ITAT, of Mumbai

Prism Cement Ltd. vs JCIT

Income-Tax Appeal No. 5857 (Mum.) of 2000 Assessment Year 1997-98

G.D. Agarwal, Accountant Member and Sunil Kumar Yadav, Judicial Member

23 March 2006

P.J. Pardiwala for the Applicant
Vijay Shankar for the Respondent

ORDER

Per Shri Sunil Kumar Yadav, Judicial Member - This appeal by the assessee is directed against the order of the CIT(A) on a solitary ground that the CIT(A) has erred in upholding the action of the Assessing Officer in treating the amount written back on forfeiture of debentures as income exigible to tax thereby adding a sum of Rs. 14,19,000 to the total income of the assessee.

2. Having heard the rival submissions and from the careful perusal of the record we find that the assessee has issued 38 lakhs debentures, 13.5 per cent non-convertible debentures of Rs. 150 each. During the previous years relevant to the impugned assessment year, 62,250 non-convertible debentures (NCDs) were forfeited due to non-payment of call money. This can be re-issued at the option of the assessee. On account of forfeiture of debentures, the amount paid earlier on such debentures have been written back. In "Schedule D" of the Audited Accounts, the assessee credited an amount of Rs. 14.19 lakhs being the amount written back on forfeiture of debentures and set it off against the expenditure of Rs. 6,482.59 lakhs. According to the Assessing Officer, though the commercial production had not been commenced by 31-3-1993 the monies were borrowed through non-convertible debentures for the purpose of business. As NCD's holders defaulted in making payment of the call money, they lost the right to retrieve the amount paid and the forfeited NCDs can be re-issued upon the option of the assessee only. Thus, the benefit has been derived by the assessee-company in monetary terms and the same was liable to be taxed as income of the assessee. The Assessing Officer further held following the judgment of the Hon'ble Apex Court in the case of CIT v. T.V. Sundaram lyengar and Sons Ltd. [1996] 222 ITR 3441 that even though it was derived from the course of setting up of business the same do not loose the character of income and is liable to tax as income from other sources.

3. The assessee has filed appeal before the CIT(A) with the submissions that it is settled position of law that by charging provisions of sections 4 and 5, the general liability to tax is imposed upon income but the Income-tax Act does not provide that whatever is received by the person must be regarded as income chargeable to tax. In all cases in which the receipt is sought to be taxed as income, burden lies upon the department to prove that it is within the taxing provisions, in view of the judgment of the Apex Court in the case of Parimmisetti Seetharamamma v. CIT [1965] 57 ITR 532. The revenue has not discharged the burden cast on it to establish that amount forfeited partakes the character of income. The amount which the assessee has initially received by issuance of the debentures was not of income in nature. The mere fact that subsequently the debenture holder, on account of failure on his part to pay the call money has forfeited his right to receive back the amount does not change the character of the receipt. The character of the amount when it was received that of

a loan. On account of the forfeiture by the assessee of the debenture the character of the receipt does not change to that of the income in the absence of specific provision made in the Act to that effect. In support of this plea he has placed reliance upon the judgment in the case of Commissioner of Agricultural Income-tax v. Kerala Estate Mooriad Chalapuram [1986] 161 ITR 1551. The CIT(A) re-examined the issue in the light of various judicial pronouncement but was not convinced with the explanation of the assessee and has held that the benefit has been derived by the assessee in monitory terms which is liable to be taxed as income of the assessee, relying upon the judgment of the Hon'ble Apex Court in the case of National Cement Mines Industries Ltd. v. CIT [1961] 42 ITR 69 after having observed that, in order to decide whether the receipt is a capital incojne, the receipt has to be,examined from the commercial point of view and the character of receipt in the hands of the receiver.

4. Aggrieved assessee has preferred this appeal before the Tribunal with the submissions that the assessee has issued the non-convertible debentures in order to raise its capital and whatever amount was received it was credited to the capital account as a loan or advance. No doubt call money was required to be paid by a subscriber and in case the subscriber fails to make the payment, the amount so paid as an advance money against the non-convertible debentures would be forfeited by the assessee. Since the assessee has received the advance money on account of issuance of NCDs in order to raise its capital the character of receipt is also of a capital nature. In case the subscribers paid the call money the entire amount goes to the capital account of the assessee. On their default for non-payment of call money the advance money paid by the subscribers is forfeited by the assessee but the nature remains the same as capital receipt. The learned counsel of the assessee further argued the charging sections of Income-tax Act, 1961, are sections 4 and 5 and under these sections only those income can be charged to tax which falls under any head of income. If it does not fall under any prescribed head of income that receipt cannot be subjected to tax. With regard to applicability of the provisions of section 41(1) of the Act, the learned counsel for the assessee has invited our attention to the provisions of section 41(1) of the Act with the submissions that only that liability can only be ceased if it has been debited to the profit and loss account in the earlier years as a loss or expenditure or trading liabilities. Unless and until that liability debited to the profit and loss account in the earlier years it cannot become an income of the assessee on its cessation in view of the provisions of section 41(1) of the Act. He has also invited our attention to the provisions of section 28 of the Act which deal with various types of receipts which can formed part of "profits and gains of business or profession" with the submission that this type of receipt does not fall in any category of the receipts given under section 28 of the Act. Since there is no specific head with regard to chargeability of receipt on account of forfeiture of non-convertible debentures for default in making payment of call money, the forfeited amount cannot assume the character of taxable income. In-support of this contention, the assessee has placed reliance on the various judgments which are as under:

(i) Comfund Financial Services (I) Ltd. v. Dy. CIT [1998] 67 ITD 304 (Bang.)

(ii) CIT v. Chetan Chemicals (P.) Ltd. [2004] 267 ITR 7701 (Guj.)

(iii) Mahindra and Mahindra Ltd. v. CIT [2003] 261 ITR 5012 (Bom.)

(iv) CIT v. Hukumchand Mohanlal [1971] 82 ITR 624 (SC)

(v) Mehboob Productions (P.) Ltd v. CIT [1977] 106 ITR 758 (Bom.).

5. Learned DR, on the other hand, besides placing heavy reliance upon the order of the CIT(A) has invited our attention to the fact that whatever NCDs were issued it was issued during the course of business activities, as such the amount received on issuance of NCDs assumes the character of business receipt and so long it does not forfeited, it may be loan liability upon the assessee but once it is forfeited it becomes a business receipt of the assessee which is liable to be taxed. In support of this plea the learned DR relied upon the judgment of the Hon'ble Supreme Court in the case of CIT v. Lakshmi Vilas Bank Ltd. [1996] 220 ITR 305', the judgment of the Hon'ble Punjab and Haryana High Court in the case of Atlas Cycle Industries Ltd. v. CIT [1981] 128 ITR 60, the judgment in the case of CIT v. Haryana Co-op. Sugar Mills Ltd. [1985] 154 ITR 751 (Punj. and Har.) and the decision of the Madras High Court in the case of CITv. Aries Advertising (P.) Ltd. [2002] 255 ITR 510.

6. Having given a thoughtful consideration to the rival submissions and from the perusal of the record, we find that the assessee has issued 38,00,000 NCDs of Rs. 150 each out of which 62,250 NCDs were forfeited due to non-payment of call money though these forfeited debentures can be re-issued but it can only be done at the option of the assessee. It is also made clear that once this initial payment is forfeited on account of non-payment of call money the subscriber has lost every right to retrieve the amount so paid by it. The forfeited amount of Rs. 14.19 lakhs was credited to the Debentures Account and was adjusted against the expenditure of Rs. 6,482.59 lakhs. It is also admitted fact that commercial production was not commenced during the previous year relevant to the impugned assessment year in question and the money was borrowed through NCDs to raise capital of the assessee. Now, the issue before us is with regard to the character of the borrowed fund through issuance of NCDs whether it was of the capital nature or a revenue receipt? Once it is held that the borrowed funds were received through issue of NCDs to raise the capital, it is of capital nature and its character cannot be changed even if it is forfeited by the assessee on account of default of nonpayment of a call money. It is also to be examined as to what would be a character of the entire amount received on account of issuance of NCDs if call money is paid in time, whether it would be a capital or revenue receipt? Before dwelling upon the issue, we have to examine the various judgments referred to by the parties during the course of hearing.

7. In the case of T.V. Sundaram lyengar and Sons Ltd. (supra) which has been heavily relied upon by the Assessing Officer while treating the forfeited amount as revenue receipt and we found from the fact of the case that the assessee became richer by the amount which is transferred to its profit and loss account as the money had arisen out of ordinary trading transactions. The amount originally received were not of income nature, but it remained with the assessee for a long period unclaimed by the credit parties. By lapse of time the claim of the deposit became time-barred and the amount attained totally different quality. It became definite trade surplus and assessee itself has treated this money as its own money and taken the amount to its profit and loss account. In the light of these facts the Hon'ble Apex Court has held that if an amount is received in the 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 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.

8. In the case of Lakshmi Vilas Bank Ltd. (supra), the similar type of issue was raised and Their Lordships have held that when bank forfeited margin money deposited by the customers with it, the bank was doing something which was in the course of its usual banking business. If the deposits made by the constituents were forfeited by the bank, the forfeited amount became bank's money and there is no reason why this amount should not be treated as income of the bank earned in the course

of carrying on its business. The bank undertook to buy the securities on behalf of its constituents. Before purchasing the securities, the bank took from its constituents "margin money deposits". These deposits served two purposes. In the events of the constituent paying the balance amount, the deposits were to be treated as part payment of the price of the securities. But in the interval between the deposit and the due date of the payment of the balance amount, the deposits were to be treated as earnest money liable to be forfeited. In this case the bank bought the securities on behalf of its constituents in the course of its business and for the purpose of making profits. If the contract was duly executed, the bank would have been entitled to charge brokerage. The entire transaction was a profit making process of the bank. This is not a case of pre-deposit of money for acquisition of licence or business contract which had to be kept deposited with the principal for the entire duration of the period.

9. With regard to the cessation of liability, we have examined the judgment of the Hon'ble Gujarat High Court in the case of Chetan Chemicals (P.) Ltd. (supra) in which Their Lordships have held that on a reading of section 41(1) of the Income-tax Act, 1961, it is apparent that before the section can be invoked, an allowance or a deduction has been granted during the course of assessment for any year in respect of loss, expenditure or trading liability which is incurred by the assessee, and subsequently during any previous year the assessee obtains, whether in cash or in any other manner, any amount in respect of such trading liability by way of remission or cessation of such liability. In that case, either the amount obtained by the assessee or the value of the benefit accruing to the assessee can be deemed to be the profits and gains of business or profession and can be brought to tax as income of the previous year in which such amount or benefit is obtained.

10. In the case of Mahindra and Mahindra Ltd. (supra), Their Lordships of Hon'ble High Court has also examined the scope of section 41(1) of the Income-tax Act, 1961 and has observed that in order to apply'section 41(1), an assessee should obtain a deduction in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. In this case, the assessee has not obtained such allowance or deduction in respect of expenditure or trading liability. The assessee had paid interest at 6 per cent over a period of ten years to KJC on Rs. 57,74,064. In respect of that interest, the assessee never got deduction under section 36(1)(iii) or section 37. In the circumstances, section 41(1) of the Act was not applicable. Their Lordships have further held that even assuming that the assessee has got deduction on allowance even then section 41(1) was not applicable because such deduction was not in respect of loss, expenditure or trading liability.

11. In the case of Comfund Financial Services (I) Ltd. (supra), the Tribunal has held that the waiver of initial interest liability towards loan taken by the assessee does not constitute a revenue income in the hands of the assessee. The facts of this case are similar to the facts of the case in hand. We therefore extract' the relevant portion of the order of the Tribunal as under:

"Facts

The assessee-finance company dealt with share and securities in a very large manner. DB acted as manager-banker. Major portion of transactions entered into by the assessee-company, whether purchase or sale, were routed through DB only. The assessee-company incurred expenses towards purchase price of shares and securities brought from other parties and made payments out of its O/D account with DB. On account of huge loss suffered by the assessee-company DB wrote off principal of Rs. 44.7 crores and interest of Rs. 2.6 crores. The assessee treated interest as interest income for the current year but claimed that Rs. 44.7 crores could not be considered as income of the assessee under section 41(1) inasmuch as no deduction had been claimed in respect of this amount in the

computation of income in any assessment year. However, the Assessing Officer held that all its security transactions entered into with DB which were towards the purchases made and purchase of securities were claimed as expenditure. Therefore, he treated the entire amount of Rs. 44.7 crores remitted by DB towards principal as the assessee's income under section 41(1). On appeal, the Commissioner (A) affirmed the order of the Assessing Officer.

On second appeal:

Held

The facts of the case clearly indicted that the assessee had incurred expenses in past or even in this year towards the purchase price of shares and securities brought from other parties and than the payments in that regard were made by the assessee out of us overdraft account with DB. When DB remitted or wanted the principal amount of such loan, it could not be said that any portion of the purchase price was waived by recipients of such prices. The expenses towards purchases had already been incurred and there was no remission from the side of the said sellers of securities, etc., in favour of the assessee out of such purchase prices. The transactions between the assessee and DB (apart from those relating to direct purchases and sales of shares and securities between the two parties) were mostly of the nature of loan, transactions. These transactions were, therefore, in capital account. The waiver or remission of the liability towards loan incurred by the assessee could not, therefore, be considered to constitute a revenue income in the hands of the assessee. The departmental contention that the entire transactions with DB represented trading liabilities of the assessee could not be accepted. There was a clear-cut distinction between trading transactions entered into by the assessee with third parties and payments or receipts of money from such transactions finding place in the bank account of the assessee. The departmental contention that in all those transactions with third parties. DB merely attend as an agent of the assessee, could not be accepted. The role of DB as an agent was limited merely to making payment of or collection of dues by or to the assessee. Even if DB be considered as an agent in making the purchase and sales of the shares and securities, the transactions between the assessee and DB would be of the nature of banking transactions only. Unless it could be shown that, on the other hand, DB acted as agents of the third parties with whom the assessee had transitions in shares, etc., the accounts of the assessee with DB could not at all be considered to represent any trading transactions. This was certainly not the case of the Department that DB merely represented an agent of the third parties.

Different Courts has held that the liability of an assessee towards purchase of assets is completely different from the liability incurred by it on raising loan for the purpose of the same purchases. Thus, it has been held repeatedly by different courts that the liability towards interest payments incurred on loan specifically utilized for acquiring capital assets would also form revenue expense in the hands of the assessee. Thus, the loans from credits stand completely on a different footing from the transactions in which the assessee indulged by utilizing such loans. In the instant case, therefore, the trading transactions of the assessee could neither be equated nor could directly be connected with the liability of assessee towards loan incurred by it from its bank, viz., DB. Therefore, so far as remission of principal amount was concerned, the provisions of section 41(1) would not at all be applicable.

The main reason why the provisions of section 28(iv) would not be applicable to the instant case was that the benefit did not arise to the assessee on its revenue account. Even according to general commercial principles and various decisions of different courts, it cannot be said that a waiver of a loan as such constitutes income in the hands of the debtor. Such waiver clearly affect that capital accounts of the assessee and hence, in ordinary sense, such waiver cannot constitute income of the

assessee. For the purpose of applicability of section 28(iv) the benefit or perquisite must relate to the revenue account of the assessee. Hence, remission of the liability towards principal amount could not constitute income in the assessee's hands either under section 41(1) or under section 28(iv).

Now taking into consideration the different facets of transitions between the assessee and DB even apart from DB acting as banker of the assessee the total expenses on interest on overdraft, guarantee, commission, bank charges, etc. came to Rs. 6,89,28,002 out of which only Rs. 1,85,60,598 constituted interest on overdraft account. It was not understood as to what happened to the other expenses aggregating Rs. 5,03,67,404 also incurred by the assessee and remained payable to DB. Since these expenses were clearly of the nature of revenue expenses already incurred and also claimed by the assessee in its accounts remission of any portion of those expenses would clearly constitute income in the assessee's hands either by way of direct deduction from the expenses incurred or under section 41(1). The Assessing Officer should therefore, examine this limited matter and come to a clear cut conclusion so that the amount or any portion thereby if remitted by the bank, could be treated as the assessee's income."

12. In the case of Kerala Estate Mooriad Chalapuram (supra) their Lordships of the Apex Court have held that the remission cannot be considered as amounting to receipt of agricultural income. What was allowed to be deducted from the total agricultural income of the assessee was interest pursuant to section 5. It was a deduction made permissible by the Act. To be regarded as taxable in the hands of the assessee, the amount which was subject of the remission must be capable of being described as agricultural income, therefore, the High Court has correctly observed "what was returned to the assessee has nothing to do with the activities of the assessee, it does not arise from business nor does it arise from agricultural operations when the assessee is an agriculturist".

13. We have also carefully examined the judgment of the Madras High Court in the case of Aries Advertising (P.) Ltd. (supra) but the ratio laid down in this case cannot be applied here as the facts altogether are different to the present case. In that case, the assessee has not treated the amount as a liability and more particularly a continuing liability. On the other hand, the assessee has transferred this amount to General Reserve. Their Lordships have held that it is a Trite Law that an amount transferred to a general reserve would be out of the profits alone. Once the assessee transferred this amount to general reserve it treated same as the profit. The amount represents the various credits and deposits during the trading with a firm. They remained for a long time to be recovered (even before the limitation period) and thus remained unclaimed. The amounts were then transferred by the assessee-company to the general reserve obviously treating them to be the profits. In that view an amount has to be treated as income of assessee chargeable to income-tax.

14. In the light of the ratio laid down by the Hon'ble Apex Court and the various High Courts in the above mentioned cases, we are of the view that for invoking the provisions of section 41(1) of the Act an allowance or deduction must have been granted during the course of assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently during any previous year, the assessee obtains, whether in cash or in any other manner whatsoever or any amount in respect of such trading liability by way of remission or cessation of such liability. Unless and until the liability which has been ceased or remitted during the impugned assessment year, has been debited and claimed to the profit and loss account and allowed in earlier years, it cannot be treated to be an income under section 41(1) of the Act. If that liability was not allowed or its

deduction was not granted in earlier years it would not assume a character of income chargeable to tax in this year by virtue of section 41(1) of the Act. The facts of instant case are examined in the light of proposition of law laid down in the aforesaid cases and we would find that the NCDs were issued to raise a capital of the assessee before commencement of the business and whatever earnest money or advance was received on account of issuance of NCDs, was kept in separate account and was shown as loan liability upon the assessee and this liability was never debited to the profit and loss account nor was its deduction claimed in the relevant assessment year. Since, the NCDs were issued in order to borrow the funds to raise the capital, the amount received in lieu thereof has assumed the character of capital receipt if at all not treated to be a loan liability, inasmuch as issuance of NCDs was not a business of the assessee.

15. Thus, the earnest money or an advance amount received on account issuance of NCDs, if forfeited on account of nonpayment of call money, the loan liability would only convert into a capital receipt. It would not assume a character of revenue receipt or business receipt because NCDs were not issued in the course of regular business of the assessee as evident from the facts of the case. Assessee's main business is of cement and it was in the process of set up of cement manufacturing plant at Satna during the impugned assessment year. In these circumstances, we are constrained to hold that the amount received by the assessee in lieu of issuance of NCDs which were forfeited later on account of non-payment of call money assumes a character of capital receipt which earlier was shown as a loan liability in the books of account of the assessee. If we consider this receipt to be a business receipts even then it would not be taxable to tax under the provisions of sectipn 41(1) of the Act, inasmuch as there was no allowance or deduction of this liability in the earlier years. We also do not find any provision in this Act according to which this type of receipts are chargeable to tax. We, therefore, are of the considered view that the revenue was not justified in treating this receipt as revenue receipt. We therefore, set aside the order of CIT(A) and delete the addition.

In the result, the appeal of the assessee is allowed. This order is announced in the open court on this 23rd day of March, 2006.