REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.3702 OF 2003

COMMISSIONER OF INCOME TAX, GUJARAT — APPELLANT

VERSUS

M/S. SAURASHTRA CEMENT LIMITED — RESPONDENT

SUPREME COURT OF INDIA

J U D G M E N T

D.K. JAIN, J.:

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JUDGMENT

1. This appeal, by special leave, at the instance of the Revenue is directed against the judgment and order dated 27th June, 2001 delivered by the High Court of Gujarat at Ahmedabad in Income Tax Reference No.44 of 1986. By the impugned judgment, the High Court has answered the following questions, referred to it by the Income Tax Appellate Tribunal, Ahmedabad (for short "the Tribunal") under Section 256(1) of

the Income Tax Act, 1961 (for short "the Act"), in the affirmative and in favour of the assessee.

(i) Whether the Tribunal has not erred in law on facts in holding that the amount of Rs.8,50,000/- received by the assessee was not taxable as revenue receipt in the hands of the assessee?

(ii) Whether the finding of the Tribunal that the receipt relating to liquidated damages cannot be treated as a revenue receipt but must be held to be a capital receipt not exigible to tax is correct in law?

(iii) Whether the assessee is entitled to the addition made to the machinery during the year thus determining the capital employed for the purpose of claim under Section 80J of the Income Tax Act, 1961?

2.At the outset, we may note that insofar as question No.(iii) is concerned, it was conceded on behalf of the Revenue before the High Court that answer to the said question stood concluded in favour of the assessee by the decision of this Court in ***C.I.T.,***

Gujarat *Vs.* ***M/s Elecon Engineering Co. Ltd.***[1]. Relying on the said decision, the High Court answered the question in favour of the assessee. Therefore, only question Nos. (i) and (ii), which in effect involve only one issue, survive for our consideration.

3. The reference pertains to the Assessment Year 1974-75 for which the relevant previous year ended on 30th June, 1973. The factual background in which the issue, covering both the questions, has arisen, is as follows :

The assessee, engaged in the manufacture of cement etc; entered into an agreement with M/s Walchandnagar Industries Limited, Bombay, (hereinafter referred to as "the supplier") on 1st September, 1967 for purchase of additional cement plant from them for a total consideration of Rs.1,70,00,000/-. As per the terms of contract, the amount of consideration was to be paid by the assessee in four instalments.

The agreement contained a condition with regard to the manner in which the machinery was to be delivered and the consequences of delay in delivery. Insofar as the present appeal

[1] (1987) 4 SCC 530

is concerned, clause No.6 of the agreement is relevant and it reads as follows:

> "6. xxx xxx xxx
> Delayed Deliveries:
>
> In the event of delays in deliveries except the reason of Force Majeure at para 5 mentioned above, the Suppliers shall pay the Purchasers an agreed amount by way of liquidated damages without proof of damages actually suffered at the rate of 0.5% of the price of the respective machinery and equipment to which the items were delivered late (*sic*), for each month of delay in delivery completion. It is further agreed that the total amount of such agreed liquidated damages shall not exceed 5% of the total price of the plant and machinery."

As per the said clause in the agreement, in the event of delay caused in delivery of the machinery, the assessee was to be compensated at the rate of 0.5% of the price of the respective portion of the machinery for delay of each month by way of liquidated damages by the supplier, without proof of actual loss. However, the total amount of damages was not to exceed 5% of the total price of the plant and machinery.

4. The supplier defaulted and failed to supply the plant and machinery on the scheduled time and, therefore, as per the terms of contract, the assessee received an amount of Rs.8,50,000/- from the supplier by way of liquidated damages.

5.During the course of assessment proceedings for the relevant assessment Year, a question arose whether the said amount received by the assessee as damages was a capital or a revenue receipt. The Assessing Officer negatived the claim of the assessee that the said amount should be treated as a capital receipt. Accordingly, he included the said amount in the total income of the assessee. Aggrieved, the assessee filed an appeal before the Commissioner of Income Tax (Appeals), but without any success. The assessee carried the matter further in appeal to the Tribunal. Relying on the ratio of the decisions of this Court in ***Commissioner of Income Tax, Nagpur*** *Vs.* ***Rai Bahadur Jairam Valji and Others***[2] and ***Kettlewell Bullen and Co. Ltd.*** *Vs.* ***Commissioner of Income-Tax, Calcutta***[3], the Tribunal came to the conclusion that the said amount could not be treated as a revenue receipt. According to the Tribunal, the payment of liquidated damages to the assessee by the supplier was intimately linked with the supply of machinery i.e. a fixed asset on capital account, which could be said to be connected with the source of income or profit making apparatus rather than a receipt in course of profit earning process and, therefore,

[2] (1959) 35 ITR 148 (SC)
[3] AIR 1965 SC 65

it could not be treated as part of receipt relating to a normal business activity of the assessee. The Tribunal also observed that the said receipt had no connection with loss or profit because the very source of income viz., the machinery was yet to be installed. Accordingly, the Tribunal allowed the appeal and deleted the addition made on this account.

6.Being dissatisfied with the decision of the Tribunal, as stated above, at the instance of the Revenue, the Tribunal referred the afore-noted questions of law for the opinion of the High Court. The reference having been answered against the Revenue and in favour of the assessee, the Revenue is before us in this appeal.

7.We have heard Mr. R.P. Bhatt, learned Senior Counsel appearing for the Revenue and Mr. Bhargava V. Desai on behalf of the assessee.

8.Mr. Bhatt submitted that although the said amount of damages had been received by the assessee under clause 6 of the agreement for breach of contract, yet the said amount had been received as compensation for the loss of profit, and therefore, it is in the nature of a revenue receipt. According to

the learned counsel, it was on account of late commissioning of the plant that the assessee could not commence production as per its schedule and thereby suffered loss in its profits, which was compensated by the supplier and, therefore, the said amount should have been considered as revenue receipt.

9.Per contra, Mr. Desai, learned counsel appearing for the assessee, while supporting the decision of the High Court submitted that the amount received by the assessee was by way of compensation for delay in the delivery and installation of the plant and had a direct nexus with the capital asset and therefore, it was in the nature of a capital receipt. Learned counsel also argued that answer to the questions stands concluded in favour of the assessee by the decision of the High court of Madras in ***E.I.D. Parry Ltd.*** *Vs.* ***Commissioner of Income Tax***[4]***,*** which has attained finality on account of dismissal of the Civil Appeal preferred by the Revenue against the said judgment.

10. Thus, the short question for determination is whether the liquidated damages received by the assessee from the supplier

4 [1998] 233 ITR 335 (Mad)

of the plant and machinery on account of delay in the supply of plant is a capital or a revenue receipt?

11. The question whether a particular receipt is capital or revenue has frequently engaged the attention of the Courts but it has not been possible to lay down any single criterion as decisive in the determination of the question. Time and again, it has been reiterated that answer to the question must ultimately depend on the facts of a 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 conclusion. In ***Rai Bahadur Jairam Valji*** (supra), it was observed thus:

> "The question whether a receipt is 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***[5]. That, however, is not to say that the question is one of fact, for, as observed in ***Davies***

[5] (1935) 3 I.T.R. (Eng. Cas.) 17

> ***(H.M. Inspector of Taxes)*** v. ***Shell Company of China Ltd.***[6]***,*** "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."

12. In ***Kettlewell Bullen and Co. Ltd.*** (supra), dealing with the question whether compensation received by an agent for premature determination of the contract of agency is a capital or a revenue receipt, echoing the views expressed in ***Rai Bahadur Jairam Valji*** (supra) and analysing numerous judgments on the point, this Court laid down the following broad principle, which may be taken into account in reaching a decision on the issue :

> "Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated) the receipt is revenue : Where by the cancellation of an agency the trading structure of the assessee is impaired, or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt."

[6] (1952) 22 I.T.R. (Suppl.) 1

13. We have considered the matter in the light of the afore-noted broad principle. It is clear from clause No.6 of the agreement dated 1st September 1967, extracted above, that the liquidated damages were to be calculated at 0.5% of the price of the respective machinery and equipment to which the items were delivered late, for each month of delay in delivery completion, without proof of the actual damages the assessee would have suffered on account of the delay. The delay in supply could be of the whole plant or a part thereof but the determination of damages was not based upon the calculation made in respect of loss of profit on account of supply of a particular part of the plant. It is evident that the damages to the assessee was directly and intimately linked with the procurement of a capital asset i.e. the cement plant, which would obviously lead to delay in coming into existence of the profit making apparatus, rather than a receipt in the course of profit earning process. Compensation paid for the delay in procurement of capital asset amounted to sterilization of the capital asset of the assessee as supplier had failed to supply the plant within time as stipulated in the agreement and clause

No.6 thereof came into play. The afore-stated amount received by the assessee towards compensation for sterilization of the profit earning source, not in the ordinary course of their business, in our opinion, was a capital receipt in the hands of the assessee. We are, therefore, in agreement with the opinion recorded by the High Court on question Nos. (i) and (ii) extracted in Para 1 (supra) and hold that the amount of Rs.8,50,000/- received by the assessee from the suppliers of the plant was in the nature of a capital receipt.

14. We, therefore, dismiss the appeal with no order as to costs.

…………………………………J.
(D.K. JAIN)

…………………………………J.
(C.K. PRASAD)

NEW DELHI;
JULY 9, 2010.