

IN THE INCOME TAX APPELLATE TRIBUNAL
COCHIN BENCH, COCHIN
BEFORE S/SHRI CHANDRA POOJARI, AM & GEORGE GEORGE K., JM

I.T.A. No. 502/Coch/2018
Assessment Year : 2015-16

The ITO, Corporate Ward-2(4), Kochi.	Vs.	M/s. Team Front Line Ltd., 63/642A, Prasanth Bhavan, Opp. Girinagar Fire Station, Kochi-682 017. [PAN:AAACT 8674Q]
(Revenue-Appellant)		(Assessee-Respondent)

Revenue by	Smt. A.S. Bindhu, Sr. DR
Assessee by	Shri Mathew Joseph, CA

Date of hearing	19/03/2019
Date of pronouncement	22/03/2019

ORDER

Per CHANDRA POOJARI, AM:

The appeal filed by the Revenue is directed against the order of the CIT(A)-I, Kochi dated 31/07/2018 and pertain to the assessment year 2015-16.

2. The Revenue has raised the following grounds:

1. The Commissioner of Income Tax(Appeals) is not justified in deleting the addition of Rs.1,59,25,662/- towards loans written off.
2. The Commissioner of Income Tax(Appeals) ought to have appreciated that the loans waived were not taken for the purpose of acquisition of capital assets and therefore CIT(A) erred in holding that waiver of principal portion of loan is not taxable in the hands of assessee company.
3. It is submitted that the decision of the Supreme Court in the case of CIT vs Mahindra and Mahindra . (Civil Appeal No.6949-6950 of 2004) was dealing

with the issue as to whether the waiver of principal portion of loan which was taken for purchase of capital assets is taxable in the hands of the borrower and is not applicable to the facts of the present case.

4. The CIT(A) failed to appreciate that the loans taken from the shareholders in the present case were towards funding the working capital requirements of the assessee company and ought to have appreciated that upon waiver the amount of loan was retained in the business by the assessee and therefore constitutes taxable income of the assessee company.

5. The CIT(A) ought to have followed the decision of the Bombay High Court in the case of Solid Containers vs CIT (308 ITR 407) wherein it was held that the amount which initially did not fall within the scope of the provisions rendering it liable to tax, subsequently upon waiver have become the assessee's income being part of the trading of the assessee.

3. The facts of the case are that the assessee-company was started as a private limited Company on 13.6.1996 and converted to public limited Company on 11.2.2005. The Company was initially incorporated by Mr S.R.Nair, Mrs.Saleena Nair and Mr. Venkitachalam. Mr. Venkitachalam left the Company in few years. The other two promoters were holding 50% of shares of the Company. The Company was dealing in sales and services of computers and computer relating systems, networking, integration and implantation of software. Since computer business industry was not doing well, the Directors sold their shares in the company to three of its employees. Accordingly, they entered into an agreement and all the assets and liabilities were taken over by the outgoing shareholders, including bank loan and personal loan of the Directors. The writing off of the unsecured loan of Rs.1,59,25,662/-, is a nomenclature error, it is only the taking over of certain loans, loss, assets, debtors and creditors from the company by the outgoing partners,

since incoming partners don't want to take the liability of such items which is doubtful or not realizable. .

3.1 On going through the agreement dated 28.2.2015 made between the outgoing partners and incoming shareholders, the Assessing Officer found that the outgoing shareholders had taken over some of the assets and liabilities of the company to effect the takeover of the Company by the existing Directors. After the above adjustments, outgoing shareholders, Shri S.R.Nair and Smt. Saleena Nair agreed to set off the accumulated loss of the company against their loan outstanding with the assessee company which was Rs.31,08,832/-and 1,14,87,737/- respectively. The third outgoing shareholder M/s.Peso Infrastructures P Ltd agreed to waive the loan of Rs. 15,37,304/- which was given by them to the assessee company. The total amount set off/waived came to Rs. 1,61,33,873/-. However, the amount added to the Reserve and Surplus during the year as waiver of loan was only Rs.1,59,25,662/-. By adjusting the above amount of Rs. 1,59,25,662/-, the accumulated loss as per the Reserve and Surplus of the company reduced to Rs. 19,04,681/- from the loss of Rs.1,78,30,343/- as shown below :

Opening balance as on 1.4.2015		9599464(-)
Add: current year profit		
Profit as per P&L	3387396(-)	
Stock written off due to taken over	4843483	8230879(-)
		17830343
Add : Loan written of by the shareholders		15925662(+)
Reserve & Surplus as on 31/03/2015		19,04,681(-)

3.2 The Assessing Officer noticed that the amount credited to the reserves becomes a part of shareholder's fund and these balances together with the capital constitute the net worth of the Company. Accordingly, it was noticed that by reducing the loss, the company had gained that much money. According to the Assessing Officer, the assessee could not prove the source of credit of Rs.20 lakhs on 11.11.2014 as loan from Smt. Saleena Nair. The assessee failed to substantiate the amount of Rs.90 lakhs credited to Shaleena's account on 6.11.2014, which was transferred to assessee's account on 7.11.2014 accounted as loan. So, the entire amount of Rs.11000000/- brought into assessee's business as loan from Smt. Shaleena Nair was treated as assessee's own money and whatever liability was outstanding as on 1.4.2014, apart from Director's loan, it was met by the assessee's own money. Hence, the Assessing Officer assessed the amount of Rs. 15925662/- added to the Reserve & Surplus during the year as loan waiver as income of the assessee.

4. On appeal, the CIT(A) observed that three outgoing shareholders Shri S.R.Nair, Smt.Shleena Nair and M/s Peso Infrastructure Pvt Ltd waived the loan given to the assessee company of Rs.31,08,832/-, Rs.1,14,87,737/- and Rs.15,37,304/- respectively totalling to Rs.1,61,33,873/-, However, total amount added to the Reserve & Surplus during the year as waiver of loan was Rs.1,59,25,662/- only, which the Assessing decided to add to the total income of the assessee company. Because of this waiver of loan, the accumulated loss of the assessee company got reduced to Rs.10,19,04,681/- from the loss of Rs.1,78,30,343/-. Before the CIT(A),

the Ld. AR contended that loan from Director was on the capital account and was not claimed as expenses and it was not a trade or revenue liability which was waived and therefore the same cannot be added u/s. 41(1) for cessation of liability to the total income of the assessee. The Ld. AR contended that benefit from a loan liability is not covered u/s 41(1) of the Act and to support his contention, he placed reliance on the decision of Hon'ble Bombay High Court in the case of Mahindra & Mahindra Ltd Vs CIT (261 ITR 501), which has been recently confirmed by Supreme Court in May, 2018.

“Capital asset loan waiver neither perquisite u/s 28(jv) nor cessation of trading liability. ”

4.1 The CIT(A) agreed with the contention of the assessee and held that the waiver of loan by a Director of the Company cannot be treated as income of the assessee as waiver was on capital account and the same had never been claimed as expenditure and therefore, under these circumstances, provisions under section 41(1) cannot be invoked. Thus, the CIT(A) deleted the addition of Rs. 1,59,25,662/-

5. Against this, the Revenue is in appeal before us. The Ld. DR submitted that submitted that the loans taken from the shareholders were towards funding the working capital requirements of the assessee company and upon waiver, the amount of loan was retained in the business by the assessee and therefore, it is to be treated as taxable income of the assessee company. He further submitted that the assessee had become richer by this amount in the course of carrying on its business and, therefore, in the light of the decision of Apex Court in the case of CIT

vs T.V. Sundaram Iyengar & Sons Ltd, 220 ITR 344 (SC), this amount is liable to be included as income of the assessee, notwithstanding the fact that this amount was not includible in the income at the time when it was received.

6. On the other hand, the Ld. AR submitted that during the year the assessee company had written back the loan from directors amounting to Rs.1,59,25,662/- which the assessing officer had added stating that cessation of liability is taxable. The CIT(A) after considering the facts in detail allowed the claim of the assessee based on the latest decision of the Apex Court in Mahindra & Mahindra (404 ITR 1). Regarding the contention of the revenue that loan waived which was not taken for purchase of capital asset would constitute income, as per judgment of the Apex Court in the case of CIT Vs T V Sundaram Iyengar and Sons Ltd. (222 ITR 344), deposit received during the course of business which was no longer repayable was assessed as income. In the assessee's case the waiver was loan from directors and not deposit received in the course of business.

6.1 The Ld. AR submitted that the issues in the case relied on by the CIT (A) are different and, therefore, not applicable in the present case. In this case, the Apex Court had considered the applicability of section 28(iv) in relation to loan waived. With regard to the question of application of section 28 (iv) in relation to waiver of loan, the Apex Court had held in the case of Mahindra and Mahindra (supra) that section 28 (iv) of the IT Act cannot be applied in the case considered since the receipts are in the nature of cash or money. It was submitted that in the case of

Mahindra and Mahindra loan received from one Kaiser Jeep Corporation which was used for acquiring capital asset was waived by the lender and the assessing officer assessed the waived amount as income u/s 28 (iv) of the Act. On appeal by the Revenue against High Court order, the Apex Court had declined to interfere with the judgment of the High court in view of the reasons that section 28 (iv) of the Act did not apply if the receipts are in the nature of cash or money and held that the utilisation of loan (whether for purchase of asset or for working capital purpose .. etc.) is irrelevant to decide the applicability of section 28 (iv) in respect of receipt in the nature of cash or money. It was submitted that in the present case, loan from directors was received in cash and on waiver of loan the assessee became owner of money received as loan. Moreover, according to the Ld. AR, the receipt of loan in the form of cash is not in dispute at any stage of assessment proceedings. Hence, it was submitted that the amount of Rs. 1,59,25,662/- cannot be chargeable to income-tax u/s 28 (iv) of the Act.

7. We have heard the rival submissions and perused the record. Originally, the assessee company was started as private limited company on 13.6.1996 and converted to public limited Company on 11.2.2005. On incorporation, the directors were Shri S.R.Nair, Smt.Saleena Nair and Shri Venkitachalam. Shri Venkitachalam left the Company in few years. The other two promoters were holding 50% of shares of the Company. In the meanwhile, the directors sold their shares in the Company and they entered into an agreement and all the assets and liabilities were taken over by the outgoing shareholders, including bank loan and personal loan of

the Directors. The agreement was entered into on 28/02/2015 and the accumulated loss of the Company was set off against the loan outstanding with the outgoing Directors, namely Shri S.R Nair and Smt. Saleena Nair at Rs. 31,08,832/- and 1,14,87,737/- respectively. The third outgoing shareholder, M/s. Peso Infrastructures P. Ltd. waived the loan of Rs.15,37,304/- and the total amount waived comes to Rs.1,61,33,873/-. However, the amount of Rs.1,59,25,662/- as waived loan was taxed the hands of the assessee. Now the question that arises is whether the waiver of this amount which is credited to the Reserve and Surplus account is income chargeable to tax under the Act. According to the Assessing Officer the assessee derived benefit by way of waiver of loans in the course of running of its business activities and therefore, the amount to that extent waived by the Directors is includible in the hands of the assessee as business income. In our opinion, there cannot be any dispute with regard to the contention of the assessee that the waiver of this amount of loan is not hit by Section 41(1) of the Act. In other words, no dispute has been raised by the AO with regard to the applicability of the provisions of section 41(1) of the Act. In this situation, now the question arises as whether the waiver of the above loan can be treated as business income in view of the principles laid down in the case of T.V. Sundaram Iyengar & Sons (222 ITR 344). In the present case, in order to decide the question as to whether the decision of Supreme Court in the case of T.V. Sundaram Iyengar & Sons (supra) is applicable to the present case, we deem it necessary on our part to dwell upon the facts of the present case, particularly to find out the nature and purpose for which the loan was taken and utilized. The outgoing shareholders, Shri S.R.Nair and Smt.

Saleena Nair agreed to set off the accumulated loss of the company against their loan outstanding with the assessee company which was Rs.31,08,832/-and 1,14,87,737/- respectively. The third outgoing shareholder M/s.Peso Infrastructures P Ltd agreed to waive the loan of Rs. 15,37,304/- which was given by them to the assessee company. The total amount set off/waived came to Rs. 1,61,33,873/-.

7.1. The decision of Hon'ble Supreme Court in the case of CIT vs. T.V. Sundaram Iyengar & Sons (supra) and Hon'ble Bombay High Court in the case of Mahindra & Mahindra Ltd. vs CIT (supra) had been referred to by the CIT(A). Assessee claimed that the said impugned loan was the capital receipt and has not been claimed as deduction from the taxable income as expenses and, therefore, did not come u/s 41(1) of the Act. The credit balance written back was treated by the AO to be the income of the assessee u/s 28 of the Act in view of the fact that the credit balance was directly arising out of the business activity. The assessee, relying upon the judgment of Supreme Court in the case of Mahindra & Mahindra Ltd. (supra) contended that in relation to the transaction in question, Section 28(iv) was not attracted and even provisions of Section 41(1) of the Act could not be applied to treat the same as business income of the assessee liable to tax.

7.2 On an appeal, CIT(A) reversed AO's action by placing reliance on the judgment in the case of Mahindra and Mahindra (supra). However, we find that the Supreme Court in the case of CIT vs. T.V. Sundaram Iyengar (supra) held that if the amount

is received in the course of trading transactions, even though it is not taxable in the year of receipt, as being of capital character, the amount changes its character when the amount becomes assessee's own money because of limitation or by any other statutory or contractual right. Where the assessee received deposits in the course of trading transactions, the amount of such credit balances, which were barred by limitation and which were returned back by the assessee to the profit and loss account, were to be assessed as the assessee's income. In our opinion, the principle stated by the Supreme Court in the case of T.V. Sundaram Iyengar & Sons (supra) would be squarely applicable to the facts of that case and, therefore, the amount, which was initially did not fall within the scope of the provisions rendering it liable to tax, subsequently have become the assessee's income being part of the trading of the assessee. Further, the assessee because of this transaction became richer by the amount, which had been transferred and/or retained in the Reserve and Surplus account of the assessee. The following observation of Hon'ble Apex Court in T.V. Sundaram Iyengar & Sons Ltd.'s case has been noted by Hon'ble Bombay High Court in the case of Solid Containers Ltd. vs DCIT (308 ITR 417):

"22. The principle laid down by Atkinson J. applies in full force to the facts of this case. If a common sense view of the matter is taken, the assessee because of the trading operation had become richer by the amount, which is transferred to its profit and loss account. The moneys had arisen out of ordinary trading transactions. Although the amounts received originally were not of income nature, the amounts remained with the assessee for a long period unclaimed by the trade parties. By lapse of time, the claim of deposit became time barred and the amount attained a totally different quality. It became a definite trade surplus, Atkinson J. pointed out that in Morley's case (supra) no trading asset was created. Mere change of method of book-keeping had taken place. But, where a new asset came into being automatically by operation of law, common sense demanded that the

amount should be entered in the profit and loss account for the year and be treated as taxable income. In other words, the principle appears to be that if an amount is received in course of a trading transaction, even though it is not taxable in the year of receipt as being of revenue character, the amount changes its character when the amount becomes if assessee's own money because of limitation or by any other statutory or contractual right. When such a thing happens, common sense demands that the amount should be treated as income of the assessee.

23. In the present case, the money was received by the assessee in course of carrying on his business. Although it was treated as deposit and was of capital nature, at the point of time, it was received by efflux of time the money has become the assessee's own money. What remains after adjustment of the deposits had not been claimed by the customers. The claims of the customers have become barred by limitation. The assessee itself has treated the money as its own money and taken the amount to its profit and loss account. There is no explanation from the assessee why the surplus money was taken to its profit and loss account even if it was somebody else's money. In fact, as Atkinson J. pointed out that what the assessee did was the common sense way of dealing with the amounts."

7.3 The operative portion of decision in the case of Solid Containers Ltd. vs. DCIT (supra) is as under:

"3. The present appellant can hardly derive any advantage from the case of Mahindra & Mahindra Ltd. (supra). As in that case, a clear finding was recorded that the assessee continued to pay interest at the rate of 6 per cent for a period of 10 years and the agreement for purchase of toolings was entered into much prior to the approval of loan arrangement given by the Reserve Bank of India. Therefore, the loan agreement, in its entirety, was not obliterated by such waiver. Secondly, the purchase consideration related to capital assets. The toolings were in the nature of dies and the assessee was a manufacturer of heavy vehicles. The import was that of plant and machinery and the waiver could not constitute business. The facts of the present case are entirely different inasmuch as it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in business by the assessee. Thus, the principle stated by the Supreme Court in the case of T.V. Sundaram Iyengar & Sons Ltd. (supra) would be squarely applicable to the facts of the present case. The amount which initially did not fall within the scope of the provisions rendering it liable to tax subsequently have become the assessee's income being part of the trading of the assessee. Similar view was also taken by a Bench of Madras High Court in the case of CIT vs Aries Advertising (P) Ltd. (2002) 255 ITR 510. The court took the view that the assessee because of trading operation became richer by the amount which

had been transferred and or retained in the Profit and Loss Account of the assessee."

7.4 In the case of CIT vs Aries Advertising P. Ltd., 255 ITR 510 (Mad), an amount of Rs.1,77,886/-, being the balance due to Printers; Block Makers and Souvenir publishers by the erstwhile firm of an outstanding more than three years had been transferred to general reserve since these amounts had remained unclaimed for a long period of time. It was held by the Hon'ble High Court that in the case of unclaimed balance written back, if a common sense view of the matter is taken, the assessee, because of the trading operation, becomes richer by the amount, which it has transferred to its general reserve account. The money had arisen out of ordinary trading transactions. Although the amounts received originally were not of income nature, but subsequently, it becomes the assessee's income when the amount was written off in the accounts. In this case, the Hon'ble Madras High Court has also observed that once the assessee transferred any amount to the general reserve, it treated the same as the profit. In this connection, reference was made to the decision of Hon'ble apex court in the case of Wazir Sultan Tobacco Ltd. (1981) 132 ITR 559, where it has been held that a reserve is appropriation of profits.

7.5 In the light of the discussion made above, and following the decision of Bombay High Court in the case of Solid Containers Ltd. vs. DCIT (supra) where the principle enunciated by the Supreme Court in the case of CIT vs T.V. Sundaram Iyengar & Sons Ltd. (supra) has been applied, we held that the principal amount of loan, which is taken for the purpose of business or trading activity, on its waiver by

the creditor, would constitute income chargeable to tax under the Act. However, if the loan is utilized for the purpose of acquiring any capital asset, the same, on its waiver, would not constitute income chargeable to tax as held by Hon'ble Bombay High Court in the case of Mahindra & Mahindra Ltd. vs CIT (supra) and Hon'ble Delhi High Court in the case of CIT vs. Tosha International Ltd. 176 taxmann 187 either under section 41(1) or 28(iv) or 2(24) of the Act.

7.6. In the instant case, it would be the duty of the assessee to prove and establish that the amount of loan taken from the Directors/shareholders was utilized for the purpose of business. If on an enquiry and verification, it transpires that the assessee had utilized the loan for the purpose of its business activity or trading activity, the amount of loan to the extent it has been waived by the Directors/shareholders shall be deemed to be the assessee's income chargeable to tax as per the decision of Hon'ble Bombay High Court in the case of Solid Containers Ltd. vs DCIT (supra), where the principle laid down by the Supreme Court in the case of CIT vs. T.V. Sundaram Iyengar & Sons Ltd. (supra) has been applied and followed. In the present case, the total amount waived was Rs.161,33,873/-. However, the amount added to the Reserve and Surplus during the year as waiver of loan was only Rs.1,59,25,662/-. It was found that there was no details furnished by the assessee as to how the loan amount was utilized or applied or for the purpose for which the loan was raised. Hence, we remit this issue to the file of the Assessing Officer for fresh consideration.

8. In the result, this appeal filed by the revenue is treated to be allowed for statistical purposes.

Order pronounced in the open Court on this 22nd March, 2019

sd/-
(GEORGE GEORGE K.)
JUDICIAL MEMBER

sd/-
(CHANDRA POOJARI)
ACCOUNTANT MEMBER

Place: Kochi

Dated: 22nd March, 2019

GJ

Copy to:

1. M/s. Team Front Line Ltd., 63/642A, Prasanth Bhavan, Opp. Girinagar Fire Station, Kochi-682 017.
2. The Income Tax Officer, Corporate Ward-2(4), Kochi.
3. The Commissioner of Income-tax(Appeals)-I, Kochi.
4. the Pr. Commissioner of Income-tax, Kochi
5. D.R., I.T.A.T., Cochin Bench, Cochin.
6. Guard File.

By Order

(ASSISTANT REGISTRAR)
I.T.A.T., Cochin