IN THE INCOME TAX APPELLATE TRIBUNAL
"B" BENCH : BANGALORE

BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SMT. BEENA PILLAI, JUDICIAL MEMBER

ITA No.1864/Bang/2019
Assessment year: 2014-15

The Income Tax Officer, Ward 4(1)(2), Bengaluru.	Vs.	M/s. Kaptronics Pvt. Ltd., No.165/4, C.K. Palya, Bannerghatta Road, Bengaluru – 560 083. **PAN: AABCK 1953C**
APPELLANT		RESPONDENT

Appellant by	:	Shri Priyadarshi Mishra, CIT(DR)(ITAT), Bengaluru.
Respondent by	:	Shri S.V. Ravishankar, Advocate

Date of hearing	:	16.03.2022
Date of Pronouncement	:	07.04.2022

O R D E R

Per Chandra Poojari, Accountant Member

This appeal by the revenue is against the order of CIT(Appeals), Bangalore-9, Bangalore dated 19.7.2019 for the assessment year 2014-15 on the following grounds:-

"1. The Order of the Ld. CIT (A)-9, Bangalore, in so far as it is prejudicial to the interest of the Revenue, is opposed to law and the fact and circumstances of the case.

2. Whether on the facts and circumstances of the case, the Ld. CIT(A) was correct, in allowing relief to the assessee on the issue of addition of Rs. 2,55,35,871/- u/s 28(iv) of the IT Act only on the ground that the money was received through

banking channel in the form of loan which was waived by the creditors?

3. Whether on the facts and circumstances of the case, the Ld. CIT(A) ought to have appreciated that the assessee has taken loan for the purpose of business activity of the company which remained with him for a longer period of time and after waiver it made the loan acquire the nature of income to the above extent and hence ought to have been taxed as income u/s 28(iv) of the IT Act?.

4. For these and other grounds that may be urged at the time of hearing, it is prayed that the order of CIT(A) is so far as it relates to the above grounds may be reversed and that of Assessing officer may be restored.

5. The appellant craves the right to add, alter, amend and / .or delete any of the grounds that may be urged."

2. The facts are that the assessee is a private limited company in the business of manufacturing of DBR equipments for railways. It filed its return of income during the year declaring a nil income on 23.09.2014. Same has been revised on 19.05.2015 declaring loss of Rs. 15,23,278/-. The case was selected under CASS under "Limited Scrutiny" category and notice was served u/s 143(2) of Income tax Act. The assessment was completed u/s 143(3) of Income tax Act by making an addition of Rs. 2,55,35,871.

3. In the profit and loss account drawn by the assessee company for the financial year ending 31.3.2014, it claimed waiver of loan of Rs. 2,55,35,871 as income. In the computation, this income was claimed as exempt from tax and same was shown as a capital receipts. The AO treated the said income as the value of benefit or perquisite arising from business u/s 28(iv) of Income tax Act. The assessee made its submissions wherein it contested that the said amount of Rs. 2,55,35,871 is a capital receipt and hence cannot be considered as income. However the AO made

the addition of Rs. 2,55,35,871 for the returned loss and completed the assessment.

4. The CIT(Appeals) placed reliance on the judgment of the Karnataka High Court in the case of *CIT v. Compaq Electric Ltd., ITA No.172 of 2011 dated 18.10.2011* wherein it was held that waiver repayment of certain amount in respect of which there was no allowance or deduction claimed by the assessee during previous years, amounted to capital receipt and is not liable to tax u/s. 41(1). He observed that in the present case the assessee is a wholly owned subsidiary company of DRL for AY 2003-04. In view of huge losses suffered by assessee company, operations of company had been funded by way of unsecured loans from DRL from year to year. During the relevant assessment year, assessee company proposed and DRL accepted a request to agree for conversion of unsecured loan partly into equity share capital and waive balance as not recoverable. The AO was of the view that loans were received during course of assessee's business with DRL and that liability of assessee was a trading liability. AO thus held that provisions of section 41(1) were attracted in respect of amount of unsecured loan written off. There was no allowance or deduction claimed by the assessee in respect of amount in question for the previous years, when creditor waived repayment of the said amount, it amounted to capital receipt not liable to tax.

5. The CIT(A) was of the opinion that to the extent of interest claimed and allowed as business expenditure, it would be business income. According to him, the decision of Hon'ble Madras High Court in *CIT v. Ramaniyam Homes (P) Ltd. [2016] 68 taxmann.com 289/239* would be applicable to the extent of waiver of interest, irrespective of the purpose for which loan is taken. However, in the assessee's case the loan is interest free unsecured loans. The remission would become income u/s. 41(1) only if assessee claimed deduction in respect of expenditure in its P&L account.

The assessee has not claimed any deduction u/s. 36(1)(vii) of the Act in respect of payment of interest in any previous year and the remission would not become income u/s. 41(1). Thus the CIT(A) held that remission cannot be treated as income u/s. 41(1) in the assessee's case.

6. As regards whether loan is a trading liability or working capital requirement for taxability u/s. 28(iv) of the Act, the AO relied on *T.V. Sundaram Iyengar [1996] 222 ITR 344.* According to the CIT(A), as per this decision, it is to be ascertained whether loan is a trading liability or working capital requirement. In that case, the issue pertained to unclaimed security deposit directly taken from customer and not waiver of working capital loan. The Supreme Court held that the security deposit directly taken from customer is directly connected to trading activity whereas in the assessee's case it is in the nature of working capital loan. According to the CIT(A), the unsecured loan in the nature of borrowings for working capital is in the nature of finance transaction and therefore waiver of such working capital loan is different factually and thus this decision relied on by the AO is not applicable to assessee's case.

7. The assessee placed reliance on the Supreme Court decision in the case of *CIT v. Mahindra & Mahindra Ltd. [2018] 93 taxmann.com 32 (SC).* According to the CIT(A), in this case relief was given as the loan was taken for acquisition of capital asset whereas in the present case loan is obtained for working capital requirement. Hence this decision cannot be attracted in the assessee's case. Further, the Supreme Court in this judgment had held that for invoking provisions of section 28(iv), benefit received has to be in some form other than in the shape of money and since waiver amount represented cash/money, the CIT(A) observed that provisions of section 28(iv) were not applicable. In the present case, the benefit is in the form of money. In the case of Mahindra & Mahindra Ltd. (supra) the amount was received by cash, In the present case also, the amount claimed as waiver

was also received as cash through banking channels. Therefore, according to the CIT(A), this decision squarely applied to the assessee's case and therefore he deleted the addition u/s. 28(iv) of the Act. Against this, the revenue is in appeal before us.

8. The ld. AR submitted that the assessee failed to establish that the unsecured loan was used for day to day business of the assessee and this is nothing but working capital loan availed by the assessee because it is long term and waiver of the same cannot constitute capital receipt and it should be in the revenue field and same to be taxed.

9. The ld. AR submitted that there is no question of applicability of section 41(1) of the Act as the assessee has not claimed any deduction in any assessment year on this count. He submitted that it is a long term unsecured loan which was waived and it is a capital receipt. He relied on the judgment of the Supreme Court in the case of *CIT v. Mahindra & Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)* and also supported the order of the CIT(Appeals). He also relied on the following decisions:-

CIT v. Compaq Electric Ltd., 204 Taxman 58 (Kar)
CIT v. Chetan Chemicals Pvt. Ltd., 267 ITR 770 (Guj)
CIT V. Alchemic Pvt. Ltd. 130 ITR 168 (Guj)

10. We have heard both the parties and perused the material on record. In this case, the assessee borrowed loan as long term unsecured loan at Rs.2,55,35,871/ This amount has been waived in the assessment year under consideration. The assessee has taken this amount as income in the Profit & Loss account. However, while computing income of the assessee, it was deducted from the total income. Accordingly taxable income of the business has been computed.

11. The contention of the ld. AR is that this long term unsecured loan is used for the purpose of day to day business of the assessee and the

condition laid down in section 28(iv) is not complied with. As per section 28(iv) of the Act, the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession is chargeable to income tax as part of income from business/profession and it is deemed to be income u/s. 2(24) of the Act. The clause does not apply to receipt in cash. To apply this provision, the assessee should have appropriated the sum in question to its Profit & Loss account. According to the ld. DR, in the present case the assessee appropriated the sum to Profit & Loss account and it represents income of the assessee. Further, it is admitted fact that unsecured loan availed by the assessee has been used in day to day affairs of the assessee company not being acquisition of any capital asset which indicates that assessee has obtained the unsecured loan for its business activity or trading operation. As such, once the assessee transferred the amount to Profit & Loss account as income, though it was not originally income in nature, but because of the subsequent action of the assessee it becomes assessed income when the amount was written off to the Profit & Loss account. In this connection, reference may be made to the decision of *Supreme Court* in the case of *Vazir Tobacco Co. v. CIT, 132 CTR 559* wherein it was held that gratuity reserve is appropriation of profit. The Bombay High Court in the case of *Solid Containers Ltd. v. DCIT, 308 ITR 417 (Bom)* referred and considered the decision in *T.V. S*undaram Iyengar & Sons Ltd.'s case (supra) where it was held 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 capital character, yet the amount changes its character when the amount becomes the 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.

12. In Mahindra & Mahindra Ltd. v. CIT (261 ITR 501), the Bombay High Court held that no allowance / deduction having allowed in respect of loan taken by assessee for purchase of capital asset, section 41 was not attracted to remission of principal amount of loan.

13. In the instant case, the assessee has not claimed any deduction on account of acquisition of capital asset as the same has been reflected in the balance sheet. Remission of principal amount of loan so obtained from related parties had not been claimed as expenditure or trading liability in any of the earlier previous years so far as the waiver of the same cannot fall into the provisions of section 41(1) of the Act. However, the provisions of section 28(iv) applies to the value of benefit or perquisite whether convertible into money or not, arising from business, but it does not apply to benefit received in cash or money, as held in the case of *Mahindra & Mahindra Ltd. (supra),* waiver of principal amount of loan also does not come under the definition of income as contained under section 2(24) of the Act. The definition of income as contained under section 2(24) speaks as to what are the items to be included under the definition of income. It includes profit and gains, dividend, voluntary contribution received by a trust, value of any perquisite or profit in lieu of salary, special allowance or benefit granted to the assessee to meet his personal expenses, benefit or perquisite of directors, any such chargeable under clauses (*iiia*), (*iiib*), (*iiic*), (*iv*) and (*v*) of section 28, capital gains under section 45, profit and gains of business in accordance with section 44, winning from lotteries, races, etc., and any sum received by the assessee from his employee as contribution to any provident fund so set up. Waiver of principal amount of tax by no stretch of imagination can be treated as income within the meaning of section 2(24) of the Act. However, in that case, the court has not considered the Supreme Court judgment in the case of *T.V. Sundaram Iyengar (supra)*.

14. In the case of *Tosha International Ltd. (176 Taxman 187)(Del),* the assessee has not got any deduction on account of acquisition of capital assets as the same was reflected in the balance sheet and not in the profit and loss account, and also the remission of principal amount of loan so obtained from the bank was not claimed as an expenditure or trading liability in any of the earlier previous years. In that case the assessee had acquired capital assets and the decision of Hon'ble Bombay High Court in the case of Mahindra & Mahindra Ltd. (supra) was applied. Therefore, the decision of Tribunal in the case of Tosha International Ltd. (supra) as upheld by the Hon'ble High Court of Delhi would apply to the cases where the loan obtained by the assessee is utilized for acquiring capital assets.

15. Now, we shall come to the decision of the Hon'ble Bombay High Court in the case of Mahindra & Mahindra Ltd. (supra). In the case, the assessee was engaged in the business of manufacturing jeeps. In June, 1964, the assessee entered into an agreement with an American company, which agreed to sell to the assessee dies, welding equipments and die models, tooling for production of special type of jeeps by the assessee in India. The price of the tooling was agreed at US$6,50,000 c.i.f. Bombay. Since the assessee could not secure foreign exchange, the American company agreed to provide a loan of US$ 6,50,000 repayable after 10 years in instalment with interest @ 6 per cent free of income-tax. Consequently, the assessee received loan for securing the tooling from the American company. Subsequently, the American company was taken over in 1996 and in turn thereof, it had agreed to waive the principal amount of loan advanced to the assessee. The Assessing Officer held that on the waiver of the loan, the credits represented income. He, therefore, held that the amount was taxable under section 28 of the Act. The CIT(A) held that the same was taxable as income under section 28(iv) of the Act as such benefit by way of waiver of loan was obtained in the course of business and

the monetary value of that benefit was income. According to the Tribunal, section 28(iv) was not applicable because benefit of waiver was not received by the assessee in cash. The Tribunal further took the view that even section 41(1) of the Act was not applicable because there was no cessation of any trading liability. On reference, the Hon'ble High Court held that there were two important facts, which had been overlooked by the Assessing Officer. One of such important fact referred to by the High Court was that the purchase consideration was related to capital asset. The tooling were in the nature of dies. The assessee was manufacturer of heavy vehicles and jeeps. It required these dies for expansions. Therefore, the import was that of plant and machinery. The consideration paid was for such import of plant and machinery, i.e., capital assets. In these circumstances, it was held that section 28(iv) was not attracted. The Hon'ble High Court further found that the principal amount of loan had been foregone as a part of take over arrangement, to which the assessee was not a party, and the waiver of principal amount was unexpected, and in the circumstances, such waiver would not constitute business income. The Hon'ble High Court further held that in order to apply section 41(1), the assessee should have obtained a deduction in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. The assessee had not obtained such allowance or deduction in respect of expenditure or trading liability. In the circumstances, it was held that section 41(1) of the Act was not applicable. The Hon'ble High Court further held that even assuming that the assessee had got deduction of allowance, section 41(1) was not applicable because such deduction was not in respect of loss, expenditure or trading liability. It was lastly held that the tooling constitutes capital asset and not stock-in-trade. From the said decision, it is evident that the loan was obtained for payment of consideration for import of plant and machinery, which constitute capital asset and not stock-in-trade. In other words, the loan obtained by the

assessee was utilized for the acquisition of capital asset and not for acquiring or purchasing any stock-in-trade or not for the purpose of any trading activity. In the light of these facts, the Hon'ble Bombay High Court held that the waiver of the principal amount of loan is neither an income under section 28(iv) nor under section 41(1) of the Act.

16. In the light of the above decision of Hon'ble Bombay High Court in the case of *Mahindra & Mahindra Ltd. (supra)*, it is clear that in the case where capital assets are acquired by obtaining a loan, and subsequently, the loan amount is waived by the other party, the principal amount of loan waived by the other party cannot be brought to tax under section 28(iv) of the Act or under section 41(1) of the Act.

17. The decision of Hon'ble Supreme Court in the case of *T.V. Sundaram Iyengar & Sons Ltd. (supra)* and Hon'ble Bombay High Court in the case of *Mahindra & Mahindra Ltd. (supra)* and Hon'ble Madras High Court in the case of *Aries Advertising (P.) Ltd. (225 ITR 510)* had been referred to by the Hon'ble High Court of Bombay in the case of *Solid Containers Ltd. (308 ITR 417)*. In that case, the assessee had taken a loan of Rs. 6,86,071 for business purposes, which was written back, as a result of consent terms arrived at between M/s. P.C. Jain Motors, on the one hand, and the assessee, on the other. Assessee claimed that the said loan was the capital receipt and has not been claimed as deduction from the taxable income as expenses and, therefore, did not come under section 41(1) of the Act. The credit balance written back was treated by the Assessing Officer to be the income of the assessee under section 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 Hon'ble Bombay High 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.

18. On an appeal, CIT(A) upheld the Assessing Officer's action. On further appeal before the Tribunal, the Tribunal sustained the view taken by the Commissioner relying upon the judgment of the Hon'ble Supreme Court in the case of T.V. Sundaram Iyengar & Sons Ltd. (supra). The Tribunal observed that Hon'ble Supreme Court in the case of T.V. Sundaram Iyengar & Sons Ltd. (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. On further appeal before the Hon'ble High Court, the Hon'ble High Court held that the assessee can hardly derive any advantage from the case of Mahindra & Mahindra Ltd. (supra) as in that case, a clear finding was recorded that the purchase consideration was 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 Hon'ble High Court further observed that the facts of the case in the case of Solid Containers Ltd. (supra) were entirely different inasmuch as it was a loan taken for trading activity and ultimately upon waiver, the amount was retained in the business by the assessee. Thus, the Hon'ble Bombay High Court in that case of Solid Containers Ltd. (supra) held that 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 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. The Hon'ble Bombay High Court in this case has also observed that a similar view was also taken by the Bench of Hon'ble Madras High Court in the case of Aries Advertising (P.) Ltd. (supra) where 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. The following observation of Hon'ble Apex Court in T.V. Sundaram Iyengar & Sons Ltd.'s case (supra) has been noted by Hon'ble Bombay High Court in the case of Solid Containers Ltd. (supra) :—

> "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 loan 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 assert 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 such 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."

19. The operative portion of decision in the case of Solid Containers Ltd. (supra) is as under :—

"3. The present appellant can hardly drive 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 v. 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."

20. In the present case, the money was received by the assessee in the course of carrying on business. Although it was treated as unsecured loan from related parties under the head 'long term borrowings', and on its waiver the parties have not claimed the same. The assessee itself as treated it as its own money and taken to Profit & Loss account. There is no explanation as to why the assessee has taken it to Profit & Loss account even it was somebody else's money. At this stage, it is appropriate to refer to the decision of *Aries Advertising (P.) Ltd.* (*supra*) and *Solid Containers Ltd. v. DCIT,* 308 ITR 417 (Bom).

21. In the case of *Aries Advertising (P.) Ltd.* (*supra*) 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 *Vazir Sultan Tobacco Ltd.* v. *CIT* [1981] 132 ITR 559 , where it has been held that a reserve is appropriation of profits.

22. In the light of the discussion made above, and following the decision of Hon'ble Bombay High Court in the case of *Solid Containers Ltd.* (*supra*) where the principle enunciated by the Hon'ble Supreme Court in the case of *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 changeable to tax as held by Hon'ble Bombay High Court in the case of *Mahindra & Mahindra Ltd.* (*supra*) and Hon'ble Delhi High Court in the case of *Tosha International Ltd.* (*supra*) either under section 41(1) or 28(*iv*) or 2(24) of the Act.

23. Accordingly, we uphold the order of the CIT(Appeals).

24. In the result, the appeal by the revenue is dismissed.

Pronounced in the open court on this 7th day of April, 2022.

Sd/-	Sd/-
(BEENA PILLAI)	(CHANDRA POOJARI)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Bangalore,
Dated, the 7th April, 2022.

/*Desai S Murthy /*

Copy to:

1. Appellant 2. Respondent 3. CIT 4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.