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**(1996) 10 MAD CK 0032**  
**In the Madras High Court**  
**Case No : Tax Case No. 418 of 1982**

E.I.D. Parry Ltd.

APPELLANT

Vs

Commissioner of Income Tax

RESPONDENT

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**Date of Decision :** 29-10-1996

**Acts Referred:**

Income Tax Act, 1961 — Section 4, 41(2)

**Citation :** (1997) 138 CTR 68 : (1998) 233 ITR 335

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

**Bench :** Division Bench

**Advocate :** P.P.S. Janarthana Raja, for the Appellant; C.V. Rajan, for the Respondent

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## Judgement

Thanikkachalam, J.—At the instance of the assessee, the Tribunal referred the following question for the opinion of this Court, under s.

256(1) of the IT Act, 1961, hereinafter referred to as the "Act" :

Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the sum of Rs. 9.5 lakhs received by the

assessee was assessable as revenue receipt ?

2. The assessee-company manufactures sugar, chemicals, fertilisers, etc. It entered into an agreement with Mitsubishi on 14th July, 1965, for the

expansion of the assessee-Fertiliser Factory at Ennore. The agreement comprises of two documents; (1) For importing plant and equipments from

Japan called "The imported plant contract" of the value of US Dollars 28,21,000; (2) For procuring plant, machinery and equipment in India and to

provide engineering services; and to erect and construct the works and put the same into operation called "Indian plant and work contract", of the

value of Rs. 60,83,000. According to the above agreement, Mitsubishi undertook

to complete the construction of the works within 673 days after the effective date of contract. In the execution of this contract, the contractor, viz., Mitsubishi failed in two respects (1) Delay in the completion of work, and (2) failure to produce the guaranteed results. The completion of the plant was delayed by 40 days and the guarantee tests were completed 128 days late. There was correspondence between the assessee and Mitsubishi. Finally, they agreed to settle the issue in terms of cl. 52 of the agreement, dt. 14th July, 1965. The settlement was incorporated in the memorandum of settlement, dt. 25th July, 1968, under which Mitsubishi had to pay Rs. 9.5 lakhs to the assessee in full settlement of the assessee's claim for compensation arising out of the various clauses of the agreement between the assessee and Mitsubishi. The assessee contended before the ITO that Rs. 9.5 lakhs representing compensation arising out of settlement between the assessee and Mitsubishi, Japan, hereinafter referred to as Mitsubishi, as capital receipt. The relevant accounting year ended on 30th Sept., 1968. Before the ITO, the assessee, by its letter dt. 14th Feb., 1972, submitted that the above sum was a capital receipt and non-taxable. The ITO held for the reasons stated by him, that the receipt of Rs. 9.5 lakhs was only for the loss of production occasioned by the delay in the completion of contract, being to compensate the consequent loss of profits. The ITO, therefore, held that it was a revenue receipt. On appeal before the AAC, the assessee submitted that the above sum was a capital receipt in its hands and even assuming that a portion of it was received for loss of production, only a reasonable proportion could be taxed as revenue receipt. The AAC referred to the relevant cls. 32, 34, 35, 36, 40 and 42 of the Indian Plant and Work Contract. The AAC noted that the assessee had calculated that it was entitled to compensation of Rs. 82 lakhs as per cl. 40 of the agreement and at last Rs. 16 lakhs was accepted while loss of production was taken into account. The entire issue was, however, finally settled at Rs. 9.5 lakhs. Considering the note signed by one Mr. O. P. Featheratons special director, the AAC pointed out that it was clear from the above note that the sum of Rs. 9.5 lakhs received by the assessee on ad hoc basis really represented the compensation for loss of production being damages recovered for an injury inflicted on the assessee's trading, making a hole in the profits. The AAC further

observed that in this case 100 per cent loss of production and the assessee claimed compensation of Rs. 82 lakhs. The assessee proposed

compensation at Rs. 16 lakhs based on the theory of loss of production, which was finally settled at Rs. 9.5 lakhs, presumably because according

to cl. 42 of the agreement, dt. 14th July, 1965, Mitsubishi had to retain in India Rs. 9,75,800. The AAC concluded that the sum of Rs. 9.5 lakhs is

taxable in the assessee's hands as revenue receipt.

3. Aggrieved, the assessee filed a second appeal before the Tribunal. The Tribunal, considering cls. 32, 34(vi)(a) and 40 of the Indian Plant and

work Contract and the ultimate settlement under which the Japanese company had agreed to pay Rs. 9.5 lakhs, held that a sum of Rs. 9.5 lakhs

received by the assessee should be assessed as revenue receipt. In this respect, the Tribunal relying upon its earlier order in the case of the same

assessee with regard to the compensation received from Simon Graves in the asst. yr. 1965-66, agreed with the view taken by the AAC in

considering the sum of Rs. 9.5 lakhs received by the assessee as revenue receipt.

4. Before us, the learned counsel appearing for the assessee submitted that the compensation of Rs. 9.5 lakhs received by the assessee was a

capital receipt, since it related to the defects and delay in the installation of the plant and in effect related to the warranty of the quality of the plant,

though the payment was measured in terms of loss of production. The counsel further submitted that the decision rendered by the Tribunal with

regard to the compensation received from Simon Graves in ITA No. 270/Mds/1977-78, dt. 15th Oct., 1979, against the assessee was not

accepted by the assessee. According to the learned counsel appearing for the assessee by way of final settlement, compensation was arrived at Rs.

9.5 lakhs. The demand of Rs. 16 lakhs which was made earlier which was calculated on the basis of loss of profit, was not accepted by the

Japanese company and therefore, it cannot be said that Rs. 9.5 lakhs was received on the basis of calculating the compensation as loss of profit. In

order to support his contention, the learned counsel appearing for the assessee relied upon the following decisions :

Commissioner of Income Tax Vs. Barium Chemicals Ltd., , The Commissioner of Income Tax, Andhra Pradesh, Hyderabad Vs. Sirpur Paper

Mills Ltd., Hyderabad, : and Associated Oil Mills Ltd., Madras Vs. Commissioner of

Income Tax, Madras, .

5. On the other hand, the learned standing counsel appearing for the Department, submitted that in as much as compensation was received not for any injury to the profit making apparatus, it cannot be considered as capital in nature. It was submitted that Rs. 9.5 lakhs was paid by the Japanese company to the assessee since the assessee was prepared to receive this amount as a reduction from Rs. 16 lakhs, which was claimed on the basis of loss of profit due to the defects committed by the Japanese company in delivering the plant. According to the learned standing counsel even though in the agreement under cl. 32 that for the breach of the contract, the Japanese company would pay 3 per cent out of the total contract rate, it would represent only damages for loss of profit. According to the learned standing counsel, the decision of the Andhra Pradesh High Court in Commissioner of Income Tax Vs. Barium Chemicals Ltd., would not be applicable to the facts of this case, since there was total abandonment of the project by the foreign company according to the facts arising in that case. For these reasons, it was submitted that the Tribunal was correct in holding that Rs. 9.5 lakhs received by the assessee should be considered as revenue receipt.

6. We have heard the rival submissions. The recitals in the memorandum of settlement, dt. 25th July, 1968, would make it clear that the assessee's claim for compensation arose out of cls. 32, 34(vi) and 40 of the Indian Plant Contract.

The compensation payment was the result of Mitsubishi's failure to complete the work and to perform the test for guaranteed results. Clause 40 of the Indian Plant Contract agreement in terms refers to liquidated damages for failure to produce guaranteed results. The compensation was originally worked out at Rs. 16 lakhs with reference to value of loss of production for 54 days. According to the Tribunal, the assessee agreed to receive Rs. 9.5 lakhs as a sort of reduction from Rs. 16 lakhs which was calculated on the basis of loss of profit.

7. In this contest, a reading of the finally settled settlement for Rs. 9.5 lakhs regarding which the note signed by Mr. Featheratons, special director, assumes importance and it is as follows :

Work on the expansion of the Ennore Factory has been satisfactorily concluded

and the plant commissioned and guarantee tests required under the contract fulfilled. The completion of the plant was, according to the strict reading of the contract, late by a matter of 40 days, which could have entitled us to a penalty of slightly less than Rs. 1 lakh, and on the same basis, the guarantee tests were completed 128 days late. There were, however, a number of delays due to strikes, etc., which were not attributable to the contractors. Nevertheless, on the strict reading of the context, even one day's delay entitled us to damages of 30 per cent of the contract value - approximately Rs. 70 lakhs. It was appreciated that in arbitrations, we would not be successful in getting payment of anything approaching this amount and we were also strongly advised by Mr. A. D. Vickers not to press for this scale of compensation which might result in our requiring a bad reputation with the comparatively small number of international chemical plant contractors thus prejudicing our position for further projects.

2. Negotiations have accordingly been held with MSK in which we pressed for compensation on the basis of actual losses sustained. On a reduced period of 54 days, after giving due allowance for the time lost not due to the fault of the contractors, a figure of Rs. 16 lakhs was proposed by us. This, however, was not acceptable to MSK and in view of the satisfactory conduct of the contract and the advisability to preserve good relations for the future a final settlement has been made in a sum of Rs. 9.5 lakhs.

In cl. 2 of the above said note, it is clearly stated that the figure of Rs. 16 lakhs proposed by the assessee towards compensation was not accepted by the Japanese company. In view of the satisfactory conduct of the contract and the advisability to preserve good relations for the future, a final settlement has been made in a sum of Rs. 9.5 lakhs. This sum of Rs. 9.5 lakhs is not based upon the calculation made in respect of the loss of profit. In the final settlement the Japanese company agreed to pay Rs. 9.5 lakhs as per the memorandum of settlement dt. 25th July, 1968. The Japanese company agreed to pay compensation for delay in completion of the work and failure to produce the guaranteed results. Under cl. 32 the compensation for the above said delays was agreed to be compensated not exceeding 3 per cent of the total contract price."Contract price"

means price for procurement, the erection and construction of the works and the performance of all other duties to be performed by the contractor

under the terms of the contract and contract price shall be Rs. 60,83,000. Therefore, Rs. 9.5 lakhs paid by the Japanese company under cl. 32 of

the agreement, dt. 25th July, 1968, would go towards compensation for procurement, erection and construction of the works and the performance

of all other duties to be performed by the contractor under the terms of the contract. Therefore, out of Rs. 9.5 lakhs, a portion would relate to

delay in procurement of the capital assets. Delay in procurement of capital assets would lead to delay in coming into existence of the profit making

apparatus. Compensation paid for such delay in procurement of capital assets would amount to sterilisation of the capital assets of the assessee in

that the Japanese company failed to erect the machinery and plant according to the agreement, dt. 25th July, 1968. The sterilisation of assets need

not be in order to make a payment a capital receipt. In CIT vs. Barium Chemicals Ltd. cited supra, the Andhra Pradesh High Court held that in

order to decide whether or not a payment is a revenue receipt, its true nature and substance must be looked into. If the payment is received in the

ordinary course of the business of the assessee for loss of stock-in-trade, it is a revenue receipt. If, on the other hand, the payment received is

towards compensation for extinction, or sterilisation, partly or fully of a profit earning source, such receipt, not being in the ordinary course of the

assessee's business, is a capital receipt. Thus, considering the final settlement arrived at between the assessee and the Japanese company, dt. 25th

July, 1968, and cls. 28, 32, 34, 34(i), 34(vi) and 40, in the agreement, dt. 14th July, 1965 and 28th Feb., 1967, we are of the opinion that a

portion of Rs. 9.5 lakhs paid by the Japanese company should be treated as capital in nature and such portion is determined by us as 1/3rd of Rs.

9.5 lakhs which related to delay in procurement of capital assets. In so far as 2/3rd of Rs. 9.5 lakhs is concerned, we are not disturbing the order

passed by the Tribunal holding that such quantum of compensation is revenue in nature, since the said sum relates to erection and construction of

the works and the performance of all other duties.

8. Reliance was placed upon the decision of the Supreme Court in CIT vs. Sirpur Paper Mills Ltd. (supra). According to the facts arising in that

case, the building, plant and machinery belonging to the respondent, were covered by the insurance against loss by fire. They were partly damaged

by fire and the respondent received a sum of Rs. 9,41,070 as compensation in respect of the loss. The respondent spent only a sum of Rs.

1,57,813 and restored the building, plant and machinery to working condition. The question was, whether the balance of Rs. 7,03,207 was

assessable to tax either as a revenue receipt nor under s. 41(2) of the IT Act. While answering this question, the Supreme Court held that since the

plant and machinery was only partly damaged by fire and after repairing the damage, the plant and machinery was recommissioned there was no

scope for the applicability of s. 41(2). In the absence of specific provision in the Act, the amount received by the respondent in respect of damage

to the plant and machinery could not be brought to tax and the Revenue could not seek to tax the amount by resorting to the analogy of s. 41(2).

This decision was cited by the learned counsel appearing for the assessee in order to support his contention that the compensation received in the

present case should also be considered as capital nature. However, the learned standing counsel appearing for the Department pointed out that in

The Commissioner of Income Tax, Andhra Pradesh, Hyderabad Vs. Sirpur Paper Mills Ltd., Hyderabad, , the compensation was paid for the loss

of a part of building, plant and machinery. Therefore, the compensation would be in the nature of capital. But to the present case the above said

decision would render no assistance to the assessee, since compensation was not paid for loss of capital goods.

9. In order to support his contention, the learned standing counsel appearing for the Department, relied upon the decision reported in Shree

Digvijay Cement Co. Ltd. Vs. Commissioner of Income Tax, Gujarat-V, , wherein the Gujarat High Court held that the actual cost or price of the

machinery and compensation payable to the assessee-company were two different and distinct things. Compensation was paid to set off or reduce

the loss which the assessee suffered as a result of delay in supply of machinery. It had nothing to do with the cost of machinery. Though adjusted

against the cost of machinery, it was none the less compensation. The actual cost of machinery could not be reduced by Rs. 5,72,216 and

depreciation and development rebate had to be allowed on the entire cost of machinery as per the agreement.

10. On the facts available in this case, this Court came to the conclusion that a portion of the compensation paid related to delay in bringing into existence the profit making apparatus. Therefore, a portion of the compensation paid should be considered as capital in nature. Accordingly, this Court also kept in mind while deciding the issue arising in this case that actual cost or price of the machinery and compensation payable to the assessee-company were two different and distinct things.

11. The learned standing counsel also relied upon the decision of the Supreme Court reported in Commissioner of Income Tax, Poona Vs. Manna

Ramji and Co., , wherein it was held that it is for the Tribunal to find facts and it is for the High Court and Supreme Court to lay down the law

applicable to the facts found. Neither the High Court nor the Supreme Court has jurisdiction to go behind or to question the statement of facts

made by the Tribunal. The statement of case is binding on the parties and they are not entitled to go behind the facts of the Tribunal in the

statement. When the question referred to the High Court speaks of "on the facts and circumstances of the case, it means on the facts and

circumstances found by the Tribunal and not on the facts and circumstances as may be found by the High Court. In the present case, decision was

rendered on the facts recorded by the Tribunal, considering the several clauses in the agreement, dt. 25th July, 1968 and the subsequent

understanding between the parties recorded in the note of Mr. C. P. Featheratons.

12. The learned standing counsel also placed reliance upon the decision of the Court of Appeal reported as LONDON AND THAMES HAVEN

OIL WHARVES LTD. Vs. ATTWOOLL (INSPECTOR OF TAXES)., , wherein the Court of Appeal held that the amount received in respect

of the sterilisation of a capital asset would be capital in nature and not a trading receipt.

13. The attention of this Court was also drawn to the decision of the Calcutta High Court in Commissioner of Income Tax (Central) Vs. Rohtas

Industries Ltd., . In the abovesaid decision, a question arose whether on the facts and circumstances of the case, the Tribunal was right in holding

that a sum of Rs. 2,44,922 was a payment for low out-put and as such a revenue receipt, and not a rebate on the actual price of the machinery

originally supplied by M/s Escher Wyss, affecting the written down value of the

machinery for Income Tax purposes? While answering this question, the Calcutta High Court held that payment for low out-put, as such is a revenue receipt and not a rebate on the actual price of machinery originally supplied by the German firm to the assessee. In the present case, on the facts, it was held that a part of the compensation paid related to sterilisation of profit making apparatus, which was paid as a contract price. Payment for low out-put as such was not separately taken into consideration in the instant case. In view of the foregoing reasons, we answer the question referred to us in the negative in so far as that part of question which related to payment made for sterilisation of the profit making apparatus, viz., 1/3rd of Rs. 9.5 lakhs. Accordingly, we answer this part of the question in the negative and in favour of the assessee. In respect of the rest of the portion of the amount paid by the Japanese company, we are answering that portion of the question in the affirmative and against the assessee. No costs.