

Saiba Developers (P.) Ltd. Vs. Fifteenth Income-tax Officer

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Court : Income Tax Appellate Tribunal ITAT Mumbai

Decided On : Oct-23-1991

Reported in : (1992)40ITD419(Mum.)

Judge : O Jain, G Veerabhadrapa

Appellant : Saiba Developers (P.) Ltd.

Respondent : Fifteenth Income-tax Officer

Judgement :

1. This appeal by the assessee arises out of the order dated 27-4-1988 of the Commissioner of Income-tax (Appeals) for the assessment year 1984-85.
2. The assessee is a company. For the assessment year 1984-85, previous year ended on 31-3-1984. The assessee is engaged in property development and exports of cashewnuts. The assessee had entered into cashewnut business in the month of March 1983 And entered into eight contracts with M/s. Commodim (Produce) Ltd., London, for the supply of 10,300 cartons of W-320 Indian cashewnuts kernels during the month of July to September 1983. Out of the total eight contracts for 10,300 cartons, the assessee-company did fulfil two contracts for supply of 1000 cartons in the month of December 1983. Six contracts for 9,300 cartons were not fulfilled by the assessee because of failure to procure the required quantity of cashewnut at a reasonable cost due to cashew crops failure during that season. The assessee would have incurred heavy losses if it had actually supplied the material. Upon the assessee not fulfilling the commitment,

the buyers, M/s. Commodim (Produce) Ltd., London, had written a letter to the brokers indicating that the seller (assessee) went in default to fulfil the contractual terms and conditions desiring to refer the matter to the Arbitrator as the price of the cashewnut has erratically fluctuated in the market.

The assessee was driven to the arbitration proceedings at London in terms of the 'other conditions' clause in CENTA, i.e., the Combined Edible Nut Trade Association Rules. The Arbitrators awarded a damage to be payable by the assessee at Rs. 37,58,987. The amount of damages fixed by the award along with the fees was debited to the profit and loss account and the assessee claimed deduction. The Income-tax Officer did not entertain the assessee's claims for reasons detailed in his order of assessment, which runs as under:-- (1) the arbitrators award was not final decision and the assessee's liability of paying the compensation was not legally binding to the assessee. Further, no suit was filed against the assessee in any court of law in India and no decree was passed by the Court making the assessee legally liable for the payment of the compensation.

(2) that the assessee could legally pay/remit the said sum only after getting NOC from the authorities concerned. If the concerning authorities do not issue NOC the question of remittance or payment does not arise. It directly means that only when the NOCs are obtained (i.e., the day on which all NOCs are obtained) assessee's liability of payment compensation could legally become due. In the assessee's case no NOC was obtained during the previous year relevant to the assessment year. As such it is very clear that under any circumstances the so called liability was not absolutely due in the year.

(3) further, it is noteworthy and interesting feature that the assessee has not made any attempt or taken any legal action against its suppliers who have really put the company into this situation.

On the contrary the assessee company had agreed for appointment of the Arbitrators and also readily accepted the decision of the Arbitrators. All these facts show that the company was more interested in creating the liability rather than taking any steps to compensate its losses by taking legal steps against the local suppliers. This creates doubt about the bonafides of the expenditure.

The discussion made above leads to the only conclusion that the assessee's claim can not be entertained and as such disallowed.

The assessee was unsuccessful before the Commissioner of Income-tax (Appeals). The CIT(Appeals) held that the assessee does not deserve to succeed for the reason that the liability to pay had not arisen in the period relevant to the assessment year under consideration. In his opinion, the liability to pay damages to a foreign party was required to be in accordance with the Foreign Exchange Regulation Act, 1973. The prior approval of the Foreign Exchange Control Department of the Reserve Bank of India is required before a liability can be incurred to make any payment in foreign exchange to a non-resident. Such approval was granted by the Reserve Bank of India in February 1986, i.e., in the period relevant to assessment year 1986-87 and, therefore, in the opinion of the CIT(Appeals) there is no liability in law to pay damages in the assessment year in appeal. The CIT(Appeals) further went on to observe that the assessee had not made remittance of foreign exchange liability on account, of damages even till the date of his order. On this, he came to a finding that the permission of the Reserve Bank of India itself was obtained in a contrived situation and under a colourable device, just to be able to get undeserved deduction under Income-tax Act and to suppress the tax liability, as in a genuine transaction and situation-remittances would have taken place after receipt of approval from the Reserve Bank of India. With these observations, the assessee's plea for deduction came to be turned down by the CIT(Appeals). Thus the assessee is before us.

3. The learned counsel for the assessee submitted that the arbitration award was given on 22-12-1983 for default of contractual obligations, which should have taken place between August 1983 to October 1983. It was submitted by the assessee's counsel that approval was received from Reserve Bank of India in February 1986 permitting the remittance of foreign exchange. Drawing our attention to the terms and conditions of trade, the assessee claimed that the view of the tax authorities that all was a contrived situation and a colourable device to claim deduction under the Act, was not fair and justified. The approval of the Reserve Bank of India was a mere formality, which has no bearing on the fastening of the liability or its accrual. It was submitted that as per the Foreign

Awards (Recognition and Enforcement) Act, the liability has accrued on the assessee at the time the foreign award was passed and it shall be binding on the persons as between whom it was made. Our attention was drawn to the arbitration award dated 22nd December 1983.

Our attention was also drawn to a letter dated 14th February 1986 by the Indian Council of Arbitration (sponsored by the Ministry of Commerce, Government of India) to the Reserve Bank of India, Bombay indicating that the Council does not have any objection for the remittance of foreign exchange in respect of arbitration award. As per the contract entered by the assessee with M/s. Commodim (Produce) Ltd., any dispute between the parties had necessarily to be referred to arbitration and the Arbitrator's award was final and binding on both the parties. It was his submission, the Foreign Exchange Regulation Act or the no objection certificate from Reserve Bank of India does not affect the accrual of the liability. They can only affect the discharge of the liability. The discharge of the liability does not determine the accrual of liability. The fact that, the amount was never paid is only irrelevant for allowing the deduction under the Act in respect of genuine liability accruing within the previous year. The learned counsel for the assessee reiterated that the damages became completely ascertained liability within the previous year relevant to the assessment year. Section 9 of Foreign Exchange Regulation Act provides for bar only against the payment. Further reliance was placed on the decisions in CIT v. Grand Cashew Corpn. [1990] 182 ITR 216 (Ker.), A.Yunus Kunju v. ITO [1986] 19 ITD 9 (Coch.), CIT v. Mathulal Baldeo Prasad [1961] 42 ITR 517 (All.), Shrikant Textiles v. CIT [1971] 81 ITR 222 (Bom.) and ITO v. Pfizer Corpn. [1985] 12 ITD 351 (Bom.) and also the decision of the Supreme Court in Satish Kumar v. Surinder Kumar AIR 4. The departmental representative, on the other hand, relying upon the order of the Assessing Officer and the CIT (Appeals), submitted that the assessee is not entitled to claim the deduction in the facts and circumstances of the case. The agreed prices were revised in respect of two contracts. Why not the same revision took place in respect, of the six other contracts? The assessee has failed to safeguard the rate variation in the contract. The assessee has not gone for revision of contract. The conduct of the assessee that it immediately accepted the award only shows that, all is not fair in the transaction. The assessee has not

opened letter of credit for six other contracts. The assessee has no intention to pay the damages in terms of the award. The foreign buyer has not enforced for the recovery even till this date. It was his submission that entire transaction is to create a liability and loss.

Reliance was placed on to the decision of the Supreme Court in *Non such Tea Estate Ltd. v. CIT* [1975] 98 ITR 189, to the proposition that the liability to pay the arbitration award does not accrue till it was approved by the Reserve Bank of India.

5. We have carefully considered the rival submissions and also perused the records. The assessee had entered into contracts for supply of eight lots of cashewnuts of different quantity to be supplied during the previous year relevant to the assessment year under consideration.

All these contracts are not doubted by the department. The assessee, in fact, executed the two contracts and failed to execute the other six contracts. There was a breach of the contract and obligations. The matter, under the terms of contract, came to be referred to arbitration. The department has not placed any material to doubt the genuineness of the arbitration or the determination of the arbitration award to say that there was a colourable device created by the assessee to get an undeserved deduction under the Income-tax Act. We are unable to persuade ourselves to accept these findings by the tax authorities without any material. The arbitration award was passed on 22-12-1983 Awarding damages to be paid by the assessee. The nature of the liability under the arbitration award, in the instant case, is one for unliquidated damages and the liability to pay the damages became crystallized when the amount of damages is accepted either by negotiation or is determined by an Arbitrator or by a competent Court.

It was found that the awards were passed during the relevant accounting year and the assessee had accepted the award. No suspicion can be cast on the assessee merely because he simply accepted the award. So many business considerations may compel the assessee to accept certain damages without question or dispute for the fear of other consequences that may follow in the international trade. The

assessee had explained that it would have been forced to suffer heavy loss had it honoured the contractual obligations for the remaining six lots. The Kerala High Court, on identical set of facts, held that the assessee would be entitled to claim the damages under arbitration award as deduction the moment they were determined by the awards passed. The Kerala High Court held that the moment the award was adjudicated, it becomes a debt. The Kerala High Court further held that the claim for damages was ascertained and determined when the award was passed. The award, even if it was not made a decree of the law, had existence in law. In coming to such conclusions, the High Court relied upon its own earlier decision in *Asuma Cashew Co. v. CIT* [1990] 182 ITR 175/51 Taxman 345 (Ker.). In accordance with the Foreign Award (Recognition and Enforcement) Act, 1961, the liability in respect of the arbitration award accrued on the assessee the moment a foreign award is passed.

Reference may be made to provisions of Sections 4 to 7 of the said Act.

The other regulatory provisions for obtaining the Reserve Bank of India approval for payment, etc., will not affect the time of accrual. The case relied upon by the revenue does not squarely apply to the facts before us. In the case before the Supreme Court, it was concerned with the provisions of Section 326 of the Companies Act, 1956, which contained an absolute prohibition against an appointment or reappointment of a Managing Agent before approval of the Central Government was obtained. In those circumstances, the Supreme Court held that the assessee's liability to pay the remuneration to Managing Agent arose only when the Government conveyed its approval and not prior to that day. In the case before us, such are not the provisions relating to the Foreign Awards (Recognition and Enforcement) Act, 1961 or the Foreign Exchange Regulation Act, 1973. The regulations required of the assessee to effectuate the payment, do not alter the liability already fastened on him. We are unable to accept the department's contention.

Therefore, we direct that the assessee be given a deduction on account of damages payable to its foreign customers in terms of the arbitration award.

6. and 7. [These paras are not reproduced here as they involve minor issues.]

