Commissioner of Income Tax Vs Abbasbhoy A. Dehgamwalla and others

Court: Bombay High Court

Date of Decision: April 24, 1991

Acts Referred: Income Tax Act, 1961 â€" Section 2(14), 2(47), 45, 45(1), 48

Citation: (1992) 101 CTR 425 : (1992) 195 ITR 28

Hon'ble Judges: T.D. Sugla, J; B.N. Srikrishna, J

Bench: Division Bench

Advocate: Dr. V. Balasubramanian, for the Appellant; S.E. Dastur, for the Respondent

Judgement

T.D. Sugla, J.
These are cross references by the Department and the assessee. The assessment year involved is 1970-71. The Income

Tax Appellate Tribunal has referred to this court the following questions for opinion u/s 256(1) of the Income Tax Act, 1961 :

R.A. No. 1583 (Bom)/1974-75 :

(1) Whether, on the facts and in the circumstances of the case, the amount of Rs. 2,52,000 being the compensation received by the assessee from

the Central Government can be treated as capital gains in the hands of the assessee ?

R. A. No. 1540 (Bom)/1974-75 :

(2) Whether, on the facts and in the circumstances of the case, the sum of Rs. 1,56,030 received by the assessee as per the terms of the consent

decree dated June 11, 1969, is liable to be taxed as income of the assessee ?

(3) If the answer to question No. 2 is in the affirmative, whether such sum is liable to be taxed for the assessment year 1970-71 ?

2. It is pertinent to mention that the issue involved herein had come up for consideration in the context of wealth-tax before us in the assessee''s

own case for the assessment years 1963-64 to 1969-70 (both inclusive) in Wealth-tax Reference No. 12 of 1977 with Wealth-tax Reference No.

5 of 1977, Akber A. Dehgamwalla v. CWT [1992] 195 ITR 16 and, by our judgment delivered yesterday, it was held that both the amounts of

Rs. 2,52,000 (being damages for breach of contract) and Rs. 1,56,030 being interest thereon for the period from January 30, 1959, to the date of

consent decree, i.e., June 11, 1969, had accrued to the assessee on the date of the consent decree, i.e., on June 11, 1969, and that, as a result

thereof, no part of the amount of damages or interest was includible as ""asset"" belonging to him on any of the valuation dates falling before the date

of the consent decree.

3. However, it may be desirable to briefly refer to the facts once again. The assessee had agreed to take on lease certain land and the Government

of India had agreed to give it to the assessee. That was in 1945. The deal did not go through. The assessee filed Suit No. 37 of 1959 for specific

performance in this court with an alternative claim for damages for breach of contract. The suit was decreed on September 20, 1961, in terms of

which the claim for specific performance was rejected. Holding that the breach of contract had taken place on January 7, 1958, and the assessee

was entitled to compensation for breach of contract, the suit was referred to the Commissioner of the High Court for taking accounts for the

purpose of determining the amount of compensation, if any, to which the assessee may be entitled for the breach of contract by the Union of India.

The assessee accepted the judgment and decree of the learned single judge. But the Union of India challenged the same by filing an appeal before

the Division Bench, inter alia, on the grounds which challenged the very existence of valid contract. The Division Bench dismissed the appeal by

judgment dated July 16, 1965. The Commissioner submitted his report on June 29, 1968, and recommended compensation of Rs. 10,92,000.

This was objected to both by the assessee and the Union of India. Eventually, there was a compromise between the parties and a consent decree

was passed on June 11, 1969, in terms of which the Union of India was directed to pay to the assessee a sum of Rs. 4,08,030 made up of Rs.

2,52,000 as damages and Rs. 1,56,030 as interest at the rate of 6 per cent. per annum from January 30, 1959, up to the date of the consent

decree.

4. The assessee did not include any part of the amount of Rs. 2,52,000 received by way of damages for breach of contract in his income for the

year under reference. He also did not include any part of Rs. 1,56,030 as his income on the ground that amount was also a part of the damages.

The Income Tax Officer, however, held that the assessee had an enforceable right as a result of the acceptance of his offer by the Union of India in

1945, and that the said right was acquired back by the Government of India on payment of Rs. 2,52,000 in the year 1969. Accordingly, he held

that the amount of Rs. 2,52,000 was taxable in the hands of the assessee as long-term capital gains while the amount of Rs. 1,56,030 was interest.

Since it was received as a result of the consent decree during the previous year, the whole of it was taxable in the year under reference.

5. The appellate Assistant Commissioner accepted the assessee''s claim that he had no capital asset and the amount of Rs. 2,52,000 could not be

treated as capital gains. As regards the amount of Rs. 1,56,030, however, the Appellate Assistant Commissioner agreed with the Income Tax

Officer and held that the said amount represented interest accrued and received by the assessee on the amount of compensation during the

previous year and since the money was received as a result of the consent decree during the previous year, it was rightly taxed in that year.

6. Both the assessee and the Department filed appeals against the order of the Appellate Assistant Commissioner before the Tribunal. The case of

the Department was that even the amount of compensation, i.e., Rs. 2,52,000, ought to have been taxed as capital gains. The case of the assessee

was that the amount of Rs. 1,56,030 was not taxable as the income of the assessee at all. For reasons more or less similar to those given by the

Appellate Assistant Commissioner, the Tribunal dismissed both the assessee''s and the Department''s appeals.

7. Placing reliance on the decisions of our High Court in the cases of Commissioner of Income Tax, Bombay City I Vs. Tata Services Ltd., and

Commissioner of Income Tax Vs. Vijay Flexible Containers, , Dr. Balasubramanian, learned counsel for the Revenue, submitted that the

assessee''s right to get the deed of conveyance executed under the 1945 contract constituted a capital asset and when the amount of compensation

was received by the assessee in lieu of that right, the amount so received was taxable as income under the head ""Capital gains"". Dr.

Balasubramanian referred to sections 45, 48 and 2(47) of the Income Tax Act, 1961, to show that capital gains was chargeable on the transfer of

a capital asset and that the word ""transfer"" as defined in section 2(47) included within it not only sale or exchange but also relinquishment of the

asset and/or the extinguishment of any right therein. According to him, in the present case, the assessee''s right to get the deed of conveyance

executed was extinguished. In lieu thereof, the amount of Rs. 2,52,000 was received as compensation. The amount was, therefore, taxable as

capital gains.

8. Shri Dastur, learned counsel for the assessee, also referred to sections 45 and 48 of the Act. He emphasized that, u/s 45, profits or gains arising

from the transfer of a capital asset were taxable as the income of the previous year in which the transfer takes place. The breach of contract in this

case, he stated, took place in January, 1958, as held by the learned single judge in his judgment and decree dated September 20, 1961. Assuming

that the assessee''s right to get the lease deed executed in terms of the acceptance of the assessee''s offer to purchase the suit land in 1945 was a

capital asset and assuming further that any consideration was received as a result of the transfer of that capital asset, the breach of the contract

having taken place in 1958, any part of that amount would be taxable, if at all, for the assessment year 1958-59 or 1959-60 and certainly not for

the year under reference. This submission was in addition to the contention that the amount received herein was received as damages for breach of

the agreement and not as consideration for the ""transfer"" of the capital asset under the agreement. Referring to section 48 of the Act, Shri Dastur

further contended that even if it was assumed that the amount of Rs. 2,52,000 was received for the transfer of the capital asset under the

agreement during the previous year, there being no cost for this ""capital asset"" to the assessee, no part of it could be taxed as the assessee''s

income under the head ""Capital gains"" in view of the Supreme Court decision in the case of Commissioner of Income Tax, Bangalore Vs. B.C.

Srinivasa Setty, . Shri Dastur further contended that, in this case, there was no ""transfer"" at all within the meaning of section 45 read with section

2(47). His submission is that, considering the case from any point of view, the amount of Rs. 2,52,000 is not taxable as the income of the assessee

for the assessment year 1970-71 as capital gain at all.

9. Section 45(1), as it stood at the relevant time, reads as under :

45(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 and 54B, 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.

10. Shri Dastur is evidently right in contending that profits or gains arising from the transfer of a capital asset u/s 45 are to be taxed as income of

the previous year in which the transfer takes place. It, thus, becomes necessary to examine as to whether the ""transfer"" of the assessee''s right to

get the lease deed executed assuming for the present that it constituted ""capital asset"" took place during the previous year relevant for the

assessment year under reference. To put it differently, when did the ""transfer"" of the ""capital asset"" take place. The relevant facts in brief have been

mentioned in paragraph 2 of this judgment. The facts in detail are referred to in the judgment in the wealth-tax references disposed of yesterday

(see [1992] 195 ITR 16). The learned single judge has held in his judgment and decree dated September 20, 1961, that the breach of the

agreement took place on January 7, 1958, and that the suit was filed on January 30, 1959. In terms of the decree passed, the assessee''s claim to

specific performance of the agreement was rejected. As regards the alternative claim for damages for breach of agreement, the Commissioner was

directed to take accounts and determine the amount of compensation, if any, for breach of the agreement. Thus, while, in view of our court''s

judgment in Commissioner of Income Tax, Bombay City I Vs. Tata Services Ltd., and Commissioner of Income Tax Vs. Vijay Flexible

Containers, relied upon by Dr. Balasubramanian, we have no difficulty in holding that such a right constituted a ""capital asset"", we cannot but

conclude that such a right got extinguished at least on September 20, 1961, when our court refused to grant specific performance of the

agreement, if not earlier on January 7, 1958, i.e., the date of breach of contract mentioned by our court in its decree.

11. It may not be out of place to mention here that Dr. Balasubramanian had strenuously argued that, as a result of the breach of the agreement,

the assessee acquired another right, i.e., the right to receive damages and that the right originally acquired in 1945 did not really come to an end on

the breach of contract but was converted into another right, i.e., the right to receive damages for breach of contract. When this right materialised

and the amount of damages was specified in the consent decree of the court, the amount so received represented the consideration for the transfer

of the original right. His contention, thus, was that the assessee''s right to have the lease deed executed under the agreement of 1945 was, as a

matter of fact, extinguished during the previous year only. We find it difficult to accept this argument of Dr. Balasubramanian for more that one

reason. It is trite law that income can be held to accrue only when the assessee acquires a right to receive the income. Unlike compensation

payable by the State when it acquires a citizen''s land under the Acts such as the Land Acquisition Act where the right to receive compensation is

statutory right that a person acquires on the establishment of a breach of contract is at best a mere right to sue. Despite the definition of the

expression ""capital asset"" in the widest possible terms in section 2(14), a right to a capital asset must fall within the expression ""property of any

kind"" in the context of transferability makes an exception in the case of mere of a mere right to sue. The decisions thereunder make it abundantly

clear that the right to sue for damages is not an actionable claim. It cannot be assigned. Transfer of such a right is as much opposed to public policy

as is gambling in litigation. As such, it will not be quite correct to say that such a right constituted a ""capital asset"" which in turn has to be ""an

interest in property of any kind"". The question of the assessee''s right under the agreement of 1945 being converted or substituted by another right

which can be said to be a ""capital asset"" does not, therefore, arise. In the next place, the right to sue for damages for breach of contract. But that

happens only when the damages claimed for breach of contract are either admitted or decreed and not before. For this purpose, the first stage is a

finding as to the breach of contract. The second stage will be a finding that the party claiming damages for breach of contract has established that it

suffered loss as a result of breach of contract by the other party and is required to be compensated by way of damages for breach of that contract.

The last stage is that the amount of loss established to have been suffered by the assessee is either agreed to by the other party or decreed by the

court. In the present case, the learned single judge did not even pass a decree for damages. What he decreed was only this that the Commissioner

was directed to take accounts and to determine the compensation payable, if any, by way of damages for breach of the contract. Thus, even at

that point of time, no right to receive damages as such for breach of contract accrued or can be said to have accrued to the assessee, much less at

the point of time when there was breach of contract.

12. Besides, the judgment and decree of the learned single judge was challenged in appeal and the appeal was dismissed in the year 1965 only.

Thus, even a mere right to sue for damages for breach of contract could not be said to have accrued to the assessee until then. The dismissal of the

appeal does not certainly improve the mere right to sue qualitatively. At best, the position that the Commissioner was to take accounts for

determining the amount of compensation payable by way of damages for the breach of contract, if any, revived thereby. This only meant that the

Commissioner would then go into all the relevant questions and recommend damages if he is satisfied that the assessee is entitled to the damages. It

is true that, in the year 1968, the Commissioner submitted his report whereby he recommended damages to the extent of Rs. 10,92,000.

However, as state earlier, both the parties filed their objections to the report and but for the compromise reached between the parties, there would

have been prolonged litigation between the parties and it is difficult to say with any amount of certainty as to what would have been the fate of the

litigation. In our judgment, the only reasonable conclusion is that the right to receive damages in this case accrued to the assessee on the date of the

consent decree only. Since, as already stated by us, the right under the agreement came to an end in the year 1961, if not earlier, and the right

acquired in lieu thereof was only a mere right to sue, it cannot be accepted that the amount of Rs. 2,52,000 was received as consideration for the

transfer of a ""capital asset"", i.e., his right to the execution of a lease deed in terms of the 1945 agreement during the previous year. In that view of

the matter, we are in agreement with the Tribunal that no part of the amount of Rs. 2,52,000 was taxable as capital gains. In the premises, it is not

necessary to consider the other aspects of the question such as whether there was any transfer at all or whether there being no cost of such a

capital asset, the amount was taxable.

13. This takes us to the assessee''s reference. So far as the first question is concerned, it is seen that the consent decree, clearly and categorically,

mentions the fact that the amount of Rs. 1,56,030 represents interest for the period from January 30, 1959, up to the date of the consent decree

on the amount of damages for breach of contract determined at Rs. 2,52,000. The Tribunal was, therefore, right in holding that the amount was not

a part of the compensation for breach of contract merely because the decree in the first instance refers to the total amount payable as Rs. 4,08,030

though the break up of the amount is clearly given in the following sentence. In this view of ours, we are fortified by the decision of the Supreme

Court in the case of Dr. Shamlal Narula Vs. Commissioner of Income Tax, Punjab, that interest on the amount of compensation is not a capital

receipt but a revenue receipt. Accordingly, we answer the first question at the instance of the assessee in the affirmative and in favour of the

Revenue.

14. As regards the second question at the instance of the assessee, however, we find that the Supreme Court has held in the cases of

Commissioner of Income Tax, Madras Vs. T.N.K. Govinda Raju Chetty, and Rama Bai and Others Vs. Commissioner of Income Tax, Andhra

Pradesh Hyderabad and Others, that, in the case of interest on compensation, the amount of interest in the case of an assessee following the

mercantile system of accountancy is to be taxed as having accrued from year to year rather that in the year of receipt. Dr. Balasubramanian, on the

other hand, relied on a Kerala High Court decision in Rockwell Engineering Co. Ltd. Vs. Commissioner of Income Tax, for the proposition that

the entire amount of the interest as per the settlement arrived at between the parties ought to be taxed as the income of the year of receipt. In this

context, it is pertinent to note that the assessee''s method of accounting is, of course, mercantile as is evident from the order of assessment.

However, it is not free from doubt whether the assessee can be said to be following the mercantile system of the accountancy in respect of receipts

not forming part of the activities for which accounts are maintained. That apart, it sounds strange that the amount of damages itself is held to accrue

on the date of the consent decree and the interest thereon will have to be held to have accrued from year to year. However, the Supreme Court

decisions Commissioner of Income Tax, Madras Vs. T.N.K. Govinda Raju Chetty, and Rama Bai and Others Vs. Commissioner of Income Tax,

Andhra Pradesh Hyderabad and Others, appear to us to clearly lay down that interest in the case of an assessee following the mercantile system of

accountancy must be taken to have accrued from year to year and not on the date of the order of the court granting enhanced compensation from

the date of delivery of possession of the land till the date of such order. In the circumstances, we take the view that interest in the present case also

is taxable as if it had accrued from year to year from January 30, 1959, to the date of consent decree. Thus, that part of interest which is referable

to the amount of compensation for the year under reference alone will be taxable as the income of the previous year.

15. We are aware that there is some contradiction between our judgment in the wealth-tax references and the judgment herein. While deciding the

wealth-tax references, we have held that the right to receive damages and interest thereon accrued to the assessee on the date of the consent

decree. In this Income Tax reference, we have held that interest has accrued from year to year. In view of the Supreme Court decisions in

Commissioner of Income Tax, West Bengal-II, Calcutta Vs. Hindustan Housing and Land Development Trust Ltd., and Commissioner of Income

Tax, Madras Vs. T.N.K. Govinda Raju Chetty, and Rama Bai and Others Vs. Commissioner of Income Tax, Andhra Pradesh Hyderabad and

Others, , it is not for us to take any other view. In an appropriate case, the Supreme Court will resolve the controversy. As far as we are

concerned, we would like to repeat the comments of the learned commentators Kanga and Palkhivala in their latest treatise on The Law and

Practice of Income Tax at page 222 :

One of the delights of Income Tax law is occasional incongruity. The Supreme Court had held in an earlier case, Commissioner of Income Tax,

West Bengal-II, Calcutta Vs. Hindustan Housing and Land Development Trust Ltd., , that enhanced compensation accrues only when finally

decreed. Thus the effect of the two decisions is that interest on enhanced compensation accrues even before accrual of the enhanced compensation

itself.

16. The incongruity does not end here. Despite the conclusion that interest in such cases accrues from year to year, it is doubtful whether it will be

possible to hold the assessee responsible for not disclosing interest income in the past on accrual basis. The assessee can always take a stand that

the amount of compensation including enhanced compensation or damages having been determined subsequently, he could not possibly anticipate

accrual of interest.

17. In the result, the second question at the instance of the assessee is answered thus :

Only that part of the interest which pertains to the period from April 1, 1969, up to the date of the consent decree is taxable as the assessee''s

income of the year under reference.

18. There will be no order as to costs.