Equivalent citations: (2003) 182 CTR Bom 34, 2003 261 ITR 501 Bom

Bench: S Kapadia, J Devadhar

Mahindra And Mahindra Ltd. vs Commissioner Of Income-Tax on 29/1/2003

JUDGMENT

S.H. Kapadia, J.

1. In this reference three applications are consolidated into one income-tax reference and, accordingly, we have answered the questions as per Reference Application No. 1561 of 1982 filed by the assessee and Reference Applications Nos. 1708 of 1982 and 1709 of 1982 filed by the Department.

2. The main dispute falls under Reference Application No. 1709 of 1982 filed by the Department under which the following questions of law arise for determination.

"I, Whether, on the facts and in the circumstances of the case, the sum of Rs. 57,74,064 due by the assessee to Kaiser Jeep Corporation of America and written off by the lender constituted taxable income of the assessee ?

2. Whether, on the facts and in the circumstances of the case, the assessee having obtained deduction of Rs. 27,29,585 by way of depreciation on the cost of machinery and toolings, was taxable under Section 41(1) of the Income-tax Act as the cost of the machinery/ toolings being forgone by Kaiser Jeep Corporation during the assessment year 1976-77 ?

3. Whether the Tribunal was right in holding that waiver of the loan repayment was not related to stock-in-trade but to capital asset and, therefore, it was not a remission of liability under Section 41(1) of the Act ?

4. Whether the Tribunal was right in holding that the amount of Rs. 57,74,064 constituted a benefit of perquisite in cash and, therefore, it did not fall within Section 28(iv) of the Income-tax Act ?"

3. Questions Nos. 2, 3 and 4 referred to hereinabove are reframed questions. They have been reframed with the assistance of the learned advocates on both sides.

Facts :

4. In this reference, we are concerned with the accounting year ending October 31, 1975, corresponding to the assessment year 1976-77. The assessee, Mahindra and Mahindra Limited, had detailed plans to expand its jeep product line by including FC-150 and FC-170 models. On June 18, 1964, therefore, the assessee entered into an agreement with Kaiser Jeep Corporation situate in America. In terms of this agreement, Kaiser Jeep Corporation (hereinafter referred to for the sake of brevity as "KJC") agreed to sell to the assessee dies, welding equipments, and die models (hereinafter referred to for the sake of brevity as "toolings"). This was for production of special type of jeeps by the assessee in India. The price of the toolings was agreed at $ 6,50,000 c.i.f., Bombay. The import of the toolings was approved by the Government of India, Department of Heavy Engineering, Ministry of Industry, vide their letter dated January 15, 1965. By that letter, the Government of India approved the request of the assessee for importing the toolings required for manufacture of jeeps valued at Rs. 36.50 lakhs against a loan from KJC bearing interest of 6 per cent., free of income-tax and repayable after ten years in instalments. The import of toolings was done against a licence dated April 9, 1965, which was obtained by the assessee for a c.i.f. value of Rs. 31,26,500. Since the assessee could not secure foreign exchange, KJC agreed to provide loan for an amount of $ 6,50,000 repayable after ten years in instalments with interest at 6 per cent., free of income-tax. For this purpose, the assessee addressed a letter on

June 7, 1965, to the Reserve Bank of India. Consequently, the loan arrangement was approved, both by the Reserve Bank of India and Ministry of Industry. On the licence, a condition was imposed to the effect that the foreign exchange involved equivalent to Rs. 31,26,500 would be net out of foreign exchange loan of $ 6,50,000 obtained by the assessee from Kaiser Jeep International Corporation of USA. At this stage, it may be mentioned that the export marketing unit of KJC was Kaiser Jeep International Corporation also situate in USA. The total cost of the toolings received was $ 6,50,000. The toolings were received as per invoice dated September 29, 1965, for $ 309,693.37; October 29, 1965, for $ 339,861.63 and on November 16, 1965, for $ 445.00 in all amounting to $ 6,50,000. Consequently, in terms of the approval granted by the Central Government, the assessee received loan for securing the toolings from KJC for which the assessee gave three promissory notes dated September 16, 1965, October 28, 1965, and November 19, 1965, in all for $ 6,50,000. Accordingly, the toolings were supplied by KJC.

5. The cost of the toolings inclusive of the difference in exchange rate consequent upon devaluation of the rupee in 1966 and customs duty paid on the import of the toolings was treated by the company as current assets and shown under the sub-head "Tools". The cost of the tools was amortised each year based on the number of trucks produced. In the company's accounts for the year ending October 31, 1975, corresponding to the assessment year in question, the tools at their amortised value were transferred to fixed assets as the company treated the tools as capital assets. The assesee had obtained benefit of amortisation for the years ending October 31, 1966, up to October 31, 1974, amounting to Rs. 34,84,269. Out of the total amortised value of Rs. 34,84,269, the proportionate invoice cost amortised over a period of nine years was paid directly out of the loan obtained by the assessee from KJC. On February 17, 1976, the President of KJC informed the assessee that American Motor Corporation had taken over KJC. That, American Motor Corporation (hereinafter referred to for the sake of brevity as "AMC") has agreed to waive the principal amount of loan advanced by KJC to the assessee and to cancel the promissory notes as and when they got matured. This was vide letter dated February 17, 1976, by which AMC agreed to waive the principal amount and not interest as a part of total take over of KJC by AMC.

6. On June 30, 1976, the assessee filed its return of income for the assessment year 1976-77. In Part III of the return, the assessee has shown an amount of Rs. 57,74,064 as cessation of its liability towards AMC. The Income-tax Officer came to the conclusion that with the waiver of the loan the credits represented income and not a liability. Accordingly, the Assessing Officer held that the sum of Rs. 57,74,064 was taxable under Section 28. The Assessing Officer concluded that the loan arose from business dealings and, therefore, when the waiver took place, credits received by the assessee no longer represented liability but they became part of the business income. Being aggrieved, the assessee went in appeal to the Commissioner of Income-tax (Appeals) who took the view that with the waiver of loan, a benefit was received by the assessee and, therefore, the sum of Rs. 57,74,064 was taxable as income under Section 28(iv) of the Act as such benefit was obtained in the course of business and the monetary value of that benefit was income. Alternatively, the Commissioner of Income-tax (Appeals) took the view that the waiver of the loan amount of Rs. 57,74,064 amounted to remission of trading liability and, consequently, the said amount was taxable under Section 41(1) of the Income-tax Act. The Commissioner of Income-tax (Appeals) further held that, in any case, the assessee had purchased the toolings with the help of the loan which the assessee received from KJC and since the assessee had written off the cost of toolings and since the assessee had got the benefit of depreciation allowance over a period of nine years amounting to Rs. 27,29,585 on waiver of the loan, the said amount of Rs. 27,29,585 had to be adjusted or set off against the amount of Rs. 57,74,064. Being aggrieved, the matter was carried in appeal to the Tribunal which took the view that the contract of purchase of toolings and the loan agreement constituted one contract/transaction for purchase of toolings. That, these two transactions cannot be treated as two separate transactions. That, there was only one transaction for purchase. That the Government of India had directed the assessee to obtain a loan in order to finance a purchase because, at that time, there was acute shortage of foreign exchange. That the promissory notes were for value received. That the consideration for which promissory notes came to be made was against shipment of goods. Therefore, the Tribunal, on the facts, came to the conclusion that there was one contract of purchase of the tools and that purchase consideration was paid vide promissory notes. The Tribunal further concluded that Section 28(iv) of

the Act is applicable only to benefits or perquisites received by the assessee in kind. Therefore, according to the Tribunal, in this case, Section 28(iv) was not applicable because benefit of waiver was not received by the assessee in kind. The Tribunal further took the view that even Section 41(1) of the Act was not applicable because there was no cessation of trading liability. That the asses-see had never incurred the trading liability. That the assessee had bought the toolings as capital assets. In the circumstances, Section 41(1) of the Act had no application. The Tribunal further took the view that, in the present case, we are concerned with the purchase consideration relating to a capital asset and, therefore, Section 28(iv) was not applicable. The Tribunal took the view that the purchases effected were in respect of plant and machinery and tooling equipment which represented capital assets. That the amount has not been debited to trading account or the profit and loss account in any of the assessment years and, therefore, remission of that liability cannot be treated as income under Section 41(1) of the Act. The Tribunal held that the toolings bought by the assessee were not stock-in-trade. In the circumstances, the Tribunal took the view that Section 41(1) of the Act was not applicable. Being aggrieved by the decision of the Tribunal, the Department has come to this court by way of reference vis-a-vis the above questions under Section 256(1) of the Act.

Arguments :

7. Mr. R. V. Desai, learned senior counsel appearing on behalf of the Department, contended that, in this case, the assessee was to receive the toolings against payment of Rs. 57,74,064 which was payable to KJC. That, on waiver, the assessee got the toolings without payment. Therefore, the assessee received a benefit which was capable of evaluation in terms of money. He contended that such a benefit accrued to the assessee out of business transaction. Therefore, the benefit was taxable as business income under Section 28(iv) of the Act. Alternatively, he contended that this was a case of cessation of a trading liability under Section 41(1) of the Act. He contended that purchase of toolings was on revenue account. That the toolings constituted stock-in-trade of the assessee. That the toolings did not constitute capital asset. That, the nature of accounts and the manner in which the income is accounted for by the assessee in its books was not relevant. That the assessee had purchased the toolings as a part of trading activity. That the assessee had incurred a trading liability of Rs. 57,74,064 when it entered into an agreement for purchase of toolings with KJC. Therefore, on waiver, there was a remission of trading liability and, consequently, Section 41(1) of the Act stood attracted. In further alternative, it was urged on behalf of the Department that the assessee had received depreciation allowance for nine years amounting to Rs. 27,29,585 which should have been adjusted against a sum of Rs. 57,74,064 under Section 41(1) of the Act

8. In reply, Mr. Mistry, learned counsel appearing on behalf of the assessee, submitted that the assessee had not imported trading goods. He contended that the assessee had imported toolings as a part of plant and machinery. That the assessee is a manufacturer of jeeps. That the toolings were dies. That these toolings did not constitute trading goods. That the assessee had not received deduction for Rs. 57,74,064 on import of the equipment. He contended that in order to attract Section 41(1) of the Income-tax Act, the first requisite which ought to be satisfied was that the assessee should have got deduction or benefit of allowance in respect of loss, expenditure or trading liability incurred by the assessee and that subsequently during any previous year the assessee receives any amount in respect of such loss, expenditure or trading liability by way of remission or cessation thereof. He contended that in this case in respect of Rs. 57,74,064, the assessee has never received allowance or deduction and, therefore, Section 41(1) of the Act was not attracted. That, even assuming for the sake of argument that assessee had received the benefit of deduction or allowance, such deduction was not in respect of any loss, expenditure or trading liability. That under Section 41(1) of the Act, what is waived is payment of Rs. 57,74,064. That, it is the case of the Department that, by such waiver, the assessee got remission of Rs. 57,74,064. That the assessee has not got remission for depreciation of Rs. 27,29,585. Therefore, Section 41(1) of the Income-tax Act does not apply to the facts of this case. He contended that, in this case, the point at issue was : whether remission of Rs. 57,74,064 constituted income ? He contended that remission would become income only if the assessee had received allowance or deduction in respect of expenditure or trading liability. He contended that in respect of Rs. 57,74,064 the assessee has not got deduction. He contended that the Department's case was that by virtue of waiver the assessee got remission of

Rs. 57,74,064. He contended that the Department's case is not of remission for depreciation. Therefore, Section 41(1) of the Act was not applicable. Mr. Mistry further contended that even Section 28(iv) of the Act was not applicable as that section does not apply to cash receipts. That, Section 28(iv) was applicable to benefits/perquisites received in kind. In this connection, he invited our attention to the judgment of the Supreme Court in the case of CIT v. Mafatlal Gangabhai and Co. (P.) Ltd. [1996] 219 ITR 644, the judgments of the Gujarat High Court in the case of CIT v. Alchemic Pvt. Ltd. [1981] 130 ITR 168 and in the case of CIT v. New India Industries Ltd. [1993] 201 ITR 208. He submitted that Section 28(iv) states that what is received by the assessee should be the value of benefit or perquisite in kind. That, in this case, the assessee has not received any benefit or perquisite in kind which could be valued. He, therefore, submitted that Section 28(iv) was not applicable. That, in any event, such benefit should be in the nature of income. Otherwise, he contended that all capital receipts would become income under Section 28(iv). In the circumstances, he contended that no interference is called for in the view expressed by the Tribunal.

Findings :

9. At the very outset, we wish to point out three facts which are undisputed : (a) that a loan was advanced by KJC to the assessee, (b) that the assessee had paid interest at 6 per cent. per annum for ten years being the period of contract, (c) that the assessee never got deduction for payment of interest under Section 36(1)(iii) or under Section 37 of the Act. These three facts are not disputed by the Department. Therefore, we are required to consider the applicability of the provisions of Sections 28(iv) and 41(1) of the Act in the light of the abovementioned three undisputed facts.

(A) On Section 28(iv) :

10. At the outset, we wish to clarify that this judgment is confined to the facts of this case. This is because the value of any benefit or perquisite arising from business, as contemplated by Section 28(iv), could accrue in numerous ways. The income which can be taxed under Section 28(iv) must not only be referable to a benefit or perquisite, but it must be arising from business. Secondly, Section 28(iv) does not apply to benefits in cash or money (see CIT v. Alchemic Pvt. Ltd. ). Applying Section 28(iv) to the facts of this case, one finds that on June 18, 1964, the assessee entered into an agreement to purchase toolings from KJC. In 1964-65, India was facing foreign exchange crunch. In the circumstances, around June 7, 1965, the Government of India and the Reserve Bank of India, in this case, approved the arrangement under which KJC (supplier of toolings) was permitted to advance a loan of $ 6,50,000 to the assessee for ten years bearing interest at the rate of 6 per cent., free from income-tax. KJC was later on taken over by AMC and as a part of take-over, AMC agreed to waive the principal amount of the loan and not the interest. In the circumstances, as stated in the above three undisputed facts, the assessee paid interest at 6 per cent. per annum, for ten years, being the contractual period. According to the Assessing Officer, the loan arose from business dealings. According to the Assessing Officer when AMC waived the loan, the credits became part of business income ; that prior to such waiver, the credits represented liability. In the circumstances, the Assessing Officer has taxed such credits as business income. However, in this connection, there are two important facts which are overlooked by the Assessing Officer. Firstly, the assessee has continued to pay interest at 6 per cent. for a period of ten years on the loan amount. In this case, the Assessing Officer has not gone behind the loan agreement. In this case, the approval by the Government of India and the Reserve Bank of India are on record. In this case, the agreement for purchase of toolings was entered into, much prior to the approval of the loan arrangement given by the Reserve Bank of India. Therefore, the loan arrangement, in its entirety, was not obliterated by such waiver. Secondly, in this case we are concerned with the purchase consideration relating to capital asset. The toolings were in the nature of dies. The assessee was a manufacturer of heavy vehicles and jeeps. It required these dies for expansion. Therefore, the import was that of plant and machinery. The consideration paid was for such import. In the circumstances, Section 28(iv) is not attracted. Lastly, we may mention that, in this case, AMC agreed to forego the principal amount of loan as a part of take-over arrangement with KJC to which the assessee was not a party. The waiver of the principal amount was unexpected. In the circumstances, one fails to understand how such waiver would constitute business income.

(B) On Section 41(1) :

11. Alternatively, it was argued on behalf of the Department that in this case waiver constituted remission of trading liability and, therefore, Section 41(1) stood attracted. We do not find any merit in this argument. Firstly, in the present case, the prerequisite of Section 41(1) is not applicable. In order to apply Section 41(1), an assessee should have obtained 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. It is not disputed that the assessee has 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. Secondly, even assuming for the sake of argument that the assessee had 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. In order to get over this alternative argument, it was argued by the Department that the loan was used to buy toolings on which assessee got depreciation allowance of Rs. 27,29,585 and, therefore, the amount of Rs. 27,29,585 should be set off against Rs. 57,74,064. We do not find any merit in, this argument. The Department's case is that the assessee got remission of Rs. 57,74,064. Remission for depreciation is not in issue before us. The only argument of the Department throughout has been that the waiver constituted remission of Rs. 57,74,064. In the circumstances, we cannot direct set off of Rs. 27,29,585 against Rs. 57,74,064. It is important to bear in mind that before Section 41(1) came to be enacted, various judgments as reported in Mohsin Rehman Penkar v. CIT [1948] 16 ITR 183 (Bom) and Orient Corporation v. CIT [1950] 18 ITR 28 (Bom) had laid down that remission was not income and in order to get over those judgments Section 41(1) came to be enacted. In the case of CIT v. Phool Chand Jiwan Ram , the asses-see-firm had purchased goods. They had also obtained loans from a party, accounts were settled and the balance was credited ,to the partners' account. It was held by the Delhi High Court that the amount referable to loans was not a trading liability. That, only amounts allowed as deduction in earlier years could be treated as a trading liability. In other words, unless the amounts have been allowed as deduction in earlier years they cannot be treated as trading liability. In the circumstances, Section 41(1) was not applicable. This case applies to the facts of our case also. In the case of CIT v. A.V.M. Ltd. , it has been held by the Madras High Court that every deposit money does not constitute trading receipt. That, although such a receipt may be in connection with business, it could not be dealt with by the assessee as a receipt of its trade. Therefore, the amounts referable to loans received for purchase of capital assets would not constitute a trading liability and accordingly Section 41(1) was not attracted.

12. In our case, the most fundamental fact which is required to be borne in mind is that there was no deduction given to the assessee in earlier years and, therefore, Rs. 57,74,064 could not be included as income under Section 41(1) of the Act. Lastly, it is important to bear in mind that the toolings constituted capital asset and not stock-in-trade. Therefore, taking into account all the above facts, Section 41(1) of the Act is not applicable.

13. In the circumstances the above questions are all answered in the affirmative, i.e., in favour of the assessee and against the Department.

14. This disposes of Reference Application No. 1709 of 1982 filed by the Department.

Reference Application No. 1708 of 1982 filed by Department :

15. The learned advocates on both sides have informed us that the questions falling under Reference Application No. 1708 of 1982 stand covered by various judgments of our court. Accordingly, we answer the following questions.

"(i) Whether, on the facts and in the circumstances of the case, the Tribunal was justified in holding that the assessee was entitled to deduction of 100 per cent. of the initial contribution made to approved superannuation fund ?"

Answer :

16. In view of the judgment of the Supreme Court in the case of CIT v. Sirpur Paper Mills [1999] 237 ITR 41, the abovesaid question No. (i) is answered in the affirmative, i.e., in favour of the assessee and against the Department.

"(ii) Whether, on the facts and in the circumstances of the case, expenditure of Rs. 20,000 for supply of tea and soft drink constituted entertainment expenditure under Section 37(2B) of the Income-tax Act during the assessment year in question ?"

Answer :

17. Since the amount involved is only Rs. 20,000, we do not wish to answer the above said question No. (ii).

"(iii) Whether the Tribunal was right in holding that the roads constructed by the company constituted plant within the meaning of Section 43(3) of the Act and whether it was eligible for depreciation allowance ?"

Answer :

18. In view of the judgment of the Supreme Court in the case of CIT v. Gwalior Rayon Silk Mfg. Co. Ltd. [1992] 196 ITR 149, we hold that roads are buildings and not plant and, therefore, the abovesaid question No. (iii) is answered in the negative, i.e., in favour of the Department and against the assessee.

"(iv) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the donation for Rs. 92,500 to an education society was allowable as expenditure incurred for business purposes ?"

Answer :

19. The Tribunal has given a finding of fact which shows that Mahindra and Mahindra had paid Rs. 92,500 to an education society which runs the school in which children of the employees of the company study. We do not wish to interfere with this finding of fact. The Tribunal has held that the amount should be allowed as business expenditure because it was incurred predominantly for staff welfare. In the circumstances, we answer the question in the affirmative, i.e., in favour of the assessee and against the Department.

Reference Application No. 1561 of 1982 filed by the assessee :

"Whether, on the facts and in the circumstances of the case, the Tribunal was justified in law in disallowing under the provisions of Section 40A(7) of the Income-tax Act, 1961, a gratuity liability was made in the accounts ?"

20. In view of the judgment in the case of Shree Sajjan Mills Ltd. v. CIT , we answer the above question in the affirmative, i.e., in favour of the Revenue and against the assessee.

21. Accordingly, the reference is disposed of. No order as to costs.