Marybong Kyel Tea Estates Ltd. Vs Commissioner of Income Tax

Court: Calcutta High Court

Date of Decision: Dec. 7, 1979

Acts Referred: Income Tax Act, 1961 â€" Section 2(14), 2(47), 256(1), 41, 41(2)

Citation: (1980) 3 TAXMAN 481

Hon'ble Judges: Sankar Prasad Mitra, C.J; Deb, J

Bench: Division Bench

Advocate: K. Ray and S.N. Dutta, for the Appellant;B.K. Bagchi and B.K. Naha, for the Respondent

Judgement

Sankar Prasad Mitra, C.J.
This is a reference u/s 256(1) of the income tax Act, 1961. The assessment year is 1967-68. The relevant

previous year ended on December 31, 1966. The assessee''s business is manufacture and production of tea. In 1964, a fire broke out in the

assessee''s factory resulting in, according to the statement of the case, ""the damage and/or destruction of some assets"". These assets were covered

by fire insurance policies. The assessee received under the policies a total sum of Rs. 6,15,507. The original cost of the assets ""destroyed by fire

was Rs. 1,20,463. The written down value was Rs. 23,821.

2. The ITO treated Rs. 96,642 (Rs. 1,20,463 - Rs. 23,821) as profit u/s 41(2) of the income tax Act, 1961. This sub-section of section 41, inter

alia, provides that where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the

purposes of business is destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together

with the amount of scrap value, if any, exceed the written down value, so much of the excess as does not exceed the difference between the actual

cost and the written down value shall be chargeable to income tax as income of the business or profession of the previous year in which the monies

payable for the building, machinery, plant or furniture became due.

3. The balance of the amount, namely, Rs. 4,95,044, which the assessee received from the insurance company, was assessed by the ITO as

capital gains. To appreciate the points of law that arise in this reference it is necessary to set out at this stage some of the provisions of the Act.

4. Section 2(14) of the Act defines ""capital asset"". It says:

''Capital asset'' means property of any kind held by an assessee, whether or not connected with his business or profession, but does not include-

.....

5. The significance of this definition in the context of the present reference is that excepting certain assets specified in section 2(14) of the Act,

property of any kind held by the assessee whether or not connected with his business or profession is a capital asset.

6. Section 2(47) of the Act defines ""transfer"" in relation to a capital asset. It is in these words:

Transfer, in relation to a capital asset, includes the sale, exchange or relinquishment of the asset or the extinguishment of any rights therein or the

compulsory acquisition thereof under any law.

7. The dictionary meaning of the word ""transfer"" requires our attention. ""Transfer"" is derived out of the Latin word ""transferee"". The French

equivalent is ""transferer"". The Latin word ""transferee"" consists of two words-""trans"" and ""feree"". ""Trans"" means ""to convey or to take from one

place, person to another; to transmit, transport; to give or hand over from one to another"". ""Feree"" means ""to bear, to carry"". When title, right or

property is conveyed or made over by one person to another, a transfer takes place. (Vide Shorter Oxford English Dictionary "", 3rd Edn., p.

2230).

8. Section 2(47) gives a very wide definition of the word ""transfer"" in relation to a capital asset and from the language used, it appears that in

relation to a capital asset a ""transfer"" may take place either by volition of the parties or by operation of law.

9. We now come to sections 45 and 48 of the Act. These are as follows:

45. Capital gains. -(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided

in sections 53, 54, 54B, 54D and 54E be chargeable to income tax under the head '' Capital gains '', and shall be deemed to be the income of the

previous year in which the transfer took place.

48. Mode of computation and deductions. -The income chargeable under the head ''Capital gains'' shall be ""computed by deducting from the full

value of the consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely:-

(i) expenditure incurred wholly and exclusively in connection with such transfer;

(ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

10. Section 45, therefore, is the charging section for capital gains and section 48 prescribes the mode of computation and deduction in respect of

capital gains.

11. In the statement of the case, the Tribunal says that before the ITO it was argued that the amount, namely, Rs. 4,95,044, represented realisation

under an insurance policy and none of the provisions u/s 45 read with section 2(47) of the Act was attracted and, therefore, the said amount was

not taxable under capital gains. The Tribunal further says in the statement of the case that the ITO rejected the assessee"s contention in the

following words:

It is an inherent condition of all insurance against destruction and damage of assets that the damaged assets will become the property of the insurer

when a claim is settled. In the instant case the assets involved which were mostly machinery and damaged machinery, etc., became the property of

the insurer, vide assessee"s letter No. ITX: KB dated 28-8-70. It can therefore be said with certainty that assets (though in damaged condition but

they still remained assets) were transferred to the insurance companies. Assessee, therefore, received the sum in question out of a contractual

obligation vis-a-vis the insurance company on the transfer of assets. Section 45 is, therefore, applicable to this case and the amount aforesaid is

treated as capital gains of the assessee.

12. In the last para, of the statement of the case, the Tribunal has said:

The draft statement was circulated among the parties and their suggestions have been incorporated in the statement of case. The learned, counsel

for the assessee, however, insisted that the question as raised in the assessee"s reference application be referred to the Hon"ble High Court. In our

opinion the question as mentioned above clearly brings cut the controversy between the parties before us and it is because of this that we have

referred the above question for the opinion of the hon"ble High Court.

13. This para shows that the statement of the case was prepared with the knowledge of the parties concerned and they had opportunities to make

such additions or alterations as they intended to do. The Supreme Court in Commissioner of Income Tax, West Bengal Vs. Calcutta Agency Ltd.,

has expressed the view that the statement of the case under the rules framed under the income tax Act is prepared with the knowledge of the

parties concerned and they have a full opportunity to apply for any addition or deletion from that statement of the case. If they approve of that

statement, says the Supreme Court, that is the statement of facts agreed to by the parties on which the High Court is to pronounce its judgment. It

is the clear duty of the High Court to start with that statement of the case as the final statement of facts.

14. In view of these observations of the Supreme Court we called for the original letter dated the 28th August, 1970, which the ITO had referred

to in his order. The department has produced the original letter before us. This is a letter of the tax adviser of the assessee. In this letter there is a

categorical statement on how the ""disposal of salvage resulting from the destruction by fire"" had taken place. The statement is: ""The entire salvage

was taken over by the insurance company"".

15. This matter then went up to the AAC, who has observed as follows:

On looking into the insurance policy under consideration I find, in the "Condition" attached to that policy, that "on the happening of any loss or

damage to any property insured by that policy the insurance company takes possession of the property so damaged or lost.

16. The AAC, according to the statement of the case, was referring to condition No. 12, which reads thus:

On the happening of any loss or damage to any of the property insured by this policy the insurers may-

(a) enter and take and keep possession of the building or premises where the loss or damage has happened;

(b) take possession of or require to be delivered to them any property of the insured in the building or on the premises at the time of the loss or

damage;

(c) keep possession of any such property and examine, sort, arrange, remove, or otherwise deal with the same;

(d) sell any such property or dispose of the same for account of whom it may concern.

The powers conferred by this condition shall be exercisable by the insurers at any time until notice in writing is given by the insured that he makes

no claim under the policy or, if any claim is made, until such claim is finally determined or withdrawn, and the insurers shall not, by any act done in

the exercise or purported exercise of their powers hereunder, incur any liability to the insured or diminish their right to rely upon any of the

conditions of this policy in answer to any claim.

If the insured or any person on his behalf shall not comply with the requirements of the insurers or shall hinder or obstruct the insurers in the

exercise of their powers hereunder, all benefits under this policy shall be forfeited.

The insured shall not in any case be entitled to abandon any property to the insurers, whether taken possession of by the insurers or not.

17. The AAC held that the assessee"s claim fell within the meaning of the word ""transfer"" as denned in section 2(47) of the Act and it was liable to

capital gains tax u/s 45 of the Act. The ITO"s addition was thus confirmed by the AAC.

18. Before the Tribunal counsel for the assessee argued that it was wrong to say that the insurance company took possession of the assets which,

according to him, was not possible as they were destroyed by fire. He of course admitted that the insurance company took possession of the

salvaged assets not by virtue of any transfer but under the Insurance Act. He next referred to the definition of the word ""transfer"" in section 2(47)

of the Act but submitted that the extinguishment of any rights therein meant rights in the capital asset which again, according to him, was not

possible with the destruction of the asset. He further argued that the extinguishment of any rights in the asset presupposed the existence of the asset

but ""non-continuation of the rights and the rights followed the ''asset''"" (sic); and if the asset vanished, there was no question of continuation of any

rights over it and naturally there was no such extinguishment as held by the lower authorities. He also submitted that capital asset meant that asset

which was actually insured and not its burnt out remains as, according to him, the asset was destroyed by fire when it was actually burnt out.

19. The departmental representative submitted to the Tribunal that the assessee had received the compensation from the insurance company only

because of the extinguishment of its rights in the capital assets. He also submitted that it was wrong to say that the assets were destroyed by fire.

According to him the assessee had rights even in the remains of the assets which were left over after burning or destruction. He, therefore,

supported the order of the AAC.

20. The Tribunal did not agree with the reasoning of the assessee''s counsel that an asset was destroyed when it was burnt by fire and that its

remains could not be called an asset.

21. According to the Tribunal, it was an admitted fact that the assessee was in possession of certain capital assets which were burnt out by fire; it

was also a fact that the insurance company as per conditions attached to the policy of insurance was entitled to take possession of the property

which was salvaged from fire. In the opinion of the Tribunal this left-over property was an asset and its take over by the insurance company led to

the extinguishment of the assessee''s rights therein. This, according to the Tribunal, therefore, amounted to ""transfer"" as per its definition in section

2(47) of the Act. It would, in the opinion of the Tribunal, not be correct to say that the burnt out remains could not be called a capital asset, the

difference being only the change in the shape and size.

22. The Tribunal has also said that there is another argument and that argument is that section 2(47) defines ""transfer"" in relation to a capital asset

as including besides others the extinguishment of any rights therein. Since the asset belonging to the assessee was destroyed by fire, it could be said

that the rights of the assessee therein were extinguished and, therefore, there was a transfer in relation to that asset. In the opinion of the Tribunal it

could not be denied that the compensation money which the insurance company had paid was in connection with the above extinguishment or

transfer. Section 45 lays down that any profits or gains arising from the transfer of a capital asset subject to certain exceptions be chargeable to

income tax under the head ""Capital gains"". According to the Tribunal, the profit which has arisen to the assessee in the present case, as already

stated above, was from the extinguishment of its rights in the capital asset and, therefore, had arisen from the ""transfer"" of such asset. Looked at

from either of the reasonings, the Tribunal agreed with the lower authorities that the sum of Rs. 4,95,044 had been properly brought to tax as

capital gains.

23. The above views of the Tribunal have been expressed in paras. 14 and 15 of its order. Before us long arguments were advanced on the

Tribunal''s reasonings in para. 15. But, as the Supreme Court has said in Homi Jehangir Gheesta Vs. The Commissioner of Income Tax, Bombay, ,

it is not necessary to examine the Tribunal''s order, sentence by sentence, through a microscope as it were, so as to discover a minor lapse here or

an incautious opinion there to be used as a peg on which to hang an issue of law.

24. It seems to us that the Tribunal''s order read as a whole means that the original asset belonging to the assessee remained after the fire in a

changed form and shape. What remained in a changed form and shape was transferred by operation of law to the insurer. As a result of this

transfer the assessee received compensation of which Rs. 4,95,044 was assessable as capital gains.

25. The Tribunal has referred to this court the following question:

Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that there was a ""transfer"" as defined in section 2(47)

of the income tax Act, 1961, and that the sum of Rs. 4,95,044 had been properly brought to tax as capital gains u/s 45 of the Act ?

26. Various cases have been cited before us. We would, however, refer only to one decision which appear to us to be relevant for the purpose of

deciding this reference.

27. Mr. Roy appearing for the assessee has invited us to ignore the assessee''s tax adviser''s letter of the 28th August, 1970. His contention is that

neither the AAC nor the Tribunal had relied on that letter for reaching their respective conclusions. The ITO''s order merged in the AAC''s order

and the AAC''s order merged in the Tribunal''s order. And for this reference all that we are entitled to take into account are facts found by the

Tribunal and no other authority.

28. It is not possible for us, on the facts and in the circumstances of this case, to accept this argument of Mr. Roy. The said letter of the 28th

August, 1970, has been specifically brought to our notice by the Tribunal"s statement of the case and in that letter, as we have stated earlier, we

find an admission on behalf of the assessee that the salvaged property was taken away by the insurer.

29. In any event, the Tribunal has relied on condition No. 12 of the insurance policy and has found it as a fact that the left-over property was taken

over by the insurance company. Condition No. 12 of that policy gives the insurer the right to take possession of, or require to be delivered to him,

any property of the insured in the building or on the premises at the time of the loss or damage. It gives him the further right to remove the said

property or otherwise deal with the same.

30. The position in law has been clearly stated by several authorities. In Barwell"s The Law of Insurance in British India (1940), the terms of

clause 12 have been elaborately considered along with similar other clauses. The learned author observes, inter alia, at p. 274:

As the insurer, if he pays an indemnity, has a right to the salvage (for otherwise an assured, by keeping the salvage as well as the indemnity, would

be over-compensated), the effect of the last-named stipulation is to enable the insurer to decide for himself what he will retain.

31. In Ivamy"s Fire and Motor Insurance, 3rd Edn., at p. 9, it is stated:

If the insured has once received from the insurers the full value of the subject-matter of the insurance, he cannot retain for himself any benefit

whatever arising out of his interest in such subject-matter, by reason of which he would be more than fully indemnified. He is bound, therefore,

upon payment of his indemnity to account to the insurers for any compensation which he may receive from any third person legally responsible for

the loss, and to hand over to them, if it is in his power to do so, whatever remains of the subject-matter of the insurance together with all his rights,

if any, against third persons arising out of the loss.

32. In Macgillivray and Parkington"s Insurance Law, 6th Edn., art. 1770, at p. 729, it is stated, inter alia:

In practice, however, insurers often pay as for a total loss on goods which are seriously damaged and when they do so they are entitled to the

damaged goods as salvaged or their value.

33. In Kanga and Palkhivala"s The Law and Practice of Income Tax, 7th Edn., Vol. I, at p. 144, it is observed:

Where property is insured, receipts under the policy would be capital or trading receipts according as the policy relates to capital or trading assets.

34. In the instant case, the receipts under the policy related to capital assets and, therefore, these were capital receipts.

35. Prestaon and Colinvaux in Law of Insurance, 2nd Edn., at p. 327, say:

Insurer"s right of entry. -As soon as a fire breaks out the insurers have an obvious interest in fighting it and saving what they can from the flames.

However, their common law right of entry on to the premises for this purpose is vague, although they probably have some such right. Besides, their

right to retain insured property as salvage will only arise after they have paid the assured under the policy. A provision is, therefore, usually

included in the policy allowing them to enter and take possession of the premises or its contents in the event of a fire.

36. Article 772 at p. 502 and art. 774 at p. 503 of Halsbury''s Laws of England, 2nd Edn., Vol. 18, read thus:

772. The amount for which the insurers are liable depends upon the extent to which the insured property is destroyed or damaged. It is, therefore,

clear that they are directly interested in the steps taken to minimise the loss. It is the duty of the assured to minimise the loss; but it is not a sufficient

protection to the insurers to rely upon this. They are, therefore, entitled to enter and remain on the premises where the fire is, and to take

possession of any salvage there. Their powers in this respect are in practice amplified and extended by the express terms of the policy.

774. There are no rules as to notice of abandonment in fire insurance, but on payment of the loss in full the salvage is transferred to the insurers.

37. The authorities quoted above support, in our opinion, the ultimate conclusions which were reached by the Tribunal on the facts of the present

case. The Tribunal construed condition No. 12 of the insurance policy and took the view that on payment of the policy money to the extent

indicated above, the insurer became entitled to what remained of the capital assets and took it over. It was, therefore, a case of a transfer of that

capital asset in a changed shape and form within the meaning of section 2(47) of the income tax Act, 1961. It seems to us that this conclusion of

the Tribunal cannot be assailed.

38. In this connection, we may refer to a judgment of the Gujarat High Court which was cited before us. This was the judgment in the case of

Commissioner of Income Tax Vs. Vania Silk Mills (P.) Ltd., . In this case, the assessee''s machinery was taken on hire by a private limited

company; the hirer insured the machinery together with its own machinery; the insurance was on reinstatement basis; a fire broke out in the

premises of the hirer causing extensive damage to the machinery in such premises and the machinery was rendered unfit for use as such; the hirer

claimed and received certain amount from the insurer on account of the damage caused to the machinery; the insurer while paying the amount took

over the damaged machinery; out of the amount which the hirer received from the insurer, the hirer paid on a pro rata basis the sum of Rs.

6,32,533 to the assessee and the amount so received by the assessee exceeded the original cost of its machinery by Rs. 3,50,792. The Gujarat

High Court was of opinion that the sum of Rs. 3,50,792 could be subjected to the capital gains tax. This case, in our view, lends further support to

the Tribunal''s order in the instant case and the sum and substance of its reasons.

39. Mr. Roy also contended before us that assuming that there was a transfer in the present case within the meaning of section 2(47), in order to

compute the ""capital gains"" in terms of section 48 of the Act, it must be shown that the consideration which the assessee had received was the

consideration for the transfer of the capital asset concerned. In the instant case, Mr. Roy, drawing our attention to para. 15 of the Tribunal''s order,

submits to us that the Tribunal has not held that the consideration or the compensation money was received as a result of the transfer. On the

contrary, the Tribunal has stated that this compensation money was paid by the insurance company ""in connection with"" the transfer. Mr. Roy, in

making the submission, is ignoring para. 15 read as a whole. It is true that the Tribunal has used the expression ""in connection with"" with the above

extinguishment or transfer. But in the subsequent sentences, the Tribunal has said:

The profit which has arisen to the assessee in the present case as already stated above is from the extinguishment of its rights in the capital asset

and, therefore, has arisen from the transfer of such asset. Looked at from either of the reasonings we agree with the lower authorities that the sum

of Rs. 4,95,044 has been properly brought to tax as capital gains.

40. We are of opinion that this contention of the learned counsel for the assessee cannot be accepted. For all the reasons stated above, our answer

to the question referred to us is in the affirmative and in favour of the department.

Deb, J.

I agree.