Income Tax Appellate Tribunal - Hyderabad
Elegant Chemicals Enterprises ... vs Assistant Commissioner Of Income ... on 31 March, 2004
Equivalent citations: 2004 91 ITD 85 Hyd, 2004 271 ITR 56 Hyd, (2004) 85 TTJ Hyd 441
Bench: D Manmohan, J S Reddy
ORDER D. Manmohan, J.M.

1. This appeal filed at the instance of the assessee-company is directed against the order of CIT(A)-II, Hyderabad, and it pertains to the asst. yr, 1998-99,

2. Addition of Rs. 87,33,066/- made by the AO in the proceedings under Section 148 of the Act and confirmed by the CIT(A) is the subject-matter of dispute before us.

3. The facts of the case revolve in a narrow compass. In respect of the asst. yr, 1998-99, assessee declared total income of Rs. 15,15,242/- which was accepted by the AO in the proceedings under Section 143(l)(a) of the Act on 30th Sept., 1999. Subsequently, it was noticed that the company credited an amount of Rs. 87,33,056/- to the 'reserves and surplus account' by treating it as capital receipt. The said amount represents compensation received from M/s Procter & Gamble (I) Ltd. (hereinafter called "P & G Ltd."). On 9th Dec., 1999, survey was conducted at the business premises of the assessee-company. It was found during the course of survey that the assessee had embarked upon a project for manufacture of certain formulations for M/s P&G Ltd. Machinery and other equipment were purchased for manufacturing and supplying the formulations on job work basis. However, due to certain reasons, M/s P&G Ltd. did not go ahead with the job work contract and thus the assessee had to discontinue the project. The assessee-company requested M/s P&G Ltd. for payment of compensation for the losses suffered by it due to discontinuance of the project. Ultimately, in the year 1997, M/s P&G Ltd. agreed to pay compensation of a total sum of Rs. 1.08 crores. Though the assessee has declared a sum of Rs. 14,40,944/- and Rs. 7/- lakhs as income for the asst. yr. 1998-99, a sum of Rs. 87,33,056 received from M/s P&G Ltd. was not offered to tax on the ground that it was a capital receipt.

4. On the basis of material found at the time, of survey, the AO was of the puma facie view that a sum of Rs. 87.33/- lakhs received by the assessee has escaped assessment inasmuch as it is a revenue receipt. Accordingly, notice was issued under Section 148 of the Act on 16th Sept., 2000. In response to the said notice, the assessee filed a return of income and upon discussing with the assessee's Authorised Representative, the assessment was completed by the AO on a total income of Rs. 1,02,86,160/-. According to the AO, the compensation amount of Rs. 87,33,056/- is a revenue receipt.

5. Aggrieved, assessee challenged the order of the AO before the CIT(A)-II, Hyderabad, contending, inter aha, that the reopening of assessment is bad in law and the sum of Rs. 87.33/- lakhs received by the assessee was wrongly treated as revenue receipt. Detailed arguments were advanced before the learned CIT(A) with regard to the validity of reopening of assessment as well as the legality of addition made by the AO. The case of the assessee is that all the primary facts were on record before the AO even while processing the return under Section 143(l)(a) of the Act and thus there was full and true disclosure of the particulars concerning the receipt of Rs. 87.33/- lakhs. Thus, there is no

escapement of income so as to invoke the provisions of Section 148 of the Act. It was also submitted that the impugned amount was received as a compensation for sterilisation of capital asset resulting in extinction of the profit earning source and thus it is a capital receipt. At this juncture, the learned CIT(A) directed the Addl. CIT, Range-I, Hyderabad, to furnish a remand report. Pages 166 to 170 of the assessee's paper book contain the remand report. In short, the case of the Addl. CIT was that there is no written agreement between the parties and the correspondence between the assessee and M/s P&G Ltd. with regard to the claim of compensation amount shows that the assessee incurred expenditure in the form of interest, depreciation, etc., which are all in the Revenue field and the compensation was claimed towards reimbursement of such expenses. The agreement between the parties was terminated in the year 1996 itself after taking the trial production in the year 1995. By cancellation of the agreement, the trading structure of the assessee was not impaired because the assessee continued to supply other formulations, on job work basis, to M/s P&G Ltd. and thus the cancellation of the agreement did not result in loss of source of the assessee's business or cessation of business leading to destruction of the source of income. It was also pointed out, in the remand report, that even after termination of agreement the assessee continued to have the physical possession of assets and continued to claim depreciation and interest expenditure on borrowings relatable to the said assets. The assets purchased for the purpose of this project can be used for manufacture or production of formulations for others on job work basis. Therefore, the compensation received by the assessee is not for loss of assets or for destruction of assets but only for loss of profit which the assessee would have earned had the Latin American Project been continued.

6. On consideration of the rival submissions, the learned CIT(A) concluded that the abandonment of the project did not lead to sterilisation of assets and the business did not come to an end inasmuch as the manufacturing process of the assessee-company continued and in fact there are several assets which are commonly used in the process of manufacture of similar types of products. The fact that the assessee continued to claim depreciation on the plant and machinery was highlighted to come to the conclusion that there was no impairment of source of income, but the cancellation of contract resulted in loss of profit for which the compensation was received by the assessee.

7. With regard to the validity of reopening of assessment, the learned CIT(A) observed that the return of income filed by the assessee having been processed under Section 143(1) of the Act. Explanation 2 to Section 147 of the Act empowers the AO to reopen such case inasmuch as there was no previous assessment made; processing of return cannot be equated to an assessment. He also observed that as per Section 147, as amended w.e.f. 1st April, 1989, where an assessment is reopened within four years from the end of the relevant assessment year, it is not necessary for the AO to verify as to whether there was full and true disclosure of all the material facts or not and it would be sufficient if the AO has reason to believe that the income chargeable to tax has escaped assessment. Thus, on both counts, the assessment made under Section 143(3) r/w Section 147 of the Act was held to be in accordance with law.

8. Further aggrieved, assessee is in appeal before us. Learned counsel appearing on behalf of the assessee, strongly submitted that the reopening of assessment is not valid in law inasmuch as the assessee has filed return of income giving complete details of the compensation amount received,

which amounts to full and true disclosure of particulars. It was also submitted that the assessment was completed under Section 143(1) of the Act, upon verification of the details furnished by the assessee along with return of income. Reliance was placed on the decision of Hon'ble Punjab & Haryana High Court in the case of Vipan Khanna v. CIT (2002) 255 TTR 220 (P&H) and the decision in the case of CIT v. Kelvinator of India Ltd. (2002) 256 ITR 1 (Del)(FB) in support of the aforementioned contentions.

9. As regards the addition made by the AO, learned counsel submitted that the facts and the circumstances of the case were not properly appreciated by the tax authorities and a capricious view was taken for the purpose of making the addition. Learned counsel adverted our attention to pp. 20, 50 to 55, 195, 203 of the paper book and also p. 4 of the assessment order as well as p. 10. of the CIT(A)'s order to buttress his contention.

10. The learned counsel submitted that on 15th Dec., 1994, M/s P&G Ltd. has entered into an agreement whereby the assessee was to supply certain formulations, on job work basis, at Latin America on behalf of M/s P&G Ltd. On 8th Aug., 1995, the assessee was advised by M/s P&G Ltd. to purchase the following equipment before the end of October, 1995 :

(i) Shifter

(ii) Multi mill

(iii) V Cone blender

(iv) Compression machine 37 stations

(v) Neocoata

(vi) Blister pack

(vii) A/C However, vide letter dt. 10th July, 1996, M/s P&G Ltd. directed the assessee to discontinue the project. After considerable negotiations, M/s P&G Ltd. agreed to pay a total sum of Rs. 1,08,94,000/- in full and final settlement of the compensation out of which Rs. 21,16,944/- was offered to tax by the assessee as revenue receipt. The learned counsel submitted that the sum of Rs. 87,33,056/-was not offered to tax mainly because it was a compensation on account of sterilisation of capital assets which resulted in extinction of the profit earning source and thus it acquired the character of capital receipt. Learned counsel submitted that the assessee never carried on the business of manufacture and sale of specific formulations which were supposed to be supplied by the assessee to Latin America and it was completely a business venture undertaken by the assessee and upon abandonment of the said project, there was complete loss of source of earning from the said new business and any compensation received on that count would result in capital receipt. He also submitted that the plant and machinery which was purchased specifically for this purpose could not be utilised in the manufacture of other formulations and thus the assessee could not utilise the assets to its optimum upon discontinuance of the project. Reliance was placed on the decision of

Andhra Pradesh High Court in the case of CIT v. Barium Chemicals Ltd (1987) 168 ITR 164 (AP) in support of his contention that any amount received upon discontinuance of the project, whether partly or fully, would partake the character of capital receipt. He has adverted our attention to pp. 137 to 139 of paper book to submit that substantial investment was made towards purchase of the specified equipment for manufacture of the formulations required to be exported to Latin America and thus the amount can only be said to be received towards sterilisation of capital asset.

11. He has also raised an alternative contention by referring Expln. 10 to Section 43(1) of the Act. He submitted that the compensation amount was received to offset the loss to the assessee on account of sterilisation of capital assets and thus it is in the form of subsidy or reimbursement given towards purchase of capital asset. Consequently, the amount received goes to reduce the cost of machineries. Thus, it was contended that the impugned receipt is not taxable. It was also submitted that there was no intention on the part of the assessee to escape, from taxation but for the fact that it was a capital receipt. .

12. Interest charged under Section 234B of the Act was challenged by the assessee by placing reliance on the decision in the case of CIT v. Sedco Forex International Drilling Co. Ltd. (2003) 264 ITR 320 (Uttranchal).

13. On the other hand, learned Departmental Representative submitted that the reopening of assessment is valid in law inasmuch as it was not a case of reassessment within the meaning of Expln. 2 to Section 147 of the Act. It was submitted that the return of income filed by the assessee was originally processed under Section 143(1) of the Act which cannot be equated to 'assessment'. Reliance was placed OR the following decisions :

(a) Mahanagar Telephone Nigam Ltd. v. Chairman, CBDT (2000) 246 ITR 173 (Del)

b) A. Pusalal v. CIT (1988) 169 ITR 215 (AP)

(c) CIT v. Abad Fisheries (2002) 258 ITR 641 (Ker)

(d) Jorawar Singh Baid v. Asstt. CIT (1992) 198 ITR 47 (Cal)

(e) Pradeep Kumar Har Saran Lal v. AO (1997) 229 ITR 46 (Ah)

(f) Punjab Tractors v. Jt. GIT (2002) 254 ITR 242 (P&H)

(g) Bharat V. Patel v. Union of India (2004) 134 Taxman 178 (Guj).

It was also submitted that in order to reopen the assessment under Section 147 of the Act, it is not necessary for the AO to show that he exhausted the remedy of issuing the notice under Section 143(2) of the Act for making the regular assessment. His contention is that it is not correct to say that having missed to issue notice under Section 143(2), the AO cannot take recourse to Section 147 of the Act.

14. On merits of the addition, the learned Departmental Representative submitted that in order to appreciate as to whether the receipt is revenue in nature or not, it is necessary to appreciate as to whether there was sterilisation of assets or not. Learned Departmental Representative has taken us through pp. 166 to 169, 170 to 172 and 197 of paper book to submit that the claim made by the assessee within three weeks from the date of discontinuance of project reflects the mind of the assessee as well as the correct state of affairs. The claim made by the assessee vide letter dt, 2nd Aug., 1996, clearly indicates that the compensation claimed for was not on account of sterilisation of capital assets but only to compensate the expenditure incurred by the assessee and also for loss of profits. It was thus contended that the final letter dt. 17th April, 1997, was only an afterthought and there is no correspondence from M/s P&G Ltd. to show that the compensation amount was paid on account of sterilisation of capital assets. He further submitted that first of all there is no written agreement between the parties and, at any rate, the material gathered by the Revenue authorities as. well as the material furnished by the assessee do not indicate that there was any negative covenant debarring the assessee from carrying on manufacture of formulations which were agreed to be supplied to Latin America. He has also referred to pp. 20, 50 to 55, 115, 116, 124, 126, 203 to 206 of the assessee's paper book to submit that the assessee has continued to utilise the assets and also continued to carry on job work contracts, with regard to the various other formulations, with M/s P&G Ltd. and thus there was no loss of source of income; the entire claim was to recoup the revenue loss incurred by the assessee and entering into a job work agreement was only incidental to the business of the assessee. In substance, the contention of the learned Departmental Representative is that the letter dt. 17th April, 1997, setting the compensation amount is only a self-serving letter but if the overall circumstances and the earlier claims of the assessee are taken into consideration, it cannot be said that the sum of Rs. 87.33/- lakhs was received on account of sterilisation of capital assets. Reliance was placed on the decision of Hon'ble Supreme Court in the case of CIT v. Durga Prasad More (1971) 82 ITR 540 (SC) to submit that the entirety of the circumstances should be taken into consideration to appreciate the evidence. Learned Departmental Representative has also relied upon the following decisions to submit that the impugned amount is a revenue receipt :

(1) CIT v. Manna Ramji and Co. (1972) 86 ITR 29 (SC) (2) Blue Star Ltd. v. CIT (1996) 217 ITR 514 (Bom) (3) Indian Engg. & Commercial Corpn. v. CIT (1994) 205 ITR 1 (Bom) (4) CIT v. State Trading Corpn. of India (2001) 247 JTR 114 (Del) (5) CIT v. Manoranjan Pictures Corpn. (P) Ltd. (1997) 228 ITR 202 (Del).

With regard to the alternative contention of the assessee, learned Departmental Representative submitted that Expln. 10 to Section 43(1) does not apply to a revenue receipt. Therefore, learned CIT(A) has not considered ground No. 4 raised before him. He submitted that the compensation amount received by the assessee does not specifically indicate as to what is the amount reimbursed towards a specific asset and thus Expln. 10 would not apply, even otherwise. He has also distinguished the judgment of the Andhra Pradesh High Court in the case CIT v. Barium Chemicals Ltd. (supra) by submitting that the judgment was rendered under a different context.

15. Joining the issue, learned counsel submitted that the decisions cited by the learned Departmental Representative are distinguishable on facts and also submitted that a part of compensation was received towards reimbursement of cost and expenditure and, in fact, it was

offered to tax as revenue receipt. Thus, the specific amount received on account of sterilisation of capital assets cannot be treated as revenue receipt.

16. We have carefully considered rival submissions and perused the record. With regard to the jurisdiction of the AO to initiate proceedings under Section 148 of the Act, we are of the view that the amended provisions of Section 148/147 provide ample power to the AO to initiate reassessment proceedings when he is of the opinion that the income chargeable to tax has escaped assessment. Admittedly, in the instant case, the return of income was merely processed under Section 143(1) of the Act. The legislature in its wisdom has given two options to the AO, i.e., (a) accepting the return of income by merely processing it under Section 143(1) of the Act without making investigation and (b) taking up the case for scrutiny and to complete assessment under Section 143(3) of the Act. The return processed under Section 143(1) of the Act cannot be equated to 'assessment'. This point was considered in great details by the Hon'ble Delhi High Court in the case of Mahanagar Telephone Nigam Ltd. v. Chairman of CBDT (supra) and also by the Hon'ble Gujarat High Court in the case of Bharat Patel v. Union of India (supra). Merely because the AO has two options for reopening the matter processed under Section 143(1), non-exercise of option under Section 143(2) to correct the assessment made under Section 143(1) does not exclude AO's power to reopen the assessment under Section 147 of the Act, as has been held by the Hon'ble Andhra Pradesh High Court in the case of A. Pusalal (supra). The decisions cited by the learned counsel were not directly on the point. Consistent with the view taken by the Hon'ble Andhra Pradesh High Court and also in the light of Expln. 2 to s. 147 of the Act, we are of the view that the reopening of assessment is valid in law in the circumstances of the case. We accordingly uphold the order of the CIT(A) on this issue.

17. The assessee has also challenged levy of interest under Section 234B of the Act on the strength of the judgment of Hon'ble Uttranchal High Court in the case of Sedco Forex International Drilling Co. Ltd. (supra). It may be noticed that apart from the fact that the decision of Hon'ble Uttranchal High Court is distinguishable, the apex Court in the case of CIT v. Anjum M.H. Ghaswala & Ors. (2001) 252 ITR 1 (SC) held that interest under Section 234B is mandatory. No material was furnished before us to indicate as to how interest is not chargeable in this case. Under these circumstances, we reject the ground urged by the assessee.

18. This leaves us with the main issue, i.e., whether the amount of Rs. 87.33/-lakhs, received by the assessee is assessable as revenue receipt or has to be treated as 'capital receipt'. Whether the particular income arising on termination of contract is a 'capital receipt' or a 'revenue receipt', is a vexed question and the decision depends largely on the facts of each case. In the case of Barium Chemicals (supra), the jurisdictional High Court at p. 180 of its report held as under :

"There is no infallible test to draw a clear-cut demarcation between a capital receipt and a revenue receipt."

At p. 187, the Court observed as under:

"That in order to decide whether or not a payment is a revenue receipt, its true nature and substance must be looked into. The form in which it is expressed is not decisive. How the assessee treated the

payment is not conclusive of its nature".

It may not be out of place to mention that the Hon'ble High Court has treated the amount received by the assessee-company as a capital receipt by appreciating the facts of that case and observed in that regard, at p. 187 as under :

"The settlement dt. 22nd Feb., 1967, concluded between the assessee and the English company cannot be treated as one in the ordinary course of business carried on by the assessee. Installation of machinery and parts was not the business of the English company. It was the business of the English company. There has been a sterilisation of capital assets of the assessee in that the English company failed to erect the machinery and plant according to the original specifications....."

In the case of Blue Star Ltd. (supra), the Court based its judgment on the following principles :

(a) Where, on a consideration of the circumstances, a payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of the recipient's business nor deprives the recipient of what in substance is the source of income, termination of the contract being a normal incident of the business and such cancellation leaves the recipient of the amount free to carry on his trade, the receipt is 'revenue'.

(b) Where, by cancellation of agency, the trading structure of the assessee is impaired or such cancellation results in the loss of what may be regarded as the source of the assessee's income, payment made to compensate for such cancellation of agency is normally a capital receipt.

In the case of Manna Ramji and Co. (supra), the apex Court observed that in order to resolve the controversy as to whether a receipt is of revenue character or capital in nature one must try to ascertain the true nature and character of the payment. The Court further observed that in the borderline cases, the controversy has to be resolved in the light of facts and circumstances of each individual case. It was observed that on requisition of sheds by the Government, the assessee was not permanently deprived of source of income and the compensation represents the profit which the assessee would have earned during the years the premises were under requisition and thus there was no sterilisation and destruction of capital assets. In the case of Durga Prasad More (supra), the Court observed, at p. 545 of the report, as under :

"It is true that an apparent must be considered real until it is shown that there are reasons to believe that the apparent is not the real. In a case of the present kind a party who relies on a recital in a deed has to establish the truth of those recitals, otherwise, it will be very easy to make self-serving statements in documents either executed or taken by a party and rely on those recitals. If all that an assessee who wants, to evade tax is to have some recitals made in a document either executed by him or executed in his favour then the door will be left wide open to evade tax."

The Court further observed as under :

"The taxing authorities were not required to put on blinkers while looking at the documents produced before them. They were entitled to look into the surrounding circumstances to find out the reality of the recitals made in those documents "

At pp. 546 and 547 of the report, their Lordships further observed as under :

"Science has not yet invented any instrument to test the reliability of the evidence placed before a Court or Tribunal. Therefore, the Courts and Tribunals have to judge the evidence before them by applying the test of human probabilities."

19. Bearing in mind the well-settled legal principles referred to above, we proceed to analyse the facts of the case. Admittedly, the assessee is carrying on business of manufacture of various pharmaceutical formulations and carried on business of rendering job works. It is also not in dispute that the assessee-company entered into a job work contract with M/s P&G Ltd. for manufacturing and supply, in India, of Vicks-500. The source of income for the assessee is carrying on job work contracts. In the course of its carrying on its business, it entered into an agreement with M/s P&G Ltd. in 1994 for manufacture of new formulations for export to Latin America. As could be seen from the letter dt. 8th Aug., 1995, addressed by M/s P&G Ltd. to the assessee, the trial run was to begin in November, 1995 and regular commercial production from March, 1996, and the assessee was advised to go ahead to procure the equipments such as shifter, multi mill, etc., before the end of October, 1995. However, the books of account of the assessee indicate that the manufacture of Vicks Action-1000 by names, Vick Noctyl and Vick Diatyl, which was supposed to be supplied on trial run basis to the Latin America, took place during the month of May, 1995, itself and the same product was exported to Latin America vide invoice No. 139/A 144/CL on 22nd Sept., 1995. From the above, it is clear that the assessee-company has manufactured, on trial run basis, the new formulations without procuring extra machinery or assets. The letter dt. 8th Dec., 1999, of the assessee, addressed to the Dy. CIT, Comp. Cir-7{3), Hyderabad, also shows that the assessee-company already had business relations with the P&G Ltd. and by agreement with regard to the manufacture of two new formulations to be exported to Latin America, it only wanted to extend business relations and thus it cannot be said it is a new business altogether. By cancellation of the agreement, the assessee was merely deprived of the job work charges which it would have otherwise earned. Letter dt, 25th Jan., 2002, furnished before the Asstt. CIT (p. 11.5 of the paper book) also indicates that the assessee was in the business of manufacture of pharmaceutical formulations on job work basis to various principals. Merely because a particular contract for job work was terminated, it cannot be said that there is loss of what may be regarded as the source of the assessee's income; it can at best be termed as a normal incidence of the business.

20. It is not the case of the assessee-company that the assets which were acquired for manufacture of specific formulations were completely abandoned. On the contrary, the note by the assessee-company indicates that the assets could not be exploited to its optimum. In other words, the assets were neither sold nor discarded but put to use to the extent possible. It is be noticed that some of the machineries which were mentioned in the letter dt. 8th Aug., 1995, were already available with the assessee prior to the said date. For example, multi mill, which was advised to be purchased by the assessee for manufacture of two new formulations, was in fact available with the

assessee and purchased on 22nd July, 1994. Thus, it cannot be said that the plant and machineries which were purchased for the purpose of two new formulations were not useful for any other purpose in the course of carrying on its business of manufacture of other formulations on job work basis. In fact, the claim for compensation made by the assessee immediately after the termination of the contract, shows that the compensation was claimed towards reimbursement of expenses of revenue nature. The claim was made for a sum of Rs. 1.53/- crores and the detailed claim does not indicate that it was for sterilisation of capital assets. The claim was made within very short period from the date of the discontinuance of the project and thus the claim can be considered to be made on an analysis of actual facts. Under these circumstances, the later agreement dt. 17th April, 1997, cannot be accepted on its face value unless it is corroborated by some other evidence, as has been held by the Hon'ble Supreme Court in the case of Durga Prasad More (supra). As could be seen from answers to question Nos. 19 and 20, in the sworn statement of Sri Chedda, the compensation was claimed especially to recover the loss of profit. In response to question No. 23, Sri Chedda stated that there was substantial addition to the fixed assets because the company saw an opportunity in the liquid department and went ahead with updating the same. The totality of circumstances thus indicate that by cancellation of the agreement the trading structure of the assessee is not impaired and it is only a normal incidence of the business; for the loss of future profits, etc. the assessee was compensated. We are, therefore, of the firm view that the amount of Rs. 87,33,066/- received by the assessee from M/s P&G Ltd. is a revenue receipt, liable for taxation.

21. Learned counsel raised an alternative contention that the amount was received in the form of reimbursement of the cost of the assets and, therefore, it is a capital receipt. It may be noticed here that there is no evidence on record to indicate that the payment was towards reimbursement of cost of any asset. Since the learned CIT(A) held that the amount received is of revenue character, there was no need for him to consider as to whether it was towards reimbursement of cost of the assets. No bifurcation was furnished even before us to indicate that M/s P&G Ltd. has reimbursed a particular percentage of assets or a specific portion of each asset. Under these circumstances, we do not find any substance in the alternative contention of the assessee.

22. In the result, we uphold the order of the CIT(A) and dismiss the appeal filed by the assessee.