(1997) 12 AHC CK 0026

In the Allahabad High Court

Case No : Income-tax Reference No. 206 of 1982

Commissioner of Income Tax APPELLANT

Vs

Malik Construction Co. RESPONDENT

Date of Decision : 23-12-1997

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Section 34
Income Tax Act, 1961 — Section 256(1)

Citation : (1999) 238 ITR 450 : (1999) 106 TAXMAN 175

Hon'ble Judges : R.K. Gulati, J;M.C. Agarwal, J

Bench : Division Bench

Judgement

R.K. Gulati, J.—At the instance of the Commissioner of Income Tax, Meerut, the Income Tax Appellate Tribunal, Delhi Bench "D" has referred the following question of law for the opinion of this court u/s 256(1) of the Income Tax Act, 1961 :

"Whether, on the facts and circumstances of the case, the Tribunal was. legally correct to confirm the order of the Commissioner of Income Tax (Appeals) holding that the sum of Rs. 2,00,080 received as interest should be treated as that of payment in the nature of ex gratia payment that cannot be liable to tax ?"

2. The dispute pertains to the assessment year 1977-78. During that year the assessee was a registered firm engaged in the business of execution of works contract. It had executed a contract "Balimela Project" for the Government of Orissa. After the receipt of the said contract in the year 1974 certain disputes arose between the assessee and the contracted (i.e., the Government of Orissa). The assessee claimed that it had to carry out certain work over and above the items stipulated in the agreement. It demanded payment for the additional work and also interest thereon at the rate of 15 per cent, from the date when the payment ought to have been made till July 13, 1974. The matter was ultimately referred to arbitration and the arbitrator gave an award dated May 21, 1976, holding that the assessee was entitled to recover Rs. 3,19,244 for the additional

items of work executed by the assessee and the interest on the said amount at 12 1/2 per cent. which was calculated at Rs. 96,226. Thus, the assessee became entitled to recover Rs. 4,15,470 on this amount, the arbitrator further awarded pendente lite interest at 12 1/2 per cent. per annum for the period July 14, 1974 to May 21, 1976. The total amount of compensation awarded came to Rs. 5,16,020. The arbitrator also directed that the said amount was payable within 45 days of the date of award otherwise the assessee was entitled to further interest at 6 per cent. to be carried from the date of default till the date of payment. Because of the default provision the assessee received an amount of interest amounting to Rs. 3,304. In this way the total amount received under the award was Rs. 5,19,324. After adjusting an amount of Rs. 13,611 as irrecoverable security from the State Government, the balance amount of Rs. 5,05,713 was transferred by the assessee to its profit and loss account in the previous year relevant to the assessment year under consideration. In the agreed statement of the case the Tribunal has stated that the "assessee, however, showed net profit of Rs. 3,76,691 only and declared the income at still shorter amount of Rs. 1,80,877. One of the disputes at the stage of assessment was that according to the assessee an amount of Rs. 2,00,080 received by way of interest was not liable to be taxed." The case taken was that the interest payable by the contractee was neither under a statute nor under a contract and so it was only on an ex gratia basis and cannot be taxed as a revenue receipt. The Income Tax Officer, however, did not accept the claim of the assessee and completed the assessment on the income 6f Rs. 3,30,256.

3. The assessee carried the matter in appeal. The appellate authority relying upon a decision of the Orissa High Court in Govinda Choudhury and Sons Vs. Commissioner of Income Tax, , accepted the claim of the assessee on the view that in a case where interest was awarded neither under a statute nor under a contract, the same was not eligible to tax with the result, it directed that the amount of Rs. 2,00,080 be excluded from the computation of the total income of the assessee.

4. The Revenue felt aggrieved and preferred a second appeal before the Income Tax Appellate Tribunal which was dismissed with the following observation :

". . . learned Departmental Representative did not point out any feature to distinguish the facts of the present case from those of Govinda Choudhury and Sons Vs. Commissioner of Income Tax, . That being the position, we see no reason to disturb the learned Commissioner''s finding. On the assessee''s side, copy of the Delhi Bench of the Tribunal''s decision dated April 7, 1981, in the case of one (Dewan Chand Chadha-I. T. A. No. 1598 (Delhi) of 1980), was also produced. In that case, the Tribunal had, under circumstances similar to those obtaining in the present case, relied on the ruling in the case of Govinda Choudhury and Sons Vs. Commissioner of Income Tax, , and had felt bound to follow that view in view of Commissioner of Income Tax Vidarbha Vs. Godavaridevi Saraf, Revenue fails. Appeal is dismissed."

5. We have heard learned counsel for the parties. The question to be considered is whether the amount of Rs. 2,00,080 received by the assessee as the amount of interest under the award by the arbitrator, could be taxed as its income. It was argued on behalf of the assessee that the amount in dispute constituted damages for unlawful retention of money by the authorities concerned of the Orissa Government and, therefore, it was a capital receipt.

6. We do not think that there is any justification for this argument. The controversy between a capital and revenue receipt has defied solution. A review of the reported decisions on the subject would indicate that the courts have enunciated various rules as furnishing a key to the solution of the controversy but the courts have not been able to lay down any single test as infallible which could be regarded as decisive in all eventualities in determining the question, which must ultimately depend on the facts of the particular case. The name given to the sum awarded have varied ; "damages", "interest", "compensation" but the label under which the amount is received, is not conclusive for determination of the question with which we are concerned.

7. In the decision relied upon by the Govinda Choudhury and Sons Vs. Commissioner of Income Tax, , a Division Bench of the Orissa High Court had expressed the view that where interest had been awarded under a statute or under a contract, the same is income eligible to tax. However, where it is not attributable to either statute or contract but has been awarded on an ex gratia basis ; it would partake of character of compensation though styled as the payment of interest and was not, therefore, a revenue receipt liable to tax.

8. In Secretary, Irrigation Department, Government of Orissa and others Vs. G.C. Roy, , one of the questions that fell for consideration before a Constitution Bench of the Supreme Court was whether the arbitrator had no power to award pendente lite interest. Earlier in a three-judge Bench decision of the Supreme Court in Executive Engineer (Irrigation), Balimela and Others Vs. Abhaduta Jena and Others, , the view expressed was that the arbitrator to whom the reference is made without the intervention of the court does not have jurisdiction to award interest pendente lite. While overruling the above decision, after a detailed discussion and review of a good deal of case law, if we may say so with respect, it was pointed out that where a person is deprived of the use of money to which he is legitimately entitled he has a right to be compensated for the deprivation, call it by any name. It may be called interest, compensation or damages. The basic consideration is as valid for the period the dispute is pending before the arbitrator as it is for the period prior to the arbitrator entering upon the reference. This is the principle of Section 34 of the CPC and there is no reason or principle to hold otherwise in the ease of arbitration. It was held that where the agreement between the parties does not prohibit grant of interest and where a party claims interest and that dispute (along with the claim for the principal amount or independently) is referred to the arbitrator, he shall have the power to award interest pendente lite. This is for the reason that in such a case it must be

presumed that interest was an implied term of the agreement between the parties and, therefore, when parties refer all their disputes to the arbitrator, he shall have the power to award interest.

9. Now, if the quality of the claim for interest is compensation, for the reason that the claimant had been deprived of the use of the money and had not had his money at the due date, it would be income in his hands. It may be regarded either as representing the profit he might have made if he had had the use of the money in time or conversely the loss he had suffered because he had not had that use.

10. It would be useful at this stage to refer to the decision of the House of Lords in Riches v. Westminster Bank Ltd. [1947] 15 ITR (Suppl.) 86, where it was pointed out that there was no incompatibility for the purpose of Income Tax between "interest proper" and "interest by way of damages". The court observed that it is immaterial whether the money was due to him under the contract express or implied or statute or whether the money was due only for any other reason in law. In either case, the money was due to him and not paid or in other words, was withheld from him by the debtor after the time when the payment should have been made, in breach of his legal rights and the interest was a compensation. The court further observed whether the compensation was liquidated under an agreement or was unliquidated or claimable under the agreement or statute, was of little relevance. The essential quality of the compensation is the same and the compensation is properly described as interest.

11. The decision of the Orissa High Court in Govinda Choudhury and Sons Vs. Commissioner of Income Tax, , was appealed against by the Revenue before the Supreme Court in Commissioner of Income Tax, Orissa Vs. Govinda Choudhury and Sons, Gosaninuagaon, Orissa, , and it was observed (page 884) :

"The assessee is a contractor. His business is to enter into contracts. In the course of the execution of these contracts, he has also to face disputes with the State Government and he has also to reckon with delays in payment of amounts that are due to him. If the amounts are not paid at the proper time and interest is awarded or paid for such delay, such interest is only an accretion to the assessee''s receipts from the contracts. It is obviously attributable and incidental to the business carried on by the assessee . . . .".

12. The court then pointed out that

". . . it is difficult to comprehend how the interest receipts by the assessee can be treated as receipts which flow to him de hors the business which was carried on by him."

13. Their Lordships also held that the interest payable in such circumstances to the contractor partakes of the same character as the receipt for the payment of which he was otherwise entitled under the contract and which payment had been delayed as a result of certain dispute between the parties. The interest cannot be

separated from the other amount granted to the contractor under the award.

14. In Commissioner of Income Tax Vs. Builders Union, and CIT v. Lenka (A.) and Partners [1995] 215 ITR 298 , two different Division Benches of the Orissa High Court in referring to the decision of the Supreme Court on appeal in the case of Commissioner of Income Tax, Orissa Vs. Govinda Choudhury and Sons, Gosaninuagaon, Orissa, , have held that the earlier decision of that High Court was no longer a good law. Following the ratio of the Supreme Court decision it was held that the interest out of award was taxable.

15. In view of the above discussion and the legal position that emerges from the decisions discussed above, it must be held that the receipt of pre-award and post-award interest was a revenue receipt attributable and incidental to the business carried on by the assessee and it bears the same character of receipts payment of which it was otherwise entitled to under the contract. The disputed amount of interest is only an accretion to the assessee''s receipts from the contract business. The Income Tax Tribunal was not legally correct in taking the view that the sum of Rs. 2,00,080 received as interest by the assessee was an ex gratia payment which was not liable to tax.

16. The question referred to this court is, therefore, answered in the negative, in favour of the Revenue and against the assessee.

