

(1996) 01 MAD CK 0077

In the Madras High Court

Case No : Tax Cases No"s. 1144 and 1145 of 1982 (References No"s. 699 and 700 of 1982)

E.I.D. Parry Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

Date of Decision : 11-01-1996

Acts Referred:

Income Tax Act, 1961 — Section 28, 32(1), 34(1), 41(2), 41(2)

Citation : (1997) 226 ITR 836

Hon'ble Judges : N.V. Balasubramanian, J;K.A. Thanikkachalam, J

Bench : Division Bench

Advocate : Deokinandan and C.V. Rajan, for the Appellant; P.P.S. Janarthana Raja for Subbaraya Aiyar, Padmanabhan and Ramamani and K.M.L. Majele, for the Respondent

Judgement

K.A. Thanikkachalam, J.—At the instance of the assessee, the Tribunal has referred the following three questions for the opinion of this court for the assessment year 1971-72 u/s 256(1) of the Income Tax Act, 1961 :

"1. Whether the Tribunal was right in holding that the withdrawal of the depreciation amounting to Rs. 1,04,994 is correct ?

2. Whether, on the facts and in the circumstances of the case, the provisions of section 41(2) are attracted and that the replacement of the boiler has to be interpreted to be brought within the words "moneys payable" ?

3. Whether the Tribunal was right in holding that the provisions of the capital gains are attracted to the facts of the case ?"

2. The assessee purchased a Mitsubishi boiler during the accounting year 1967-68, relevant to the assessment year 1969-70 at an actual cost of Rs. 8,01,563. Depreciation totalling to Rs. 2,76,592 was allowed on this boiler for the assessment years 1969-70 and 1970-71 and the written down value as on October 1, 1969, was Rs. 5,24,971. This boiler had been insured with the

Hercules Insurance Company, Madras, against the risk of damage, explosion or collapse. Under the policy, "in the event of any explosion or collapse, the insurance company may at its own option, repair or reinstate or replace the damaged property or pay for the loss or damage in money". The boiler exploded on November 11, 1969. The insurer opted to fulfil its part of the contract by purchasing a boiler of equivalent capacity and quality from the Punalur Paper Mills Ltd. at a cost of Rs. 3 lakhs to replace the exploded one of the insured, i.e., the assessee. Almost six years later on October 9, 1975, the insurer addressed a letter to the assessee saying that they had disposed of certain damaged parts to one V. Chinnasamy.

3. The assessee, in the original assessment, had claimed depreciation on the written down value of Rs. 5,24,971 and the same was allowed, but subsequently the Income Tax Officer reopened the assessment on the ground that such allowance was erroneous. In the reassessment, the Income Tax Officer withdrew the depreciation of Rs. 1,04,994 allowed in the original assessment. The asset was discarded during the year. The Income Tax Officer further held that even the exchange of assets will come within the purview of section 41(2) and hence the value of the new boiler should be taken as "moneys payable". The Income Tax Officer assessed the profit u/s 41(2) at Rs. 2,76,592 limiting it to the difference between the original cost and the written down value. The difference between the "moneys payable" in respect of the discarded boiler of Rs. 9 lakhs and the written down value of the boiler, viz., Rs. 5,24,971 was Rs. 3,75,029, as computed by the Income Tax Officer. Excluding the profit u/s 41(2), i.e., Rs. 2,76,592, the Income Tax Officer treated the balance of Rs. 98,437 as capital gain.

4. On appeal by the assessee, the Commissioner of Income Tax held that the notional profit u/s 41(2) cannot be taxed. According to the appellate authority what remained in the original boiler was a drum, chimney, etc., and the boiler was rendered completely useless, necessitating its replacement by a new boiler. The Commissioner further referred to the provisions of sections 41(2), 48 and 32(1)(iii) and held that u/s 41(2), the term "moneys payable" cannot refer to any debt payable in any shape or kind; but must refer only to "money" or cash, as decided in Commissioner of Income Tax, W.B. I Vs. National and Grindlays Bank Ltd., Calcutta, . He further held that there was no taxable capital gain. He agreed with the assessee that the transfer of capital asset must necessarily be the same asset as on the date of transfer, as it was on the date of its acquisition. He further held that in the assessee's case there was no transfer of the original capital asset either by way of sale or exchange or by way of relinquishment or extinguishment of any right therein, since the capital asset, which was transferred in exchange for a new boiler from the insurer, was not the discarded or exploded boiler, but the right enuring in favour of the insured, against the insurer, under the contract of insurance. He, therefore, held that there was no capital gain. This was the view taken by the Commissioner with regard to the trading profits, as contemplated u/s 41(2) of the Act.

5. With regard to depreciation, the Commissioner held that the Income Tax Officer was correct, since depreciation could not be allowed on the discarded old boiler in view of the provisions in section 34(2)(ii). He also rejected the assessee's claim that the depreciation should be allowed on the value of the new boiler of Rs. 9 lakhs given in replacement by the insurer on the ground that "actual cost" u/s 43(1) meant "actual cost" of the asset to the assessee, i.e., what the assessee had spent for acquiring the asset. As in the present case, the assessee did not incur any cost, the Commissioner rejected the assessee's claim for depreciation on Rs. 9 lakhs.

6. On further appeal both by the assessee and the Revenue, the Tribunal held that as regards the replacement of the boiler, the sum of Rs. 9 lakhs was the money payable to the assessee in respect of the old boiler, which was discarded by the assessee, as having been destroyed and, hence, the assessee is liable to pay tax for profits u/s 41(2). In order to come to this conclusion, reliance was placed on the Gujarat High Court judgment in Commissioner of Income Tax Vs. Vania Silk Mills (P.) Ltd., . On the question of allowing depreciation, the Tribunal held that since during the previous year, the old Mitsubishi boiler was destroyed and discarded, the Income Tax Officer was correct in withdrawing the depreciation allowable on the old boiler in the original assessment. In the matter of levying capital gains tax, the Tribunal held that the profit arising out of the transfer is, therefore, to be assessed as capital gain. Thus, the Tribunal allowed the appeal filed by the Revenue and the appeal by the assessee was treated as partly allowed for statistical purposes.

7. In so far as question No. 1 is concerned, in view of the provisions contained in section 34(1)(ii) of the Act, the assessee is not entitled to depreciation on an asset, which is not in existence. Therefore, we answer this question in the affirmative and against the assessee.

8. In so far as a question No. 2 is concerned, reliance was placed by both counsel on the terms of the agreement of insurance. According to the Department, in view of the tripartite agreement, the boiler was purchased by the assessee and the money was paid by the insurer. Therefore, inasmuch as money was paid, the provisions u/s 41(2) of the Act are attracted. On the other hand, learned counsel for the assessee submitted that money was not directly paid to the assessee; but the boiler was supplied by Punalur Paper Mills Ltd. and the money was paid by the insurer directly to Punalur Paper Mills Ltd. Therefore, inasmuch as money was not directly paid to the assessee and under the insurance coverage, there is an option for the insurer either to replace the goods in specie or pay the amount of compensation for the goods lost, according to him, the provision of section 41(2) will not be applicable to the facts of this case. In Kasturi and Sons Ltd. Vs. Commissioner of Income Tax, , this court, while considering the provisions of section 41(2) of the Act, held as follows :

"In the instant case, by exercising the option to replace the damaged aircraft, the insurer discharged his liability under the terms of the policy to make good

the loss sustained, in specie, and in such a case, there was no question of payment of any money at all as the liability of the insurer to make the payment to cover the loss sustained by the insured would cease on the exercise of the option rendering the contract one for reinstatement ab initio which would mean that the contract between the insurer and the insured would be deemed in law to have always been from the inception one for reinstatement only and not for payment of money. Consequently, there was no question of payment of any money by the insurance company and, hence, the provisions of section 41(2) were not attracted."

9. On the facts of the case on hand, the boiler was supplied by Punalur Paper Mills and the insurer paid the value of the boiler to Punalur Paper Mills and no money was paid to the assessee by the insurance company. Therefore, when money was not paid to the assessee, the provisions of section 41(2) would not stand attracted. Accordingly, we answer question No. 2 in the negative and in favour of the assessee.

10. In so far as question No. 3 is concerned, it is the admitted case that the old boiler, which got exploded, was replaced by a new one. The original cost of the old Boiler was Rs. 8,01,563 and the written down value was Rs. 5,24,971 and the difference being Rs. 2,76,592. The difference between the cost of new boiler, i.e., Rs. 9 lakhs, and the written down value, i.e., Rs. 5,24,971 being Rs. 3,75,029, the Income Tax Officer has taken capital gains at Rs. 98,437, i.e., difference between Rs. 3,75,029 and profit u/s 41(2) of Rs. 2,76,592. A similar question came up for consideration before the Supreme Court in Vania Silk Mills (P) Ltd. Vs. Commissioner of Income Tax, Ahmedabad [OVERRULED], wherein the Supreme Court held :

"In the case of damage, partial or complete or destruction or loss of the property, there was no transfer of it in favour of a third party. The money received under the insurance policy in such cases was by way of indemnity or compensation for the damage, loss or destruction of the property. It was not in consideration of the transfer of the property or the transfer of any right in it in favour of the insurance company. It was by virtue of the contract of insurance or of indemnity, and in terms of the conditions of the contract . . . When an asset is destroyed, there is no question of transferring it to others. The destruction or loss of the asset, no doubt, brings about the destruction of the right of the owner or possessor of the asset, in it. But it is not on account of transfer. It is on account of the disappearance of the asset. The extinguishment of right in the asset on account of extinguishment of the asset itself is not a transfer of the right, but its destruction. By no stretch of imagination can the destruction of the right on account of the destruction of the asset be equated with the extinguishment of right on account of its transfer."

11. In that view of the matter, the Supreme Court held that no capital gains tax would be leviable in such a case. In view of the aforesaid decision of the Supreme Court, we answer this question in the negative and in favour of the

assessee. There will, however, be no order as to costs.