Supreme Court of India
Sutlej Cotton Mills Ltd vs Commr. Of Income Tax, West Bengal, ... on 27 September, 1978
Equivalent citations: 1979 AIR, 5 1979 SCR (1) 976
Author: P Bhagwati
Bench: Bhagwati, P.N.

PETITIONER:
SUTLEJ COTTON MILLS LTD.

Vs.

RESPONDENT:
COMMR. OF INCOME TAX, WEST BENGAL, CALCUTTA

DATE OF JUDGMENT27/09/1978

BENCH:
BHAGWATI, P.N.
BENCH:
BHAGWATI, P.N.
TULZAPURKAR, V.D.

CITATION:
1979 AIR 5 1979 SCR (1) 976
1978 SCC (4) 358
CITATOR INFO :
RF 1980 SC 680 (11)

ACT:
Income Tax Act, 1922-Secs. 10(1), 10(2)-Loss occasioned on account of devaluation-Whether deductible as revenue expenditure-Circulating capital and fixed capital.
The assessee is a Limited Company having its Head Office in Calcutta.

HEADNOTE:
It has inter alia a Cotton Mill situated in West Pakistan where it carries on business of manufacturing and selling cotton fabrics. For the accounting year relevant to the assessment year 1954-55, the assessee made a large profit in the unit in West Pakistan. The Pakistan profit, according to the official rate of exchange, which was then prevalent, namely, 100 Pakistani rupees being equal to 144 Indian rupees amounted to Rs. 1,68,97,232 in terms of Indian rupees. Since the assessee was taxed on accrual basis, the sum of Rs. 1,68,97,232 representing the Pakistani profit was included in the total income of the assessee for the assessment year 1954-55 and the assessee was taxed accordingly after giving double taxation relief in accordance with the bilateral agreement between India and

Pakistan. On 8th August, 1955, the Pakistani rupee was devalued and parity between Indian and Pakistani rupee was restored. The assessee thereafter succeeded in obtaining the permission of the Reserve Bank of Pakistani to remit a sum of Rs. 25 lakhs in Pakistani rupees out of the Pakistani profit for the assessment year 1954-55. The profit of Rs. 25 lakhs in terms of Pakistani rupees had been included in the total income of the assessee for the assessment year 1954-55 as Rs. 36 lakhs in terms of Indian rupees according to the then prevailing rate of exchange and, therefore, when the assessee received the sum of Rs. 25 lakhs on remittance of the profit of Rs. 25 lakhs in Pakistani rupees during the assessment years 1957-58, the assessee suffered a loss of Rs. 11 lakhs, in the process of conversion on account of appreciation of the Indian rupee qua Pakistani rupee. Likewise, in the assessment year 1959-60, a further sum of Rs. 12,50,000 was remitted by the assesses to India out of the Pakistani profit for the assessment year 1954-55 and suffered a loss of Rs. 5,50,000. The assessee claimed in its assessment for the year 1957-58 and 1959-60 that these losses of Rs. 11 lakhs and Rs. 5,50,000 should be allowed in computing the profit from business. The Income Tax Officer and the Tribunal disallowed the claim. On a reference to the High Court, the High Court took the view that no loss was sustained by the assessee on remittance of the amounts from West Pakistan and that in any event, the loss could not be said to be a business loss because it was not a loss arising in the course of business of the assessee but it was caused by devaluation which was an act of State. The High Court accordingly answered the question in favour of the Revenue and against the assessee.

Disposing of the appeals by special leave the Court,

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HELD: The first question that arises is whether the assessee suffered any loss on the remittance of Rs. 25 lakhs and Rs. 12,50,000. These two amounts admittedly came out of the Pakistani profit for the assessment year 1954-55 and the equivalent of these two amounts in Indian currency, namely, Rs. 36 lakhs and Rs. 18 lakhs respectively was included in the assessment of the assessee as part of Pakistani profit but by the time these amounts came to be repatriated to India, the rate of exchange had undergone change on account of devaluation of Pakistani rupee and, therefore, on repatriation, the assessee received only Rs. 25 lakhs and Rs. 12.50 lakhs in Indian currency instead of Rs. 36 lakhs and Rs. 18 lakhs. The assessee thus suffered a loss of Rs. 11 lakhs in one case and Rs. 5.50 lakhs in the other case. The fact that no loss was reflected in the books of the two accounts of the assessee was not a conclusive factor and the High Court ought not to have relied on it. It is now well-settled that the way in which entries are made by an assessee in his books of account is not determinative of the

question whether the assessee has earned any profit or suffered any loss. [981 A-D, 982 A-B C]

Commissioner of Income Tax v. Tata Locomotive Engineering Co., 60 I.T.R. 405 relied on.

The question arising in the case is whether the loss sustained by the assessee was a trading loss and if it was a trading loss whether it would be liable to be deducted in computing the taxable profit of the assessee under Sec. 10(1) of the Income Tax Act, 1922. The argument which found favour with the High Court was that because the devaluation was an act of the sovereign power, it could not be regarded as a loss arising in the course of the business of the assessee or incidental, to such business, is plainly erroneous. It is true that a loss in order to be a trading loss must spring directly from the carrying on of business or be incidental to it, but it would not be correct to say that where a loss arises in the process of conversion of foreign currency which is part of trading asset of the assessee, such loss cannot be regarded as a trading loss because the change in the rate of exchange which occasions such loss is due to an act of the sovereign power. [982 D-G]

Badri Das Dada v. C.I.T., 34 I.T.R., 10 relied on.

It is not the factor or circumstance which caused the loss that is material in determining the true nature and character of the loss, but whether the loss has occurred in the course of carrying on the business or is incidental to it. If there is a loss in trading asset, it would be a trading loss, whatever be its cause, because it would be a loss in the course of carrying on the business. If the stock in trade of a business is stolen or burnt the loss, though occasioned by external agency or act of God would clearly be a trading loss. Whether the loss suffered by the assessee is a trading loss or not, would depend on the answer to the query whether the loss is in respect of a trading asset or a capital asset. In the former case, it would be a trading loss but not so in the latter. The test may be formulated in another way by asking the question whether the loss is in respect of circulating capital or in respect of fixed capital. It is, of course, not easy to define precisely what is the line of demarcation between fixed capital and circulating capital but there is a well recognised distinction between the two concepts. Adam Smith in his 'Wealth of Nations' describes fixed capital as what the owner turns to profit by keeping it in his
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own possession and circulating capital as what he makes profit of by parting with it and letting in change masters. Circulating capital means capital employed in the trading operations of the business and the dealings with it comprise trading receipts and trading disbursements, while 'fixed capital' means capital not so employed in the business, though it may be used for the purposes of a manufacturing business but does not constitute capital employed in the

trading operations of the business. [982 H, 983 A-F]

Golden Horse Shoe (new) Ltd. v. Thurgood, 18 T.C. 280; approved.

Landes Bros. v. Simpson 19 T.C. 65; Davis v. Shell & Co. of Chine Ltd. 32 T.C. 133; Imperial Tobacco Co. v. Kelly; 25 T.C. 292; referred to with approval.

Commr. of Income-tax. Bombay City v. Tata Locomotive & Engineering Co. Ltd. 34 I.T.R. 10 approved.

Commr. of Income-tax, Mysore v. Canara Bank Ltd . 63 I.T.R. 308 approved.

It is clear from the authorities that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be trading profit or loss if the foreign currency is held by the assesses on Revenue account or as trading asset or as part of circulating capital embarked in the business. But if, on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature. [991 B-C]

In the present case, no finding has been given by the Tribunal as to whether the sum of Rs. 25 lakhs and Rs. 12.50 lakhs were held by the assessee in West Pakistan on capital account or Revenue account and whether they were a part of fixed capital or of circulating capital embarked and adventured in the business in West Pakistan. If these two amounts were employed in the business in West Pakistan and formed part of the circulating capital of that business, the loss of Rs. 11 lakhs and Rs. 5.50 lakhs resulting to the assessee on remission of these two amounts on account of alterations in the rate of exchange, would be a trading loss, but if instead these two amounts were held on capital account and mere part of fixed capital the loss would plainly be a capital loss. [991 C-E]

The Court was, therefore, unable to answer the question whether the loss suffered by the assessee was a trading loss or a capital loss. Ordinarily, the Court would have called for a supplementary statement of the case, from the Tribunal but since both the parties agreed that it would be proper that the matter should go back to the Tribunal with a direction to the Tribunal either to take additional evidence itself or to direct the Income Tax Officer to take additional evidence and make a report, the Court made an order accordingly and directed the tribunal to dispose of the case on the basis of the additional evidence and in the light of the law laid down in the Judgment. [991 E-H]

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal Nos. 1847- 1848/72.

From the Judgment and Order dated 30-4-1970 of the Calcutta High Court in Income Tax Reference No. 128 of 1966.

V. S. Desai, P. V. Kapur, S. R. Agarwal, R. N. Bajoria, A. T. Patra and Praveen Kumar for the Appellant.

J. Ramamurthy and Miss A. Suhbashini for the Respondent.

The Judgment of the Court was delivered by BHAGWATI, J.-These appeals by special leave are directed against a judgment of the Calcutta High Court answering the first question referred to it by the Tribunal in favour of the Revenue and against the assessee. There were in all five questions referred by the Tribunal but questions Nos. 2 to 5 no longer survive and these appeals are limited only to question No. 1. That question is in the following terms:-

> "Whether on the facts and in the circumstances of the case, the assessee's claim for the exchange loss of Rs. 11 lakhs for the assessment year 1957-58 and Rs. 5,50,000/- for the assessment year 1959-60 in respect of remittances of profit from Pakistan was not allowable as a deduction?

Since there are two assessment years in regard to which the question arises, there are two appeals one in respect of each assessment year, but the question is the same. W will briefly state the facts as that is necessary for the purpose of answering the question.

The assessee is a limited company having its head office in Calcutta. It has inter alia a cotton mill situate in West Pakistan where it carries on business of manufacturing and selling cotton fabrics. This textile mill was quite a prosperous unit and in the financial year ending 31st March, 1954, being the accounting year relevant to the assessment year 1954-55, the assessee made a large profit in this unit. This profit obviously accrued to the assessee in West Pakistan and according to the official rate of exchange which was then prevalent, namely, 100 Pakistani rupees being equal to 144 Indian rupees, this profit, which may for the sake of convenience be referred to as Pakistan profit, amounted to Rs. 1,68,97,232/- in terms of Indian rupees. Since the assessee was taxed on actual basis, the sum of Rs. 1,68,97,232/- representing the Pakistani profit was included in the total income of the assessee for the assessment year 1954-55 and the assessee was taxed accordingly after giving double taxation relief in accordance with the bilateral agreement between India and Pakistan. It may be pointed out that for some time, after the partition of India. there continued to be parity in the rate of exchange between India and Pakistan but on 18th September 1949, on the devaluation of the Indian rupee, the rate of exchange was changed to 100 Pakistani rupees being equal to 144 Indian rupees and that was the rate of exchange at which the Pakistani profit was converted into Indian rupees for the purpose of inclusion in the total income of the assessee for the assessment year 1954-55. The rate of exchange was, however, once again altered when Pakistani rupee was devalued on 8th August, 1955 and parity between Indian and Pakistani rupee was restored. The assessee thereafter succeeded in obtaining the permission of the Reserve Bank of Pakistan to remit a sum of Rs. 25 lakhs in Pakistani rupees out of the Pakistani profit for the assessment year 1954-55 and pursuant to this permission, a sum of Rs. 25 lakhs in Pakistani rupees was remitted by the

assessee to India during the accounting year relevant to the assessment year 1957-58. The assessee also remitted to India during the accounting year relevant to the assessment year 1959-60 a further sum of Rs. 12,50,000/- in Pakistani rupee out of the Pakistani Profit for the assessment year 1954-55 after obtaining the necessary permission of the Reserve Bank of Pakistan. But by the time these remittances came to be made, the rate of exchange had, as pointed out above, once again changed to 100 Pakistani rupees being equal to 100 Indian rupees and the amounts received by the assessee in terms of Indian rupees were, therefore, the same, namely, Rs. 25 lakhs and Rs. 12,50,000. Now, the profit of Rs. 25 lakhs in terms of Pakistani rupees had been included in the total income of the assessee for the assessment year 1954-55 as Rs. 36 lakhs in terms of Indian rupees according to the prevailing rate of exchange of 100 Pakistani rupees being equal to 144 Indian rupees and, therefore, when the assessee received the sum of Rs. 25 lakhs in Indian rupees on remittance of the profit of Rs. 25 lakhs in Pakistani rupees on the basis of 100 Pakistani rupees being equal to 100 Indian rupees, the assessee suffered a loss of Rs. 11 lakhs in the process of conversion on account of appreciation of the Indian rupee qua Pakistani rupee. Similarly, on remittance of the profit of Rs. 12,50,000 in Pakistani currency the assessee suffered a loss of Rs. 5,50,000/-. The assessee claimed in its assessments for the assessment years 1957-58 and 1959-60 that these losses of Rs. 11 lakhs and Rs. 5,50,000/- should be allowed in computing the profits from business. This claim was however rejected by the Income Tax Officer. The assessee carried the matter in further appeal to the Tribunal but the Tribunal also sustained the disallowance of these losses and rejected the appeals. The decision of the Tribunal was assailed in a reference made at the instance of the assessee and Question No. 1 which we have set out above was referred by the Tribunal for the opinion of the High Court. On the reference the High Court took substantially the same view as the Tribunal and held that no loss was sustained by the assessees on remittance of the amounts from West Pakistan and that in any event the loss could not be said to be a business loss, because it was not a loss arising in the course of business of the assessee but it was caused by devaluation which was an act of State. The High Court accordingly answered the question in favour of the Revenue and against the assessee. The assessee thereupon preferred the present appeal after obtaining certificate of fitness from the High Court.

The first question that arises for consideration is whether the assessee suffered any loss on the remittance of Rs. 25 lakhs and Rs. 12,50,000/- in Pakistani currency from West Pakistan. These two amounts admittedly came out of Pakistan profit for the assessment year 1954-55 and the equivalent of these two amounts in Indian currency, namely, Rs. 36 lakhs and Rs. 18 lakhs respectively. was included in the assessment of the assessee as part of Pakistan profit. But by the time these two amounts came to be repatriated to India, the rate of exchange had undergone change on account of devaluation of Pakistani rupee and, therefore, on repartition, the assessee received only Rs. 25 lakhs and Rs. 12,50,000/- in Indian currency instead of Rs. 36 lakhs and Rs. 18 lakhs. The assessee thus suffered a loss Rs. 11 lakhs in one case and Rs. 5,50,000/- in other in the process of conversion of Pakistani currency into Indian currency. It is no doubt true-and this was strongly relied upon by the High Court for taking the view that no loss was suffered by the assessee-that the books of account of the assessee did not disclose any loss nor was any loss reflected in the balance- sheet or profit and loss account of the assessee. The reason was that though, according to the then prevailing rate of exchange, the equivalent of Pakistani profit in terms of Indian rupee was Rs. 1,68,97,232/- and that was the amount included in the assessment of the assessee for the assessment year 1954-55, the

assessee in its books of account maintained at the Head Office did not credit the Pakistani profit at the figure of Rs. 1,68,97,232/-, but credited it at the same figure as in Pakistani currency. The result was that the loss arising on account of the depreciation of Pakistani rupee vis-a-vis Indian rupee was not reflected in the books of account of the assessee and hence it could not figure in the balance-sheet and Profit and Loss Account. But it is now well settled that the way in which entries are made by an assessee in his books of account is not determinative of the question whether the assessees has earned any profit or suffered any loss. The assessee may, by making entries which are not in conformity with the proper accountancy principles, conceal profit or show loss and the entries 10-699SCI/7 made by him cannot, therefore, be regarded as conclusive one way or the other. What is necessary to be considered is the true nature of the transaction and whether in fact it has resulted in profit or loss to the assessee. Here, it is clear that the assessee earned Rs. 36 lakhs and Rs. 18 lakhs in terms of Indian rupees in the assessment year 1954-55 and retained them in West Pakistan in Pakistani currency and when they were subsequently remitted to India, the assessee received only Rs. 25 lakhs and Rs. 12,50,000/- and thus suffered loss of Rs. 11 lakhs and Rs. 5,50,000/- in the process of conversion on account of alteration in the rate of exchange. It is, therefore, not possible to accept the view of the High Court that no loss was suffered by the assessee on the remittance of the two sums of Rs.25 lakhs and Rs. 12,50,000/- from West Pakistan. This view which we are taking is clearly supported by the decision of this Court in Commissioner of Income Tax v. Tata Locomotive Engineering Company (1) which we shall discuss a little later.

That takes us to the next and more important question whether the loss sustained by the assessee was a trading loss. Now this loss was obviously not an allowable deduction under any express provision of section 10(2), but if it was a trading loss, it would be liable to be deducted in computing the taxable profit of the assessee under section 10(1). This indeed was not disputed on behalf of the Revenue but the serious controversy raised by the Revenue was whether the loss could at all be regarded as a trading loss. The argument which found favour with the High Court was that the loss was caused on account of devaluation of the Pakistani rupee which was an act of the sovereign power and it could not, therefore, be regarded as a loss arising in the course of the business of the assessee or incidental to such business This argument is plainly erroneous and cannot stand scrutiny even for a moment. It is true that a loss in order to be a trading loss must spring directly from the carrying on of business or be incidental to it as pointed out by Venkatarama Iyer, j., speaking on behalf of this Court in Badri Das Dage v. C.I.T. (2) but it would not be correct to say that where a loss arises in the process of conversion of foreign currency which is part of trading asset of the assessee, such loss cannot be regarded as a trading loss because the change in the rate of exchange which occasions such loss is due to an act of the sovereign power. The loss is as much a trading loss as any other and it makes no difference that it is occasioned by devaluation brought about by an act of State. It is not the factor or circumstance which causes the loss that is material in determining the true nature and character of the loss, but whether the loss has occurred in the course of carrying on the business or is incidental to it. If there is loss in a trading asset, it would be a trading loss, whatever be its cause, because it would be a loss in the course of carrying on the business. Take for example the stock-in-trade of a business which is sold at a loss. There can be little doubt that the loss in such a case would clearly be a trading loss. But the loss may also arise by reason of the stock-in-trade being stolen or burnt and such a loss, though occasioned by external agency or act of God, would equally be a trading loss. The cause which occasions the loss would be

immaterial : the loss, being in respect of a trading asset, would be a trading loss. Consequently, we find it impossible to agree with the High Court that since the loss in the present case arose on account of devaluation of the Pakistani rupee and the act of devaluation was an act of sovereign power extrinsic to the business, the loss could not be said to spring from the business of the assessee. Whether the loss suffered by the assessee was a trading loss or not would depend on the answer to the query whether the loss was in respect of a trading asset or a capital asset. In the former case, it would be a trading loss, but not so in the latter. The test may also be formulated in another way by asking the question whether the loss was in respect of circulating capital or in respect of fixed capital. This is the formulation of the test which is to be found in some of the English decisions. It is of course not easy to define precisely what is the line of demarcation between fixed capital and circulating capital, but there is a well- recognised distinction between the two concepts. Adam Smith in his `Wealth of Nations' describes `fixed capital' as what the owner turns to profit by keeping it in his own possession and `circulating capital' as what he makes profit of by parting with it and letting it change masters. `Circulating capital' means capital employed in the trading operations of the business and the dealings with it comprise trading receipts and trading disbursements, while `fixed capital means capital not so employed in the business, though it may be used for the purposes of a manufacturing business, but does not constitute capital employed in the trading operations of the business. Vide Golden Horse Shoe (new) Ltd. v. Thurgood.,(1) If there is any loss resulting from depreciation of the foreign currency which is embarked or adventured in the business and is part of the circulating capital, it would be a trading loss, but depreciation of fixed capital on account of alteration in exchange rate would be a capital loss. Putting it differently, if the amount in foreign currency is utilised or intended to be utilised in the course of business or for a trading purpose or for effecting a transaction on revenue account, loss arising from depreciation in its value on account of alteration in the rate of exchange would be a trading loss, but if the amount is held as a capital asset, loss arising from depreciation would be a capital loss. This is clearly borne out by the decided cases which we shall presently discuss.

We will first refer to the English decisions on the subject for they are quite illuminating. The first decision to which we should call attention is that in Landes Brothers v. Simpson(1). There the appellants who carried on business as fur and skin merchants and as agents were appointed sole commission agents of a company for the sale, in Britain and elsewhere, of furs exported from Russia, on the terms, inter alia, that they should advance to the company a part of the value of each consignment. All the transactions between the appellants and the company were conducted on a dollar basis, and owing to fluctuations in the rate of exchange between the dates when advances in dollars were made by the appellants to the company against goods consigned and the dates when the appellants recouped themselves for the advances on the sale of the goods, a profit accrued to the appellants on the conversion of prepaid advances into sterling. The question arose whether this profit formed part of the trading receipts of the appellants so as to be assessable to tax. Singleton, J., held that the exchange profit arose directly in the course of the appellants' business with the company and formed part of the appellants' trading receipts for the purpose of computing their profits assessable to income tax under Case I of Schedule D. The learned Judge pointed out that "the profit which arises in the present case is a profit arising directly from the business which had to be done, because-the business was conducted on a dollar basis and the appellants had, therefore, to buy dollars in order to make the advances against the goods as prescribed by the agreements. The

profit accrued in this case because they had to do that, thereafter as a trading concern in this country re- transferring or re-exchanging into sterling." Since the dollars were purchased for the purpose of carrying on the business as sole commission agents and as an integral part of the activity of such business, it was held that the profit arising on retransfer or re-exchange of dollars into sterling was a trading profit falling within Case I of Schedule D. This decision was accepted as a correct decision by the Court of Appeal in Davis v. Shell & Co. of Chine Ltd.(2) We may then refer to the decision of the Court of Appeal in Imperial Tobacco Co. v. Kelly(1). That was a case of a company which, in accordance with the usual practice, bought American dollars for the purpose of purchasing in the United States, tobacco leaf. But before tobacco leaf could be purchased, the transaction was interrupted by the outbreak of war and the company had, at the request of the Treasury, to stop all further purchases of tobacco leaf in the United States. The result was that the company was required to sell to the Treasury and owing to the rise which had in the mean time occurred in the dollar exchange, the sale resulted in a profit for the company. The question was whether the exchange profit thus made on the dollars purchased by the company was a trading profit or not ? The Court of Appeal held that it was a trading profit includible in the assessment of the company under Case I of Schedule D and Lord Green, Master of the Rolls delivering the main judgment, said :

> "The purchase of the dollar was the first step in carrying out an intended commercial transaction, namely, the purchase of tobacco leaf. The dollars were bought in contemplation of that and nothing else. The purchase on the facts found was, as I say, a first step in the carrying out of a commercial transaction,-" "The Appellant Company having provided themselves with this particular commodity "namely, dollars" which they proposed to exchange for leaf tobacco, their contemplated transactions became impossible of performance, or were not in fact performed. They then realised the commodity which had become surplus to their requirements". When I say "surplus to their requirements" I mean surplus to their requirements for the purpose and the only purpose for which the dollars were acquired."
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> "In these circumstances, they sell this surplus stock of dollars : and it seems to me quite impossible to say that the dollars have lost the revenue characteristic which attached to them when they were originally bought, and in some mysterious way have acquired a capital character. In my opinion, it does not make any difference that the contemplated purchasers were stopped by the operation of Treasury or Governmental orders, if that were the case; nor is the case affected by the fact that the purchase was under a Treasury requisition and was not a voluntary one. It would be a fantastic result, supposing the Company had been able voluntarily, at its own free will, to sell these surplus dollars, if in that case the resulting profit should be regarded as income, whereas if the sale were a compulsory one the resulting profit would be capital. That is a distinction which, in my opinion, cannot possibly be made."
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> "To reduce the matter to its simplest elements, the Appellant Company has sold a surplus stock of dollars which it had acquired for the purpose of affecting a transaction on revenue account. If the transaction is regarded in that light, any trader

> who, having acquired commodities for the purpose of carrying out a contract, which falls under the head of revenue for the purpose of assessment under Schedule D, Case I, then finds that he has bought more than he ultimately needs and proceeds to sell the surplus. In that case it could not be suggested that the profit so made was anything but income. It had an income character impressed upon it from the very first."

This decision clearly laid down that where an assessee in the course of its trade engages in a trading transaction, such as purchase of goods abroad, which involves as a necessary incident of the transaction itself, the purchase of currency of the foreign country concerned, then profit resulting from appreciation or loss resulting from depreciation of the foreign currency embarked in the transaction would prima facie be a trading profit or a trading loss.

The last English decision to which we may refer in this connection is Davis v. The Shell Company of Chine, (supra). The Company made a practice of requiring its agents to deposit with the company a sum of money usually in Chinese dollars which was repayable when the agency came to an end. Previously the Company had left on deposit in Shanghai amounts approximately equal to the agency deposits, but because of the hostilities between China and Japan, the Company transferred these sums to the United Kingdom and deposited the sterling equivalents with its parent company which acted as its banker. Owing to the subsequent depreciation of the Chinese dollar with respect to sterling, the amounts eventually required to repay agency deposits in Chinese currency were much less than the sums held by the Company to meet the claims and a substantial profit accrued to the Company. The question arose whether this exchange profit was a trading profit or a capital profit. The Court of Appeal held that it was a capital profit not subject to income tax and the argument which found favour with it may be stated in the words of Jenkins, L. J., who delivered the main judgment :

> "I find nothing in the facts of this case to divest those deposits of the character which it seems to me they originally bore, that is to say the character of loans by the agents to the company, given no doubt to provide the company with a security, but nevertheless loans. As loans it seems to me they must prima facie be loans on capital, not revenue account; which perhaps is only another way of saying that they must prima facie be considered as part of the company's fixed and not of its circulating capital. As appears from what I have said above, the evidence does not show that there was anything in the company's mode of dealing with the deposits when received to displace this prima facie conclusion.
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> In my view, therefore, the conversion of company's balance of Chinese dollars into sterling and the subsequent re-purchase of Chinese dollars at a lower rate, which enabled the company to pay off its agents' deposits at a smaller cost in sterling then the amount it had realised by converting the deposits into sterling, was not a trading profit, but it was simply the equivalent of an appreciation in a capital asset not forming part of the assets employed as circulating capital in the trade."

Since the Court took the view that the deposits were in the nature of fixed capital, any appreciation in their value on account of alteration in the rate of exchange would be on capital account and that is why the Court held that such appreciation represented capital profit and not trading profit.

That takes us to the two decisions of this Court which have discussed the law on the subject and reiterated the same principles for determining when exchange profit or loss can be said to be trading profit or loss. The first decision in chronological order is that reported in Commissioner of Income-Tax, Bombay City v. Tata Locomotive and Engineering Co. Ltd. (supra). There the assessee, which was a limited company carrying on business of locomotive boilers and locomotives, had, for the purpose of its manufacturing activity, to make purchases of plant and machinery in the United States. Tata Ink, New York, a company incorporated in the United States, was appointed by the assessee as its purchasing agent in the United States and with the sanction of the Exchange Control Authorities the assessee remitted a sum of $ 33,850/- to Tata Ink, New York for the purpose of purchasing capital goods and meeting other expenses. The assessee was also the selling agent of Baldwin Locomotive Works of the United States for the sale of their products in India and in connection with this work, the assessee incurred expenses on their behalf in India and these expenses were reimbursed to the assessee in the United States by paying the amount to Tata Ink, New York. The assessee also earned a commission of $ 36,123/- as selling agent of Baldwin Locomotive Works and this amount received as commission was taxed in the hands of the assessee in the relevant assessment year on accrual basis after being converted into rupees according to the then prevailing rate of exchange and tax was paid on it by the assessee. Now these amounts paid by Baldwin Locomotive Works in reimbursement of the expenses and by way of commission were not remitted by the assessee to India but were retained with Tata Ink, New York for the purchase of capital goods with the sanction of the Exchange Control Authorities. The result was that there was a balance of $. 48,572.30 in the assessee's account with Tata Ink, New York on 16th September, 1949 when, on devaluation of the rupee, the rate of exchange which was Rs. 3.330 per dollar shot upto Rs. 4.775 per dollar. The consequence of this alteration in the rate of exchange was that the assessee found it more expensive to buy American goods and the Government of India also imposed some restrictions on imports from the United States and the assessee, therefore, with the permission of the Reserve Bank of India, repatriated $ 49,500/- to India. The repatriation of this amount at the altered rate of exchange gave rise to a surplus of Rs. 70,147/- in the process of converting dollar currency into rupee currency. The question arose in the assessment of the assessee to income tax whether that part of the surplus of Rs. 70,147/-, which was attributable to $ 36,123/- received as commission from Baldwin Locomotive Works was a trading profit or a capital profit. The matter was carried to this Court by the Revenue and in the course of the judgment delivered by Sikri, J., this Court pointed out that the answer to the question :

> "..... depends on whether the act of keeping the money, i.e., $ 36,123/02, for capital purposes after obtaining the sanction of the Reserve Bank was part of or a trading transaction. If it was part of or a trading transaction then any profit that would accrue would be revenue receipt; if it was not part of or a trading transaction, then the profit made would be a capital profit and not taxable. There is no doubt that the amount of $ 36,123.02 was a revenue receipt in the assessee's business of commission agency. Instead of repatriating it immediately, the assessee obtained the

> sanction of the Reserve Bank to utilise the commission in its business manufacture of locomotive boilers and locomotives for buying capital goods. That was quite an independent transaction, and it is the nature of this transaction which has to be determined. In our view it was not a trading transaction in the business of manufacture of locomotive boilers and locomotives; it was clearly a transaction of accumulating dollars to pay for capital goods, the first step to the acquisition of capital goods. If the assessee had repatriated $ 36,123.02 and then after obtaining the sanction of the Reserve Bank remitted $ 36,123.02 to the U.S.A., Mr. Sastri does not contest that any profit made on devaluation would have been a capital profit. But, in our opinion, the fact that the assessee kept the money there does not make any difference specially, as we have pointed out, that it was a new transaction which the assessee entered into, the transaction being the first step to acquisition of capital goods."

This Court held that the act of retaining $ 36,123/- in the United States for capital purposes after obtaining the sanction of the Reserve Bank of India was not a trading transaction in the business of manufacture of locomotive boilers and locomotives, but it was clearly a transaction of accumulating dollars to pay for capital goods, the first step in the acquisition of capital goods and the surplus attributable to $ 36,123/- was, therefore, capital accretion and not profit taxable in the hands of the assessee. It would, thus, be seen that the test applied by this Court was whether the appreciation in value had taken place in a capital asset or in a trading asset or in other words, in fixed capital or in circulating capital and since the amount of $ 36,123/-, though initially a trading receipt, was set apart for purchase of capital goods and was thus converted into a capital asset or fixed capital, it was held that appreciation in its value on conversion from dollar currency to rupee currency was a capital profit and not a trading profit. The position was the same as if the assessee had repatriated $ 36,123/- in the relevant assessment year in which it was earned and then immediately remitted an identical amount to the United States for the purchase of capital goods and profit had accrued on subsequent repatriating of this amount on account of alteration in the rate of exchange.

The other decision to which we must refer is the one in Commissioner of Income Tax, Mysore v. Canara Bank Ltd.(1). The assessee in this case was a public limited company carrying on the business of banking in India and it had opened a branch in Karachi on 15th November, 1946. After the partition in 1947, the currencies of India and Pakistan continued to be at par until the devaluation of the Indian rupee on September 18, 1949. On that day the Karachi branch of the assessee had with it a sum of Rs. 3,97,221/- belonging to its Head Office. As Pakistan did not devalue its currency, the old parity between Indian and Pakistani rupee ceased to exist. The exchange ratio between the two countries was, however, not determined until 27th February, 1951 when it was agreed that 100 Pakistani rupees would be equivalent to 144 Indian rupees. The assessee did not carry on any business in foreign currency in Pakistan and even after it was permitted to carry on business in Pakistani currency on 3rd April, 1951, it carried on no foreign exchange business. The amount of Rs. 3,97,221/, which was lying with the Karachi branch remained idle there and was not utilised in any banking operation even within Pakistan. On July 1, 1953, the State Bank of Pakistan granted permission for remittance and two days later, the assessee remitted the amount of Rs. 3,97,221/- to India. This amount, in view of the difference in the rate of exchange

became equivalent to Rs. 5,71,038/- in terms of Indian currency and in the process, the assessee made a profit of Rs, 1,73,817/- . The question arose in the assessment of the assessee whether this profit of Rs. 1,73,817/- was a revenue receipt or a capital accretion. Ramaswami, J., speaking on behalf of this Court, pointed out that the amount of Rs. 3,97,221/- was lying idle in the Karachi branch and it was not utilised in any banking operation and the Karachi branch was merely keeping that money with it for the purpose of remittance to India and as soon as the permission of the State Bank of Pakistan was obtained, it remitted that money to India. This money was "at no material time employed, expended or used for any banking operation or for any foreign exchange business". It was, to use the words of Ramaswami, J., "blocked and sterilised from the period of the devaluation of the Indian rupee upto the time of its remittance to India". Therefore, even if the money was originally stock- in-trade, it "changed its character of stock-in-trade when it was blocked and sterilised and the increment in its value owing to the exchange fluctuation must be treated as a capital receipt". Since the sum of Rs. 3,97,221/- was, on the finding of fact reached by the Revenue authorities, held on capital account and not as part of the circulating capital em-

barked in the business of banking, it was held by this Court that the profit arising to the assessee on remittance of this amount on account of alteration in the rate of exchange was not a trading profit but a capital accretion.

The law may, therefore, now be taken to be well settled that where profit or loss arises to an assessee on account of appreciation or depreciation in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be trading profit or loss if the foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. But if on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature. Now, in the present case, no finding appears to have been given by the Tribunal as to whether the sums of Rs. 25 lakhs and Rs. 12,50,000/- were held by the assessee in West Pakistan on capital account or Revenue account and whether they were part of fixed capital or of circulating capital embarked and adventured in the business in West Pakistan. If these two amounts were employed in the business in West Pakistan and formed part of the circulating capital of that business, the loss of Rs. 11 lakhs and Rs. 5,50,000/- resulting to the assessee on remission of these two amounts to India. On account of alteration in the rate of exchange, would be a trading loss, but if, instead, these two amounts were held on capital account and were part of fixed capital, the loss would plainly be a capital loss. The question whether the loss suffered by the assessee was a trading loss or a capital loss cannot, therefore, be answered unless it is first determined whether these two amounts were held by the assessee on capital account or on revenue account or on revenue account or to put it differently, as part of fixed capital or of circulating capital. We would have ordinarily, in these circumstances, called for a supplementary statement of case from the Tribunal giving its finding on this question, but both the parties agreed before us that their attention was not directed to this aspect of the matter when the case was heard before the Revenue Authorities and the Tribunal and hence it would be desirable that the matter should go back to the Tribunal with a direction to the Tribunal either to take additional evidence itself or to direct the Income Tax Officer to take additional evidence and make a report to it, on the question whether the sums of Rs. 25 lakhs and Rs. 12,50,000/- were held in West Pakistan as capital asset or as trading asset or, in other words, as part of fixed capital or part of circulating capital in the

business. The Tribunal will, on the basis of this additional evidence and in the light of the law laid down by us in this judgment, determine whether the loss suffered by the assessee on remittance of the two sums of Rs. 25 lakhs and Rs. 12,50,000/- was a trading loss or a capital loss.

We accordingly set aside the order of the High Court and send the case back to the Tribunal with a direction to dispose it of in accordance with the directions given by us and in the light of the law laid down in this judgment. There will be no order as to costs of the appeal. P.H.P. Appeals allowed and case remanded.