Oil India Co. Ltd. Vs. Commissioner of Income-tax, Central-ii

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Court : Kolkata

Decided On : Dec-17-1980

Reported in : [1982]137ITR156(Cal)

Judge : Sabyasachi Mukharji and ;Sudhindra Mohan Guha, JJ.

Acts : Income Tax Act, 1961 - Sections 41(2) and 80E

Appeal No. : Income-tax Reference No. 71 of 1977

Appellant : Oil India Co. Ltd.;commissioner of Income-tax, Central-ii

Respondent : Commissioner of Income-tax, Central-ii;oil India Co. Ltd.

Advocate for Pet/Ap. : K. Roy, ;R.N. Datta, ;B.L. Pal and ;B.K. Naha, Advs.

Judgement :

Sabyasachi Mukharji, J.

1. In this reference under Section 256(1) of the I.T. Act, 1961, the Tribunal has referred certain questions of law both at the instance of the assessee as well as at the instance of the Revenue. In order to understand these questions, it is necessary to note that the assessment year involved is the assessment year 1967-68. The assessee had taken a loan of 3,94,433, from the Burmah Oil Co., London, in 1966, which was free of interest. It was repaid in December, 1966. In the meantime, there was a devaluation of the Indian rupee on the 6th June, 1966. As a result of the devaluation, the assessee had to pay in terms of the Indian currency Rs. 83,24,896 as against Rs. 52,50,000 received by the assessee as the original amount of loan. The extra amount of Rs. 30,74,896 was claimed by the assessee as a loss incidental to its business or as an expenditure under Section 37 of the I.T. Act, 1961. The assessee had also taken another loan of 10,250,000 from the Bank of Scotland on 30th June, 1963. Out of this 163,063 had remained unutilised and was retained in the U.K. The balance amounting to 1,086,937 was utilised by the assessee for the purchase of capital assets and stores as also as expenses for raising the loan, for repatriation of the amount to India and as operational expenses for its business. In terms of the Indian currency the entire expenditure came to Rs. 1,347.26 lakhs. There was no dispute before the Tribunal that the original loan of 10,250,000 converted into Indian currency to Rs. 1,369.04 lakhs was payable by the assessee in sterling in the U.K. As a result of the devaluation on the 6th June, 1966, the assessee was of the opinion that this liability with regard to the above loan was increased by Rs. 6,78,37,595 which it was required to incur for its repayment in sterling. There was also another amount due by the assessee by way of retention money to Bank Bush Murphy Ltd. According to the assessee, due to devaluation, it was required to incur an additional expenditure of Rs. 3,14,985 on

repayment of this money also in sterling. The assessee, therefore, worked out its loss as a result of devaluation at Rs. 7,12,27,476 as per the following details :

Rs.(1)On loan from Bank of Scotland6,78,37,595(2)On retention money to Bank Bush Murphy Ltd. 3,14,985(3)On loan from B.O.C., London 30,74,896

7,12,27,476

2. Against the above, the assessee had a gain of Rs. 1,93,137 on account of devaluation on money realised in the U.K. for an insurance claim in respect of the damage caused to its pipeline lying along the Dhansiri Bridge. This gain was originally adjusted against the loss stated above and after the adjustment the net devaluation loss was claimed at Rs. 7,10,34,340. Subsequently, the assessee changed its stand and claimed that the devaluation gain in respect of insurance claim was not taxable at all and as such the devaluation loss should not be reduced by that amount. The above loss of Rs. 7,12,27,476 was allocated by the assessee towards the capital and revenue expenses as the loan itself was utilised for such combined purposes. The allocation as given was as under :

Rs.(i)Loss on capital assets6,13,37,796(ii)Loss relating to stores held in stock 6,11,730(iii)Loss relating to sterling loan raising expenses already incurred and allowed in earlier years

12,98,585(iv)Loss relating to repatriation to India incurred and allowed in earlier years

40,35,230(v)Loss relating to operational expenses already incurred and allowed in earlier years

8,69,189(vi)Loss relating to loan from B.O.C. repaid during 1966 30,74,896

Total7,12,27,476

3. The assessee claimed depreciation on the enhanced value of Rs. 6,13,37,796 which was allowed by the ITO under Section 43A of the Act. The ITO also observed that the claim for deduction of Rs. 6,11,780 would be embedded in the cost of stores as and when these were consumed and debited to the accounts in the subsequent years and that it would come for consideration in those years. These decisions of the ITO were accepted by the assessee. The claim was, therefore, reduced to Rs. 92,77,900. The assessee urged before the ITO that the above amount of Rs. 92,77,900 was either allowable as an expenditure under Section 37 of the Act or as a loss incidental to its business under Section 28 of the Act. It was urged that since the amount of loan to which the amount was attributable had been spent as a revenue expenditure for the purposes of the business and had also been allowed as a deduction in the respective years, the additional liability was also in the nature of expenditure of the year under appeal as it accrued in this year and required to be allowed. In the alternative, it was submitted that the loss had arisen to the assessee as a result of the devaluation and it was incidental to the business and was allowable under Section 28 of the Act. The ITO rejected both the contentions of the assessee for the reasons given by him in his order.

4. The assessee went up in appeal before the AAC. It was urged before him that there

was no justification for the distinction made by the ITO between the additional liability in respect of admissible business expenditure and in respect of outstanding temporary loan taken for such expenditure and that both were referable to expenditure of a revenue nature. It was, therefore, urged that the entire loss was required to be allowed according to the method of accounting followed by the assessee. Reliance in this connection was placed on certain decisions. It was also urged before the AAC that the list of allowances enumerated in Sections 30 to 37 of the Act, was not exhaustive and an item incidental to the business was deductible in computing the profits and gains even if it did not fall in any of the specified items. Reliance was also placed on certain decisions of the Supreme Court but the AAC, however, upheld the order of the ITO on the ground that the loss was not in respect of any item in the nature of expenditure and the expenditure had already been incurred much earlier and no additional liability arose on account of devaluation and when the loss was claimed to have been suffered the character was of a capital liability. It was further urged that the loan itself could not be considered as allowable and any variation in its value had to be ignored for computing the income of the assessee. The assessee went up in appeal before the Tribunal. Before the Tribunal, the assessee confined its claim to the extent of Rs. 92,77,900 only. It was submitted that as per the agreement with the Bank of Scotland by the Burmah Oil Co., and also with the Bank Bush Murphy Ltd. the assessee-company was required to repay the loans in sterling in United Kingdom and, therefore, it was not correct on the part of the Revenue to hold that there was any variation in the value of the loan. According to the assessee the amount of the loan due to the above parties, who were 'entitled to repayment in England, remained the same and it could not he said that there was any variation in the value of the loan or that the enhanced liability was in any way a capital liability as was held by the AAC. It was further urged on behalf of the assessee that the extra amount was by way of additional cost of the assessee for discharging its liability and was an admissible deduction in view of the decision of the Supreme Court. The assessee also repaid two instalments of 6,94,146 as also 7,13,235 as per instalment scheme laid down in the agreement of 30th June, 1966, and 31st December, 1966, to the Bank of Scotland. It was urged that for the purpose of remittance, which was of a revenue expenditure, the assessee had to incur an extra cost of Rs. 9,85,664 and these remittances were made during the previous year relevant to the year under appeal. It was stated before the Tribunal that the above amount of Rs. 92,77,900 should be bifurcated into two instalments, one of Rs. 40,60,560 (Rs. 30,74,896 plus Rs. 9,85,654) which was an expenditure incurred in the year under appeal itself on the repayment of loans to Burmah Oil Co. on 30th December, 1966, and to the Bank of Scotland on 30th June, 1966, and 31st December, 1966. It was pointed out that the assessee followed the calendar year 1966 as its accounting year and the other sum of Rs. 52,17,340 related to the balance of loans which had not been repaid and which was outstanding not only on the date of devaluation but also at the end of the accounting year. It was urged that the sum of Rs. 40,66,560 had to be treated as a revenue expenditure of the year under appeal as it had been incurred in the year. With regard to the remaining amount, it was submitted that even though it had not been spent in the sense that it had not been paid off as no remittance was made to England, yet it constituted an expenditure of the year in view of the principles laid down by the Supreme Court in the case of Kedarnalh Jute . v. CIT : [1971]82ITR363(SC) , On behalf of the assessee, it was further submitted that the disbursement of the loan had been held as a revenue expenditure in the past and had been allowed in the computation of income an extra liability relating to the payment of the loan also required to be treated as an expenditure as the assessee followed the mercantile system of accounting. The important point to be borne in mind in this

connection is the system of accounting. It was submitted that the liability had to be ascertained and allowed in the year as it arose in this year alone. Several decisions were placed before the Tribunal. On the other hand, on behalf of the Revenue, it was urged that the alleged increased cost did not relate to the running of the business of the assessee and it did not fall on the assessee as a trader. It was emphasised on behalf of the revenue, it was not sufficient that the loss should be merely connected with the business but it should be incidental to the business and should arise in the course of the running of the business. Reliance was also placed on several decisions and specially on the decisions in the case of Bestobell India Ltd, and Dunlop India Ltd. before the Tribunal. After dealing with the rival contentions, the Tribunal observed on the main contention as follows:

' We will deal with the claim of the assessee in two parts, one relating to Rs. 40,60,560, being the actual expenses incurred by the assessee in the repayment of its loan to Burmah Oil Co. and payment of two instalments to Bank of Scotland and the second of Rs. 52,17,340 which according to the assessee was only an accrued expenditure or loss as per mercantile system of accounting followed by it. As already stated above, the assessee had already incurred the various expenses for raising the loss, for repatriation of the amount to India and for operational purposes in the earlier years which had also been allowed in those years. '

5. The claim was accordingly rejected. The Tribunal then dealt with the claim of the assessee for the other amount, viz., Rs. 40,60,650. The Tribunal noted the fact that the assessee had spent the aforesaid sum as additional expenditure in repaying its loan to the Burmah Oil Co. or a part of the loan to the Bank of Scotland in the year under appeal. With regard to this amount also, according to the Tribunal, the assessee contended that this loss should be considered to be a loss incidental to the business and allowed it under Section 28 of the Act, or alternatively it should be allowed under Section 37 of the Act. The Tribunal noted that there was a distinction between loss and expenditure. Therefore, the Tribunal was of the view that the amount of Rs. 40,60,560 which, the assessee had to incur by way of extra expenditure during the year under appeal in connection with the repayment of its loan was of the nature of a loss. Once this position was accepted, according to the Tribunal, its disallowance like the assessee's claim for the other amount of Rs. 52,17,340 could not but be upheld or sustained following the decision of the Calcutta High Court in the case of Sutlej Cotton Mills Ltd. v. CIT : [1971]81ITR641(Cal) . The Tribunal, therefore, did not consider it necessary to examine whether the loss arose in the course of the assessee's carrying on its business as it was not in the nature of a loss at all. The Tribunal then considered whether the above amount could also be considered or be treated as an expenditure of the year under appeal only because there was devaluation of the Indian rupee in terms of sterling. In their opinion, the case of the assessee was fully governed by the principle laid down by the Tribunal in the case of Bestobell India Ltd. (ITA No. 888 (Cal) of 1972-73, and S.T.A. No. 11 (Cal) of 1972-73, dated 31st October, 1973), to which one of them, the Accountant Member was a party.

6. The Tribunal also dealt with several decisions. The Tribunal noted that the Tribunal followed the decision of the Calcutta High Court in the case of Sutlej Cotton Mills Ltd. v. CIT : [1971]81ITR641(Cal) and also relied on the decision in the case of Bestobell India Ltd. v. CIT and observed that the claim of the assessee amounting to Rs. 52,17,340 can neither be treated as a business expenditure wholly and exclusively laid out or expended for the purpose of the assessee's business so as to qualify for

allowance under Section 37(1) of the Act. It was urged before the Tribunal on behalf of the Revenue that the expenditure had already been incurred in the earlier years and, therefore, the additional payment made in repayment of the loan taken in earlier years could not be allowed as it was not permissible, according to the Revenue, in view of the decisions of the Supreme Court in the cases of CIT v. A. Gajapathy Naidu : [1964]53ITR114(SC) and CIT v. Swadeshi Cotton and Flour Mills P. Ltd. : [1964]53ITR134(SC) . The Tribunal was, however, of the opinion that the Tribunal was not dealing with the expenditure or any part of expenditure which had already been incurred in earlier years and were allowed in those years. The Tribunal was dealing with an independent expenditure which was forced upon the assessee became of the devaluation of the rupee in the year under appeal itself. Therefore, the Tribunal was of the view that the expenditure accrued or arose and was also incurred in the year, in the light of the decisions of the Supreme Court, referred to before, and that this claim of the assessee on this head had to be accepted as an expenditure of the year under appeal.

7. The other limb of the question was as to whether the above expenditure was also wholly and exclusively laid out for the purposes of the assessee's-business. The argument of the department was that it did not fall on the assessee as a trader and it had no connection with the running of its business. The claim of the assessee, on the other hand, was that it related to the business. The Tribunal, however, was unable to accept this contention and in this connection the Tribunal observed--and it is necessary to quote the exact findings as follows : ' There is no dispute that the borrowings were made for meeting the assessee's revenue expenditure and directly related to its business. ' Therefore, the Tribunal was of the view that though this was an income loss, it was an expenditure incurred for the carrying on of the business and the Tribunal allowed this sum of Rs. 40,60,560 as an expenditure wholly and exclusively laid out for the purpose of its business.

8. There was another aspect of the matter so far as the pipelines were concerned. There, the facts were that the assessee-company was the owner of a pipeline used for carrying its crude products to the refineries. The pipeline was insured with an insurance company in the U.K. A part of this pipe line laid along Dhansiri Bridge was damaged in floods. A compensation of 24,923 was awarded to the assessee which in terms of the Indian rupee at its pre-devaluation value came to Rs. 3,32,880. The assessee actually received a sum of Rs. 5,26,017 in India which included the original amount of Rs. 3,32,880 and again on account of devaluation of sterling in terms of the Indian rupee amounting to Rs. 1,93,137. Out of this Rs. 3,32,880, the assessee offered Rs. 36,218 for taxation which related to expenses not capitalised and credited to profit and loss account included in the miscellaneous income of Rs. 68,022. Besides, it also offered two sums, Rs. 25,000 and Rs. 19,921, aggregating to Rs. 44,927 as profits under Section 41(2) of the Act. After deducting Rs. 36,210 from the sum of Rs. 3,32,880, there remained a sum of Rs. 2,96,662. From this the assessee deducted the original cost of the asset being destroyed, viz., the sum of Rs. 2,36,459 which has left a balance of Rs. 60,203 which was claimed as a capital receipt. The assessee, therefore, claimed an exemption from tax from these two amounts of Rs. 1,93,137, being the gain arising out of devaluation of sterling or devaluation of rupee on 6th June, 1966, and another Rs. 60,203, being the excess receipt over the cost of asset destroyed. The ITO as well as the AAC rejected the assessee's claim on the ground that the entire amount of Rs. 5,26,017 had been received in the course of the day-to-day business of the assessee-company and, therefore, it was intimately connected with the payment of insurance premium. According to the ITO as well as the AAC, the

amounts of Rs. 1,23,137 and Rs. 66,203 were assessable either as profit arising out of the business or as income under Section 41(1) of the I.T. Act, 1961. When the matter went up before the Tribunal it was urged on behalf of the assessee that it was riot the assessee's business to trade in insurance claim and, therefore, it could not be said that the receipt of Rs. 5,26,017 had arisen to it in the course of its business. It was submitted that only that amount which fall under Section 41(2) of the Act should be taxed and, according to the assessee, that amount was only Rs. 44,927 which had already been offered for tax partly in the assessment year 1965-66 and partly in the assessment year under appeal. Reliance was placed on several decisions. The Tribunal considered the respective contentions. The Tribunal noted that the assessee was awarded a compensation of Rs. 3,32,880. The Tribunal was of the view that out of this, once the assessee conceded, as it did, that the sums of Rs. 36,218 and Rs. 44,927 were liable to tax in India, it was difficult to understand why the extra amount received by it as a result of the devaluation of the Indian rupee could not also be brought to tax. The Tribunal was of the view that once a part of the amount, Rs. 3,32,880, was held to be taxable under the I.T. Act, as a corollary, it would also have to be accepted that any gain arising to the assessee on that part was also assessable as profit. The Tribunal, therefore, directed the ITO to find out the amount of devaluation gain referable to the above two amounts and bring it to tax.

9. The next question that arose before the Tribunal was the claim for Rs. 66,203 and the devaluation gain relating thereto and also the devaluation gain relating to other remittances referable to the costs of the assets destroyed. The Tribunal was of the view that these amounts were covered by the ratio of the decision of the Supreme Court and, therefore, the Tribunal was of the opinion that the remaining amount of Rs. 66,203 or any devaluation gain relating thereto as a balance of the devaluation was not relating to the original cost of the assets destroyed and could not represent the profit in the commercial sense and, therefore, it could not be brought to tax.

10. The assessee also made a claim for Rs. 19,04,811 as relief under Section 80E of the I.T. Act, 1961. As the assessee's profits and gains had been determined at nil after setting off the unabsorbed depreciation brought forward from earlier years, the ITO held that these resulted in no income available for relief under Section 80E. He, therefore, negatived the assessee's claim which was also confirmed by the AAC. For the year 1966-67 also there was a similar claim made by the assessee which was disallowed by the lower authority on the ground that there was no income liable to tax after setting off the unabsorbed depreciation brought forward. The Tribunal, following the decision of the Kerala and Mysore High Courts, held that the assessee was entitled to relief on the profits and gains attributable to the business of priority business before their reduction by any unabsorsed depreciation brought forward from the earlier years. It was urged on behalf of the revenue that Section 80E referred to the total income as computed in accordance with the other provisions of the Act, which, among other things, included Section 32(2) of the Act and according to it the unabsorbed depreciation brought forward from the earlier years had to be added to the amount of the allowance for depreciation for the current year and deemed to be part of that allowance. It was submitted, if it was done, then the total income of the assessee had to be taken at nil and, therefore, the question of allowing relief under Section 80E of the Act did not arise. The Tribunal following its decision in the previous case directed that the assessee's claim should be accepted--the previous decision being in the case of Balanoor Tea & Rubber Co. Ltd. (sic)--and the relief should be granted to the assessee.

11. As mentioned hereinbefore, both the assessee and the revenue raised certain questions and asked the Tribunal to refer those to the High Court under Section 256(1) of the I.T. Act, 1961. Out of the assessee's reference application, the Tribunal referred the following three questions to this court:

' 1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the amount of Rs. 52,17,340 was not deductible in computing the assessee's income in the assessment year 1967-68?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 40,60,500 was not allowable as a business loss ?

3. Whether, on the facts and in the circumstances of the case, the Tribunal was right in directing the Income-tax Officer to find out the amount of devaluation gain referable to the amounts of Rs. 36,218 and Rs. 44,927 and bring it to tax '

12. In respect of the application made by the revenue, the Tribunal referred the following two questions to this court:

' 1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the sum of Rs. 40,60,560 being the additional expenses incurred by the assessee in the payment of its loan to M/s. Burmah Oil Co. Ltd., London, and to the Bank of Scotland due to the devaluation of the Indian rupee was an expenditure wholly and exclusively laid out by the assessee for the purpose of its business and as such was an allowable revenue expenditure under Section 37 of the Income-tax Act, 1961, for the assessment year 1967-68 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the assessee was entitled to relief under Section 80E of the Income-tax Act, 1961, on the profits and gains attributable to the activities of the priority industries before their reduction by the unabsorbed depreciation carried forward from the earlier years '

13. We will first deal with question No. 1 of the assessee's application. It appears to us that the contentions on this point are covered by the ratio of the decision, viz., whether the amount of Rs. 52,17,340 could be deducted from the assessee's income in view of the principles, on this aspect, decided by this court in the case of Bestobell (India) Ltd. v. CIT : [1979]117ITR789(Cal) . It has to be borne in mind that the Tribunal based its decision in disallowing this claim of the assessee on the Tribunal's own decision in the aforesaid case which ultimately came up before this court, as referred to hereinbefore.

14. In that case, the assessee, an Indian subsidiary of a non-resident company incorporated in the United Kingdom, was engaged in executing a contract awarded by a Govt. of India undertaking. In executing the said contract the funds of the assessee to the extent of over Rs. 24 lakhs became blocked. The assessee, therefore, approached its parent-company for a loan of 37,500 being about Rs. 5 lakhs in Indian currency at that time. The foreign principal company agreed to advance the amount to the assessee and the assessee by its letter dated 18th January, 1965, sought the approval of the Reserve Bank of India for the loan of Rs. 5 lakhs from the parent-company with a permission to repatriate the amount when required after one year or earlier if funds would become available. The permission was granted by the Reserve

Bank for the loan and the assessee received the loan on 25th February, 1965. The loan was not repaid at the expiry of one year and remained outstanding in the books of the assessee up to 6th June, 1966, on* which date the Indian rupee was devalued. As a result of the devaluation, the assessee had to arrange for a sum of Rs. 7,87,622 to repay the original loan of 37,500 and, consequently, an extra amount of Rs. 2,87,692 was necessary to repay the original loan of Rs. 5 lakhs. After deducting a gain of about Rs. 4,078 on the assessee's sterling deposit in a London bank, the assessee debited its profit and loss account with a sum of Rs. 2,83,614 for the assessment year 1967-68 and claimed deduction of this amount. The ITO rejected the claim of the assessee on the ground that the increase of liability arising from devaluation on account of the sterling loan was of a capital nature and could not be allowed as a revenue expense. On appeal, the AAC also held that the loss on account of the devaluation in connection with a loan could not, under any circumstance, be considered to be revenue loss, that accretion in the amount of the borrowing was not admissible as a deduction, that the assessee not being a dealer in foreign exchange, loss was not incidental to its business or in carrying on the same, and confirmed the disallowance of the loss. On further appeal to the Tribunal, the assessee contended that the amount should be allowed as business expenditure under Section 37(1) of the I.T. Act, 1961, as a loss incidental to the business, that although the loan had not been repaid during the relevant year, as the assessee's accounts were kept on the mercantile system, liability having arisen in the relevant year by reason of the devaluation, it was in the nature of an expenditure incurred by the assessee and allowable under Section 37, that the expenditure for the purpose of the business included the payment of the assessee's statutory dues and taxes, and that the loan had been taken by the assessee for the purpose of its business and the loss occasioned by devaluation was suffered in the business. The revenue had contended that the expenditure or the loss was not allowable inasmuch as, (a) no expenditure or loss had been incurred during the assessment year ; (b) even if such expenditure was incurred, it had not been laid out or expended wholly or exclusively for the purpose of the assessee's business; and (c) the expenditure or loss was capital in nature inasmuch as it went to increase the amount of loan which the assessee was required to pay to its principal. The revenue also contended that the loss arising out of devaluation could not be allowed as a loss incidental to the business. The revenue further contended that the loss, if any, was of a capital nature because there was no change in the amount of the loan and the provision for a higher amount for repaying the loan could not be called a revenue expenditure as it was related to capital and was connected with the return thereof. The Tribunal accepted the contention of the revenue and dismissed the appeal of the assessee. It was also held by this court that the contention of the revenue that notion-ally the expenditure, if any, incurred by or any loss accruing to the assessee by reason of the devaluation did not arise in the year of assessment could not be accepted. The assessee maintained its accounts on mercantile basis. On devaluation of the Indian currency, the liability of the assessee immediately increased to the extent the rupee was devalued and the assessee became liable to pay and/or spend an extra amount in rupees in order to pay its dues. The liability of the assessee arose during the assessment year and could not be said to be a contingent liability or an anticipated future loss. However, the Division Bench observed, the extra expenditure, deemed or otherwise, or the loss, was inextricably connected with the assessee's indebtedness and did not arise de hors the indebtedness. Therefore, the extra amount which the assessee had to provide for as a result of devaluation could not be considered as extra expenditure to be incurred for meeting a debt like postal expenses or bank charges or as extra expenditure resulting in a business loss of a revenue nature. The Division Bench was also of the view that

the loss was a capital loss in view of the nature of the transaction. Now, so far as we are concerned, in this reference it has to be borne in mind that the Tribunal has noted that there was no dispute, in the instant case before us, that the expenditure in reality was an expenditure of revenue nature. Therefore, we are not concerned with the ratio of the decision of the Calcutta High Court, in so far as it held that the loss related to a capital expenditure. We need not further also express any final opinion on the question whether the expression ' loss ' should be interchanged with the expenditure in respect of a certain transaction, if the expenditure was incurred creating an additional liability in discharging its obligation putting the assessee at a loss, because that is not necessary for our present purposes. For our present purposes it is sufficient to refer that the contention that was mainly made before the Division Bench, upon which the Tribunal had decided its earlier case, was that the expenditure or loss had not been incurred during the assessment year and, secondly, it was not for the purpose of the business.

15. Now, it has also to be borne in mind that, in the instant case, the assessee maintains the mercantile system of accounting. At, p. 796 (of 117 ITR) of the report Sen J., delivering the judgment of the Division Bench of this court, observed as follows:

' On question No. 2 Mr. Roy for the assessee contended first that the extra amount of Rs. 2,83,614, which the assessee had to provide as a result of devaluation, was in the nature of an ordinary business expenditure. It was as much an expenditure as bank or postal charges which might have had to be incurred by the assessee if the amount was remitted by post or through bank for repayment of the loan. In terms of sterling the amount of loan remained fixed but in obtaining the foreign currency the assessee had to incur an extra expenditure in rupees. This, according to Mr. Roy, was a normal and proper business expenditure allowable under Section 37 of the Act,

Mr. Roy submitted next that as the assesses at the relevant time maintained its accounts under the mercantile system, this expenditure was incurred during the relevant year. The moment devaluation took place, the liability for the extra amount was incurred by the assessee and had to be debited in the assessee's profit and loss account in that year. Alternatively, in providing for the extra amount on account of the devaluation, the assessee suffered a loss and such loss was connected with, incidental to and was incurred for the purpose of the assessee's business. It was a loss of a revenue nature and not of a capital nature.

Mr. Roy, lastly, submitted that even if it was admitted that the object of the assessee in obtaining the loan was to meet its income-tax liabilities, the extra expenditure incurred in connection with such loan would also come within the ambit of the expression ' purpose of the assessee's business' in Section 37 of the Act. Mr. Roy submitted that by reason of the subsequent decisions of the Supreme Court, the decision of this court in Mannalal Ratanlal's case : [1965]58ITR84(Cal) was no longer good law. '

16. Thereafter, Their Lordships referred to the several decisions and observed as follows at p. 802 of the report:

' In the facts of this case as found we are unable to accept the contention of the revenue that notionally the expenditure, if any, incurred by or any loss accruing to the assessee by reason of the devaluation did not arise in the year of assessment. The

assessee admittedly maintained its accounts on mercantile basis. On devaluation of the Indian currency the liability of the assassee immediately increased to the extent the rupee was devalued and the assessee became liable to pay and/or spend an extra amount in rupees in order to pay its dues. This liability accrued during the relevant period. In the event this debt would be remitted or would become irrecoverable from the assessee in future then under Section 41 of the I.T. Act, 1961, the same would again be treated as income accruing to the assessee. The liability of the assessee during the relevant period cannot be said to be a contingent liability or an anticipated future loss. On such facts the instant case is clearly distinguishable from the decisions cited by the revenue, i. e., Edward Collins & Sons Ltd. [1924] 12 TC 773 (C. Sess) and Whimsier & Co. [1925] 12 TC 813 and the principles laid down in the said decisions have no application in the instant case.

The enquiry as to whether by reason of the devaluation the assessee has incurred an expenture or has suffered a business loss is, in our view, of little relevance. No doubt, an expenditure is something which directly goes out or is deemed to go out of the pocket or till and a loss may fall on a business without any immediate liability to pay or disburse anything. There also may be cases where a loss arising from causes ab extra may necessitate immediate expenditure. But in all such cases, the expenditure as also the losses, if they are business losses, have to be taken into account and deducted in determining the profit. Therefore, the distinction between loss suffered without any immediate disbursemennt and an expenditure incurred would be of not much significance.'

17. We have already observed that the Division Bench held, in the facts of the case before that Bench, that the loss was a capital loss. But that is not the controversy here and it is undisputed that the expenditure in respect of the additional expenditure incurred was of a revenue nature. Following the ratio of the said decision on the two aspects, we are of the opinion that the Tribunal was in error in not holding that the amount was not deductible in computing the assessee's income for the assessment year 1967-68. In this connection, we may observe that strong reliance was placed on behalf of the assessee on this decision, though learned advocate for the assessee submitted that the final decision, according to him, was not correct. Further, counsel submitted, that it was not proper to rely wholly upon the observation in the decision in the case of Davies (H. M. Inspector of Taxes) v. Shell Co. of China Ltd. : [1952]22ITR1(All) . It was urged that that decision had dealt with profit and the ratio of that decision should not be applied, according to the learned advocate for the assessee, in a case where the question was about the allowability of a loss, because ultimately business is carried on by an assessee for earning profits, and no assessee carries on business for incurring losses. Loss is an incident that befalls on the assessee in the course of carrying on the business and the true test that has to be found out is whether the loss fell on the assessee in the character of a trader or person carrying on the business in question. We may incidentally note that our attention was drawn to the observations of the English Court of Appeal in the case of Davies (H. M. Inspector of Taxes) v. Shell Co. of China Ltd. : [1952]22ITR1(All) , and our attention was drawn to the observations of Jenkins L.J, at p. 154 and at p. 157 of the report.

18. Reliance was also placed on the decision of the English Court of Appeal in the case of Radio Pictures Ltd. v. IRC [1938] 22 TC 106 (CA), and our attention was drawn to the observations of Sir Wilfrid Greene M.R., at p. 122 and at p. 128 of the report and the observations of Scott L.J., at p. 132 of the report. In view of the facts of

the case before us and the ratio of the Division Bench referred to hereinbefore, it is not material for our present purpose to refer to the said decisions in any greater detail.

19. We must, however, refer to another decision of the Supreme Court in the case of Sutlej Cotton Mills Ltd. v. CIT : [1979]116ITR1(SC) , which was an appeal from the decision of the Division Bench of the Calcutta High Court in the case : [1971]81ITR641(Cal) in respect of the same assessee on which the Tribunal had relied. The said decision of the Calcutta High Court was reversed by the Supreme Court by the aforesaid decision. There, the Supreme Court noted that where profit or loss arose to an assessee on account of appreciation or depreciation in the value of the foreign currency held by him, on conversion into another currency, such profit or loss would ordinarily be considered a profit or loss if the foreign currency was held by the assessee on revenue account or as a trading asset or as part of the circulating capital in the business. But if, on the other hand, the foreign currency was held as a capital asset or as fixed capital, such profit or loss would be of capital nature. Reliance was placed on the observations of the Supreme Court at p. 6 of the report. In this case, in view of the specific finding of the Tribunal that the expenditure in respect of which additional liability of Rs. 52,17,340 had to be incurred was on revenue account, it is not necessary for us to examine in detail whether the said observations of the Supreme Court made in the context of that case would be equally applicable in the case of loss.

20. On behalf of the assessee, however, reliance was placed on the decision in the case of Badridas Daga v. CIT : [1958]34ITR10(SC) , where the Supreme Court was dealing with Section 10(1) of the Indian I.T. Act, 1922, which was in pari materia with Section 37 of the I.T. Act, 1961, and the Supreme Court reiterated that that section imposed a charge on the profits or gains of a business and it did not matter how those profits were to be computed and Section 10(2) of the Indian I.T. Act, 1922, which was similar to Section 37(1) of the present Act, enumerated the various items which were admissible as deduction, but they were not exhaustive of all the allowances which could be made in ascertaining the profits of a business taxable under Section 10(1). The profits and gains which were liable to be taxed under Section 10(1) were what were understood to be such under ordinary commercial principles.

21. When a claim was made for a deduction for which there was no specific provision under Section 10(2), whether it was admissible or not would depend on whether, having regard to the accepted commercial practice and trading principles, it could be said to arise out of the carrying on of the business and would be incidental to it. Emphasis was laid on this aspect that the additional liability was suffered by the assessee, in this case, not as a trader or a person carrying on the business but, the expression used by the learned advocate for the revenue ' as the owner of the foreign currency '. For this he placed strong reliance on the observations of the Supreme Court in the case of CIT v. Malayalam Plantations Ltd, : [1964]53ITR140(SC) . It is true that the assessee was the owner of a fund, but while the assessee became the owner of the fund, the assessee had to incur this loss in order to carry on its business or to facilitate the carrying on of the business. Therefore, in our opinion, merely because for the purpose of carrying on the business the assessee borrowed money and thereby became temporarily the owner of the fund, if the assessee had to incur an additional liability it would be loss in connection with or arising out of the business and would certainly be an expenditure or a liability to be allowed in computing the revenue profit. It has to be borne in mind that very often in the case of additional

liability the expressions ' loss' and ' expenditure ' have been used as interchangeable expressions.

22. Our attention was also drawn to the decision in the case of CIT v. A. Gajapathy Naidu : [1964]53ITR114(SC) . There, the Supreme Court reiterated the principle of accrual of interest in the mercantile system of accounting. Reliance was also placed for the same proposition in the case of CIT v. Swadeshi Cotton and Flour Mills P. Ltd. : [1964]53ITR134(SC) . The principles upon which the mercantile system of accounting is based are fairly well settled and it is not necessary, in our opinion, now to deal with these principles in detail. In that view of the matter, in our opinion, question No. 1 of the assessee's reference must be answered in the negative and in favour of the assessee.

23. Question No. 2 of the assessee's application is the same as question No. 1 of the revenue's application. In this connection, we have set out in detail the facts and the reasons upon which the Tribunal allowed this expenditure. It is not necessary, in our opinion, to actually deal with the question whether it was to be allowed as business loss or to be allowed as expenditure. In this connection, we may, however, observe that it should be treated as deductible in consequence of the liability which involved the expenditure in view of the facts found by the Tribunal. In this connection, a reference may be made to the observations of the House of Lords in the case of Strong and Company of Romsey Ltd. v. Woodifield (Surveyor of Taxes) [1906] 5 TC 215 (HL) where Lord Davey at p. 220 of the report, observed as follows :

' My Lords, the question in this appeal is whether a sum of 1,490, which the appellants have had to pay for costs and damages occasioned to a person staying in their inn by the fall of a chimney, is a proper deduction in arriving at the profits of the appellants' trade for the purpose of the income tax. The answer to that question, in my opinion, depends on the answer to be given to another question, whether the deduction claimed was a disbursement or expense wholly and exclusively laid out or expended for the purpose of the appellants' trade, within the moaning of Rule 1 applying to both Cases 1 and 2 of Schedule D in Section 100 of the Income Tax Act, 1842.

It has been argued that the deduction claimed was a loss connected with or arising out of the appellants trade within Rule III, applying to Case 1 only. Case 1 relates to trades, manufactures, adventures, or concerns in the nature of trade, and I think that the word ' loss' in Rule III means what is usually known as a loss in trading, or in speculation. It contemplates a case in which the result of the trading or adventure is a loss, wholly or partially, of the capital employed in it. I doubt whether the damages in the present case can properly be called a trading loss. I prefer to decide the case upon Rule 1, which applies to profits of trades and also to professions, employments, or vocations. I think that the payment of these damages was not money expended ' for the purpose of the trade'. These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think that the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits. In short, I agree with the judgment of the Master of the Rolls.'

24. Reliance was also placed on a certain observation in the case of IRC v. E. C.

Warnes & Co. Ltd. [1919] 12 TC 227 (KB), where at p. 231 of the report, Mr. Justice Rowlatt observed that the detriment suffered was a loss. Reliance was also placed in the case of Firestone Tyre & Rubber Co. Ltd. v. Evans (Inspector of Taxes] [1977] STC 104 ; [1976] 51 TC 615, where a taxpayer-company was indebted to its parent-company in the United States in the sum of 3,699,323. The indebtedness arose prior to 1931 and the amount represented the balance outstanding of an intercompany dollar account between the taxpayer-company and the parent company. In the year ended 31st October, 1938, the debts stood at 76,117, the sum arrived at by converting various dollar liabilities into sterling at the exchange rate ruling at the dates when the debts comprising the indebtedness were occurred. The approximate average exchange rate at that time was dollar 4.86. When the taxpayer-company was required to pay for the debt in 1964, the exchange rate had fallen to dollar 2.80 to the pound. Secondly, the taxpayer-company incurred be allowed as expenditure (sic). Without expressing our final opinion as to whether it should also be allowed as loss, for the reasons recorded by the Tribunal, we are of the opinion that the decision of the Tribunal in so far as it allowed the deduction is correct. Our attention was drawn to the observations of the Supreme Court in the case of Cambay Electric Supply Industrial Co. Ltd, v. CIT : [1978]113ITR84(SC) and reliance was placed on the observations made at p. 91 of the report. In view of the facts of the present case, we are of the opinion, that the said observations would not be of much assistance to us in resolving the present controversy.

25. For the reasons stated above, question No. 2 of the assessee's application and question No. 1 of the revenue's application are answered in favour of the assessee and the assessee was entitled to the deduction.

26. There remains two other questions, viz., question No. 3 of the assessee and question No. 2 of the revenue. First, we shall deal with question No. 3 of the assessee. The Tribunal has observed and directed the ITO to find out the amount of devaluation gains referable to the above two amounts. Our attention was drawn by the learned advocate for the assessee to the observations of the Kerala High Court in the case of CIT v. Union Engineering Works : [1976]105ITR311(Ker) . There, the assessee-firm carried on a business of manufacturing and selling tea chest fittings and battery covers. For the accounting year under the relevant assessment year 1968-69 it imported tin sheets from London. Upon arrival of goods, it was found that more than half of the quantity was rusty. The goods were insured with an insurance company in London. The loss of 568 489 for the purchase of dollars was to pay off the debt. In computing the profits for the purpose of corporation taxes, the taxpayer-company claimed that part of the loss was not excluded as an allowable deduction Section 137 of the I.T. Act, 1952, of England. It was common ground between the Crown and the taxpayer-company on the question that where the loss was sustained in paying that part of the debt incurred for capital items, it was not an allowable deduction. Accordingly, the question arose as to how the debt should be apportioned between capital and revenue. In the course of correspondence with the Inspector of Taxes between 1932 and 1935 the taxpayer-company's accountant made submissions that 90 per cent. of the debt should be apportioned to capital and 10 per cent. to revenue. On that evidence, the Special Commissioners came to the conclusion that for the purpose of computing the profits for corporation tax for the period ended 31st October, 1965, 90 per cent. of the debts was attributable to capital and 10 per cent. to revenue. The taxpayer-company appealed contending that the statements made in the years between 1932 and 1935 in the correspondence were not binding since they were only a convenient concession made by the accountants to the Crown and did not

establish an agreement between the parent-company and the taxpayer-company. It was held that the question as to the apportionment of the debt between capital and revenue was one of fact. In this connection, for our present purpose, it is only relevant to bear in mind whether the additional liability should be allowed at all either as expense or as a loss. The Tribunal has noted that there is an inconsistency on the part of the assessee, that is to say, once it was accepted that a part of the amount of Rs. 3,32,880 was taxable under the I.T. Act, it should also have to be accepted that any gain arising to the assessee on that part was also to be assessed as profit and the ITO was directed to find out the amount of devaluation gain which would be assessed as profit. Therefore, in the facts of the case, the direction given by the Tribunal, in our opinion, was a proper direction. Question No. 3 of the assessee's application is, therefore, answered in the affirmative and in favour of the revenue.

27. So far as question No. 2 of the revenue's application is concerned, the question is concluded by the decision of the Supreme Court in the case of Cambay Electric Supply Industrial Co. v. CIT : [1978]113ITR84(SC) and it is answered in the negative and in favour of the revenue.

28. In the premises:

So far as question No. 1 of the assessee's application is concerned, it is answered in the negative and in favour of the assessee.

29. So far as question No. 2 of the assessee's application is concerned, for the reasons mentioned hereinbefore, this question is answered by saying that the assessee was entitled to a deduction of Rs. 40,60,560 in computing its profit for the year in question.

30. So far as question No. 3 of the assessee's application is concerned, it is answered in the affirmative and in favour of the revenue.

31. So far as the revenue's application is concerned, question No. 1 is answered in the affirmative and in favour of the assessee and so far as question No. 2 of the revenue's application is concerned, it is answered in the negative and in favour of the revenue.

32. Each party will pay and bear its own costs.

Sudhindra Mohan Guha, J.

33. I agree.