

BOMBAY HIGH COURT

Commissioner of Income-Tax

Vs

Mogul Line Ltd

(V.S. Desai and Y Tambe, JJ.)

11.09.1961

JUDGMENT

V.S. Desai, J.

1. This is a reference under section 66(1) of the Indian Income-tax Act at the instance of the Commissioner of Income-tax. The assessee concerned in this reference is a limited liability company having its head office in India. Its business is plying ships on hire and it has an agency in Karachi. In September, 1949, when the Indian rupees was devalued the company had a balance standing to its account in its agent's books at Karachi. The amount in this account was Rs. 7,33,794 as on 30th April, 1950. On devaluation there was a prohibition by the Pakistan authorities on remitting monies from Pakistan to India. The company succeeded in obtaining permissions to remit its amounts to India. But the permission was granted only in respect of earnings after May, 1950, The balance of Rs. 7,33,794, in Pakistan rupees, standing to the company's account as on 30th April, 1950, remained unremitted to India. After the devaluation, the company ascertained that the vale in Indian rupees of the amount which was to its credit in its agent's books at Karachi would have to be increased by a sum of Rs. 3,22,869 in the Bombay books in terms of the Indian currency. It credited this amount to an account styled as "Pakistan Exchange Suspense Account", and in its balance-sheet for the year ending 31st December, 1950, it showed the value of its assets in Indian rupees, and the sum of Rs, 3,22,869 in the Pakistan Exchange Suspense Account was shown on the liability side.

2. In the year of account, which was the year ending with 31st December, 1951, the Pakistan authorities determined the company's liability to tax for the assessment years 1947-48, 1948-49 and 1949-50 at Rs. 12,52,799 (Pakistan rupees). This amount was equivalent to Rs. 17,79,793 in Indian coin. The company, in its accounts, debited a sum of Rs. 12,52,799 to the taxation account and debited the balance of Rs. 5,26,994 to the Pakistan Exchange Suspense Account, in which there was a credit balance of Rs. 3,22,869 brought forward from the preceding year. There was, therefore, a resulting debit balance to the extent of Rs. 2,04,124 in the Pakistan Exchange

Suspense Account, which was written off by the assessee in its profit and loss account for the year under reference. In assessing the company's income for the accounting year ending 31st December, 1951, the Income-tax Officer added back the sum of Rs. 5,26,994 to the company's income. He took the view that in utilizing the amount of Rs. 7,33,794, which was lying to the credit of the company on 30th April, 1950, in Pakistan rupees, in the payment of its tax liabilities in Pakistan, the company had realised a profit of Rs. 3,22,869 as a result of exchange differences. This profit was, therefore, liable to be taxed. The amount of Rs. 2,04,124 which was claimed as a loss by the assessee was not permissible since that debit was in connection with the payment of tax. In the result, therefore, according to the Income-tax Officer, the entire amount of Rs. 5,26,994 was required to be added back to the company's income.

3. The assessee appealed to the Appellate Assistant Commissioner who agreed with the Income-tax Officer so far as disallowance of the item of Rs. 2,04,124 was concerned, but disagreed with him with regard to the balance of Rs. 3,22,869. According to him, there having been no remittance of the money to India, the assessee could not be said to have realised a profit of Rs. 3,22,869 on devaluation. He therefore, directed that from the amount added back by the Income-tax Officer, a sum of Rs. 3,22,869 should be deleted. The department appealed to the Tribunal against the decision of the Appellate Assistant Commissioner. The Tribunal accepted the contention which was urged before it by the department that, as a result of the devaluation of the Indian currency, profit could have accrued to the assessee. It also took the view that at the time when the assessee company paid to the Pakistan authorities the tax due by it, it realised its appreciation of the Pakistan rupee. It negatived the argument urged on behalf of the assessee that the appreciation, if any, could only be assessed in the previous assessment year 1951-52 and not for the assessment year 1952-53 and held that appreciation could be assessed only in the year in which it was realised and since, in the present case, the appreciation was realised by utilising the fund for the payment of Pakistan tax in the year 1951, the amount was taxable in the year of account and not in the earlier year.

4. The Tribunal was, however, of the opinion that it was necessary to ascertain the assets and liabilities in Pakistan of the assessee company on the date of devaluation in order to find out what part of the appreciation of its fund in Pakistan can be regarded as profit on exchange fluctuation. If there was a liability in Pakistan equal to the sum standing to the credit of the assessee's account in Pakistan books no profit could possibly accrue to the assessee. Profit would only accrue to the assessee if there was an excess of assets over liabilities in Pakistan at the material time and, according to the Tribunal, therefore, it was necessary to determine that position in order to determine the profit on devaluation. It therefore directed the Income-tax Officer that he should ascertain whether the tax paid to Pakistan related to a period prior to the devaluation of the currency, and if that was so, such payment should be taken out from the credit balance lying to

the assessee's account with its agents at the time of the devaluation, and profit on devaluation of the currency should be only taken in respect of the excess of the credit balance in the books of the agents over the liabilities payable by the assessee company in Pakistan at the material time. In the view that the Tribunal took of the matter, it allowed the appeal and directed the assessment to be modified on the lines indicated in its order. On an application for reference made under section 66(1) of the Income-tax Act by the department, it drew up a statement and referred to this court the following question :

"Whether, on the facts and in the circumstances of the case, the sum of Rs. 3,22,869 is the income of the assessee and liable to tax in the assessment year 1952-53 ?"

5. As we have pointed out earlier, the view of the Tribunal is that the appreciation of the Pakistan asset was realised by the assessee when it utilised it for payment of the tax due by it to the Pakistan authorities; but, whether this realisation amounted to profit on devaluation of Indian rupee, would depend upon whether there existed the liability of the assessee to the Pakistan authorities in respect of the tax relating to the period prior to devaluation. If there was such a liability, and the said liability was equal to or more than the amount lying to the credit of the assessee with its agents, then there was no profit since the liability also increased in terms of the Indian rupee as did the asset. If, on the other hand, the said liability was less than the asset, realisation of the appreciation on the excess of the assets over the liability would be regarded as the profit of the assessee on devaluation.

6. Mr. Joshi, learned counsel for the revenue, has argued that the view of the Tribunal that the appreciation of excess of the asset over the liability relating to the period prior to devaluation could only be regarded as profit of the assessee on devaluation, is erroneous in law. According to him, the appreciation of the entire asset is the profit of the assessee. The asset was an income asset of the assessee. It appreciated in terms of Indian rupee on devaluation. Such appreciation can be regarded as potential until the asset was utilised; but, when it was utilised, the appreciation was realised and became the taxable profit of the assessee. This happened in the year of account. The Income-tax Officer was, therefore, right in adding it back to the income in the year of account. Mr. Joshi says that even the accounts maintained by the assessee itself will show that it has realised a profit. Thus, in the accounts for the year ending 31st December, 1950, the assessee valued its Pakistan asset in Indian monies and showed the appreciation in the Pakistan Exchange Suspense Account. The asset was not then remitted to India, nor was it utilised in that year. The entry in the accounts, therefore, was a book entry and that was the explanation which the assessee gave to the Income-tax Officer in the assessment of that year, and stated that if any amount out of the balance was allowed to be remitted to India, profit on the same would be declared for the year in which the remittance was made. In the accounting year, which was the year ending 31st December, 1951, the Pakistan authorities determined the liability of the assessee

at Rs. 12,52,799 (Pakistan rupees) and the assessee paid the same. In making that payment, the assessee utilised the appreciated asset and thus realised the appreciation. The tax paid in Pakistan amounted to Rs. 17,79,793 in terms of Indian coin. In the accounts for the year ending 31st December, 1951, the payment was accounted by the assessee by debiting Rs. 12,52,799 to the taxation account and the balance in the Pakistan Exchange Suspense Account. The debit in that account was off-set against the credit carried forward from the preceding year, and the net result was written off in the profit and loss account. The loss so written off, which was at Rs. 2,04,124, was disallowed by the income-tax authorities as it was a loss on payment of tax liability. But the loss, which was to be so disallowed, according to Mr. Joshi, was not the net result in the Pakistan Exchange Suspense Account, but the entire amount of Rs. 5,26,994, which was the difference on devaluation between the figure of the tax liability in Pakistan and its equivalent in Indian rupees. In disallowing only a part of this difference and not the whole, the assessee, according to Mr. Joshi, has received a profit, on devaluation, to the extent of Rs. 3,22,869, without having brought the same to tax.

7. There is no doubt that the Pakistan asset, which had increased in value in terms of the Indian rupee has been utilised by the assessee. But, in our opinion, the said utilization has not resulted in the accrual of a taxable profit on devaluation to the assessee. The asset was never remitted to India. There has, therefore, been no actual conversion of the Pakistan moneys into Indian rupees and an increase on conversion has not been actually received by the assessee. It is no doubt true that a remittance of a foreign fund to India may result in a variety of ways without the actual conversion of the foreign money into Indian rupees, and the utilisation of a foreign fund without remittance may also result in a taxable profit as a result of currency differences. But, in order to see whether such a profit as a result of currency differences. But, in order to see whether such a profit has resulted in a given case must be determined by considering the purpose for which and the manner in which the asset has been utilised. It is undisputed that if the foreign fund is allowed to remain unused where it lies, the mere circumstance that there has been fluctuation in the currency resulting either in appreciation or depreciation of the fund in terms of the coin of another country will not result either in profit or loss to the fund-holder. If the fund is utilised in the course of trade for a trading purpose, there can be no doubt that there would be realisation of the profit on exchange, and the profit would be taxable. If, on the other hand, the fund is used not for a business operation or for the purpose of trade, but for a non-business operation, there may not be a taxable profit arising on its utilisation. In the present case, the fund was utilised for the payment of income-tax which was not a business operation. Mr. Palkhivala has argued that the payment of income-tax is merely a payment to the Government of its due share of the profit of the assessee. The assessee paid the said share of its profits, which was due to the Pakistan State, out of its Pakistan income in terms of Pakistan rupee. The payment of the Pakistan fund held by the assessee to the income-tax authorities, therefore, cannot be said to be an operation either of a

factual or constructive conversion of the currency of one country into the currency of another country and, moreover, no trading or business operation was involved in the said payment.

8. Now, it is not altogether impossible that even in a case where fund available in Pakistan has been utilised for the payment of a tax liability to the Pakistan Government, there may be an accrual of a profit on exchange differences. Thus, for instance, if, instead of the present fund lying with the assessee at Karachi, it was in the nature of a debt payable by a Pakistan debtor to the assessee in the course of its trade, and the assessee were to realise the said debt in Pakistan and utilise it in the payment of tax liability to the Pakistan Government, it may be possible to regard that, in the operation of realising the payment from the debtor in the course of trade, which was a business operation, the assessee had realised the appreciation and had therefore made a taxable profit, though in the subsequent utilisation of the amount in the payment of tax no business operation was involved. But such is not the position in the case before us. If the assessee had no fund in Pakistan and had to pay the Pakistan tax by remitting money from India and suffer a loss by reason of the devaluation the loss so suffered could not be deducted as having accrued in a non-business operation. In the same way if the assessee's fund in Pakistan has been utilised for the payment of tax in Pakistan he could not be said to have made a business profit on such utilisation to the extent to which the fund has appreciated in terms of Indian rupees. In our opinion, therefore, although there has been a utilisation of the fund in Pakistan by the assessee, such utilisation has not resulted in a taxable profit to the assessee by reason of devaluation of the Indian rupee.

9. We then come to the argument advanced by Mr. Joshi based on the entries made by the assessee in his books of account. It must be stated, in the first place, in this connection, that the matter of taxability cannot be decided on the basis of the entries which the assessee may choose to make in his accounts, but has to be decided in accordance with the provisions of law. What would determine the taxability is not whether the assessee has shown a particular item as a profit or loss in the accounting year, but whether the said item can be regarded either as a profit or loss under the provisions of the Income-tax Act (see, in this connection, *Henriksen (Inspector of Taxes) v. Grafton Hotel Ltd.* and *Commissioner of Income-tax v. C. Parekh & Co. (India) Ltd.* Moreover, even apart from this consideration, the entries made by the assessee in his books of account would not lead to the conclusion that he has regarded the profit on devaluation of the fund lying to his credit in his agent's books at Karachi as realised by him. After devaluation, he showed the value of every asset possessed by him in terms of Indian rupees. Since, there was a difference in the values as a result of the rupee having been devalued, he made entries in his books of account to show the difference. The entry for the year 1950 which showed a credit of Rs. 3,22,869 in the Pakistan Exchange Suspense Account was not the entry of a profit realised by him. It was also not regarded as the entry of the profit realised by him even on the mercantile

system of accounts maintained by him during that year, by the Income-tax Officer in assessment of that year. If in was an entry of the profit accrued, then Mr. Palkhivala says, the profit had accrued not in the year of account but in the previous year, and even on that ground it would be not taxable in the year of account. The true position of that entry, according to us, was that it was merely a book entry showing the potential appreciation of the Pakistan asset in terms of Indian rupees. The entry for the next year also, showing the debit balance to the Pakistan Exchange Suspense Account, is an entry made to account for the differences in the amount of the Pakistan tax paid in terms of Indian rupees. It is true that in taking the net result of the debit and the credit entries to the profit and loss account, the assessee attempted to show a loss in the hope that he would obtain deduction for the same in the income-tax assessment. But that was a futile hope, which was not realised. We do not, however, think that on the basis of the mere entry we can regard the assessee as having realised a profit on devaluation of the fund to the extent of Rs. 7,33,794, which would be a taxable profit.

10. There is also another matter to be taken into consideration in the present case. The Tribunal has pointed out that the factual position as regards the doubt income-tax relief which was allowed to the assessee was that the relief was allowed on the basis that the tax paid by the assessee was Rs. 12,52,799 and not Rs. 17,79,793. Mr. Palkhivala has, therefore argued that even the income-tax authorities have ignored the differences on devaluation and have regarded the tax paid by the assessee in Pakistan as not having caused any change due to currency differences. If the income-tax authorities have regarded the amount of tax paid in Pakistan to be only Rs. 12,52,799 (Indian rupees), when its value in terms of Indian rupees was Rs. 17,79,793, and given him by relief the difference on currency fluctuation as a taxable profit accruing to the assessee in the year of account in respect of the Pakistan fund utilised in payment of the tax. Mr. Joshi for the revenue, has pointed out that before the Tribunal the documents relating to double taxation were not produced and even an argument on the basis of double taxation relief was not advanced. It was the Tribunal itself which, of its own accord, made an inquiry relating to double taxation during the hearing of the appeal, and what was stated in reply to that inquiry, they have regarded as a factual position relating to the double taxation relief. Mr. Joshi has, therefore, argued that the Tribunal was not justified in making such a statement in its statement of the case and we would not be justified in taking it to be the correct position and take in into account as a circumstance in deciding the question before us. What we have stated above is what we find in the factual statement as given by the Tribunal in its statement of the case, and, if the said factual position out would certainly be a relevant circumstances to be taken into consideration. Even if it is assumed that the factual position relating to double taxation may not have been accurately stated by the Tribunal and, therefore, the said circumstance should be omitted from consideration, in view of the other reasons, which we have already set out, we must hold that the amount of Rs. 3,22,869 was not the income of the assessee which was liable to tax in the assessment year 1952-53. In our

opinion, therefore, the answer to the question referred to us by the Tribunal must be in the negative. The assessee will be entitled to its costs from the department.

11. Question answered in the negative.

