
(1988) 03 MAD CK 0024

In the Madras High Court

Case No : Tax Case No's. 521 to 523 of 1979

E.I.D. Parry Limited

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 11-03-1988

Acts Referred:

Income Tax Act, 1961 — Section 2(47), 254, 256(1), 45, 48

Citation : (1988) 69 CTR 49 : (1988) 174 ITR 11

Hon'ble Judges : M.N. Chandurkar, J; M. Srinivasan, J

Bench : Division Bench

Advocate : K.R. Ramamani, for the Appellant; N.V. Balasubvramaniam, for the Respondent

Judgement

Srinivasan, J.—The question of law referred to us by the Income Tax Appellate Tribunal, Madras, reads as follows :

Whether, on the facts and in the circumstances of the case, the amounts of Pounds 34,674, Pounds 52,301 and Pounds 23,832 are taxable as

revenue receipts or short-term capital gains ?

2. The facts leading to the reference lie in a small compass. The assessee-company was incorporated in England in 1897, under the English

Companies Act, the liability of the members being limited. It has shareholders in U. K. and India. The capital is collected in sterling and entered in

the U. K. register. The business is carried on in India. The balance-sheet and the profit and loss account are mainly published in terms of sterling

and corresponding balance-sheets, etc., in rupees also are made out. The income of the assessee for tax purposes is worked out on the basis of

rupee accounts. In 1965, the assessee had a proposal for the expansion of the fertiliser factory at Ennore and for that purpose decided to increase

its share capital by means of issue of ordinary shares. After obtaining the necessary consent of the treasury of the U.K. to the issue, shares were offered to the U.K. shareholders and amounts received from them were received and retained in the U. K. subject to the directions and restrictions imposed by the Reserve Bank of India and the Controller of Capital Issues. The company issued 4,42,570 equity shares as right shares to the existing shareholders at a premium of 16 sh. per share as regards non-resident shareholders. The allotment of shares was made on November 16, 1965. The assessee had a total amount of Pound 1,91,074 available in the U. K. out of which a portion was utilised for purchase of plant and machinery in the U.K. for the Ennore unit. The balance was repatriated to India to be utilised for the specific purpose for which the collection was made. The company's accounting year ended with September 30, each year. During the previous years relevant to the assessment years 1967-68, 1968-69 and 1969-70, the amounts repatriated came to Pound 95,200, Pound 5,874 and Pound 5,124, respectively.

3. The Indian currency was devalued on June 6, 1966, and as against the original value of Rs. 13.33 per pound sterling, the value came to Rs. 21 per pound. On account of devaluation, there was a surplus of Rs. 7,28,154 equivalent to Pound 34,674 in the remittance of Pound 95,200.

Similarly, in the remittances of Pound 6,874 and Pound 5,124, there were surpluses of Rs. 52,301 and Rs. 23,832, respectively. The assessee claimed before the Income Tax Officer that the surplus amounts represented capital receipts and were not taxable. The Income Tax Officer did not accept the contention and brought to tax all the three amounts treating them as revenue receipts.

4. On appeal, the Appellate Assistant Commissioner accepted the case of the assessee and held that the excess amount was not part of the trading transaction but an accretion to the capital raised in a foreign country. On further appeal by the Department, the Tribunal agreed with the assessee and held that it was not a revenue receipt and hence not taxable. However, the Tribunal held that the excess obtained by the assessee amounted to short-term capital gain and was taxable on that ground.

5. The aggrieved assessee sought for a reference and the Tribunal referred to us the question of law set out at the commencement of this judgment.

At the outset, learned counsel for the assessee takes exception to the framing of the question by the Tribunal. His complaint is that there was no application, oral or written, by the Revenue for reference as to whether the surplus is a revenue receipt or not. According to learned counsel, the finding of the Tribunal that the amount in question is not a revenue receipt became final in the absence of an application for reference and it is not open to the Tribunal to include the question in the reference made at the instance of the assessee. This argument is countered by learned counsel for the Revenue who contends that the order of the Tribunal in appeal is entirely in favour of the Revenue inasmuch as the entire amount has been held to be taxable and that the rate of tax for short-term capital gains being the same as the rate for revenue receipts, the Revenue is not a party aggrieved by the result of the appeal. It is, therefore, submitted by him that in a reference application filed by the assessee, it is open to the Revenue to canvass the points found against the Revenue by the Tribunal.

6. The law on this subject is settled by the decision of the Supreme Court in Commissioner of Income Tax, Kerala Vs. V. Damodaran, , on which reliance is placed by counsel on both sides. In that case, the managing director of a private company withdrew from the company during the period January to March, 1959, amounts totalling Rs. 25,107. The balance-sheet of the company as at March 31, 1958, showed a net profit of Rs. 18,950. The managing director claimed that against the profit of Rs. 18,950, provision for taxation of Rs. 11,000 and provision for dividend of Rs. 6,900 had to be deducted and only the balance of Rs. 1,050 could be considered as deemed dividend u/s 2(6A)(e) of the Indian Income Tax Act of 1922. Rejecting that contention, the Income Tax Officer assessed the whole amount of Rs. 25,107 as deemed dividend u/s 2(6A)(e) by taking into consideration also the current profits of the year ending March 31, 1959. The Tribunal held that the current profits could not be taken into consideration, and rejecting the contention of the assessee, also held that the two sums of Rs. 11,000 and Rs. 6,900 had to be taken into account as accumulated profits of the company for the purpose of section 2(6A)(e). On the Department's application for a reference, the Tribunal referred the question whether the Tribunal was right in holding that the accumulated profits will not include the current profits for the purpose of

section 2(6A)(e) of the Income Tax Act. At the assessee's request, the Tribunal included in the same reference the further question whether the

Tribunal was right in holding that Rs. 18,950 constituted accumulated profits for the purposes of the said section. The High Court answered both

the questions in favour of the assessee. The Department appealed to the Supreme Court. The Supreme Court held that the Tribunal was not

competent to refer the second question at the instance of the respondent on an application filed by the Revenue and the reference of that question

must be considered to be void. The Supreme Court found that the two questions involved the grant of separate and distinct reliefs and the decision

of one did not affect the decision of the other. The position in law was stated by the Supreme Court in the following terms (p. 578) :

Section 256(1) of the Income Tax Act, 1961, entitles the assessee or the Commissioner, as the case may be, to apply to the Appellate Tribunal to

refer to the High Court any question of law arising out of the order made by the Appellate Tribunal u/s 254. A period of limitation for making such

application is prescribed. If the application is rejected by the Appellate Tribunal, the applicant is entitled to apply to the High Court, again within a

prescribed period of limitation, and the High Court may, if it is not satisfied with the correctness of the decision of the Appellate Tribunal, require

the Appellate Tribunal to state the case and refer it. It is clear that the statute expressly contemplates an application in that behalf by a party

desiring a reference to the High Court. The application has to be filed within a prescribed period of limitation. If the application is rejected by the

Appellate Tribunal, it is the applicant thus refused who is entitled to apply to the High Court. If the Appellate Tribunal allows the application made

to it, section 256(1) requires it to draw up the statement of the case and refer it to the High Court. The statement of the case is drawn up on the

basis of the application made by the applicant, who, in that application, must specify the questions of law which, he claims, arise out of the order of

the Appellate Tribunal made u/s 254. The form of reference application prescribed by rule 48 of the Income Tax Rules, 1962, specifically requires

the applicant to state the questions of law which he desires to be referred to the High Court. He may, in appropriate cases, be permitted by the

Appellate Tribunal, to raise further questions of law at the hearing of the reference application. But, in every case, it is only the party applying for a

reference who is entitled to specify the questions of law which should be referred. Nowhere in the statute do we find a right in the non-applicant (a phrase used here for convenience) to ask for a reference of questions of law on the application made by the applicant.

In this connection, two categories of cases can be envisaged. One consists of cases where the order of the Tribunal under section 254 has decided

the appeal partly against one party and partly against the other. This may be so whether the appeal consists of a single subject matter or there are

more than one independent claim in the appeal. In the former, one party may be aggrieved by the grant of relief, even though partial, while the other

may be aggrieved by the refusal to grant total relief. In the latter, relief may be granted or refused with reference to individual items in dispute, and

accordingly, one party or the other will be aggrieved. In either case, the party who is aggrieved and who desires a reference to the High Court

must file a reference application for that purpose. It is not open to him to make a reference application filed by the other party the basis of his claim

that a question of law sought by him should be referred. The second category consists of cases where the order made by the Appellate Tribunal

u/s 254 operates entirely in favour of one party, although in the course of making the order, the Appellate Tribunal may have negatived some points

of law raised by that party. Not being a party aggrieved by the result of the appeal, it is not open to that party to file a reference application. But,

on a reference application being filed by the aggrieved party, it is open to the non-applicant, in the event of the Appellate Tribunal agreeing to refer

the case to the High Court, to ask for a reference of those questions of law also which arise on its submissions negatived in appeal by the Appellate

Tribunal. It is, as it were, recognising a right in the winning party to support the order of the Appellate Tribunal also on grounds raised before the

Appellate Tribunal but negatived by it.

7. Learned counsel for the assessee contends that the present case falls under the first category of cases envisaged in the above passage, while

according to learned counsel for the Revenue, it falls under the second category of cases, referred to by the Supreme Court. In our view, the

present case will fall under the first category and not under the second category. If the amount in question is a revenue receipt as contended by the

Department, it cannot be treated as a capital gain. If, on the other hand, it is a capital gain arising out of a transfer of capital asset, then it will not be a revenue receipt. The findings on the two questions will be mutually exclusive. It will not be possible for the Revenue to contend that the surplus amount under consideration is a revenue receipt unless it attacks the finding that it is a capital gain. This will not be a case of the winning party supporting the order of the Tribunal on grounds negated by the Tribunal, as the conclusion of the Tribunal that it is a capital gain cannot be supported by contending that it is a revenue receipt. The decision on the question whether it is a revenue receipt or not is not ancillary or incidental to the question whether it is a capital gain. The findings are independent of each other and have to be challenged separately if a party is aggrieved thereby. In this case, the Revenue did not apply for a reference in the prescribed form as required by section 256(1) of the Income Tax Act. As pointed out by learned counsel for the assessee, there was not even an oral request at the time when the application for reference filed by the assessee was considered by the Tribunal. The Tribunal did not have any power to refer the question suo motu. Hence, the Tribunal was not competent to refer the question whether the amounts under consideration are taxable as revenue receipts. To that extent, the reference must be considered to be void.

8. However, learned counsel on both sides argued the question relating to revenue receipts on merits also. Learned counsel for the assessee supported the finding of the Tribunal that the surplus amounts are not revenue receipts by relying upon the decision of the Bombay High Court in Commissioner of Income Tax, Bombay City-III Vs. Popular Metal Works and Rolling Mills, . In that case, the Bombay High Court laid down the following test to find out whether the excess amount partakes of the nature of a revenue receipt or otherwise. It was held that in order to decide whether the excess amount received by the assessee partakes of the nature of a revenue receipt, it has to be decided whether the receipt is in respect of a trading asset or whether it is in respect of a capital asset. In other words, what has first to be determined is whether the excess amount which has accrued to the assessee arises out of a transaction in respect of a trading asset or in respect of a capital asset. After referring to a

number of decisions of various courts, the Bombay High Court referred to the decision of the Supreme Court in Commissioner of Income Tax,

Mysore Vs. The Canara Bank Ltd., , and observed as follows (p. 372 of 142 ITR) :

Therefore, the reason why the excess was held to be a capital receipt was the finding that the amounts at the time when they were remitted to

India were held as capital and it ceased to be stock-in-trade. It is difficult to see how any assistance can be sought by learned counsel for the

assessee from this decision. We may, however, point out that in the same case, the Supreme Court pointed out that if by virtue of exchange

operations, profits are made during the course of business and in connection with business transactions, the excess receipts on account of

conversion of one currency into another would be revenue receipts. But, if the profit by exchange operations comes in, not by way of business of

the assessee, the profit would be capital. These observations will also show that on the view which we have taken that the recovery of

compensation for the stock-in-trade lost on account of being seized by the Government of Pakistan was in connection with the business transaction

of the assessee, viz., as a dealer in stock-in-trade, in view of the decision of the Supreme Court in Commissioner of Income Tax, Mysore Vs. The

Canara Bank Ltd., also, the excess receipt would be of a revenue nature.

9. The Bombay High Court also made a reference to the decision of the Supreme Court in Suttle Cotton Mills Limited Vs. Commissioner of

Income Tax, Calcutta, , in which the principle of law has been stated thus (p. 13 of 116 ITR) :

The law may, therefore, now be taken to be well settled that where profit or loss arises to an assessee on account of appreciation or depreciation

in the value of foreign currency held by it, on conversion into another currency, such profit or loss would ordinarily be trading profit or loss if the

foreign currency is held by the assessee on revenue account or as a trading asset or as part of circulating capital embarked in the business. But, if

on the other hand, the foreign currency is held as a capital asset or as fixed capital, such profit or loss would be of capital nature.

10. In the present case, it is not in dispute that the amount kept in the U. K. arose out of subscription monies received for allotment of shares and

there was no question of any sale of stock-in-trade. The issue of shares was itself

for the express purpose of expansion of the assessee's fertilizer factory at Ennore. There is no dispute that a part of the amount was utilised for purchase of plant and machinery in U. K. and the other part was repatriated to India to be utilised for the purposes for which it was collected. The Tribunal has found that there is no direct relation between the excess amount and the business of the assessee. Hence, the finding of the Tribunal that the amount cannot be held to be a revenue receipt is correct on the facts of the case. We do not agree with the contentions urged by learned counsel for the Revenue that the amount was only a cash balance and that it was a circulating capital. On the findings of fact given by the Tribunal, there can be no doubt that the amount in question is not a revenue receipt.

11. The only other question is whether the surplus amount is a short-term capital gain. The reasoning of the Tribunal on this aspect of the matter is that the assessee purchased the pound sterling in the United Kingdom at a particular price from the bank and kept it with the bank and when the same was remitted to India, the bank sold it to him at the enhanced rate of exchange. According to the Tribunal, the surplus which arose out of the sale by the bank of the foreign currency, which was held by the bank on behalf of the assessee, is like a capital gain arising out of the sale of any other asset such as plant, machinery, furniture or building belonging to the assessee. The Tribunal observed that so long as the bank held the pound sterling on behalf of the assessee, there is no such transfer or conversion into rupees, but the moment it is remitted into India and the assessee's account is credited in rupees in the Indian banks, the dealer in exchange has obtained for the assessee a surplus on the transfer of the exchange, and that would clearly be a short-term capital gain and taxable as such. According to the Tribunal, the assessee acquired the pound sterling by purchasing it in 1965, when the shares were issued and sold them in 1966, when the surplus was credited after devaluation.

12. We do not find it possible to agree with the reasoning of the Tribunal which is based on a fundamental misconception. The Tribunal is clearly wrong in observing that the assessee purchased pound sterling in the United Kingdom at a particular price in 1965 when the shares were issued.

The assessee-company could not be said to have acquired foreign currency at a

cost. Learned counsel for the Revenue proceeded to contend that when a company allots shares to the shareholders, the price of the share would be the cost at which the company acquires the currency. Learned counsel for the Revenue contended that a share is the interest of a shareholder in the company measured by a sum of money. Learned counsel invited our attention to a passage in Gower's Principles of Modern Company Law, Fourth Edition, page 397, which reads thus :

What, then, is the exact juridical nature of a share ? At the present day, this is a question more easily asked than answered. In the old deed of settlement company, which was merely an enlarged partnership with the partnership property vested in trustees, it was clear that the members' "shares" entitled them to an equitable interest in the assets. It is true that the exact nature of this equitable interest was not crystal clear, for the members could not, while the firm was a going concern, lay claim to any particular asset or prevent the directors from disposing of it. Even with the modern partnership, no very satisfactory solution to this problem has been found, and the most one can say is that the members have an equitable interest, often described as a lien which floats over the partnership assets throughout the duration of the firm, although it only crystallises on dissolution. Still, there is admittedly some sort of proprietary nexus (however vague and ill-defined) between the partnership assets and the partners.

13. Learned counsel proceeded to refer elaborately to the definition of "Capital" and the procedure for the raising of share capital. He drew our attention to the various provisions of the Companies Act, and submitted that the money obtained by a company on the issue of shares would tantamount to acquisition of an asset by the company and that the cost of such acquisition is the cost of the shares issued. We do not find any substance in the argument advanced by learned counsel for the Revenue on this portion of the case. We are unable to subscribe to the view that a company acquires money at the cost of the share and the cost of such acquisition is the cost of the share. It may be that a shareholder acquires a share at a particular cost; but the company can never be said to acquire the money at the cost of the amount received by it.

14. For the purpose of determining capital gains u/s 45 of the Income Tax Act,

the requirements of section 48 of the Act should be fulfilled. There should be an element of consideration received or accruing as a result of the transfer and there should be the cost of acquisition of the capital asset. Unless these elements are present, the provisions relating to taxation of capital gains will not apply. Even if there is a transfer of asset, if the transaction does not fall within the terms of section 48 of the Income Tax Act, there will be no liability for taxation as capital gains. This principle is recognised by the Supreme Court in *Sunil Siddharthbhai Vs. Commissioner of Income Tax, Ahmedabad, Gujarat*, . In that case, it was held that there was a transfer of a capital asset within the terms of section 45 of the Income Tax Act, where a partner of a firm makes over capital assets which are held by him to a firm as his contribution towards capital, but, as the consideration which a partner acquires on making over his personal asset to the firm as his contribution to its capital cannot fall within the terms of section 48 of the Income Tax Act, such a case must be regarded as falling outside the scope of capital gains taxation altogether. The Supreme Court observed that the provision in section 48 of the Income Tax Act is fundamental to the computation machinery incorporated in the scheme relating to the determination of the charge provided in section 45 of the Income Tax Act. In our view, the ratio of the decision of the Supreme Court would apply to the facts of the present case as the terms of section 48 of the Income Tax Act are not fulfilled in this case too.

15. The Supreme Court had also referred to an earlier decision in *Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty*, , on which considerable reliance is placed by learned counsel for the assessee in the present case. In *Commissioner of Income Tax, Bangalore Vs. B.C. Srinivasa Setty*, , the question related to the transfer of the goodwill in a newly commenced business. The Supreme Court held that transfer of such goodwill does not give rise to a capital gain for the purposes of Income Tax. After holding that goodwill is an asset of the business, the Supreme Court posed to itself the question whether it is an asset contemplated by section 45 of the Income Tax Act and answered the same in the following words (p. 299 of 128 ITR) :

Section 45 charges the profits or gains arising from the transfer of a capital asset to Income Tax. The asset must be one which falls within the

contemplation of the section. It must bear that quality which brings section 45 into play. To determine whether the goodwill of a new business is such an asset, it is permissible, as we shall presently show, to refer to certain other sections of the head "Capital gains". Section 45 is a charging section. For the purpose of imposing the charge, Parliament has enacted detailed provisions in order to compute the profits or gains under that head. No existing principle or provision at variance with them can be applied for determining the chargeable profits and gains. All transactions encompassed by section 45 must fall under the governance of its computation provisions. A transaction to which those provisions cannot be applied must be regarded as never intended by section 45 to be the subject of the charge. This inference flows from the general arrangement of the provisions in the Income Tax Act, where, under each head of income, the charging provision is accompanied by a set of provisions for computing the income subject to that charge. The character of the computation provisions in each case bears a relationship to the nature of the charge. Thus, the charging section and the computation provisions together constitute an integrated code. When there is a case to which the computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. Otherwise, one would be driven to conclude that while a certain income seems to fall within the charging section, there is no scheme of computation for quantifying it. The legislative pattern discernible in the Act is against such a conclusion. It must be borne in mind that the legislative intent is presumed to run uniformly through the entire conspectus of provisions pertaining to each head of income. No doubt there is a qualitative difference between the charging provision and a computation provision. And ordinarily, the operation of the charging provision cannot be affected by the construction of a particular computation provision. But the question here is whether it is possible to apply the computation provision at all if a certain interpretation is pressed on the charging provision. That pertains to the fundamental integrality of the statutory scheme provided for each head.

The point to consider then is whether, if the expression "asset" in section 45 is construed as including the goodwill of a new business, it is possible to apply the computation sections for quantifying the profits and gains on its transfer.

The mode of computation and deductions set forth in section 48 provide the principal basis for quantifying the income chargeable under the head

"Capital gains". The section provides that the income chargeable under that head 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 :

"(ii) the cost of acquisition of the capital asset ...

What is contemplated is an asset in the acquisition of which it is possible to envisage a cost. The intent goes to the nature and character of the

asset, that it is an asset which possesses the inherent quality of being available on the expenditure of money to a person seeking to acquire it. It is

immaterial that although the asset belongs to such a class, it may, on the facts of a certain case, be acquired without the payment of money. That

kind of case is covered by section 49 and its cost, for the purpose of section 48, is determined in accordance with those provisions. There are

other provisions which indicate that section 48 is concerned with an asset capable of acquisition at a cost. Section 50 is one such provision. So

also is sub-section (2) of section 55. None of the provisions pertaining to the head "Capital gains" suggests that they include an asset in the

acquisition of which no cost at all can be conceived. Yet, there are assets which are acquired by way of production in which no cost element can

be identified or envisaged. From what has gone before, it is apparent that the goodwill generated in a new business has been so regarded. The

elements which create it have already been detailed. In such a case, when the asset is sold and the consideration is brought to tax, what is charged

is the capital value of the asset and not any profit or gain.

In the case of goodwill generated in a new business there is the further circumstance that it is not possible to determine the date when it comes into

existence. The date of acquisition of the asset is a material factor in applying the computation provisions pertaining to capital gains. It is possible to

say that the "cost of acquisition" mentioned in section 48 implies a date of acquisition, and that inference is strengthened by the provisions of

sections 49 and 50 as well as sub-section (2) of section 55.

It may also be noted that if the goodwill generated in a new business is regarded as acquired at a cost and subsequently passes to an assessee in

any of the modes specified in sub-section (1) of section 49, it will become

necessary to determine the cost of acquisition to the previous owner.

Having regard to the nature of the asset, it will be impossible to determine such cost of acquisition. Nor can sub-section (3) of section 55 be

invoked, because the date of acquisition by the previous owner will remain unknown.

We are of opinion that the goodwill generated in a newly commenced business cannot be described as an "asset" within the terms of section 45

and, therefore, its transfer is not subject to Income Tax under the head "Capital gains".

16. If the principles set out in the aforesaid case are applied, there can be no doubt that the surplus amount received on account of devaluation of

the currency cannot be taxed as capital gain. Just as goodwill in a newly commenced business, for which the cost of acquisition cannot be

determined, for the pound sterling received by the company on the issue of shares to the shareholders, there can be no cost of acquisition.

17. There is considerable force in the argument advanced by learned Counsel for the assessee that no transfer of asset is involved in the present

case when the assessee has only repatriated the money collected by it in the U. K. to this country. It is only a case of an assessee bringing his own

money held by him in foreign countries into this country in accordance with the procedure prescribed under the Foreign Exchange Regulation Act.

The only method by which a person could make use of his foreign currency in this country is by converting it into rupees in accordance with the

relevant rules and regulations. Such conversion of foreign currency into Indian rupee is metaphorically termed as ""sale of foreign exchange"". No

doubt, the Foreign Exchange Regulation Act uses the term ""sale of foreign exchange"", but that would not bring the conversion of foreign exchange

within the definition of ""transfer"" u/s 2(47) of the Income Tax Act. For a transfer of an asset, there must be two persons. There cannot be a transfer

of an asset by a person in favour of himself. The conversion of foreign currency into Indian money does not involve a transfer by one person to

another. The Karnataka High Court has recently considered the question whether conversion of foreign currency into Indian money is a transfer

within the meaning of section 2(47) of the Income Tax Act in Jayakumari and Dilharkumari (Executrixes and Trustees of Late H.H. Rajkuverba)

Vs. Commissioner of Income Tax (No. 1), . While taking the view that it is not a transfer under the Income Tax Act so as to attract ""Capital gains"" ,

the Karnataka High Court made the following observations (p. 790) :

The "transfer" contemplated u/s 2(47) of the Income Tax Act envisages, no doubt, sale, exchange or relinquishment of the asset etc. But mere

conversion of one currency into another currency cannot be considered as exchange. The exchange in the context must mean transfer of one

capital asset for another capital asset. Like a sale, it requires two persons. There cannot be a sale to oneself. So too in the case of exchange. In the

first place, the ownership of the money remained with the assessee even after the exchange in the first place. Secondly, it was just a conversion of

one kind of currency into another kind in the normal course and not connected with any business. Such a conversion, in our opinion, can never be

considered as exchange within the meaning of section 2(47) of the Income Tax Act, 1961.

18. We are entirely in agreement with the above reasoning of the Karnataka High Court. Learned counsel for the Revenue draws our attention to

an earlier decision of the Karnataka High Court in Kirloskar Asea Ltd. Vs. Commissioner of Income Tax, Karnataka, , in which a different view

was taken. In that case, the assessee, an Indian company, had entered into a collaboration agreement with a foreign company in 1964 under which

the foreign collaborator contributed towards the share capital of the assessee-company a sum of Rs. 12,00,000 against which it was allotted

12,000 shares of the assessee-company. The amount was paid in foreign exchange, i.e., dollars, and in terms of dollars it came to \$ 2,52,026,

which was credited by the assessee in a foreign bank in its own name for the purpose of acquiring machinery, with the permission of the

Government. After paying for such machinery, the balance of \$ 1,10,534 available in the account of the assessee in the foreign bank was

repatriated to India during the assessment year 1971-72. On account of devaluation of the Indian rupee in 1966, the value of the dollar in terms of

rupees went up and on the date of repatriation, the assessee got Rs. 2,98,657 more than what it would have got had the foreign currency been

repatriated at the time of its acquisition. The Income Tax Officer assessed the amount as long-term capital gains and this view was confirmed by

the Appellate Assistant Commissioner and the Tribunal. On a reference, the Karnataka High Court took the view that foreign exchange is in the nature of a commodity which can be converted into local currency by selling it. It was held that the dollars, which were repatriated to India, constituted a capital asset of the assessee and any profit derived on account of its transfer should be treated as capital gain, since the assessee was able to acquire Indian currency only by transferring the capital asset and that the sale of foreign exchange was a transfer within the meaning of Section 2(47) of the Income Tax Act. The Bench did not consider whether the terms of section 48 of the Income Tax Act were fulfilled; nor is there any discussion in the judgment as to how the conversion of foreign currency could be treated as a transfer between two persons. The Bench has proceeded on the footing that local currency can be obtained only by sale of foreign currency and that such sale will fall within the definition of transfer"" u/s 2(47) of the Income Tax Act. We are not inclined to agree with the reasoning of the Bench in that case as the aspects referred to by us earlier have not been considered in that case.

19. Learned counsel for the Revenue relied upon the decision of the Andhra Pradesh High Court in Additional Commissioner of Income Tax Vs. Trustees of H.E.H. the Nizam's Second Supplementary Family Trust, . In that case, it was held that the conversion of preference shares into ordinary shares amounted to ""transfer"" by way of exchange within the meaning of section 45 of the Income Tax Act, and the capital gains that accrued on such conversion were liable to tax. Learned counsel contended that the conversion of foreign currency into Indian rupee will amount to an exchange. There is a fallacy in this argument. An ""exchange"" is defined by the Transfer of Property Act as a transaction whereby two persons mutually transfer the ownership of one thing for the ownership of another, neither thing or both things being money only. When, admittedly, the ownership of Indian money is obtained in place of ownership of foreign currency, that cannot be considered to be an ""exchange"" as defined. The contention of learned counsel for the Revenue that it is an ""exchange"" and, therefore, a ""transfer"" within the meaning of section 2(47) of the Income Tax Act cannot be accepted.

20. In the result, we hold that the surplus amount obtained by the assessee on

account of devaluation of the rupee is not a capital gain within the meaning of section 45 of the Income Tax Act. The conclusion of the Tribunal on this aspect of the matter is wrong and unacceptable.

21. The question referred to us is answered in the negative and in favour of the assessee. The Revenue will pay the costs to the assessee. One set.

Costs fixed at Rs. 1,000.