the assessee on the date of the passing of the decree was taxable in the relevant succeeding assessment year to the financial year, in which the decree was passed even though the amount under the decree may not have been actually paid or received by the assessee. In the scheme of IT Act, the taxable event is on accrual of income and not on actual receipt thereof. Pendency of litigation in respect of an amount or price due has no relevancy so far as the taxability of such accrued income is concerned. The likelihood of the income being reduced in the subsequent assessment year as a result of the litigation may give rise to resort to other remedies available in the Act for rectification and refund of the tax, but on that ground it cannot be held that no income had accrued to the assessee for the relevant assessment year. We find great support for our decision from the decision of the Supreme Court in the case of Kesoram Industries & Cotton Mills Ltd. vs. CWT {(1966) 59 ITR 767 SC)}. As for the wealth-tax so also the income-tax. The liability to pay income-tax arise in the relevant financial year on accrual of income in that year and if the income is ascertainable and quantified, it can be brought to tax in the relevant assessment year.

We agree with the observation of Madhya Pradesh High Court that Pendency of litigation in respect of an amount or price due has no relevancy so far as the taxability of such accrued income is concerned. The likelihood of the income being reduced in the subsequent assessment year as a result of the litigation may give rise to resort to other remedies available in the Act for rectification and refund of the tax, but on that ground it cannot be held that no income had accrued to the assessee for the relevant assessment year.

In CIT v. National Electric Supply and Trading Corporation Ltd. [(1996) 222 ITR 60, Delhi], the Government purchased the Undertaking on February 20, 1949 and the compensation was paid in the year 1949-50 and 1951-52. The Undertaking demanded additional compensation. The matter was compromised and the additional amount was paid on October 29, 1968. Applying the decisions in Okara Electric Supply Co. Ltd. and P.C. Gulati (supra), the Court held that the year of inclusion of the balancing charge would be when the moneys payable became due and the moneys payable could be held to have become due only when the same was ascertained.

From all the aforesaid cases dealt with by the High Courts, it is apparent that it was the contention of the assessee that the balancing charge is to be taxed in the year in which the undertaking is taken over. As against the revenue contended that when the compensation amount is determined the balancing charge is to be taxed. In the present case, the amount of compensation is determined and is paid. As there is dispute with regard to the determination of the market price, the matter is referred to the arbitrator. Presuming that it is ad hoc payment in the sense that final compensation is not determined by the arbitrator or appellate authority still the payment is towards purchase price. Section 41(2) nowhere provides that such balancing charge would be taxable in which moneys payable are determined finally by the Arbitrators or the Appellate authority or such other authority provided under the Acquisition Act. Further, it is not the case of the assessee that pending final determination of the purchase price he has not accepted the said amount. Pendency of litigation for getting additional amount in respect of moneys payable has no relevancy so far as the taxability of accrual of income -compensation received- is concerned. Hence, in case where compensation amount and its receipt is admitted, which is business profit under Section 41(2), it is to be taxed in the previous year of its receipt.

In the result, appeal is allowed. The impugned judgment and order of High Court is quashed and set aside. The question referred is answered in favour of the revenue and against the assessee and it is held that tribunal erred in holding that addition of the sum of Rs.1,29,35,557/- under Section 41(2) of the Income-tax Act, 1961 in the assessment year 1965-66 was not justified.

Ordered accordingly. The parties shall bear their respective costs.