Commissioner of Income-Tax, Mysore

Vs

The Canara Bank Ltd.

Civil Appeal No. 675 of 1965

(J. C. Shah, V. Ramaswami-I, V. Bharagava JJ)

18.10.1966

JUDGMENT

RAMASWAMI, J.

This appeal is brought, by certificate, from the judgment of the High Court of Mysore dated December 11, 1961 in Income Tax Reference Case No. 13 of 1959. The respondent (hereinafter referred to as the 'Bank') is a public limited company carrying on business of banking at its head office in Mangalore and its branches in various places. It opened one branch in Karachi on November 15, 1946. After the partition of India in 1947, the currencies of the two dominions of India and Pakistan continued to be at par until there was a devaluation of the Indian Rupee on September 18, 1949. As Pakistan did not devalue her rupee, the old parity of the Pakistan and Indian Rupees ceased to exist. The exchange ratio between the two countries was not determined until February 27, 1951. On this date it was agreed that a hundred Pakistani Rupees were equivalent to a hundred and fortyfour Indian rupees. On the date of devaluation of the Indian Rupee the Karachi Branch of the Bank had with it a sum of Rs. 3,97,221/- belonging to its head office. Owing to the difficulties of the currency situation it was impossible to remit the amount to the head office for quite a long time. On July 1, 1953, the State Bank of Pakistan permitted its remittance to India. In terms of Indian currency the said amount became equivalent to Rs. 5,71,038/-. Thus there was an appreciation of the value of the amount remitted from the Karachi branch and the Bank made a profit of Rs. 1,73,817/-. After making certain deductions, the head office of the Bank transferred a sum of Rs. 1,70,746/- to its Contingencies Reserve Account. In its return for the assessment year 1954-55, the Bank claimed that this sum was a capital gain and was not taxable. By his order dated February 9, 1955 the Income-tax Officer rejected the claim holding that the said amount of Rs. 1,70,746/- was a revenue receipt. The order of the Income-tax Officer was affirmed by the Appellate Assistant Commissioner in appeal. The Bank took the matter in further appeal to the Income-tax Appellate Tribunal which rejected the appeal by its order dated November 23, 1956. At the instance of the Bank the Income-tax Appellate Tribunal referred the following question of law for the determination of the High Court :

> "Whether the aforesaid exchange difference of Rs. 1,70,746/- is assessable under any of the provisions of the Indian Income-tax Act ?"

By its order dated December 11, 1961 the High Court reversed the finding of the Appellate Tribunal and held that the exchange difference of Rs. 1,70,746/- was not assessable to income-tax under any provision of the Indian Income-tax Act.

The question involved in this appeal is whether the profit of the Bank on account of fluctuation of

exchange arose in the course of trading operation of the Bank or whether it was incidental to any such trading operation. If by virtue of exchange operations profits are made during the course of business and in connection with business transactions, the excess receipts on account of conversion of one currency into another would be revenue receipts. But if the profit by exchange operations comes in, not by way of business of the Bank, the profit would be capital profit. In the present case, the High Court has found, after an analysis of the relevant facts, that the appreciation of the money did not arise in the course of any trading operation. In the year 1949 when there was a devaluation of the Indian rupee, the Karachi branch of the Bank was not carrying on any business in foreign currencies. It has been found by the Appellate Tribunal that until April 3, 1951 when the Bank was permitted to carry on business in Pakistan currency it carried on no foreign exchange business. Even after such permission was granted and even after the Bank obtained on April 25, 1953 a general licence to carry on business in all foreign currencies the money of the head office was not used for any business in foreign currencies. The appellate Tribunal has found that the money was lying idle in the Karachi branch and it was not utilised in any banking operation and the Karachi branch was merely keeping that money with it for the purpose of remittance to India and awaiting permission of the State Bank of Pakistan. The State Bank of Pakistan granted the permission on July 1, 1953 and the remittance actually took place two days later i.e., on July 3, 1953. It has been found by the appellate Tribunal that the sum of money was at no material time employed, expended or used for any banking operation or for any foreign exchange business. In the supplementary statement of the case the appellate Tribunal stated that "during the period April 3, 1951 to April 25, 1953 there were dealings between India and Pakistan Offices of the Bank, such as opening of letters of credit, issuing of drafts etc.", and "that all these operations were effected in a new account which was opened and the old balance of Rs. 3,97,221/- could not be utilised as per instructions of the State Bank of Pakistan". According to the agreed statement of the case the amount of Rs. 3,97,221/- was "blocked" and "sterilised" for the period from the devaluation of the Indian rupee upto the time of its remittance to India. In the context of these facts the High Court took the view that the appreciation of the value of the money did not arise in the course of the trading operation of the Bank and was not therefore taxable as revenue receipt. On behalf of the appellant Mr. Hazarnavis submitted that the appellate Tribunal was wrong in holding that there was blocking or sterilisation of the amount. Learned Counsel said that the balance sheets of the Revenue account of the Karachi branch would show that the amount of Rs. 3,97,221/- was not lying idle in the Karachi branch but was utilised by it for internal banking operations within Pakistan. We did not, however, permit Mr. Hazarnavis to produce additional evidence in this Court for controverting the findings of fact reached by the appellate Tribunal. It is a matter of significance that the original statement of the case dated May 15, 1957 and Supplementary statement of the case dated August 14, 1959 were both agreed statements. Before the High Court also the findings of the appellate Tribunal were not challenged on behalf of the Commissioner of Income-tax. On the other hand, it appears that it was conceded by the appellant before the High Court that there was no evidence that the "blocked" balance was, in fact, employed by the Karachi branch for the internal banking operations in Pakistan or for its business in Pakistan and other foreign currencies. It is therefore not permissible for the appellant at this stage to go behind the two statements of the case and to challenge the findings of fact contained therein. The argument was also stressed by Mr. Hazarnavis that the money was a 'stock-in-trade' of the bank and an increment of Rs. 1,70,746/- due to the fluctuation in the exchange rate must therefore be treated as incidental to the business of the Bank. We shall assume in favour of the appellant that the money was 'stock-in-trade' of the Bank. But it does not necessarily follow that the increment due to the fluctuation in the exchange rate was due to trading operations in the carrying on of the banking business. On the contrary, it has been found by the appellate Tribunal that the amount of Rs. 3,97,221/- was a "blocked" and "sterilised" balance and the Bank was unable to deal with that

amount or use it for any banking purpose between September, 1949 and July, 1953 when it was finally remitted to India. In our opinion, the money changed its character of 'stock-in-trade' when it was 'blocked' and 'sterilised' and the increment in its value owing to the exchange fluctuation must be treated as a capital receipt. It has also been found by the appellate Tribunal that the said amount of Rs. 3,97,221/- was not utilised for internal banking operations within Pakistan and it is hence not possible to draw an inference that the Bank realised any profit in the carrying out of its business. We accordingly hold that Mr. Hazarnavis is unable to make good his argument on this aspect of the case and the High Court was right in reaching the conclusion that the exchange difference of Rs. 1,70,746/- was not assessable to income-tax.

In the course of his argument Mr. Hazarnavis relied upon the decision of the Court of Appeal in Imperial Tobacco Company v. Kelly (25 T.C. 292.). In that case, a tobacco manufacturing company in England with a view to buying tobacco leaf in the U.S.A. during the leaf season, used to provide itself with dollar currency in advance by purchasing the same beforehand. On the outbreak of war, owing to Governmental restrictions the company had to suspend its buying operations in U.S.A. Later, the British Treasury requisitioned the accumulated dollars and paid the company sterling in exchange. The dollars in the meantime having appreciated in value, the company got more sterling that what it originally laid out. It was held by the Court of Appeal that the excess receipts were profits assessable to income-tax and the acquisition of the dollars was the first step in the commercial transaction of the company. The dollar was a 'commodity' of the company and it became a surplus stock to the company's requirements on the restriction on purchase and original revenue character would not be altered by the circumstance of the Governmental controls requisitioning the dollars. Mr. Hazarnavis also referred to the decision in Landes Brothers v. Simpson (19 T.C. 62.) where a similar view was taken. On the contrary, Counsel for the respondent relied upon the decision in McKinlay (H.M. Inspector of Taxes) v. H.T. Jenkins & Son (10 T.C. 372.) Ltd. in which it was held that the profit by exchange operations would be capital profit if the profit did not come in by way of business but by means of an investment in foreign currencies. In that case, a British company carrying on business in marbles, bought Italian Liras in advance with which to pay in Italy for marbles to be purchased there. But before the time came for purchase, finding that the Lira had appreciated, it sold away the Liras at a profit, and bought a second instalment of Liras to fulfil its contract in time. It was held by Rowlatt, J. that the first instalment of Liras should be regarded as capital lying idle and that the conversion thereof was a speculative transaction in capital. Reference was also made to the decision in Davies v. The Shell Company of China (32 T.C. 133.) Ltd. But the decision in none of these cases is exactly in point, for the material facts in the present case are different. The question of law arising in the present case must be decided on the particular facts and circumstances found by the appellate Tribunal.

For the reasons already expressed we hold that the High Court has correctly answered the question referred to it and this appeal must be dismissed with costs.

G.C.

Appeal dismissed.

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