THE HON'BLE SRI JUSTICE RAMESH RANGANATHAN

AND

THE HON'BLE SRI JUSTICE M.SATYANARAYANA MURTHY

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I.T.T.A.No.428 of 2015

JUDGMENT: (per Hon'ble Sri Justice Ramesh Ranganathan)

This appeal under Section 260-A of the Income Tax Act, 1961 is preferred against the order passed by the Income Tax Appellate Tribunal, Hyderabad in I.T.A.No.1060/Hyd/2004 dated 16.11.2012. The Revenue is aggrieved by the order of the Tribunal to the limited extent it held that the liquidated damages received by the respondent-assessee, for delay in supply of a boiler, was in the nature of a capital receipt.

Sri B.Narasimha Sarma, learned Senior Standing Counsel for the Income Tax Department, while drawing attention of this Court to the order passed by the Assessing Authority, would submit that the delay in supply of the boiler had resulted in loss of profits to the assessee, and the liquidated damages received by them is a compensation for such loss; and, consequently, the amount received towards liquidated damages constitutes a revenue receipt, and not a capital receipt.

In the assessment order, the Assessing Authority observed that the assessee had entered into an agreement with M/s.IBIL Technical Limited for supply of boiler at a cost of Rs.843 lacs; the condition stipulated was that delivery of all major equipment and materials should be completed in such a manner that the boiler should be commissioned, and commercial production should start by a particular date; the supplier failed to adhere to the time frame stipulated in the agreement; and, consequently, the assessee had encashed the bank guarantee for a sum of Rs.124.45 lacs for failure of the supplier to adhere to the time frame stipulated in the agreement. Reliance placed by the assessee on the judgment of the Gujarat High Court in ***Commissioner of Income Tax vs. Saurashtra Cements and Chemicals India Limited*** was distinguished by the Assessing Authority, and he held that failure to supply the machinery, within time, had resulted in the assessee losing profits because of the delay on the part of the supplier to instal the boiler; the amount received towards liquidated damages was nothing but a revenue receipt; the payment of liquidated damage did not result in reduction in the cost of the asset; the liquidates damages did not have any impact on the depreciation worked out; and, consequently, it was a revenue receipt.

The order of the Assessing Authority was affirmed in appeal by the Commissioner of Income Tax. Aggrieved thereby, the respondent-assessee carried the matter in appeal to the Tribunal. By the time the appeal came to be heard by the Tribunal, the judgment of the Gujarat High Court in ***Saurashtra Cements and Chemicals India Limited***[1] was affirmed by the Supreme Court in ***Commissioner of Income Tax, Gujarat vs. Saurashtra Cement Limited***. Relying on the said judgment of the Supreme Court, the Tribunal, in the order under appeal, held that the liquidates damages received by the assessee constituted capital receipts; they were not received towards the cost of acquisition of the capital asset, but were in the nature of penalties for non-performance of the contract by the supplier; they could not be considered as a reduction of the cost of acquisition of the asset; and, consequently, liquidated damages received by the assessee was a capital receipt not taxable in the hands of the assessee.

In ***Saurashtra Cement Limited***[2], liquidates damages were received by the assessee for failure on the part of the supplier to supply machinery within the stipulated time frame. On the question whether the amount received towards liquidated damages was a capital or a revenue receipt, the Supreme Court observed:

> "*....We have considered the matter in the light of the afore-noted broad principle. It is clear from clause No.6 of the agreement dated 1st September 1967, extracted above, that the liquidated damages were to be calculated at 0.5% of the price of the respective machinery and equipment to which the items were delivered late, for each month of delay in delivery completion, without proof of the actual damages the assessee would have suffered on account of the delay. The delay in supply could be of the whole plant or a part thereof but the determination of damages was not based upon the calculation made in respect of loss of profit on account of supply of a particular part of the plant.*
>
> *It is evident that the damages to the assessee was directly and intimately linked with the procurement of a capital asset i.e. the cement plant, which would obviously lead to delay in coming into existence of the profit making apparatus, rather than a receipt in the course of profit earning process. Compensation paid for the delay in procurement of capital asset amounted to sterilization of the capital asset of the assessee as supplier had failed to supply the plant within time as stipulated in the agreement and clause No.6 thereof came into play. The afore-stated amount received by the assessee towards compensation for sterilization of the profit earning*

> *source, not in the ordinary course of their business, in our opinion, was a capital receipt in the hands of the assessee……"*

In the present case also, determination of liquidated damages was not based upon the calculation made in respect of loss of profit on account of supply of the boiler, but was directly linked with the procurement of a capital asset. Delay in supply would result in delay in the coming into existence of a profit making apparatus, rather than a receipt in the course of profit earning process. The law declared by the Supreme Court in ***Saurashtra Cement Limited***[2] binds the High Court. As we are satisfied that the said judgment squarely applies to the facts of the present case also, we see no reason to interfere with the order of the Tribunal.

The appeal fails and is, accordingly, dismissed. The miscellaneous petitions pending, if any, shall also stand dismissed. There shall be no order as to costs.

RAMESH RANGANATHAN, J

M. SATYANARAYANA MURTHY, J

Date:25.11.2015.

JSU

<u>THE HON'BLE SRI JUSTICE RAMESH RANGANATHAN</u>

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