Supreme Court of India
C.I.T. Bombay City vs Bombay Burmah Trading ... on 16 July, 1986
Equivalent citations: 1987 AIR 500, 1986 SCR (3) 269
Author: S Mukharji
Bench: Mukharji, Sabyasachi (J)

PETITIONER:
C.I.T. BOMBAY CITY

Vs.

RESPONDENT:
BOMBAY BURMAH TRADING CORPORATION, BOMBAY

DATE OF JUDGMENT16/07/1986

BENCH:
MUKHARJI, SABYASACHI (J)
BENCH:
MUKHARJI, SABYASACHI (J)
SINGH, K.N. (J)

CITATION:
1987 AIR 500 1986 SCR (3) 269
1986 SCC (3) 709 1986 SCALE (2)277

ACT:
Income-tax Act, 1922, s. 10(2)(vii) Income-tax Act, 1961: 8. 41(2)
Assessee-Nationalisation of business-Compensation received from Government-Whether capital or revenue receipt-Compensation in kind in respect of deprecialble assets-Whether liable to tax-Fixed capital and circulating capital-distinction between.

HEADNOTE:
The assessee-Company, carrying on business of selling timber in India and abroad, entered into contracts in the nature of forest leases with the Government of Burma, under which it was authorised to fell teak trees, convert them into logs, and remove them after payment of royalty. These leases, which were made first in the year 1862, had been continuously renewed from time to time. Clause 27 of the agreement authorised the assessee-company even after the expiry of the lease period of 15 years to remove the logs in respect whereof extraction had been completed, upon payment of royalty during the next three years. At the relevant time the assessee-company was the owner of fifteen such forest leases. The last of these leases commenced on Ist January 1926 and 31st December, 1940 was the due date of expiry.

However, before the expiry of the period, the Second World War started and the Government of Burma extended them until such time as it became possible to resume forest operations. After formation of the Union of Burma, the ownership of the forest leases of the assessee-company was taken over by the Government of Burma in 1948-49; a third of the total teak area on June 1, 1948 and the rest on or about June 10, 1949. In terms of an agreement dated 10th June, 1949 between the parties the assessee made over to the Burmese Government its residuary rights under the forest leases together with the non-duty paid logs, wherever found, and also all the assets viz. buildings, dwelling houses, etc. pertaining to the forest leases and received 28,847 tons of teak logs in substitution of non-duty paid logs, 2,946 tons against depreciable assets and stores and 12,067 tons against livestock. The logs so received by the assessee com-
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pany were sold off by it from time to time in the accounting years 1949, 1950, 1951 and 1952.

The Income-tax Officer sought to bring these sale proceeds to tax by allocating them amongst the various assessment years. The questions that arose were: (i) whether the realisation in respect of substituted logs was exempt from tax as being a receipt of capital nature, and (ii) whether the sale proceeds in respect of logs received in lieu of depreciable assets, stores and livestock were liable to tax under the Act or were altogether free from liability. The Income-tax Officer, the Appellate Assistant Commissioner and the Tribunal held against the assessee. The High Court, however, answered the questions in favour of the assessee.

In these appeals by certificate under s. 66A(2) of the Income-tax Act, 1922 it was contended for the Revenue that the contracts entered into by the assessee company for obtaining its stock-in-trade in timber were trading contracts, that under cl. 27 of the agreements the assessee had no interest in land as such, it had only a right to collect and take away logs, its stock-in-trade, and it could not fell any fresh trees, that 28,847 tons of logs received by the assessee under the agreement were in substitution of the logs that it had already cut and had not been able to remove from the forests, merely as a recompense for its rights in the stock-in-trade, and that the excess realisation in respect of logs received against depreciable assets, stores and livestock were profits and liable to tax under s. 10(2)(vii) of the Income-tax Act, 1922.

For the assessee-respondent it was contended that the forest leases constituted the income producing capital assets of the company in which it had invested large funds in building dams, canals, roads, railways, buildings etc., that the forest leases were not ordinary commercial contracts made in the course of carrying on their trade or for the disposal of their products, these related to the whole structure of the assessee's profit making apparatus,

that the consideration for the logs received was the surrender of the residuary rights under the forest leases and acquisition of assets of the business under the take-over agreement, that the assessee was prevented from carrying on business upon the nationalisation of forest resources and acquisition of residuary rights and assets pertaining to the forest leases. It was further submitted that the compensation paid to the assessee was the sterilisation of the company's business and thus a capital receipt, not subject to tax.

Dismissing the appeals, the Court,

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HELD: 1.1. The forest leases constituted capital assets of the assessee. The payments made for cancellation or sterilization of the rights under these leases were, therefore, capital receipts and not liable to tax. [290E]

1.2. Whether in a particular case payments were capital receipts or not depends upon the facts and circumstances of the case. The basic principles are: if there was any capital asset and if there was any payment made for acuisition of that capital asset, such payment would amount to a capital payment in the hands of the payee. Secondly, if any payment was made for sterilization of the very source of profit making apparatus of the assessee, or a capital asset, then that would also amount to a capital receipt in the hands of the recipient. If on the other hand, the leases were merely stock-in-trade and payments were made for taking over the stock-in-trade then no question of capital receipt comes. The sum would represent payments of revenue nature or trading receipts. Compensation received for immobilisation, sterilization, destruction or loss, total or partial, of a capital asset would, therefore, be capital receipt. If a sum represented profit in a new form then that would be income but where the agreement related to the structure of assessee's profit-making apparatus and affected the conduct of business, the sums received for cancellation or variation of such agreement would be capital receipt. [286H; 287A-D]

In the instant case, the forest leases affected the very structure of the operation of the assessee. The compensation received for the cancellation of assessee-Company's activities could not be regarded as an income receipt, nor the legal character of the payment misjudged by the magnitude of the payment. [289A; 290C-D]

Glenboig Union Fireclay Co. Ltd. v. The Commissioner of Inland Revenue, 12 Tax Cases 427; Senairam Doongarmall v. Commissioner of Income-tax, Assam, 42 I.T.R. 392 at 406; Commissioner of Income-tax, U.P. v. Gangadhar Baijnath, 86 I.T.R. 19; Commissioner of Income-tax, Poona v. Manna Ramji and Co., 86 I.T.R. 29; Van Den Berghs Ltd. v. Clark (H.M. Inspector of Taxes), 3 I.T.R. 17 (English case): British Insulated & Helsby Cables Ltd. v. Atherton, [1926] A.C. 205; Hood Barrs v. Commissioners of Inland Revenue (No.2), 37 Tax

Cases 188; Commissioner of Income-tax, Hyderabad-Deccan v. Vazir Sultan & Sons, 36 I.T.R 175, referred to.

2. For levy of a balancing charge under s. 10(2)(vii) of the Income-tax Act, 1922 it was absolutely necessary that the depreciable
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assets should have been sold at a price agreed to between the parties. The agreement under which the assessee-company received logs by way of compensation in lieu of depreciable assets did not involve any transaction of sale between it and the Union of Burma. The assessee company never paid any money by way of a price in respect of assets delivered to it by the Government. Therefore, the sale proceeds of these logs could not be brought to tax against the assessee company under the second proviso to s. 10(2)(vii) of the Income-tax Act, 1922. [29 ID-F]

Commissioner of Income-tax v. Motors & General Stores (P) Ltd., 66 I.T.R. 692, referred to.

3. The logs delivered to the assessee company in respect of the depreciable assets, stores and livestock came into possession of the assessee in consequence of the agreement against surrender of all outstanding or residuary rights of the assessee to the Government. The arrangement was in consequence of nationalisation of forest operations. The fact is that the assessee company did not mix up these logs with any of the stock-in-trade held by it in its ordinary course of business. The sale proceeds of these logs could not, therefore, be held to have been received by the assessee company on revenue account. Consequently, the excess realisation received over the cost incurred in getting delivery of these logs was not liable to tax under the Act. [29 IG-H; 292A-C]

4. Nothing was paid by the Government to the assessee company in connection with 1/3rd area of the forest leases taken over from the assessee company. The assessee company had filed a suit in connection with the timber logs and stores taken over by the Government and succeeded in obtaining a decree. The sum awarded in the decree in lieu of the rights which the assessee company had under cl. 27 of the agreement could not, therefore, be taxed. [292F-G]

5. Normally in trade, there are two types of capital, one circulating and the other fixed. Fixed capital is what the owner turns to profit by keeping it in his own possession, circulating capital is what he makes profit of by parting with it and letting it change hands. What is capital assets in the hands of one person may be trading assets in the hands of the other. The determining factor is the nature of the trade in which the asset was employed. [287A-C]

JUDGMENT:

CIVIL APPELLATE JURISDICTION: Civil Appeal Nos. 1 of 1974 and 1355-1356 of 1973.

From the Judgment and Order dated 22/24.4.1970 of the Bombay High Court in I.T.R. No 111 of 1963 B.B. Ahuja and Miss A.Subhashni for the Appellant. F N Kaka, S.N. Talwar, Y. Chaudhary and H.S. Parihar for the Respondent.

The Judgment of the Court was delivered by SABYASACHI MUKHARJI, J. These appeals are from the judgment and order of the High Court of Bombay dated 22nd/24th April, 1970. These are by certificate granted by the High Court under section 66A(ii) of the Indian Income- tax Act, 1922. The judgment under appeal is reported in 81 I.T.R. at page 777.

The familiar yet not always easy to answer question whether a particular receipt is capital or revenue looms large in these appeals arising out of the assessment to income-tax for the assessment years 1950-51, 1951-52 and 1953-54, the accounting years respectively ending on 31st May, 1950,31st May, 1951 and 31st May, 1953.

The assessee is a public limited company limited by shares. It derived income from several sources including certain business operations. These operations were carried out in India and abroad and used to be carried out, inter alia, in Burma and Siam. The assessee company carried on business in Burma from 1862 onwards. In connection with its business of selling timber, the assessee-company had to enter into contracts which are mentioned as 'forest leases' with the Government of Burma. In the year of account ending on 31st May, 1950 the assesseecompany was the owner of about 15 forest leases. The agreed position between the parties was that all the forest leases contained provisions and clauses exactly similar to the speciman copy dated 28th October, 1925, which was taken into consideration by the High Court. It may be mentioned, however, that the forest leases were for the duration of 15 years and in respect of large areas. Under these leases, the assesseecompany was authorised to fell the teak trees and convert them into the logs and, upon completion of the extraction thereof, to remove the logs after payment of royalty to the Government of Burma for its own purposes. Clause 27 in these leases authorised the assessee-company even after the expiry of the period of 15 years of the lease to remove the logs in respect whereof extraction had been completed upon pay-

ment of royalty. The period for such removal under clause 27 was fixed at three years after the expiry of the lease period mentioned in clause 4. These leases contained renewal clauses. The forest leases of the assessee-company did not commence on the same date and related to different parts of the forests in Burma. These leases were made as mentioned hereinbefore, in 1862 first and had been continuously renewed from time to time.

It was stated that five similar business organisations obtained forest leases from the Government of Burma for their business in timber. Before the period of 15 years mentioned in these leases expired, the Second World War started and the Japanese army overran Burma. The then Government of Burma then extended the periods of current leases until such time as it became possible to resume forest operations and for such further periods as might be required for settlement of the new forest leases to be executed between these business organisations and the Government. Upon termination

of the hostilities, in connection with the resumption of the forest operations, the Government made provisional arrangements in terms of what is referred to in paragraph 7 of the statement of the case as "weight agreement". The Union of Burma came into existence from 4th January, 1948. Under section 44(2) of the Constitution of Burma, there was a directive for nationalisation, inter alia, of the forest exploitations. Thereafter correspondence took place, inter alia, between five European companies who were exploiting forests in Burma under the various leases and the Government in connection with the taking over of the exploitation by the Government of Burma. The High Court noted the relevant correspondence dealing with such arguments.

On 1st June, 1948, a third of the total teak area mentioned in the 15 forest leases of the ownership of the assessee-company was taken over by the Government of Burma. Forest exploitation in respect of the rest of the 2/3rds area was also taken over by the Government on or about 10th June, 1949. In that connection, certain correspondence had been addressed by the assessee-company to the Government. The Union of Burma on the one hand and the assessee-company and Steel Brothers & Company Ltd. on the other executed an agreement dated 10th June, 1949 on the footing that the forest leases had already been terminated. The agreement provided for making over by the assesseecompany to the President of the Government of Burma of the assessee- company's 'residuary rights' under the forest leases together with the non-duty paid logs wherever found and also for making over of all the assets pertaining to the forest leases, viz., headquarters, elephants, cattle, stores, buildings, dewelling houses, motor transport, tractors, launches, etc. and for certain other incidental matters. The agreement provided for handing over by the President of the Government of Burma the assessee-company of 50,000 tons of teak logs of the specified qualities mentioned in clause 7 of the said agreement. There was no dispute between the parties that in pursuance of the agreement the assessee-company had made over to the Government of Burma the assets mentioned in clause 1 of the agreement. There was also no dispute that in pursuance of the agreement the Government of Burma handed over in all 43,860 tons of logs to the assessee-company. There was no dispute that those 43,860 tons of logs were delivered against three kinds of assets in the following quantities:

(1) 28,847 tons against non-duty paid logs handed over by the asseessee-company to the Government.

(2) 2,946 tons against depreciable assets like land and buildings, launches, furniture and stores.

(3) 12,067 tons against livestock like elephants, etc. The account of these 43,860 tons of logs delivered by the Government was maintained by the assessee-company in what is described in the Income-tax Officer's report as "Burma forests assets realisation reserve account". These 43,860 tons of logs were sold off by the assessee-company from time to time in the accounting years 1949, 1950, 1951 and 1952. The aggregate sale proceeds during the above four years came to Rs.1,35,55,611 as appears from the assessment order which is annexed to the statement of the case. In connection with these sale proceeds, the Income-tax Officer stated that, as the receipts and sales of logs had taken place over a period of four years, the amount realised had to be allocated amongst the various years. He further stated that the basis of the allocations was agreed to by the assessee. He proceeded to make the allocation on the footing that the assessee had incurred costs for getting delivery of

these logs at the rate of Rs.225 per ton on 10th June, 1949. He then considered the proceeds realised and made the allocations for the assessment years 1950-51 and 1951-52 in the manner appearing in paragraph 9 of the statement of the case submitted to the High Court. Upon allocation made in the above manner, the Income-tax Officer's finding was that in the year ending 31st May, 1950, the assessee had received 18,676 tons of logs. The sale proceeds of Rs.65,52,153 were received in respect of non- duty paid logs delivered to the assessee-company. The sale proceeds of Rs.31,980 were received in respect of logs received against depreciable assets, stores and livestock. For the accounting year ending 31st May, 1951, the Income- tax Officer held that the assessee had received in all 16,299 tons of logs. The sale proceeds of those logs were allocated as follows:

"Rs.5,78,896 in respect of non-duty paid logs handed over by the assessee-company to the Government, Rs.2,69,975 in respect of the logs delivered against handing over of depreciable assets, stores and livestock." (81 I.T.R. p.

785.) The question that arose upon such allocations having been made in the manner indicated was as to whether the receipt of Rs.65,52,153 in the accounting year ending 31st May, 1950, and Rs.5,78,896 in the accounting year ending 31st May, 1951 was exempt from tax as being a receipt of capital nature as contended by the assessee-company. Similarly, the further question which arose was as to whether sale proceeds amounting to Rs.31,980 in the accounting year ending 31st May, 1950, and Rs.2,69,975 in the accounting year ending 31st May, 1951, in respect of depreciable assets were liable to tax under the Act or were altogether free from such liability. The Income-tax Officer as well as the Appellate Assistant Commissioner made findings against the assessee companies in connection with these amounts. On behalf of the assessee-company it was urged before the Appellate Tribunal that the entire receipt and delivery of the 43,860 tons of logs were on capital account. The submission was that the assessee's business of dealing in timber in Burma had got sterilized and the above quantity of logs was received only in respect of the said sterilization or loss of the capital asset. In connection with that submission, the Appellate Tribunal held against the assessee-company that the assessee's business had not stopped and there was no question of sterilization of its business. The forest leases owned by the assessee-company had expired and were not bound to be renewed and the "residuary rights" available to the assessee-company under clause 27 of the forest leases were merely rights to remove the extracted logs within a period of three years from the forest areas. The assessee-company had no interest in land of the forest areas.

The Tribunal, however, observed that though the agreement referred to certain residuary rights under clause 27 of the agreement there was nothing to show that any compensation was paid in respect of any rights available to the assessee under clause 27 of the lease agreement.

The contention that the realisations were in respect of capital assets was rejected. It was further held that the realisation in respect of logs received against depreciable assets, stores and livestock were profits and liable to tax. In calculating the profits it was held that the logs received by the assessee-company were received by it at the cost value of Rs.225 per ton.

After having recorded the findings in the aforesaid manner, the Tribunal referred to the High Court concerned, i.e., the High Court of Bombay, certain questions of law for the assessment year 1950-51

and 1951-52. The High Court felt that question No. 1 in both these assessment years need not be answered and this position was agreed to by the parties. The following questions for these two assessment years were really considered by the High Court:

> "I. Assessment year 1950-51:
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> .....
>
> 2. Whether, on the facts and in the circumstances of the case, the amount of Rs.65,52,153 or any part thereof was exempt from tax as being a receipt of a capital nature?
>
> 3. Whether on the facts and in the circumstances of the case, the amount of Rs.1,41,156 was liable to tax under the second proviso to section 10(2)(vii) of the Income-tax Act, and whether there was any evidence that the conditions of the application of that proviso were all satisfied?
>
> 4. Whether, on the facts and in the circumstances of the case, the amounts of Rs.5,250, Rs.1,025 and Rs.25,705, being the excess realisations over Rs.225 per ton for logs received in respect of depreciable assets, stores and livestock, respectively, were liable to tax under the Act?" "II. Assessment year 1951-52:
>
> 1.....
>
> 2. Whether, on the facts and in the circumstances of the case, the amount of Rs.5,18,896 or any part thereof was exempt from tax as being a receipt of a capital nature?
>
> 3. Whether, on the facts and in the circumstances of the case, the amounts of Rs.44,407, Rs.8,639 and Rs.2,16,929, being the excess realisations over Rs.225 per ton for logs received in respect of depreciable assets, stores and livestock, respectively, were liable to tax under the Act?"

Similarly for the assessment year 1953-54, the questions referred by the Tribunal to the High Court were as follows:

> "1. Whether, on the facts and in the circumstances of the case, the amount of Rs.5,58,188 or any part thereof was exempt from tax as being a receipt of a capital nature?
>
> 2. Whether, on the facts and in the circumstances of the case, the amount of Rs.9,493, being the amount of compensation received for stores acquired by the Burmese Government, was liable to tax under the Act?"

The High Court answered all these questions in favour of the assessee. The High Court answered for the assessment year 1950-51 the question 2 in the affirmative for the entire amount, questions 3 & 4 in the negative, for the assessment year 1951-52 the second question in the affirmative and question no. 3 in the negative. For the assessment year 1953-54 both the questions were answered in the affirmative. The revenue has come up in appeals.

In order to appreciate the controversy, broad features of the facts, some of which have been noted before, have to be borne in mind. The business in question of the assessee started in Burma in 1861. There were 15 agreements with the Government of Burma for exploitation of forests at the relevant time. The agreements were entered into at different times and provided for expiry of leases on different dates. At page 27 of the Paper Book a typical agreement dated 28th October, 1925 is indicated. Similar agreements were entered into for other leases. The terms provided, inter alia, as follows:

General rights "1. The Contractor shall within the series of of contractor: coupes into which the forest area described in Schedule I and hereinafter referred to as "the Concession Area" shall be subdivided as provided in clause 5 and during the periods for extraction there from prescribed in clause 6 and subject to such further conditions, limitations and restrictions as are hereinafter prescribed have the sole right and license to-

(a) fell the teak trees gridled or marked in that behalf by the officers of the Forest Department in accordance with the directions contained in clause 8 and any naturally dead standing teak trees;

(b) convert into logs all such trees all naturally felled teak trees and all felled teak timber left unloged from former operations; and

(c) remove all such logs and all logs were left unextracted from former operations:

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PROVIDED that is any area
to   which    a   scheme   for   concentrated
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exploitation accordance with any sanctioned working Plan has been applied the Contractor shall have no rights in standing teak trees under five feet six inches in girth measured at breast height from the ground.

Grant of other 2. The Government acting on behalf of the rights in Con- Secretary of State reserves to itself the cession Area. right to enter into agreements with other parties for the extraction of timber other than that which the Contractor is entitled to extract under this Agreement from the whole or from any part of the Concession Area."

The proviso to that clause need not be set out.

Clause 4(1) was as follows:

Period during 4. (1) This Agreement shall come into force which Agreementon the 1st day of January, 1926 and shall is in force unless previously terminated under clause 26 or clause 29 terminated after the expiry of a period of fifteen years; viz. on the 31st day of December, 1940;

PROVIDED that in respect of the rights conferred by clause 27 or by sub-clause (2) of this clause and in respect of very liability incurred under this Agreement it shall continue in force for such further period as is necessary for the enjoyment of such rights and the enforcement of such liabilities."

Clause 15 of the agreement authorises the assessee company to cut canals, make water courses, build bridges and other railway works etc. on certain conditions.

Clause 16 dealt with control of such private railways. Clause 18 dealt with the inspection etc. Other relevant clauses were, General respo- 19. Nothing herein contained shall be deemed nsibilities to relieve the Contractor, his agents and of Contractor. servants of the duty of complying with any Act of the legislature and of the rules thereunder at the time being in force and applying to the Concession Area.

20. With thirty days from the dates respectively on which measurement statements of timber have been furnished to the Contractor by the Forest Department the Contractor shall pay or to be paid into such Government Treasury as the Government may appoint royalty in respect thereof according to the following rate namely:

.... Clause 21 read as follows:

Marking of 21. The Contractor shall be entitled to have timber after the timber which has been measured for Measurement royalty marked at the time of measurement with a Government hammer-mark denoting that the timber has been so measured and after payment of such royalty the timber thus marked shall become the property of the Contractor."

Clause 23 was as follows:

"23. Until teak timber has been marked and royalties have Teak timber been paid thereon in accordance with the Goverment pro- preceding clause it shall be deemed to be perty up to property of the Government and the the payment Contractor shall have no right to sell of royalty. mortgage or hypothecate it or create any charge or lien thereon."

Clause 27 of the agreement provides as follows:

"27. On the conclusion of the period specified in clause 4 or on the termination of this agreement under clause 26 or clause 29, as the case may be,-

(a) the contractor shall be allowed a further period of three years for delivering at a measuring station and removing therefrom after payment of royalty on or otherwise

dealing as provided in clause 20 with any timber bearing his authorised hammer-marks the extraction of which has in accordance with the terms of this agreement been completed before the date such conclusion or termination and on the expiry of such further period he shall cease to have any rights whatever in timber not yet so delivered: Provided that the rates of royalty payable under this clause shall be the same as the rates fixed for the concession area under any new agreement whether with the present contractor or with other parties subsequent to this agreement or in the event of no new agreement being entered into at the rates of royalty set out in clause 20 of this agreement;

(b) the contractor shall be given such reasonable time as in the opinion of the Government may be necessary to allow him to dispose of such of his buildings, mills, railways or other structures erected for the purposes of his business under this agreement as are standing on land at the disposal of the Government."

Under clause 29 the Contractor was given the rights to terminate the agreement at any time by giving two years notice in writing.

On the 1st January, 1926, there was commencement of the agreement. 31st December, 1940 was the due date of expiry of the agreement. On 7th April, 1942, there was extension by the Government of Burma of the long term agreement till such time as it became possible H to resume forest operations and for such further period as might be required for settlement of new agreements. On 24th January, 1948, there was a letter by the Government of Burma to the assessee and others in connection with ending of joint working arrangements between consortium of 5 contractors on the one hand and Government of Burma on the other hand for exploitation of forests. On 4th February, 1948, there was the assessee's letter to the Government of Burma indicating their specific rights under the Forest Agreement in respect of logs in the course of extraction on termination of agreements.

on 10th February, 1948, the Burmese Government replied to the assessee's letter dated 4th February, 1948 informing that the normal period of currency of agreement had already expired, and the life of the agreement had been prolonged under letter dated 7th April, 1942 and also under the Weight Agreement which expired on 1st May, 1947. Government's decision to terminate long term pending lease negotiations and to terminate on 31st May, 1948 joint operations in the area intended to be taken over by Government and the Government's intention to consider any claims of residuary rights under the expiring agreements was also indicated to the assessee. On 10th June, 1949, there was an agreement between the President of Union of Burma and the assessee and Steel Bros., inter alia, dealing with the residuary rights under clause 27 of the 1925 agreement and the settlement to be made in respect thereof.

The agreement, inter alia, reiterated that whereas under lease under clause 27, there were certain residuary rights as we have noted hereinbefore, whereas certain questions had arisen in the settlement being made by the Government as regards the said rights as well as the assets of the lessees in the forest areas which the lessees desired to surrender to the Government, the parties had

agreed to resolve this question indicated under clause 1 therein. It is not necessary to set out the details here. These have been set out at pages 80-81 of the Paper Book.

We have set out the relevant portions of the material documents relied before the High Court. It may be mentioned that the High Court in its judgment has set out the discussion at page 793 of the report (81 I.T.R. 777) between the Government of Burma and the assessee company. The said discussion recorded is as follows:

> "The Government of Burma was always the grantor. Apparently this was so because the forests were always of the ownership of the Government. The Government was the single owner of all the forests. These forests were never intended to be transferred to any grantee at any time. The forest leases were always of duration of 15 years or more. They always related to extremely large areas which were sub-divided into large coupes. These coupes were also not to be worked at the same time, but according to schedule fixed in respect thereof. Each specified group of coupes was to be worked within three years. The extraction of the trees was to be completed within the fixed period of three years. The schedule fixed was compulsorily to be adhered to. The work of extraction was to be done in accordance with the rules prescribed for felling, logging and removal.

The Government was accordingly not a seller of any stock in-trade and the assessee was not a purchaser of any stock in-trade. The assessee undertook the obligations of various kinds so as to complete the work of extraction as indicated in the contract. The assessee had to maintain extremely large establishments and headquarters at various places and had in that connection put up various permises including dwelling houses and buildings. It had to maintain diverse sorts of mechanical appliances and had, inter alia, owned motor transport, tractors, launches, elephants, cattle and diverse assets for the purposes of working these forest leases. The Government was not concerned in any part of the operations, relating to the extractions done by the assessee from the contract area. It is of importance that the right of extraction and/or to fell, convert and remove that was given to the assessee was to be exercised in respect of the growing forest trees and/or uncut timber. There was a further right to log all felled teak timber left unlogged from former operations. The consideration that was charged by the Government was only the royalty agreed to be paid to the Government. G The main question, is, whether the acquisition of forest leases by the assessee was capital asset or stock-in- trade. The next question which arises for the first two years is whether there is any scope of application of section 10(2)(vii) of Indian Income-tax Act, 1922 in respect of the amount of R.S.. 1,41,156 for the assessment year 1950-51 and for 1951-52 whether the amounts of R.S.. 44,407, R.S.. 8,639 and R.S.. 2,16,929. being the excess realisations over R.S.. 225 per ton for logs received in respect of depreciable assets, stores and livestock were liable to tax under the Act. The two questions relevant for the assessment year 1953-54 will be dealt with separately.

The main submission by Shri B.B. Ahuja on behalf of the re venue was that the assessee was operating on a wide field in more than one country for obtaining its stock-in-trade in timber. The fresh con tracts entered into by the assessee (15 at the material time which commenced and expired at different times, were contracts entered in the course of its business. It was, therefore, submitted

that these were trading contracts. The assessee's right under the contract of 1925, according to Shri Ahuja, was to (i) fell teak trees. The assessee was trading in teak; (ii) convert them into logs; and (iii) remove them on payment of royalty.

Under clause 27 of the Agreement, the assessee had no interest in land as such, it had only a right to collect and take away logs, its stock-in-trade, it could not fell any fresh trees. The agreement dated 10th June, 1949 was entered into by the assessee, according to the learned counsel for the revenue, in the course of its business. He further submitted that 28,847 logs received by the assessee under the agreement dated 10th June, 1949, were in substitution of the logs that it had already cut and had not been able to remove from the forests. It was urged, it was merely a recompense for its rights in the stock-in-trade.

It has to be borne in mind that though the assessee had several sources of income including income from business operation, the assessee's company's main income was from felling the trees and carried on the said business on an extensive scale.

On behalf of the assessee, it was submitted that forest leases constituted the income producing assets of the company. Mr. Kaka submitted that these involved the setting up of the entire business and investment of large funds in building dams, canals, roads, railways, buildings, etc. He drew our attention to clause 15 of the lease agreement which has been set out at page 40 of the Paper Book in Statement of case. Mr. Kaka further reiterated that the leases were for a long duration with a first right to refusal to any subsequent leases. Reference was made in this connection to clause 4(2) of the lease agreement appearing at page 30 of the Paper Book. The Forest leases. it was urged by him, were not ordinary commercial contracts made in the A course of carrying on their trade or for the disposal of their products. These leases related to the whole structure of the assessee's profit making apparatus. It was further submitted that these regulated the assessee's activities, defined what they might or might not do and affected the whole conduct of the assessee's business. According to him the forest leases, therefore, constituted the capital assets of the assessee's business. He relied on a decision in Van-Den Berghs Ltd. v. Clark, 3 I.T.R. 17 at 25 and also Hood Bars v. Commissioner of Inland Revenue No.

2. 87 Tax Cases, 188.

Shri Kaka, therefore, submitted that the rights acquired under the contract were three-folds viz. (1) to fell trees (2) to convert the felled trees into logs and (3) to remove the logs. He referred us to clause 1 of the lease Agreement which appears at page 27 of the Paper Book. Detailed provisions were made in clauses 9, 10 and 11 regarding each of these operations.

It was further submitted that during the initial period of 15 years the assessee had the right to carry on all the three operations while under the residual rights the assessee could only carry on the operations of logging and removal of logs already felled by him.

Under clause 27, the assessee had no rights in the felled logs but only had the right to log and remove them and acquire the same after payment of royalty. It was his submissions that in the

absence of clause 27 the assessee would have no right to the felled trees which would have remained the property of the Government of Burma. We are of the opinion that he is right. It was further submitted that the assessee had not rights to felled trees which were not logged and removed within 3 years according to the terms of clause 27 of the lease agreement.

The consideration for the 43,860 tons of logs agreed to be handed over to the assessee was the surrender to the residuary rights under the Forest leases and the acquisition of the assets pertaining to the Forest Leases. He referred to us in this connection to clause 1 of the Take over Agreement which has been set out at page 80 of the Paper Book.

Mr. Kaka further submitted that one lump sum consideration was paid for both the surrender of the residuary rights and acquisition of assets of the business under clause 7 of the Take over Agreement at H p. 82. The splitting up of the consideration, according to him, in clause 10 was merely for the implementation of the agreement as Schedule provided in the manner of handing over the logs to the assessee in exchange of certain assets. If the residuary rights and assets had not been acquired by the Government the assessee would have carried on his business for another 3 years and logged and removed the felled trees. The assessee was prevented from carrying on this business upon the nationalisation of the forest resources and the consequential acquisition of the residuary rights and assets pertaining to the forest leases belonging to the assessee. Mr. Kaka urged that compensation therefore paid for acquisition of the residuary rights and assets was for the sterilization of the Company's business and therefore a capital receipt. He relied on the observations of Lord Buckmaster at page 463 and Lord Wrenbury at page 465 in Glenburg Union Fireclay Co. Ltd. v. The Commissioner of Inland Revenue, 12 Tax Cases 427. It was further urged that once it was held that the forest leases constituted the capital assets of the assessee, compensation paid for the sterilization of even part of a capital asset must be regarded as a capital receipt. Furthermore, according to him, it made no difference whether there was a sale of an asset out and out or it was a means of preventing the acquisition of profits that would otherwise be gained. He urged that in either case the asset of the company was sterilized or destroyed. Reliance was placed on the observations of this Court in Commissioner of Income Tax v. Vazir Sultan & Sons, 36 I.T.R. 175 at 191 and Godrej & Co. v. Commissioner of Income-Tax, 37 I.T.R. 381.

It is, therefore, necessary as mentioned hereinbefore to examine whether the acquisition of forest leases by assessee were acquisitions of capital assets. Though we will refer to some of the decisions to which our attention was drawn and which were referred to by the High Court, it is well to bear in mind the basic principles. These are: if there was any capital asset, and if there was any payment made for the acquisition of that capital asset, such payment would amount to a capital payment in the hand of the payee. Secondly, if any payment was made for sterilization of the very source of profit making apparatus of the assessee, or a capital asset, then that would also amount to a capital receipt in the hand of the recipient. On the other hand if forest leases were merely stock-in-trade and payments were made for taking over the stock-in-trade, then no question of capital receipt comes. The sum would represent payments of revenue nature or trading receipts. Whether in a particular case, for the contracts of the type with which we are concerned, payments were capital receipts or not would depend upon the facts and circumstances of the case. In this connection it is important to bear in mind that normally in trade there A are two types of capital, one circulating

capital and the other fixed capital. Fixed capital is what the owner turns to profit by keeping it in his own possession; circulating capital is what he makes profit of by parting with it and letting it change hands. Therefore, circulating capital is capital which is turned over and in the process being turned over, yields profits or loss. It is well-settled as the High Court observed in the judgment under appeal that what is capital assets in the hands of one person may be trading assets in the hands of the other. The determining factor is the nature of the trade in which the asset was employed. Compensation received for immobilisation, sterilization, destruction or loss, total or partial of a capital asset would be capital receipt. If a sum represented profit in a new form then that was income but where the agreement related to the structure of assessee's profit making apparatus and affect the conduct of the business, the sums received for cancellation or variation of such agreement would be capital receipt.

In Senairam Doongarmall v. Commissioner of Income-lax, Assam, 42 I.T.R. 392 at 406, this Court observed as follows after discussing several authorities:

> "All these cases were decided again on their special facts. Though they involved examination of other decisions in search for the true principles, it cannot be said that they resulted in the discovery of any principle of universal application. To summarise them: South India Pictures' case (29 I.T.R. 910) was so decided because the money received was held to be in lieu of commission which would have been earned by the business which was still going, and the receipt was treated as the fruit of the business. The same reason was given in Jairam Valiji's case (35 I.T.R. 148), and the Shamsher Printing Press case (39 I.T.R. 90). In Vazir Sultan's case (36, I.T.R.
>
> 175), the compensation was held to replace loss of capital, and in Godrej's case (37 I.T.R. 381), the compensation was said not to have any relation to the likely income or profits but to loss of capital. Each case was thus decided on its facts.
>
> We have so far shown the true ratio of each case cited before us, and have tried to demonstrate that these cases do no more than stimulate the mind, but none can serve as a H precedent, without advertence to its facts. The nature of the business, or the nature of the outlay or the nature of the receipt in each case was the decisive factor, or there was a combination of these factors. Each is thus an authority in the setting of its own facts."

All these cases have been discussed in the judgment under ap peal at page 795 of 81 I.T.R. As Hidayatullah, J. as the Chief Justice then was observed in 42 I.T.R. at page 392, each case depended upon the facts of each case.

This Court had occasion to consider some of these aspects in Commissioner of Income-tax, U.P. v. Gangadhar Baijnath, 86 I.T.R. 19 whereas at page 25 of report referring to several authorities it noted:

> "The question whether a receipt in capital or income has frequently come up for determination before the courts. Various rules have been enunciated as furnishing a key to the solution of the question, but as often observed by the highest authorities, it is not possible to lay down any single test as infallible or any single criterion as decisive in the determination of the question, which must ultimately depend on the facts of the particular case, and the authorities bearing on the question are valuable only as indicating the matters that have to be taken into account in reaching a decision: vide Van Den Berghs Ltd. v. Clark (1935 A.C. 431: 19 T.C. 390: 3 I.T.R. (Eng. Case) 17 (H.L.). That, however, is not to say that the question is one of fact, for, as observed in Davies (H.M. Inspector of Taxes) v. Shell Company of China Ltd. (32 T.C. 133; 22 I.T.R. (suppl.) 1 (C.A.), 'these questions between capital and income, trading profit or no trading profit, are questions which, though they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts'."

Similar observations were made in Commissioner of Income-tax, Poona v. Manna Ramji and Co., 86 I.T.R. 29. The Court reiterated the same principle.

We have referred to the discussion which took place with the Government of Burma on 28th October, 1925. Having regard to all A these, the forest leases, in our opinion, affected the very structure of the operation of the assessee. In this connection we may remind ourselves of the decision of the House of Lords in Van Den Berghs Ltd. v. Clark (H.M. Inspector of Taxes), 3 I.T.R. 17 (English case). In that case a Dutch company and the assessee who were competitors in the manufacture and dealing in margarine, in order to end the competition entered into an agreement in 1908, by which they bound themselves to work in friendly alliance and to share their profits and losses in accordance with an elaborate scheme therein specified; further, it was stated that they would promote the commercial, pecuniary, buying and selling and other interests of the two companies. In 1913 another agreement was entered into modifying the original basis of ascertaining and sharing profits, and, subject thereto, continued in force the provisions of the agreement of 1908 until December, 1940. During the war the agreements were not operated, but in 1920 a third agreement was made modifying the two previous agreements as to the basis of profit-sharing, extending the branches of the business, and again continuing the principal agreement of 1908 till December, 1940. In 1927, three agreements were made, under which the appellants agreed to determine the agreements of 1908, 1913 and 1920 in consideration of the payments to them of $ 450,000. The Special Commissioners held that that sum was paid in respect of the pooling agreements, and must be brought in for the purposes of arriving at the balance of the profits of the appellants for the year ending December, 1927, and consequently that the sum was an income receipt. Finlay, J., held that the cancelled agreements were capital asset of the appellants and that the sum of 450,000 was not an income receipt at all. The Court of Appeal restored the decision of the Commissioners, who had held that the sum was not received by the appellants in consideration of the surrender of a fixed capital asset, but arose from a transaction attributable to circulating capital, and therefore an income receipt. By the House of Lords it was held that $ 450,000 was not an item of profit arising to the appellants from the carrying on of their trade, as the agreements which were cancelled were not ordinary commercial contracts made in the course of trading nor

merely agreements as to how trading profits should be distributed, but affected the whole conduct of their business. It was held that money laid out in the cancellation of so fundamental an organisation of a trader's activities could not be regarded as an income receipt of disbursement. The agreements formed the fixed framework within which their circulating capital operated, and were not incidental to the working of their profit-making machine. The Court reiterated H the observations and principles laid down by Lord Cave in British Insulated & Helsby Cables Ltd. v. Atherton, [1926] A.C. 205. The observations of Lord Macmillan at page 25 of 3 I.T.R. (English case) are apposite to the facts before us. The three agreements which the appellants in that case had consented to cancel were not ordinary commercial contracts made in the course of carrying on their trade; they were not contracts for the disposal of their products or for the engagement of agents or other employees necessary for the conduct of their business. These regulated the appellant's activities, defined what the appellants might and what might not do and affected the whole conduct of the appellant's business. Accordingly, Lord Macmillan found it in that case, difficult in seeing how money laid out to secure, I or money received for the cancellation of, so fundamental an organisation of a trader's activities could be regarded as an income disbursement or an income receipt. Lord Macmillan noted that the legal character of the payment should not be mis-judged by the magnitude of payment-for the magnitude is a relative term. But the magnitude of a transaction is not an entirely irrelevant consideration. With respect we accept this approach of Lord Macmillan to the facts of the present case before us, which appears to be basically similar.

The forest lease therefore constituted, in our opinion, capital assets of the assessee. The same conclusion is fortified by the observations of House of Lords in the case of Hood Barrs v. Commissioner of Inland Revenue (No. 2), 37 Tax Cases l 88.

In Commissioner of Income-tax, Hyderabad-Deccan v. Vazir Sultan & Sons, 36 I.T.R. 175, this Court held that in considering whether compensation paid to an agent on the cancellation of his agency was a capital receipt or a revenue receipt, the first question considered was whether the agency agreement in question was a capital asset of the assessee's business and constituted its profit making apparatus and was in the nature of its fixed capital, or it was a trading asset or circulating capital or stock-in-trade of its business. If it was the former compensation received would be a capital receipt, if the agency was entered into by the assessee in the ordinary course of his business and for the purpose of carrying on that business it would fall into the latter category and the compensation received would be a revenue receipt.

Having regard to the nature of the forest leases which we have discussed before, in our opinion, the payments made for cancellation Or sterilisation of the rights under these leases would be capital receipts. See in this connection the observations of Lord Buckmaster in the decision of House of Lords in The Glenboig Union Fireclay Co. Ltd. v. The Commissioner of Inland Revenue (supra). The observations of Lord Wrenbury are at page 465.

We have discussed the facts regarding the cancellation and circumstances under which it was entered, and we may refer to the facts stated in the judgment of the High Court at pages 798-799. As a result of the above findings the High Court came to the conclusion that sum of Rs.65,52,153 mentioned in question No. 2 for the assessment year 1950-51 and the sum of Rs.5,18,896 mentioned

in question No. 2 for the assessment year 1951 -52 were related to the 28, 847 tons of logs which are exempt from tax as being receipt of a capital nature on the background of the facts found by the High Court. Question No. 3 really does not arise because for levy of a balancing charge under section 10(2)(vii) of Income-tax Act, 1922, it is absolutely necessary that the depreciable assets should have been sold at a price agreed to between the parties. See in this connection also the observations of this Court in Commissioner of Income-tax v. Motors & General Stores (P) Ltd., 66 I.T.R. 692. But in exchange there is a reciprocal transfer of interest in movable property, a corresponding transfer of interest in another movable property which is often denoted as 'barter'. The agreement of 10th June, 1949 had resulted from the enforcement of the Government's policy of nationalisation of forest operation and the agreement does not involve any transaction of sale between the assessee and the Union of Burma. The assessee company never paid any money by a price in respect of assets delivered to it by the Government, therefore, this amount of Rs.1,41,156 could not be brought to tax against the assessee company under the second proviso to section 10(2)(vii) of the Indian Income-tax Act, 1922. The question accordingly was rightly decided in favour of the assessee.

Regarding question No. 4 in the assessment year 1950-51 and the question No. 3 in the assessment year 195l-52, these related to the delivery of 2,946 and 12,067 tons of logs to the assessee-company in respect of the depreciable assets, stores and livestock mentioned in sub-clause (b) of clause 1 of the agreement dated 10th June, 1949. The High Court was right in holding that logs came into possession of the assessee company in consequence of the agreement made on 10th June, 1949 against delivery of all outstanding or residuary rights of the assets to the Government. The arrangement was in consequence of nationalisation of forest operations in Burma. The whole of the quantity of 43,860 tons of logs delivered to the assessee-company was in lieu of the asset of the forest leases and the other diverse assets which were handed over by the assessee-company to the Government on 10th June, 1949. These logs were not received by the assessee-company on revenue account at all. The fact that the assessee- company did not mix up these logs with any of the stock-in- trade held by it in its ordinary course of business is an indication of the fact that the assessee did receive these as stock-in-trade. These logs were received by the assessee- company for four years and held by it in the account which is described as 'Burma forest assets realisation reserve account'. The sale proceeds of these logs could not be held to have been received by the assessee-company on revenue account. The High Court was right. T he question No. 4 in the first year and the question No. 3 in the second year must be answered in the negative and against the revenue.

We have set out hereinbefore the questions relating to assessment year 1953-54. It appears from the facts that nothing was paid by the Government to the assessee-company in connection with 1/3 area of the forest areas which the Government had taken over from the assessee-company on 1st June, 1948. The assessee-company had filed a suit against the Government in connection with the timber logs and stores taken over by the Government on 1st June 1948. The facts in connection with the delivery of these goods appeared in the letter of the Government to the assessee-company dated 24th January, 1948. In the suit filed by it, the asessee-company succeeded in obtaining a decree for Rs.5,58, 188. The Tribunal held that the timber taken over by the Government in respect of 1/3rd area was stock-in-trade and the proceeds were taxable. Mr. Kaka was right in his submission that the timber taken over was towards the residuary rights in respect of the assets lying within 1/3rd

area taken over on 1st June, 1948. The price of the timber as such was never paid by the Government. In the decree, this sum was awarded in lieu of the rights which the assessee-company had under clause 27 in respect of 1/3rd area taken over by the Government. To these facts, the terms of the agreement dated 10th June, 1949 would be applicable. This sum cannot therefore be taxed.

On the question No. 2 for the assessment year 1953-54 no argument was advanced before the High Court on behalf of the assessee and the High Court answered the question in the affirmative.

In view of the principles involved and the nature of the transactions, we are of the opinion that the High Court was right in answering the question in the manner it did. In the premises these appeals fail and are dismissed with costs.

P.S.S. Appeals dismissed.