Commissioner of Income Tax

Vs

Chowgule & Co. Ltd.

Civil Appeal No. 1650 of 1996

(Dr. A.S. Anand, S.C. Sen JJ)

11.01.1996

JUDGMENT

SUHAS C. SEN, J. :

1. Special leave granted.

2. The CIT has come up in appeal against the judgment of the Division Bench of the Bombay High Court, quashing an order passed by the CIT under s. 263 on 30th March, 1989. The High Court was also of the view that cl. (c) of r. 115 of the IT Rules, 1962 was in conflict of the substantive provisions of the IT Act and was ultra vires the Act.

3. The controversy in this case is about the taxability of the amounts received by the assessee from foreign buyers during the period 1st July, 1982 to 30th June, 1983 (asst. yr. 1984-85). The assessee offered for assessment the amounts received as price of the goods sold to foreign buyers as and when the amounts were received in course of the accounting period and was taxed accordingly. The amounts which were not actually received from the foreign buyers in course of the accounting period were converted into rupees on the basis of the exchange rate on the last day of the accounting year i.e. 30th June, 1983 and was brought to tax accordingly for the asst. yr. 1984-85.

The CIT was of the view that the ITO had wrongly assessed the quantum of income arising out of the export sales without applying r. 115. Accordingly, he issued a notice under s. 263 upon the assessee proposing to revise the order of assessment. After giving a hearing to the assessee, the CIT passed the following order :

> "The last point is regarding application of r. 115 in respect of earnings on export of iron ore to Japan. The assessee has taken the income at the rate at which the amount has actually been credited by the bank. It did not apply the notional rate as required under r. 115. In his reply, the assessee has contended that r. 115(c) can be applied only to income which is expressed in foreign currency or not otherwise. I am afraid this interpretation is unacceptable. I, therefore, direct the Assessing Officer (AO) to find out the actual rate of conversion in respect of different remittances and also the Telegraphic Transfer buying rate at the end of the year and convert the foreign exchange at the Telegraphic Transfer buying rate on the last day of the previous year as required by r. 115, if that is more favourable to the Revenue, and bring the difference to tax."

This order was challenged by the assessee by a writ petition in the Bombay High Court in which the

vires of r. 115(c) of the IT Rules, 1962 was also questioned. The facts of the case, as recorded in the order of the High Court, are as under :

> "The petitioners in this case are a company incorporated under the Companies Act, 1956. The petitioners are exporting iron ore to foreign countries, more particularly to Japan. The petitioners entered into agreements for sale of iron ore with foreign buyers at certain prices. As per the arrangements between the foreign buyers and the petitioners, the foreign buyers opened a letter of credit with a bank in India. As soon as the iron ore is loaded into the ship, the bill of lading is signed by the master of the ship and the petitioners raise invoices against the foreign buyers for the price of the ore shipped. thereafter, these documents are presented by the petitioners to their banker in India and the petitioners receive payment through the Indian bankers in rupees at the rate of exchange prevailing then. If on the date of closing of the financial year any amount of sale proceeds remains outstanding, it is converted into Indian rupees at the rate of exchange prevailing on the last day of the financial year and is entered in the books of the petitioners and accounted for as their income."

The High Court further examined the manner in which payment was made to the assessee by the foreign buyers and observed :

> "To come to a right conclusion about this question, we will have to see in what manner the petitioners receive income and at what point of time income-tax is leviable. In the present case, the petitioners entered into agreements for the sale of iron ore to the foreign buyers at a certain price. This price is agreed in advance. The mode of payment is in foreign currency through the Indian banker who is authorised to give foreign exchange. Under the contract, the payment is made to the petitioners when the documents of bill of lading are presented by the petitioners through their bankers in India. According to the petitioners, it is at this point of time when the petitioners receive money under the contract that they are liable to be taxed. The petitioners have further stated that, during the previous accounting year from 1st July, 1982 to 30th June, 1983, the petitioners have paid tax on the actual income they received from the bank in Indian currency. It is also contended on behalf of the petitioners that, in fact, the petitioners received the money on various dates at the rate of foreign exchange prevailing on the date of the receipt of the money. The petitioners have also supplied a chart showing therein as to how, during the said relevant period, they have received the payment in Indian currency on each date as per the value of the rate of foreign exchange prevailing on the date of the receipt. The petitioners, therefore, contended that it is the actual money which they have received during the said period which is liable to be taxed under the Act and not any notional income or income which they have never received and there is no possibility of realising the same."

4. It has been contended on behalf of the appellants that the High Court failed to realise that the payments were made in foreign exchange. The contract specified that the payments will be made in foreign exchange. The price payable in the invoice was also expressed in foreign exchange. Therefore, the payments were all received by the assessee in foreign exchange. The bank, at the time of payment, might have converted the foreign exchange into rupees and paid the assessee in Indian currency. But, the fact remains that the assessee was entitled to receive the price of the goods sold in foreign exchange and, therefore, r. 115 was clearly attracted and the amount of foreign

exchange received by the assessee will have to be valued on the last day of the accounting period on the basis of the exchange rate prevalent on that day.

5. Rule 115, as it stood on the material date, was as under :

> "115. The rate of exchange for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency shall be the telegraphic transfer buying rate of such currency as on the specified date.
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> Explanation. - For the purposes of this rule, -
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> (1) "Telegraphic transfer buying rate" shall have the same meaning as in the Expln. to r. 26;
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> (2) "specified date" means -
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> (a) in respect of income chargeable under the head "Salaries", the last day of the month immediately preceding the month in which the salary is due, or is paid in advance or in arrears; (b) in respect of income chargeable under the head "Interest on Securities", the last day of the month immediately preceding the month in which the income is due;
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> (c) in respect of income chargeable under the heads "Income from house property", "Profits and Gains of Business or Profession" [not being income referred to in cl. (d)] and "Income from Other Sources" (not being income by way of dividends), the last day of the previous year of the assessee;
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> (d).....
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> (e).....
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> (f)....."
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> This rule was later amended by insertion of cl. (2) which, it is argued, is only clarificatory in nature. Clause (2) which came into effect from 1st April, 1990 is as under :
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> "Nothing contained in sub-r. (1) shall apply in respect of income referred to in cl. (c) of the Expln. to sub-r. (1) where such income is received in, or brought into, India by the assessee or on his behalf before the specified date in accordance with the provisions of the Foreign Exchange Regulation Act, 1973 (46 of 1973)."

Rule 115 merely lays down that "for the calculation of the value in rupees of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him or on his behalf in foreign currency", the rate of exchange shall be the telegraphic transfer buying rate of such currency as on the specified date. Expln. (2) has clarified that the 'specified date' will mean in respect of income chargeable under the heading of "Profits and gains of business or profession", the last day of the previous year of the assessee. This only means that if an assessee is assessable in respect of any income accruing or arising or deemed to have

accrued or arisen in foreign currency or has received or deemed to have received income in foreign currency, then such foreign currency shall be converted into rupees notionally at the telegraphic transfer buying rate of such currency as on the last day of the previous year of the assessee. If on the last day of the previous year, the assessee does not have any foreign currency in his hand or the assessee is not entitled to receive any foreign currency, then there is no question of conversion of such foreign currency into rupees. It is only the foreign currency which will have to be converted into rupees. But, if the foreign currency received by an assessee has been converted into rupees before the specified date, question of application of r. 115 does not arise. Rule 115 does not lay down that all foreign currencies received by an assessee will be converted into rupees only on the last day of the accounting period. Rule 115 only fixes the rate of conversion of foreign currency. If there is no foreign currency to convert on the last day of accounting period, then no question of invoking r. 115 will arise. The assessee in this case is agreeable to have the outstanding amount of foreign currency payable to him at the rate of exchange prevalent on the last day of the previous year of the assessee. But, this rule cannot apply to the amounts received by the assessee in course of the accounting period in rupees. Clause (2), which was introduced on 1st April, 1990, is really clarificatory and does not bring about any change in r. 115.

6. We are of the view that the High Court was clearly in error in holding that r. 115 was ultra vires the substantive provisions of the IT Act, 1961. We are also of the view that the High Court has wrongly construed this rule. The rule fixes the rate of exchange for conversion into rupees of income held in foreign currency at the end of the accounting period. This rule can only apply if any income in foreign currency has to be converted for the purpose of computing total income for any accounting period. But, if in course of the accounting period the conversion has already taken place, then there is no question of converting into rupees any income held in foreign currency.

The facts of the case, as stated by the High Court, also make it clear that the assessee from time to time had exported goods. Price was paid by the foreign buyers through an Indian bank. The Indian bank, on behalf of foreign buyers, opened letters of credit. The bills of lading, invoices and other documents were presented by the assessee through their bank to the bank of the foreign buyers. The amounts receivable by the assessee were credited in their account by their bank in rupees. The entire sum received by the assessee was offered for assessment and was duly assessed. We fail to see how the CIT came to the conclusion that the assessment was erroneous and prejudicial to the interest of the Revenue. In the facts of this case, there cannot be any question of invoking r. 115. The sale proceeds of the goods exported by the assessee were credited to their bank account in Indian rupees. There is no dispute that the amounts which were outstanding and receivable by the assessee on the last day of the accounting year from the foreign buyers had to be converted into Indian rupees at the rate of exchange prevalent on the last day of the accounting year.

7. In the circumstances, we hold that the order under s. 263 passed by the CIT was rightly quashed by the High Court. But, we also hold that the High Court was in error in striking down r. 115 of the IT Rules.

The appeal is disposed of accordingly. There will be no order as to costs.