

**Indian Shipping Co. Ltd. Vs. Assistant Commissioner of**

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**Court :** Income Tax Appellate Tribunal ITAT Kolkata

**Decided On :** Feb-18-1993

**Reported in :** (1993)45ITD352(Kol.)

**Judge :** V Dongzathang, R Easwar

**Appellant :** Indian Shipping Co. Ltd.

**Respondent :** Assistant Commissioner of

**Judgement :**

1. These cross appeals relate to the assessment year 1986-87 for which the accounting year ended on 30-6-1985.

2. In the appeal by the assessee, the first question is whether the CIT (Appeals) was justified in directing the Assessing Officer to treat the amount of Rs. 8,35,000 as long term capital gain received by the assessee from the Insurance Company. The second issue is whether the departmental authorities are justified in treating the amount of Rs. 1,65,000 under Section 41(2) of the IT Act.

3. During the year of account, the vessel "M.V. Chopra" belonging to the assessee sank in the sea near Goa. The assessee received a sum of Rs. 10 lacs from the Insurance Company for the loss of the ship. The Income-tax Officer treated the amount as the business receipt of the assessee and taxed the same accordingly. On appeal by the assessee, the CIT (Appeals) took the view that the amount received from the Insurance Company for the loss of the ship cannot be treated as

the business income of the assessee. He, therefore deleted the sum of Rs. 8,35,000 under the head 'business'. However, he took the view that the amount was assessable under Section 45 of the Act as long term capital gain on the "constructive transfer" of the sunken ship to the insurance company. He, therefore directed the ITO to treat the amount of Rs. 8,35,000 as long term capital gain. He further directed the Assessing Officer to consider the assessee's claim for exemption under Section 54E of the Act.

4. As far as the balance of Rs. 1,65,000 is concerned, the CIT (Appeals) was of the view that the same was rightly taxed as income under Section 41(2) of the Act.

5. Both the assessee as well as the department are in appeal before us.

The assessee challenges the conclusion of the CIT (Appeals) regarding the taxability under the head 'Capital gain' as well as under Section 41(2). In the department's appeal, the order of the CIT (Appeals), inasmuch as it directs the Assessing Officer to delete the amount of Rs. 8,35,000 from the business income, is challenged. The claim of the department, before us is that the order of the Assessing Officer treating the entire amount of Rs. 10 lacs as business income should be restored.

6. We have heard the rival submissions. In the assessee's appeal, the question regarding the assessability of the amount of Rs. 8,35,000 under the head "Capital gain" is to be held in its favour, following with respect the judgment of the Hon'ble Supreme Court in the case of Vania Silk Mills (P.) Ltd. v. CIT [1991] 191 ITR 647 and the judgment of the Hon'ble Madras High Court in the case of C. Leo Machado v. CIT [1988] 172 ITR 744. The judgment of the Madras High Court was expressly approved by the Hon'ble Supreme Court in the judgment cited above. It was held that where the Insurance Company paid compensation for the destruction or loss of an asset, there was no "transfer" within the meaning of Section 2(47) of the Act and the provisions of Section 45 were not attracted. It was held that the money received under the insurance policy in such case was by way of indemnity or compensation for the damage, loss or destruction of the property. It was further held that the compensation cannot be stated to be consideration for the transfer of the property or the transfer of any right in the property in favour of

the Insurance Company and that the payment was by virtue of the contract of insurance or indemnity and under the terms of the said contract.

7. Respectfully following these two decisions, we hold that the CIT (Appeals) was not right in directing the assessment of the amount of Rs. 8,35,000 under the head "Capital gain".

8. The next issue in the assessee's appeal relating to the assessment of the amount of Rs. 1,65,000 under Section 41(2) of the Act is to be decided against the assessee. The provisions of Section 41(2) read with the Explanation below Clause (iii) of Sub-section (1) of Section 32 of the Act clearly provided for the assessment of the monies payable from the Insurance Company in respect of an asset belonging to the company which is destroyed in the accounting year to the extent to which depreciation has been allowed earlier in the assessments in respect of the asset. This is called 'Balancing charge'. The CIT (Appeals) was, therefore right in directing the ITO to assess the said amount under Section 41 (2) of the Act under the head "Business".

9. In the appeal by the department, the only ground is that the CIT (Appeals) should have restored the order of the ITO treating the compensation of Rs. 8,35,000 as business income. Mr. Lahiri referred to the provisions of Section 28 of the Act and contended that the items of income enumerated thereunder are not exhaustive, but merely illustrative. He also drew our attention to Section 2(24) of the Act which defines the word "Income" and pointed out that it is an inclusive definition. He submitted that the amount received by the assessee from the Insurance Company was connected to the business of the assessee in the sense that it was in respect of the ship which was used by the assessee in its business. According to Mr. Lahiri, there was a nexus between the receipt of the insurance money and the business of the assessee, and, therefore the same was assessable as business income as was done by the ITO. He invited our attention to the decision of the Hon'ble Calcutta High Court in the case of Kesoram Industries & Cotton Mills Ltd. v. CIT [1991] 191 ITR 518 in support of his contention.

10. We are unable to accept the contention of Mr. Lahiri. Admittedly the assessee is not carrying on business in ships. The assessee is not a dealer in ships buying and selling the same. In other words, the ship is not the assessee's stock-in-trade. The business of the assessee was to carry on shipping business and its earnings are represented by the freight money. The ship in question "M.V. Chopra" was part of the assessee's fixed capital and not its circulating capital. It is a capital asset in the hands of the assessee and not a trading asset. The nature of receipt may vary among to the nature of the trade in connection with which it arises. As observed by Lord Romer in *Golden Horse Shoe Ltd. v. Thurgood* 18 TC 218, the determining factor is the nature of the trade in which the asset is employed. The land upon which a manufacturer carries on his business is part of his fixed capital, but the land with which a dealer in real estate carries on his business is part of his circulating capital. The basic principle in Tax Law is that any receipt referable to fixed capital is capital in nature and a receipt referable to circulating capital or stock-in-trade is revenue receipt, taxable as such (please see 22 ITR (supp. page 1)). In the case of *CIT v. Manilal Rayaram Mehta* [1956] 30 ITR 53 His Lordship Chief Justice Chagla, speaking for the Bombay High Court, observed that in order that a payment should be a revenue receipt, it must be earned in the course of the business. It was further held that when the capital asset is lost or destroyed or sterilised, it is really a hole in the assessee's capital asset and any compensation received to fill-up the hole can only be a capital receipt. In the case of *CIT v. Rai Bahadur Jairam Valji* [1959] 35 ITR 148, the Hon'ble Supreme Court, speaking through His Lordship Justice Venkatarama Aiyar, referred to the observations of Lord Romer in *Golden Horse Shoe Co.'s case* (supra) and held that whenever a question arises as to whether payment of compensation is a capital or revenue receipt, it would have to be considered whether the asset in regard to which the compensation was paid was in the nature of capital asset in the hands of the assessee or whether it was only part of his stock-in-trade. The Hon'ble Supreme Court held in the case of *CIT v. Vazir Sultan & Sons* [1959] 36 ITR 175 that the real test to be considered in deciding the question regarding the nature of a receipt in the hands of an assessee would be to consider whether the capital asset formed part of the fixed capital or the circulating capital. If the receipt is referable to the fixed capital, it would be a capital receipt and if it is referable to the

circulating capital or stock-in-trade of the assessee, it would be a taxable revenue receipt. The same test was adopted by the Hon'ble Supreme Court in the decision in the case of *Godrej & Co. v. CIT* [1959] 37 ITR 381. In the case of *P.H. Divecha v. CIT* [1963] 48 ITR 222, the Hon'ble Supreme Court considered all the above decisions and propounded a further test at page 231 as under : In determining whether this payment amounts to a return for loss of a capital asset or is income, profits or gains liable to income-tax, one must have regard to the nature and quality of the payment. If the payment was not received to compensate for a loss of profits of business, the receipt in the hands of the appellant cannot properly be described as income, profits or gains as commonly understood. To constitute income, profits or gains, there must be a source from which the particular receipt has arisen and a connection must exist between the quality of the receipt and the source. If the payment is by another person it must be found out why that payment. More relevance attaches to the nature of the receipt in the hands of the person who receives it though in trying to find out the quality of the receipt one may have to examine the motive out of which the payment was made.

11. Applying the above tests to the facts of the present case, we find that it cannot be stated that the ship that sank in the sea was the stock-in-trade of the assessee. It was the assessee's capital asset and was part of its profit-making apparatus. In that sense, it was part of the assessee's fixed capital and did not form part of its circulating capital. The amount received from the Insurance Company was only by way of compensation for the loss or destruction of the capital asset, and, therefore, the same can only be regarded as a capital receipt. The amount was also not received by the company in the course of its business, for, the business of the assessee company was that of shipping and nothing else. There is no link or inseparable nexus between the receipt and the assessee's business. The source of income of the assessee is its shipping business and the receipt from the Insurance Company cannot be stated to be related to that source. We cannot, therefore accept the contention of Mr. Lahiri that the receipt was in the course of the business and was, therefore taxable as business income.

12. The reference to the decision of the Hon'ble Calcutta High Court in the case of *Kesoram Industries & Cotton Mills Ltd.* (supra) is not apposite. In that case, the

sales-tax paid by the assessee was returned by the State Government as an incentive. It was in effect refund of the sales-tax. Since the sales-tax paid had been allowed as revenue expenditure, the refund of the sales-tax was also treated as revenue receipt. It was in this background that the High Court observed at page 532 that the refund of the sales-tax was closely and inseparably connected with the business carried on by the assessee. That decision has no application to the facts of the present case. In fact, if the principle of the decision is applied to the present case, it has to be held that since the cost of the ship is not and cannot be, allowed as a deduction in computing the assessee's income, the receipt from the Insurance Company cannot also be treated as a revenue receipt. The ratio of this decision is, therefore, in favour of the assessee's contention that the receipt cannot be treated as business income.

13. In the course of the arguments, Mr. Bajoria, the Ld. Counsel for the assessee referred to the provisions of Section 41(2) and Section 32(1)(iii) of the Act, to submit that the Legislature itself did not intend to bring to tax the receipt from the Insurance Company on the loss of the capital asset as income under the head 'Business'. He submitted that the Legislature has recognised the position that even in respect of a capital asset, such as building, machinery, plant or furniture owned by the assessee and used for the purposes of business, the monies payable in respect of such capital asset on the sale or destruction or demolition thereof, will be taxable only to the extent to which depreciation had already been allowed in the earlier assessments and nothing more. The provisions of the statute themselves afford, in the words of Mr. Bajoria, a clue or answer to the contention of Mr. Lahiri that the excess above the income under Section 41(2) should be taxed as business income. We see force in this contention.

Obviously, there can be no capital asset which is not connected in some manner or other to the business of the assessee. However, it is not the intention of the Legislature to treat the sale proceeds of the capital asset as income under the head "Business", but only to bring the same to assessment as capital gain under Section 45 of the Act. In the present case, the provisions of Section 45 of the Act have no application as has been discussed earlier. If the amount received is referable to a capital asset and the amount cannot be brought to tax under Section

45 of the Act, it does not automatically follow, as contended by the revenue before us, that the receipt should be brought to tax as business income, merely because the capital asset is used in the business or has some connection or link with the business. The Legislature in its wisdom had prescribed a different treatment in respect of a capital asset and if the provisions of Section 45 fail the provisions of Section 28 cannot automatically come to play. This is so notwithstanding the inclusive definition of income in Section 2(24) of the Act and even if it is assumed that the items enumerated in Section 28(i) of the Act are merely illustrative. The contention of the revenue must, therefore, fail.

14. In the result, the assessee's appeal is partly allowed and the department's appeal is dismissed.

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