INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "F": NEW DELHI

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI L.P. SAHU, ACCOUNTANT MEMBER

ITA No.739/Del/2019
Asstt. Year: 2015-16

M/s. R.S. Triveni Foods P. Ltd. F-1739, DSIIDC Industrial Area, Narela, Delhi Pin 110 040 PAN AAFCR1392A	Vs.	Addl. CIT, Circle-20(2) New Delhi.
(Appellant)		**(Respondent)**

Assessee by:	Shri Suresh Gupta, CA
Department by :	Smt. Rinku Singh,Addl. CIT
Date of Hearing	09/05/2019
Date of pronouncement	/ /2019

O R D E R

PER AMIT SHUKLA, J.M.:

The aforesaid appeal has been filed by the assessee against impugned order dated 28.12.2018, passed by Ld. CIT (Appeals) 7, New Delhi for the quantum of assessment passed u/s 143(3) for the assessment year 2015-16. In the grounds of appeal assessee has challenged the addition of Rs. 3,00,00,000/- by treating the forfeiture of application money on fully convertible debentures as capital asset by invoking the provision of section 56(2)(ix) of IT Act ignoring the fact that the said convertible debenture does not fall in definition of 'capital asset' in the hands of assessee and Ld. CIT (A) has erred both in law

and in facts of the case in making the above addition without providing any opportunity to the appellant to represent his case before himself.

2. The facts in brief assessee floated Fully Convertible Debentures (FCDs) of Rs.100/- each, partly paid Rs.50 per debenture through private placement to two entities on 06.01.2014 and thereby raised a sums aggregating Rs.3,00,00,000/- through that process. The above raised funds were shown in the balance sheet of AY 2014-15, that is, in the earlier assessment year as long term borrowings in Schedule No.5. The call money of the debentures at the rate of Rs.50 was payable by the debenture holders and as per the terms and conditions regulating the issue of FCD, the balance debenture call money of Rs.50 each was payable within 90 days of allotment of FCD's. The terms and conditions of issue of FCD's were contained in the debenture application form. The FCD's were fully and compulsory convertible into 8 equity shares of Rs.10 each at par before the expiry of 15 months from the date of allotment. As per the terms and conditions, the Board of Directors had a right to forfeit FCD's in case the debenture holder fails to make the payment of remaining debenture call money within the stipulated time of 90 days from date of allotment. The allottees of the FCD's were as under:-

Name	No. of FCD's Issued	Application Money (in Rs.)	Debenture Call Money Due
M/s. Scanner Equity Pvt. Ltd.	3,00,000	1,50,00,000/-	1,50,00,000/-
M/s Deus Trading and Construction Pvt. Ltd	3,00,000	1,50,00,000/-	1,50,00,000/-

The above allottees failed to make the payment of the balance call money of Rs.50 each before 07.04.2014; and accordingly the assessee company issued a reminder on 01.04.2014 asking the allottee to make compliance by depositing the balance call money on or before 07.04.2014. Another reminder was issued on 10.04.2014 allowing further time till 17.04.2014 to make the compliance to avoid the forfeiture of the FCD's. However, the FCD's holders failed to make any compliance of the extended time allowed till 17.04.2014. Further, a final reminder was sent on 18.4.2014 giving further time till 25.4.2014 to make payment of the debenture call money. But the above debenture holders failed to honour the commitment made by them while subscribing to the FCD's in the appellant company. The Assessee Company finally on 29.4.2014 exercised the right of forfeiture due to non-payment of the debenture call money of the FCD's through a board resolution and the intimation of the same was given to the debenture holders vide letter dated 30.4.2014. As a result of forfeiture of above FCD's the amount was taken to the capital reserve.

3. Ld. AO has treated the forfeited amount as revenue receipt and held it as taxable income of the assessee. The sums and substance the AO's finding are that; assessee is not able to prove how the same is in capital in nature as whether loan waiver or debenture forfeiture constitutes capital receipt or revenue receipt depends upon the nature of use of the amount received as part loan. If the money received was used for acquiring capital asset or some other capital transactions, then loan waiver could be treated as capital receipt, but if the loan money is used for day to day transaction then it is the nature of revenue receipt. He also referred the judgment of Hon'ble Delhi High Court in the case of **Logitronics Ltd. vs CIT in ITA No. 1623/2010,** wherein it has been held that if the loan was taken for trading purpose

and it was treated as such from very beginning, then waiver of the same shall be the revenue receipt. AO also tried to demonstrate that post such receipts the said funds have been used in day to day activities and in support of the same, he has reproduced the cash flow statement of financial year 2013-14 to show the utilisation of the funds.

4. Before the Ld. CIT(A) the assessee's main contention has been that the such unsecured FCD's cannot be held to be a trading liability even if the funds so mobilized are used in the day to day business of appellant company. It was submitted that in the present case, the AO ignored the fact that raising of funds through FCD's was the act of raising capital of the company which was to be converted into share capital after conversion. The AO has failed to draw a line between the funds raised on hypothecation of stock and other current asset and the funds raised to supplement the capital requirement of the business. Further, the judgement relied by the AO also highlights this distinction and when loans are borrowed to augment the funds available with the assessee and such borrowed funds are source of funds, then the Hon'ble Court has held that when the assessee is not in the business of borrowing and advancing loans, it can never be business of the assessee to borrow money by way of loans. Such borrowing was treated by the court as source of funds and waiver of such outstanding loan by the assessee was held to be capital receipts not taxable in the hands of the assessee. Further, reliance was placed on the judgment of Hon'ble Supreme Court in the case of CIT vs. Mahindra and Mahindra Ltd. in civil Appeal No. 6949-6950 of 2004 judgment and order dated 24.4.2018.

5. However, the Ld. CIT (A) changed the entire colour of the addition and held that same is taxable under section 56(2) (ix), which clearly provides that:

"(ix) any sum of money received as an advance or otherwise in the course of negotiations for transfer of a capital asset, if, -

(a) Such sum is forfeited ; and

(b) The negotiations do not result in transfer of such capital asset."

Further, *Explanation (d)* to section 56(2)(vii)(c) defines property and capital assets as under :-

(d) "property" [means the following capital asset of the assessee, namely :-]

(i) Immovable property being land or building or both;

(ii) Shares and securities

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6. Thus, he held that forfeiture of advance related to capital asset which includes share and securities and hence is taxable as 'income from other sources' u/s 56(2)(ix) and accordingly, the addition was confirmed entirely on a different reason.

7. Now against the said first appellate order the assessee is in appeal and there is no cross objection filed by the revenue.

8. Before us, Ld. Counsel submitted that AO has made the addition by treating as revenue receipt by and large invoking of provision of section 41(1), though not specifically stated by him. Ld. CIT (A) before issuing any notice of giving any opportunity has confirmed the addition on different ground as income from other sources by invoking the provision of section 56(2)(ix). The said section

has been brought in the statute w.e.f. assessment year 2015-16 which is deeming provision applicable only when any sum of money is received as advance or otherwise and here the money was received prior to the amendment, that is, in the assessment year 2014-15 and only the forfeiture was in this year, therefore such a deeming provision cannot be invoked. He further submitted that the raising of funds through FCD's are akin to raising capital funds which is normally done to supplement the capital base to affect the expansion of business. The issue of debentures which is compulsorily fully convertible into equity shares cannot be compared to raising of loans in routine course of business. The reason being the debenture holder has no right to claim back the return of the amount invested. It is rather an arrangement through which the debenture holder acquire prospective right to participate in the equity of the company at future date. So the funds provided by debenture holders are part of the capital base of the company as long term source of funds and such long term funds have been wrongly equated with the funds raised from the banks for a limited period where there is liability to repay back the same. Considering the above features the Ld. AO was not justified in applying the Logitronics case on the appellant qua the forfeiture of debentures where the case before the Court was waiver of loan taken by the company. The only common feature between the loan and FCD is that there is liability to pay interest in both cases and that fact alone cannot determine the nature of FCD into revenue receipt, as in case of loans taken for acquisition of capital asset there is liability to pay interest or in case of partnership firms the capital contribution by the partners also carry interest obligation but still such capital contribution is a capital receipt.

9. Further, when the funds are provided as capital, the utilization by the assessee is not the criteria to determine the nature of the same

whether capital or otherwise. When a business is established by an entity the capital contribution maybe utilized both capital and current assets. Merely because part of funds were utilized for acquiring the current asset will not turn the capital contribution of the owners/ would owners into revenue receipts. Ld. Counsel strongly relied upon the following decisions :-

i. Prism Cement Ltd Vs JCIT 103 TTJ 639(M UM)
ii. CIT Vs. Deepak Fertilizers and Petrochemicals Corporation Ltd (3041TR AT 367)
iii. Dy CIT Vs. Brijlaxmi Leasing and Finance Ltd. (3091TR AT 211)
iv. Jaikishan Dadlani v. ITO (4SOT138)
v. DCIT vs. Jayant Agro Organics Ltd. (ITA No. 5056 / Mum / 2014
vi. ITO vs M/s. Energy Development Co. Ltd. ITA No. 797/Kol/2014.

10. On the other hand, Ld. DR submitted that AO has not invoked section 41(1) as forfeiture of money received by the assessee; the AO has gone by the nature of utilisation of money and not u/s 41(1). Without prejudice she submitted that Ld. CIT(A) has treated it to be capital asset as Explanation below section 56(2)(vii) which is inclusive definition and word securities has to be seen in the context of Securities Contracts (Regulation) Act, 1956. She thus strongly relied upon the order of the Ld. CIT (A).

11. We have heard the rival submissions, perused the relevant findings as well as material referred to before us. The main issue revolves around treating the amount of Rs. 3 crores by way of forfeiture of unsecured FCDs which though was treated as revenue receipt by the AO and held taxable as normal business income; however, the Ld. CIT(A) has taxed the same as income from other

sources, by applying the deeming provision of section 56(2)(ix). As discussed above, the FCD's were allotted by the assessee company on 01.01.2014/03.01.2014, to two companies, 3,00,000/- debentures each with face value of Rs 100/-per FCD's by accepting the application money of Rs 50/- per debentures. As per the terms and conditions the FCD's, the FCD's were to carry interest @15% pa and were unsecured. The amount of Rs 50/- was payable as application money and balance Rs 50/- were payable within 90 days of allotment failing which the company had right to forfeiture. The debentures were fully convertible into equity shares of the company. Each debenture was to be allotted 8 equity shares of the company within 15 months from the date of allotment. During the year the call money received by the assessee company of Rs. 3,00,00,000/- was forfeited as the allottee companies despite various reminders and extension of time failed to submit the balance money and accordingly as per terms and conditions agreed the call money was forfeited.

12. The Ld. AO disallowed the claim of the appellant and held that the said receipt is a revenue receipt and the forfeiture of the same does not change it characteristic as the capital receipt. The ground taken by the Ld AO was that the since the amount raised through allotment of debentures was utilized for acquisition of current assets and in view of the ratio of judgment in Logitronics Ltd. case, the above receipt were held to be of revenue nature. Ld. CIT(A) as stated above has changed the entire tenor of the addition, by holding that it is taxable as income from other sources u/s 56(2)(ix). Thus, the order of the AO stands merged with the order of the Ld. CIT(A) and therefore, we are only require to adjudicate, whether the said forfeiture of FCDs can be taxed u/s 56(2)(ix).

13. In so far as the argument of the Ld. Counsel that the provision of section 56(2)(ix) would not be applicable on the facts of the present case because the said section has come w.e.f. 1.4.2015 and assessee has not received any sum or advance in this year, therefore, this provision would not be applicable. We are unable to subscribe to such an argument, because the deeming provision is attracted in the event when any sum is forfeited out of any sum and money received as advance or otherwise in the course of negotiations for the transfer of a capital assets. Here the factum of forfeiture of the FCDs has taken place in this year; therefore, taxability qua the forfeiture amount has to be seen in this year. Such an argument of the Ld. Counsel, in our opinion is untenable.

14. From a plain reading of section 56(2)(ix), it is clear that the money should have been received as an advance or otherwise in the course of negotiation for a transfer of capital assets. Therefore, sum received in course of **negotiation for transfer of a capital receipt** is *sine qua non* for invoking of the deeming provision. The negotiation has to be in relation to transfer of a capital asset in whose hands the deeming provision is attracted. In other words, the capital asset which is the subject matter of negotiation for transfer must belong to the assessee. Ld. CIT (A) has referred to *Explanation (d)* below sub *clause (vii)* of Section 56(2), which defines capital asset to include 'shares and securities'. From bare reading of the said *explanation* it is seen that it is only applicable for the purpose of *clause (vii)* where an individual or HUF receives in any of the previous year from any person or persons any sum or money without consideration or any immovable property, etc. The said definition cannot be imported for purpose of interpreting a 'capital asset' in *clause (ix).* However, without going into this aspect, whether same

definition is applicable in this clause or not, as it is not of much relevance. Here in this case, the assessee company has issued fully convertible 3,00,000 debentures to two companies, each with face value of Rs. 100/- per FCD and the application money was Rs. 50/- per debenture and balance Rs. 50/- was payable within 90 days of allotment, failing which the company had right to forfeit. *"Debenture"* is a long term debt instrument used by the companies to borrow money at a fixed rate of interest. It is a type of debt instrument which is not secured by any collateral. The debenture cannot be treated as a capital asset of the issuer company because it is a kind of debt instrument with an obligation to acknowledge the debt and pay interest. It is a capital asset in the hands of the person subscribing to the debenture or the allottee of the debenture, who is entitled to get interest at a stipulated rate and may also get right to equity shares if conditions of subscription prescribes so. The money received as advance as contemplated in section 56(2)(ix) means it should have been received during the course of negotiation for transfer of a capital asset, i.e., the capital asset of the issuer company and not the receiving company. The deeming provision is applicable in a situation where the person who owns a capital asset and enters into a negotiation for transfer of his capital asset with other person and receives certain advance which is forfeited on account of failure of negotiation of transfer of such capital asset, then money received as an advance is hit by the deeming provision which is taxable as income from other sources.

15. The aforesaid proposition is also borne out with the Legislative intent while introducing section 56(2)(ix) by Finance Act 2014, which is reproduced hereunder:-

Section 56

Finance Act, 2014

6.10 Taxability of advance for transfer of a capital asset where advance is forfeited (Sections 51 and 56)

In Travencore Rubber & Tea Co. Ltd. v. CIT [2000] 243 ITR 158/ 109 Taxman 250 (SC) it was held that forfeiture of advance money received for transfer of capital asset cannot be treated as revenue receipt chargeable to tax. In order to overcome this ruling by the Supreme Court, section 56 relating to income from other sources has been amended by the Finance (No. 2) Act, 2014 by inserting a new clause (ix) in sub-section (2) of the aforesaid section. The said new clause (ix) provides that where any sum of money, received as an advance or otherwise in the course of the negotiations for transfer of a capital asset, is forfeited and the negotiations do not result in transfer of such capital asset, then, such sum shall be chargeable to income-tax under the head "Income from other sources". This amendment will take effect from 1st April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent years.

Consequential amendments have been made to definition of 'income' in section 2(24) and in section 51. The existing provisions contained in clause (24) of section 2 define the term "income". The clause (24) has been amended so as to include any sum of money referred to in clause (ix) of sub-section (2) of section 56 in the definition of income. This amendment will take effect from 1st April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent years.

The existing provisions contained in section 51 provide that where any capital asset was on any previous occasion the subject of negotiations for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair

market value, as the case may be, in computing the cost of acquisition. Finance (No. 2) Act, 2014 has inserted a proviso in the said section, so as to provide that where any sum of money received as an advance or otherwise in the course of the negotiations for transfer of a capital asset has been included in the total income of the assessee for any previous year in accordance with the provisions of clause (ix) of sub-section (2) of section 56, then, such sum shall not be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be, in computing the cost of acquisition. This amendment aims to avoid double taxation of the forfeited advance. *This amendment will take effect from 1st April, 2015 and will, accordingly, apply in relation to the assessment year 2015-16 and subsequent years.*

[Emphasis in bold is ours]

Thus, the aforesaid amendment has to be understood in light of section 51 of the Act, which provided that where any capital asset was on any previous occasion, subject matter of negotiations for its transfer and any advance or other money has been received and retained by the assessee in respect of such negotiations, then same was to be deducted from the cost for which the asset was acquired or the written down value or the fair market value, while computing the cost of acquisition. Now, from A.Y. 2015-16, if such sum received as an advance is included in the total income then same is deducted from the cost of acquisition. Section 51 refers to capital asset belonging to the assessee which was a subject matter of negotiation for transfer and assessee receiving any sum as advance from such negotiation. It was not applicable to the transferee.

16. Here in this case the debentures were duly allotted to the subscribing companies and due to non payment of further call money under the agreement had led to the termination of the

debentures and, therefore, said sum paid by the debenture holder cannot be held to be on account of transfer of capital asset in the hands of the assessee company. Debenture is debt instrument or is a kind of long term loan to borrow money at a fixed rate of interest. It is not a capital asset although the money raised by way of debenture becomes part of the issuer company's capital structure, but it does not become share capital. Thus, in our opinion, the forfeiture of the amount is not on account of failure of negotiation of transfer of capital asset of the assessee and thus, is not hit by section 56(2)(ix). The addition sustained by the Ld. CIT (A) is directed to be deleted.

15. In the result appeal of the assessee is allowed.

Order Pronounced in the open court on 5th August, 2019.

sd/- sd/-

(L.P. SAHU)
ACCOUNTANT MEMBER

(AMIT SHUKLA)
JUDICIAL MEMBER

Dated: 05/08/2019

Veena

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi