# The Commissioner Of Income Tax, Andhra ... vs Sirpur Paper Mills Ltd., Hyderabad on 19 January, 1978

## Equivalent citations: AIR1978SC509, [1978]112ITR776(SC), (1978)1SCC468, 1978(10)UJ66(SC), AIR 1978 SUPREME COURT 509, 1978 (1) SCC 468, 1978 TAX. L. R. 480, 1978 2 ITJ 176, (1978) 50 TAXATION 75, 1978 SCC (TAX) 19, 1978 U J (SC) 127, 50 TAXATION 75, 112 ITR 776, 1978 2 SCJ 169, AIR 1978 SUPREME COURT 767

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## Bench: M.H. Beg, D.A. Desai, P.N. Bhagwati

JUDGMENT

P.N. Bhagwati, J.

1. This appeal by special leave is directed against a judgment of the High Court of Andhra Pradesh in an Income Tax Reference made at the instance of the Commissioner of Income Tax. There were five questions referred to the High Court for its opinion, but out of them only three survive for consideration in these appeals and hence we will state only so much of the facts as bear on those questions.

2. The first two questions relate to the assessment year 1962 63 for which the relevant account year is the year ending 30th June, 1961. During this accounting year there were two accidental fires in the factory of the assessee, one on 6th December, 1960 and the ocher on 21st March, 1961. The assessee carried on the business of manufacturing different varieties of paper in the factory and as a result of these two fires considerable damage was caused in the factory of the assessee. The first fire caused damage to the building, plant and machinery in Paper Machine shop No. III and the second fire in the Boiler House. The building, plant and machinery were all covered by fire insurance and in inspect of the loss caused, the assessee received an aggregate sum of Rs. 13,12,772/- by wav of compensation. This amount of Rs. 13,12,772/- included a sum of Rs. 9,41,070/- in respect of damage caused to the building, plant and machinery of Paper Machine Shop No. III. The assessee spent a sum of Rs. 1,57,813/ in carrying out repairs to the building, plant and machinery of Paper Machine Shop No III and restoring the same to working condition. This left a balance of Rs. 7,83,207/- in the band of the assessee and in the assessment of the assessee for the assessment year 1962-63 the question arose whether this amount was liable to be included in the total income of the asses-see as a revenue receipt. The Income Tax Officer took the view that this sum of Rs. 7,83,207/ went to reduce the cost of the capital assets of the assessee and he, therefore, diminished the written down value of the plant and machinery of Paper Machine Shop No. III with the result that the quantum of

depreciation and development rebate allowed to the assessee was reduced. This view was rejected by the Appellate Assistant Commissioner in the appeal preferred by the assessee, but what he held was that the sum of Rs. 7,83,207/- was not capital receipt in the hands of the assessee, but it partook of the nature of income from business and was, therefore, liable to tax, The assessee carried the matter in further appeal to the Tribunal. It was common ground between the parties at the hearing of the appeal before the Tribunal that the machinery or plant was partly damaged by fire and this damage has been repaired and the machinery and plant was recommissioned for the assessee's business of paper making. The Revenue, realising that Section 41, Sub-section (2) of the Income Tax Act, 1961 would be attracted only if the plant or machinery is "sold, discarded, demolished or destroyed and not where the plant or machinery is merely damaged, did not ugre before the Tribunal that the sum of Rs. 7,83,207/- received by the assessee was exigible to tax under Section 41, Sub-section (2). The Revenue merely invoked the analogy of the provision in Section 41, Sub-section (2) and contended that if the capital assets, instead of being demolished or discarded, are damaged by fire and then the assessee restores them to their original condition by repairing the damage, the compensation money received from the Insurance Companies in excess of the actual cost of repairs must necessarily be treated as a receipt incidental to the business of the assessee and hence liable to be taxed as income from business. This argument was negatived by the Tribunal which took the view that the entire sum of Rs 7,83,207/- represented receipt of capital nature and in the absence of any specific prevision of the Act it was not possible to say "how the surplus amount in this case, namely, Rs. 7,83,207/-representing the defence between compensation money received from the Insurance Companies for the damage caused to its capital assets and the actual expenses incurred for restoring them for use would amount to revenue profits or business profits". The Tribunal accordingly held that the sum of Rs. 7,83,207/- being capital receipt was not assessable to tax. This led to an application by the Revenue for a Reference and on the application, the following two questions were referred by the Tribunal for the opinion of the High Court:

> 1. Whether on the facts and in the circumstances of the case, the receipt of Rs. 7,83,207/- being part of the amounts received from the Insurance Companies by the assessee was a capital receipt or revenue receipt?
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> 2. If it is held to be capital receipt, whether on the facts and in the circumstances of the case the said sum of Rs. 7,83,207/- is deductable from the written down value of the plant and machinery as at the commencement of the accounting year relevant for the assessment year 1962-63?

The Revenue reiterated its cortention before the High Court that the sum of Rs. 7,83,207/- received by the assessee represented revenue receipt in its hands, but this contention was rejected by the High Court and it was held that this amount was in the nature of capital receipt. The Revenue then contended that even if this amount represented capital receipt in the hands of the assessee, it was exigible to capital tax by reason of Section 41, Sub-section (2). This contention was clearly a new contention sought to be urged for the first time before the High Court and it did not arise out of the order of the Tribunal nor was it covered by either of the two questions referred to the High Court. But even so the High Court entertained this contention and on an interpretation of Section 41, Sub-section (2) came to the conclusion that that provision had no application where a part of the

plant or machinery was sold, discarded, demolished or destroyed and it was only where the whole of the plant or machinery of which the actual cost could be predicated and in respect of which depreciation was allowable under the Act, was sold, discarded, demolished or destroyed that that provision could apply. The High Court took the view that since in the present case the whole of the plant or machinery was admittedly not destroyed by fire, but was merely damaged, Section 41, Sub-section (2) had no application and hence the sum of Rs. 7,83,207/- was not assessable to tax under that provision. The High Court accordingly answered both the questions referred to it against the revenue. The revenue thereupon preferred Civil Appeal No. 884 of 1970 with special leave obtained from this Court.

3. So far as the first question is concerned, it was not disputed on behalf of the Revenue that the sum of Rs. 7,83,207/- received by the assessee represented capital receipt in its hands and this question must accordingly be held to have been rightly answered by the High Court against the Revenue. But even if this be the position, contended the Revenue, the amount of Rs. 7,83,207/- was chargeable to tax under Section 41 Sub-section (2). The revenue submitted that the High Court was in error in taking the view that Section 41, Sub-section (2) has application only where the whole, and not merely a part, of the plant and machinery is sold discarded, demolished or destroyed and urged that though in the present case only a part of the plant and machinery was damaged, Section 41, Sub-section (2) was attracted and the entire sum of Rs. 7,83,207/- was exigible to tax. Now, it is difficult to see how this argument can at all be sustained on the facts found by the Tribunal. Section 41, Sub-section (2) postulates for its applicability that the plant or machinery, whether whole or part, is sold, discarded, demolished or destroyed. It can have no application whether the plant or machinery is merely damaged and by repairing the damage it is restored to working condition. Here, it was clearly found by the Tribunal, and that was in fact common ground between the parties, that the plant and machinery was partly damaged by fire and after repairing this damage, the plant and machinery was re commissioned for the factory. It was not the case of the Revenue, nor was it so found by the Tribunal that leaving aside the whole of the plant and machinery, even a part of it was sold, discarded, demolished or destroyed. There was, therefore, no scope for the applicability of Section 41, Sub-section (2) and in fact this provision was not even-invoke before the Tribunal by the Revenue. What the Revenue did was merely to invoke the analogy of Section 41, Sub-section (2) and the Tribunal rightly held that in the absence of specific provisions in the Act, the amount received by the assessee in respect of damage to the plant and machinery could not be brought to tax. It will, therefore, be seen that on the facts found by the Tribunal, Section 41, Sub-section (2) has no application at all and it was wholly unnecessary for the High Court to consider whether this provision would be attracted when only a part of the plant and machinery is sold, discarded, demolished or destroyed. It may be pointed out that in fact the question of applicability of Section 41, Sub-section (2) was not covered by the second question and no question was referred to the High Court raising the issue as to charge-ability of the amount of Rs. 7,83,207/- to tax under Section 41, Sub-section (2) since that was not an issued raised before the Tribunal. We cannot, therefore, countenance the argument of the Revenue that Section 41, Sub-section (2) applied in the present case and the amount of Rs. 7,83,207/ was assessable to tax under that provision. Both the questions referred by the Tribunal to the High Court must accordingly be answered against the Revenue.

4. The last question relates to the assessment year 1965-66, 1966-67 and 1967-68 for which the relevant amount years ended on 30th June, 1964, 30th June, 1965 and 30th June, 1966 respectively.

5. The assessee maintained a Guest House at Sirpur during each of the relevant account years and spent the respective sum of Rs. 44,428/- Rs. 26,428/- and Rs. 17,825/- on maintenance of the Guest House. The question arose in the assessments of assessee for the assessment years 1965-66, 1966-67 and 1967-68 whether these amounts openeded by the assessee on maintaining the Guest House were allowable as permissible deductions in computing the business income of the assessee. The claim of the assessee for deduction in each of the assessment years was negatived on the ground that the expenditure was in the nature of entertainment expenditure and was hence not allowable. The appellate Assistant Commissioner also took the same view in appeal and the matter had to be carried in further appeal to the Tribunal. Now, it appears that a similar claim for deduction in respect of expenditure incurred on maintenance of the Guest House was made in the assessment year 1961-62 and it was allowed by the Tribunal in Income Tax Appeal No. 9252 of 1967-68 and on a reference made at the instance of the Revenue the High Court, in Reference Case No. 93 of 1970 had taken the view that this amount was not in the nature of the entertainment expenditure so as to fail within the ambit of the proviso to Section 10(2)(xv) of the income Fax Act, 1922 and was, therefore, allowable as a permissible deduction. The appeals before the Tribunal in respect of the assessment years 1965-66, 1966-67 and 1967-68 came to be heard after the decision given by it in the appeal in respect of the assessment year 1961-62, but before reference Case No. 93 of 1970 came to decided by the High Court. The Tribunal, following its earlier decision in the appeal in respect of the assessment year 1961-62, held in each of the appeals before it that the expenditure incurred by the assessee on the maintenance of the Guest House was not in the nature of entertainment expenditure and was hence allowable as admissible expenditure. The Revenue, being aggrieved by the Order of the Tribunal, applied for a reference in each assessment year and on the application of the Revenue the following question of law was referred by the Tribunal for the opinion of the High Court.

Whether, on facts and in the circumstances of the case the amounts expended by the assessee for the maintenance of a guest house at Sirpur for each of the assessment years 1965-68, 1966-67 and 1967-68 is not entertainment expenditure?

The High Court, following its earlier decision in Reference Case No. 93 of 1978 agreed with the view taken by the Tribunal that the expenditure incurred on the maintenance of the Guest House was an allowable revenue expenditure and pointed out that was common ground between the parties that that decision covered the present case. The High Court accordingly answered this question in favour of the assessee and against the Revenue. The Revenue thereupon preferred Civil Appeals Nos. 885, 886 and 887 of 1974 with special leave obtained from this Court.

6. Now, it is obvious that the only question referred by the Tribunal in regard to the expenditure incurred by the assessee on the maintenance of the Guest House was whether such expenditure is Dot entertainment expenditure. The question proceeded on the assumption that if it is not entertainment expenditure, it would be allowable as a permissible deduction. It was not argued by the Revenue before the Tribunal that even if such expenditure is not entertainment expenditure, it would still not be allowable under Section 37, Sub-section (3) of the Income tax Act, 1961 and hence

no question, in general terms, was raised as to whether such expenditure was allowable as a deduction. But the question was limited only to the issue as to whether it was not entertainment expenditure Even before the High Court the only question raised was whether the expenditure on maintenance of the Guest House was not entertainment expenditure and it was common ground between the parties that the decision of the High Court in Reference Case No. 93 of 1970 in respect of the assessment year 1961 62 governed the determination of the question arising before the Tribunal. It is indeed surprising that the learned Counsel appearing on behalf of the Revenue did not urge before the Tribunal and even before the High Court that the decision of the High Court in Reference Case No. 93 of 1970 had no application in the present case because that was a decision given under the Indian Income Tax Act, 1922 whereas the question in the present case arose under the Indian Income Tax Act, 1961 where the relevant provisions was entirely different. We are constrained to observe that this was nothing but gross negligence on the part of the learned Advocate who represented the Revenue before the Tribunal and the High Court. When the only contention raised by the Revenue before the Tribunal was whether the expenditure incurred by the assessee on the maintenance of the Guest House was or was not entertainment expenditure and the Revenue conceded before the High Court that the determination of the question before it was concluded by the decision given in Reference Case No. 93 of the 1970, it is difficult to see how the Revenue can now be permitted to argue that this expenditure was not allowable as a permissible deduction under Section 37, Sub-section (3) of the Income Tax Act, 1961. It is not an aspect of the question which can be decided as a pure point of law because Section 37, Sub-section (3) provides that the expenditure incurred on the maintenance of the Guest House shall be allowed "only to the extent and to subject such conditions, if any as may be prescribed" and it would, therefore, have to be ascertained whether and to what extent the conditions prescribed by the Rules were satisfied in the present case and that would involve investigation of new facts. We cannot, therefore, permit the Revenue to raise this contention for the first time before us and the last question referred by the Tribunal must be answered against the Revenue.

7. We accordingly dismiss the appeals with costs.