

(2002) 10 BOM CK 0002

In the Bombay High Court

Case No : IT Ref. No. 425 of 1983 23 October 2002 A.Y. 1978-79 & Income-tax
Reference No. 425 of 1983

Amartaara Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 23-10-2002

Acts Referred:

Income Tax Act, 1961 — Section 256(1)

Citation : (2002) 178 CTR 199

Hon'ble Judges : S.H. Kapadia, J;J.P. Devadhar, J

Bench : Full Bench

Advocate : P.J. Pardiwalla with B.D. Damodar instructed by Kanga and Co., for the Assessee and R.V. Desai with P.S. Jetley and Mrs. S.V. Bharucha instructed by T.C. Kaushik, for the Revenue, for the Appellant;

Judgement

S.H. Kapadia, J.

This reference is made by the Tribunal u/s 256(1) of the Income Tax Act, 1961, at the behest of the assessee. It concerns assessment year 1978-79, corresponding to the previous year ending 31-8-1977. Accordingly, the following question of law has been referred to the High Court u/s 256(1) :

"Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that ad hoc compensation received by the assessee from the insurance company was taxable as income for the assessment year 1978-79 ?"

Facts

2. The assessee Amartaara Ltd. is a public limited company. The assessee, along with two other companies, as associate companies, had taken out five (5) policies of insurance under which loss or damage by fire to their buildings, plant and machinery, stock-in-trade, etc., was covered. On 15-8-1976, there was a fire in the factory of the assessee and the building, machinery and stock-in-trade were destroyed. On 19-8-1976, the insurance company addressed a letter to the

assessee and to their associate companies, stating that the insurance company had appointed M/s Mahesh Mehta to survey and assess the loss suffered by the assessee and that on receipt of the survey report, the insurance company shall proceed to settle the claim of the assessee. In the meantime, the assessee was directed to forward the police report and the fire brigade report. On 29-10-1976, the assessee addressed a letter to the insurance company to pay at least Rs. 12.50 lakhs on-account. They also submitted the police report and the fire brigade report to the insurance company. However, the insurance company paid to the assessee, Rs. 8.50 lakhs on 17-12-1976, on-account. By letter dated 24-9-1977, the insurance company made it clear to the assessee that the claim made by the assessee was fraudulent and false. By the said letter they were called upon to refund the on-account payment made to the assessee. They also repudiated their liability under clause 13 of the insurance policy on the ground of collusion between the assessee and the surveyor. On 22-12-1977, the assessee instituted on the original side of the High Court, Suit No. 242 of 1979 for a decree against the insurance company for Rs. 16.44 lakhs with further interest at 18 per cent per annum from the date of the suit till payment. In para 6 of the plaint, the assessee contended that the insurance company was fully satisfied of the loss suffered by the assessee, but the ascertainment of the quantum was likely to take time and, therefore, payment by the insurance company to the assessee amounting to Rs. 8.50 lakhs was in part-payment of the loss suffered by the assessee due to the said fire. In the same paragraph, according to the assessee, the insurance company had admitted and accepted the validity of the assessee's claim, but pending quantification, Rs. 8.50 lakhs was paid by the insurance company for minimum loss suffered by the assessee.

Therefore, the suit was filed by the assessee for recovery of the balance amount of Rs. 13.31 lakhs with interest at 18 per cent per annum. In the said suit, the insurance company has filed a written statement with their counter-claim. As stated above, the fire took place on 15-8-1976. As stated above, Rs. 8.50 lakhs was received by the assessee on 17-12-1976. Although the fire took place on 15-8-1976, i.e., during the assessment year 1977-78, the Income Tax Officer accepted the contention of the assessee that till the insurance company accepted its liability to pay payment, the receipt cannot be brought to tax on accrual basis. Accordingly, the Income Tax Officer brought to tax Rs. 8.50 lakhs in the assessment year in question i.e., 1978-79 as the amount of Rs. 8.50 lakhs was received by the assessee during the assessment year 1978-79. Accordingly, vide assessment order dated 14-8-1980, receipt of Rs. 8.50 lakhs received by the assessee was treated as income for assessment year 1978-79. It was held by the Income Tax Officer that Rs. 8.50 lakhs was received towards total damage suffered by the assessee and their associate companies. Accordingly, on pro rata basis, the Income Tax Officer held that Rs. 7.75 lakhs was received by the assessee herein and that amount was treated as "income" and it was brought to tax accordingly. Being aggrieved, the assessee carried the matter in appeal to Commissioner (Appeals). The order of Income Tax Officer was confirmed. Being

aggrieved the matter was carried in appeal to the Tribunal which took the view that by payment of Rs. 8.50 lakhs, the insurance company had acknowledged their liability to pay the assessee and their associates. That, Rs. 8.50 lakhs was paid on-account. That, by such payment on-account, the insurance company had acknowledged its liability to pay the assessee and their associates. That, subsequent quantification for pendency of the suit in the High Court was irrelevant. That, section 41(2) of the Act was not invoked by the department. Consequently, the Tribunal accepted the case of the department. Being aggrieved, the matter has come by way of reference to this court. The assessee had filed Suit No. 242 of 1979, which was unconditionally withdrawn by the assessee on 31-7-1998.

Arguments

3. On behalf of the assessee, it was contended by Mr. Pardiwalla, learned Counsel, that the assessee had shown the said receipt of Rs. 7.75 lakhs as liability. That, in the company's account, the assessee did not appropriate the said amount to any asset. That, the said amount was not credited in the profit and loss account. Therefore, the entire receipt was shown in the books of the assessee as having accrued on capital account. He contended that the assessee received the amount as ad hoc. He contended that the burden was on the department to determine the character of that receipt as income. He contended that in this case, two points arise for determination. Firstly, whether receipt of Rs. 8.50 lakhs was on revenue account and, whether it could be treated as income as done by the Income Tax Officer. According to the assessee, the entire amount of Rs. 8.50 lakhs was on capital account and, therefore, it was not taxable. In the alternative, it was argued on behalf of the assessee that in any event, what was insured by the assessee was plant and machinery, building and stock-in-trade and, therefore, it was not open to the department to bring to tax, the entire amount of Rs. 8.50 lakhs as income and that the department should have bifurcated/apportioned the said amount. In this connection he submitted that under the five insurance policies, stock-in-trade as well as plant, machinery and buildings were insured. He contended that receipt attributable to the loss on account of fire to plant, machinery and building would constitute a capital receipt, whereas loss to stock-in-trade for which the insurance company paid compensation could be brought to tax as revenue receipt. He contended as an alternate argument that, therefore, the matter should be remanded back to the Income Tax Officer to make fresh calculations on the basis of the bifurcation between loss to stock-in-trade on one hand and loss to plant, machinery and building on the other hand. This was the first argument advanced on behalf of the assessee. Secondly, it was urged that in cases of insurance contracts, the assessee's right to make a claim arises when the event takes place but the assessee's right to compensation accrues only when the insurance company accepts their liability.

That, on-account payment or ad hoc payment can never amount to acceptance

of claim. That, on-account claim was subject to finalization of the claim. That, even assuming for the sake of argument that in cases of insurance contracts the liability arises when the event takes place, even then, the Income Tax Officer did not assess the receipt in the assessment year 1977-78 when the fire took place, but the Income Tax Officer has assessed the receipt in assessment year 1978-79 as during that assessment year, Rs. 8.50 lakhs were received. Shortly, therefore, two points arise for determination, viz., whether receipt of Rs. 8.50 lakhs was on revenue account and secondly, whether it has been rightly brought to tax during the assessment years 1978-79. According to the learned counsel for the assessee, the basic test which should be applied on the second point is as to when the insurance company had accepted its liability. It was contended that in this case, the insurance company has not accepted its liability at any point of time. That, the insurance company had invoked clause 13 of the policy on the ground of fraudulent suppression of facts. That the matter was sub judice. That, the payment made on 17-12-1976, was on-account. It was an ad hoc payment. That, such payment can never constitute acceptance of its liability by the insurance company. That, the insurance company had repudiated the claim of the assessee by letter dated 24-9-1977, after payment of Rs. 8.50 lakhs and that the suit was filed on 22-12-1977. Therefore, the repudiation was also during the assessment year in question, viz., 1978-79. In the circumstances, it was submitted that the said receipt of Rs. 8.50 lakhs was on capital account. That, it was a capital receipt and, therefore, not chargeable to tax. Secondly, it was contended that in any event, no income accrued to the assessee during the assessment year 1978-79. That, during that assessment year 1978-79, the insurance company had not acknowledged their liability. That, no debt was created in favour of the assessee during the assessment year 1978-79. That the department has not invoked section 41(2) of the Act and, therefore, the argument was advanced on behalf of the assessee on general principles. That, unless the insurance company accepts their liability, income cannot be said to accrue to the assessee. That, on-account payment can never amount to acceptance of liability by the insurance company. That, income accrued accrues to the assessee only when the right to receive that income accrues.

Per contra, it was argued on behalf of the department that Rs. 8.50 lakhs was paid to the assessee and their associate company towards ultimate compensation. That, in this case, no material is produced by the assessee as to computation of loss vis-a-vis plant, machinery and building on one hand, and stock-in-trade on the other hand. That, no evidence is produced regarding the material destroyed in the fire. It was contended that under the policy in question, the right accrued to the assessee when the accident took place and on payment of Rs. 8.50 lakhs. That, filing of the suit in the High Court was for additional amount and, therefore, such subsequent events were irrelevant for judging the taxability of the receipt as "income". Reliance was placed on the judgments of the Supreme Court in *Commissioner of Income Tax, Bombay City Vs. Chunilal and Mehta and Sons P. Ltd.*, *Babulal Narottamdas and others Vs. Commissioner*

of Income Tax, Bombay, , COMMISSIONER OF INCOME TAX Vs. UNITED PROVINCES ELECTRIC SUPPLY COMPANY, and Central India Electric Supply Co. Vs. Commissioner of Income Tax,

By way of rejoinder it was urged by Mr. Pardiwalla that amounts received on destruction of a capital asset can never constitute revenue receipt. That, such receipt has to be construed only as capital receipt. He relied upon the judgment of the Supreme Court in The Commissioner of Income Tax, Andhra Pradesh, Hyderabad Vs. Sirpur Paper Mills Ltd., Hyderabad, . He contended that in the said judgment, it has been laid down that amounts received on destruction of capital assets are to be treated as receipt on capital account. He further contended that the onus was on the revenue to prove that receipt of Rs. 8.50 lakhs was on revenue account. He contended that this burden has not been discharged by the department. In this connection, he relied upon the judgment of the Supreme Court Parimiseti Seetharamamma Vs. Commissioner of Income Tax, Hyderabad, . He contended that merely because the insurance company pays Rs. 8.50 lakhs on-account, it does not follow that the insurance company had accepted its liability or that income had accrued to the assessee. That, unless the insurance company accepted their liability, income cannot accrue to the assessee. That, payment on-account cannot vest in the assessee the right to receive.

Findings

4. The short question which arises for determination in this reference is whether receipt of Rs. 8.50 lakhs was taxable as income if so, whether it was taxable in the assessment year 1978-79 ? We are confining our judgment to the facts of this case. At the very outset, we may also clarify that no evidence has been led by the assessee giving apportionment of the loss suffered by them on account of damage to plant, machinery and building on one hand and damage to stock-in-trade on the other hand. As stated hereinabove, it has been vehemently urged on behalf of the assessee in the reference that payment of Rs. 8.50 lakhs was "on-account" payment. That, it was an ad hoc payment. That, by such payment, the insurance company has not admitted its liability to compensate the assessee and, therefore, no income accrued to the assessee. This was the argument of the assessee before the Commissioner (Appeals) and the Tribunal also. In support of their case, the assessee had relied upon the suit instituted by them in the High Court, being suit No. 242 of 1979. The plaint has been annexed to the paper book (minus the insurance policy). However, vide para 6 of the plaint, the assessee averred that payment of Rs. 8.50 lakhs by the insurance company was in part-payment of the loss suffered by the assessee. That the insurance company was fully satisfied of the loss suffered by the assessee. That, only ascertainment of the quantum was deferred. That, by payment of Rs. 8.50 lakhs the insurance company had admitted and accepted the validity of the assessee's claim. That, Rs. 8.50 lakhs was paid on account of minimum loss suffered by the assessee. In the circumstances, it is assessee's own case in the plaint, relied

upon by the assessee before the department in the assessment proceedings, that Rs. 8.50 lakhs was in part-payment of the loss suffered by them and that the insurance company had accepted the validity of their claim by making such payment. This fact is very important, particularly when the assessee chose to rely upon the plaint in support of their case before the department. The question as to whether a receipt was taxable as income was required to be proved by the department. However, in this case, that burden stands discharged when the assessee has relied upon the plaint in the suit in which they have averred that Rs. 8.50 lakhs was paid on account of minimum loss suffered by them and that by such payment, the insurance company had admitted and accepted the validity of the claim of the assessee. It has been urged before us repeatedly by the assessee that income accrues when the insurance company accepts their liability. On their own showing in para 6 of the plaint, according to the assessee on payment of Rs. 8.50 lakhs the insurance company had accepted their liability. In the circumstances, in the assessment year in question income accrued to the assessee. In fact, for the earlier year the assessee had contended before the Income Tax Officer that the insurance company had not accepted their liability nor had the insurance company paid any compensation in that earlier year and, therefore, it was argued by the assessee for the earlier year that income had not accrued, either on accrual basis or on receipt basis. This argument was accepted by the Income Tax Officer for the earlier year. However, in the assessment year 1978-79, Rs. 8.50 lakhs was received and it is the case of the assessee that this amount, paid by the insurance company, amounted to acceptance of the liability by the insurance company. It is now well settled that receipt of compensation in such matters could be on capital account or on revenue account. One has to go by the facts of each case. We are confining our judgment to the facts of this case. Accordingly, we answer the above question in the affirmative, i.e., in favour of the department and against the assessee.

Conclusion

5. On the facts and circumstances of the case, we answer the above question in the affirmative, i.e., in favour of the department and against the assessee.

6. Accordingly, the reference is disposed of. No order as to costs.

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