IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No.235 of 1995

For Approval and Signature:

HONOURABLE MR.JUSTICE D.A.MEHTA Sd/-

HONOURABLE MR.JUSTICE Z.K.SAIYED Sd/-

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1	Whether Reporters of Local Papers may be allowed to see the judgment ?	**YES**
2	To be referred to the Reporter or not ?	**YES**
3	Whether their Lordships wish to see the fair copy of the judgment ?	**NO**
4	Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?	**NO**
5	Whether it is to be circulated to the civil judge ?	**NO**

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ELSCOPE PVT LTD - Applicant(s)
Versus
COMMISSIONER OF INCOME TAX - Respondent(s)

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Appearance :
MR RK PATEL for Applicant(s) : 1,
MR MANISH R BHATT for Respondent(s) : 1,

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CORAM : HONOURABLE MR.JUSTICE D.A.MEHTA
and
HONOURABLE MR.JUSTICE Z.K.SAIYED

Date : 23/01/2008
ORAL JUDGMENT
(Per : HONOURABLE MR.JUSTICE D.A.MEHTA)

(1) This reference in fact encompasses two cross references : one by the assessee (R.A. No.381/AHD/1993), and another by the Revenue (R.A. No.413 and 414/AHD/1993).

(2) The question, at the instance of the assessee, has been referred by Income Tax Appellate Tribunal, Ahmedabad Bench 'B' under Section 256(1) of the Income-tax Act, 1961 (the Act):

> "Whether, on the facts and in the circumstances of the case, the Tribunal was justified in confirming the disallowance of guarantee commission of Rs.3,16,668/-?"

The said reference is for Assessment Year 1978-79, the relevant accounting period being year ended on 30.06.1977.

(3) In Revenue's reference the Tribunal has referred the following two questions, which are identical in nature, except for the amounts involved for the two assessment years, namely, A.Y. 1978-79 and 1979-80:

"For asstt. Year 1978-79:

"Whether, the Appellate Tribunal is right in law and on facts in deleting the addition of Rs.32,50,557/- assessed by the ITO as the assessee's income observing that the assessee had acquired going concern and had transferred the same within a period of 4 months and the profit arising on the reduction of liabilities was thus trading profit which is liable to be taxed as business income?

"For asstt. Year 1979-80:

"Whether, the Appellate Tribunal is right in law and on facts in deleting the addition of Rs.24,59,188/- assessed by the ITO as the assessee's income observing that the assessee had acquired going concern and had transferred the same within a period of 4 months and the profit arising on the reduction of liabilities was thus trading profit which is liable to be taxed as business income?

(4) Heard Mr.B.D.Karia, learned advocate for the assessee and Mr.M.R.Bhatt, learned Senior Standing Counsel for the Revenue.

(5) In relation to the question referred at the

instance of the assessee it is an accepted position between the parties that the same is concluded by decision of the Apex Court in the case of Additional Commissioner of Income-tax Vs. Akkamamba Textiles Ltd., [1997] 227 ITR 464 (S.C.). In the circumstances, it is not necessary to set out the facts and contentions in detail. In light of the ratio laid down by the Apex Court decision in the aforesaid case, the question referred at the instance of the assessee is answered in the negative i.e. in favour of the assessee and against the Revenue. The Tribunal was not justified in confirming the disallowance of guarantee commission of Rs.3,16,668/-.

(6) The facts in relation to the two questions referred at the instance of the Revenue have been briefly stated as under in the statement of case:

> “7.1 The assessee had acquired four Divisions during the year as going concerns

alongwith their assets and liabilities which included amounts payable to four investment companies in five annual equal instalments in respect of purchases of the industrial units acquired by Sarabhai Chemicals Pvt. Ltd. from Karamchand Premchand Pvt. Ltd. (KPPL). The amount due to these investment companies, by mutual agreement, commuted at a discounting rate of 12% and the difference of Rs.32,50,557/- was credited to the capital reserve of the assessee company. As a result of commutation the amounts payable to these four investment companies in five equal instalments because payable on demand with interest. In reply to show cause notice the assessee explained vide letter (page 379) of the paper book) that the amount was not of the character of income or deemed income and that it had nothing to do with the trading activities of the assessee. It was submitted that the amount represented capital receipt and was not liable to tax. The ITO rejected the submissions of the assessee and observed that the assessee had acquired going concerns and had transferred the same within a period of four months with effect from 1-7-77 and the profit arising on the reduction of liabilities was thus trading profit which was liable to be tax as business income of the assessee. He, therefore, assessed the amount of Rs.32,50,557/- as assessee's income. In the

alternative, he held that the said amount was liable to tax as capital gain arising to the assessee on short term basis.

7.2 The details of commutation charges were as under:-

Name of the Investment Company	Liability as on 30th June 1977 Rs.	Commutation charges at the discounting rate of 12% Rs.	Amount payable in lumpsum on demand
Kailash Inv. Pvt. Ltd.	64,42,365-00	12,01,782-47	50,40,592-53
Dhaulagiri Inv Pvt. Ltd.	12,15,000-00	2,33,924-17	9,81,075-83
Malbar Inv. P. Ltd.	31,21,875-00	6,01,055-11	25,20,819-89
Nilgiri Inv.	62,92,365-00	12,12,815-69	50,78,549-31
	1,68,71,605-00	32,50,577-44	1,36,21,027-56

The CIT (A) held that the amount in question was not charageable to tax u/s 41(1) as it did not represent a remission of a trading liability within the meaning of section 41(1) of the Act particularly when no allowance or deduction had been made in the assessment of the assessee for any of the earlier years in respect of any loss, expenditure or the said liability and hence the pre-requisites for invoking section 41(1) were absent. He further held that the amount was not liable to tax as short term capital gain because the conditions u/s. 45 were not satisfied inasmuch as the said liability was not capital asset and further

at the time of commutation. The CIT (A), however, held that the transaction of purchase of industrial undertakings by assessee and sale thereof within period of four months amounted to adventure in the nature of trade and hence the amount of Rs.32,50,557/- represented revenue income u/s. 28 of the Act. He upheld the addition on this ground.

7.3 The Tribunal recorded the submissions of the parties in paras 23 and 24 of the order and for reasons recorded in paras 25 to 31 held that the commutation charges did not represent business income assessable u/s. 28 of the Act. The Tribunal accordingly deleted the addition made by the ITO.

7.4 As far as AY 1979-80 was concerned, the Tribunal observed that the facts had been stated in the order of the ITO and the CIT (A) and that the parties had admitted that the point in controversy was identical to that in the appeal for AY 1978-79 and that the decision on that point in said appeal would govern the decision in the appeal for A.Y. 1979-80. For reasons given while dealing with the appeal for AY 1978-79 the Tribunal held that commutation charges did not represent income of the assessee and accordingly deleted the addition of said

amount."

(7) Mr.M.R.Bhatt, learned Senior Standing Counsel, assailed the impugned order of Tribunal dated 16.04.1993 by submitting that the Tribunal had failed to appreciate that the transaction in question was falling within provisions of Section 28(i) as well as Section 28(iv) of the Act and hence, even if the Tribunal had come to the conclusion that there are no profits and gains in the business which was carried on by the assessee at any time during the previous year, at least the surplus in question was to be treated as the benefit arising from business. That the question raised by the Tribunal was wide enough to take within its sweep both Section 28(i) and Section 28(iv) of the Act and the Revenue should not be precluded from raising the said contention. It was submitted that for constituting business even one solitary transaction was sufficient, however, in the present case when both the years were taken

into consideration together there were series of transactions involving a systematic activity constituting business. It was further contended that the Tribunal had also failed to take into consideration that the Memorandum and Articles of Association of the assessee-Company permitted purchase and sale of industrial units and, therefore also, the Revenue had rightly treated the transaction in question as business. In support of the submissions made Mr. Bhatt placed reliance on the following two decisions:

(i) *Commissioner of Income-Tax, Nagpur Vs. Sutlej Cotton Mills Supply Agency Ltd.*, [1975] 100 ITR 706 (S.C.); AND

(ii) *Protos Engineer Co. P. Ltd. Vs. Commissioner of Income-Tax*, [1995] 211 ITR 919.

(8) As against that resisting the submissions made on behalf of the Revenue, Mr.Karia, learned advocate, pointed out that the findings recorded by the Tribunal were primarily based on facts of the case and in fact there was no

question of law as such. That in any view of the matter, even if the findings of the Tribunal gave rise to mixed question of law and facts, the findings recorded by the Tribunal were in consonance with the legal position and no interference was warranted. Lastly, it was submitted that the assessee-Company was required to make payment to four investment companies towards acquisition of four divisions and in case of one of the recipient companies i.e. Kailash Investment Pvt. Ltd. this Court had already come to the conclusion that the amount in question was not emanating from any business transaction and was neither relatable to any income from other sources, nor was the amount a capital loss and, therefore, in relation to the same transaction, different treatment in hands of the assessee, who is the payer company, was not warranted. In this connection attention was invited to the judgment in case of Kailash Investment P. Ltd. Vs. Commissioner of Income-

tax, [2006] 281 ITR 92 (Guj.). Mr.Karia also placed reliance on the following three decisions:

(i) *Commissioner of Income-tax, Bombay City-I Vs. Messrs. Shoorji Vallabhdas and Co.*, [1962] 46 ITR 144 (S.C.);

(ii) *Godhra Electricity Co. Ltd. Vs. Commissioner of Income-tax*, [1997] 225 ITR 746 (S.C.); AND

(iii) *Commissioner of Income-tax Vs. Industrial Credit and Development Syndicate Ltd.*, [2006] 285 ITR 310 (Karn.).

(9) The facts are not in dispute as recorded by the Tribunal. The assessee acquired four divisions during the relevant assessment year i.e. A.Y. 1978-79 as going concerns alongwith all assets and liabilities, which included the amount payable to four investment companies in five annual equal instalments. The aforesaid agreement had been entered into between Sarabhai Chemicals Pvt. Ltd. and Karamchand Premchand Pvt. Ltd., the original vendee and

the vendor respectively. The assessee-company re-worked the terms of the agreement by mutual consent, and commuted the liabilities by applying discounting rate of 12% on the outstanding amount and credited the difference to the capital reserve of the assessee-Company. As a result of the modification of the agreement the amount which was payable in five equal instalments to the four investment companies became payable on demand with interest at the stipulated rate.

(10) In hands of Kailash Investment Pvt. Ltd., one of the investment companies, who was to receive the sale consideration from the assessee, the amount in question was claimed as business loss for the very same assessment year i.e. A.Y. 1978-79. Alternatively, the commutation charges of Rs.12,01,782/- were claimed as a deduction under Section 57(iii) of the Act. The second alternative claim was that the amount represented capital loss under Section 45 of the Act. This Court in the

reported decision in case of Kailash Investments Pvt. Ltd. (supra) has recorded the facts as under:

> "The assessment year is 1978-79 and the relevant accounting period is the year ended on 30th September 1977. The assessee company, a wholly owned subsidiary company of Karamchand Premchand Pvt. Ltd. (KPPL) had issued share capital divided into 1,11,000 shares of face value of Rs.100 per share. KPPL was holding 1,10,998 equity shares, while remaining 2 shares were held by nominees of KPPL. It appears that first and final call of Rs.90 per share was due from KPPL on 27/7/1973. The Board of Directors of the assessee company, therefore, resolved to call upon KPPL to make payment of Rs.90 per share towards first and final call on or before 11/8/1973.
>
> KPPL, in its turn, having sold some of its industrial undertakings to another wholly owned subsidiary company, Sarabhai Chemicals Pvt. Ltd. (SCPL), was entitled to recover a sum of more than Rs.3.95 crores from SCPL over a period of eight years from 1/7/1974 onwards, the last installment being receivable on 1/7/1981. KPPL,

therefore, after obtaining consent of SCPL, proposed to the assessee company to transfer and assign a sum of Rs.99,89,820/- from the aforesaid receivable amount from SCPL to the assessee company. The Board of Directors of the assessee company met on 10/8/1973 and passed a resolution accepting the said proposal. This resulted in a tripartite agreement between the assessee company, KPPL and SCPL. According to the terms of agreement, the assessee company was to receive the total amount of Rs.99,89,820/- towards first and final call due from KPPL from SCPL in eight equal annual installments, each installment being of Rs.12,48,727=50. Accordingly, the deed of assignment was signed by the three parties on 22nd September 1973. It is an admitted fact that the assessee company received first three installments and as on 30th September 1976, a sum of Rs.62,42,365/- was outstanding.

In the meantime, ownership of SCPL changed hands and SCPL became division of M/s Elscope Pvt. Ltd. On 28/6/1977, the assessee wrote to SCPL proposing to convert the outstanding receivable in annual installments into an amount receivable on demand and for this purpose, a discount of 12% was offered. On SCPL agreeing to the proposal, the due

amount was reduced to Rs.50,40,483/-, and the same was placed in a current account with SCPL. The sum of Rs.50,40,483/- was to carry interest at a rate which was equivalent to the rate of interest chargeable by bankers on working capital to SCPL from time to time. The assessee became entitled to interest from the date of such conversion on the balance outstanding. Accordingly, as on 30th June 1977, an amount of Rs.12,01,782/- was commuted being the discount and the assessee claimed the said amount as a deductible expenditure of the year under consideration."

Thereafter, the following finding was recorded:

"The facts as recorded hereinbefore make it amply clear that the assessee company was to receive call money towards shares issued to KPPL. KPPL got substituted by SCPL and the period over which the call money liability was to be discharged got extended over a period of eight years. Thereafter, three annual installments were received and then the terms of payment underwent change once again, whereunder the assessee company agreed to forgo the sum of Rs.12,01,782/-. However, the basic fact that the moneys

were receivable against shares issued to KPPL remained as it is without any change or modification. The only change that kept on taking place from time to time was in relation to the terms of payment, including the payer and the period, but the nature of payment remained the same, namely, call moneys payable towards shares issued by the assessee company. Once this position is clear, it is apparent that the amount that assessee company was to receive is towards share capital and would be its liability."

(11) In light of the aforesaid position of law as enunciated by this Court, the findings recorded by the Tribunal are required to be appreciated. The Tribunal has found that the difference between the total amount payable in five annual equal installments and the total amount payable on demand represented reduction in the capital liability. The reduced amount represented present value of the original liabilities which were payable in instalments in future, at the discounting rate of 12%. The Tribunal thereafter records that such commutation of liabilities which were to be

discharged at a future point of time did not have characteristic of income but was merely an unpaid purchase price, which was never claimed as an allowance or deduction in the assessment of the assessee for any of the prior years. The Tribunal, therefore, states that in no circumstances such commutation charges can be treated as deemed income. It has further been found by the Tribunal that the business of the assessee was not of acquiring trading concerns or industrial units as stock-in-trading and selling the same. In support of this finding the Tribunal notes that factually the assessee carried on manufacturing activities and ran the industrial units from the date of purchase till the point of time of sale. The undertakings in question had, therefore, been acquired for carrying on business and hence, were capital assets of the assessee and not trading assets. The contention regarding the transaction being an adventure in nature of

trade has been repelled by the Tribunal by noting that the industrial unit had not been acquired from any third party, but had been acquired and disposed of in the course of a scheme of re-organization of the business units of Sarabhai group. In relation to the reliance of revenue on the clause in the Memorandum and Articles of Association the Tribunal says that mere empowerment to acquire industrial undertakings by itself cannot mean that the assessee carried on business of acquisition of industrial undertakings. The Tribunal has also noted that in hands of the predecessor company, namely, Sarabhai Chemicals Pvt. Ltd., the liability in question had been treated as capital liability as accepted by the Commissioner (Appeals) and, therefore, the said liability would not be of the nature of business income in hands of the assessee when the liability was in relation to the same transaction of purchase and sale. The Tribunal has also not accepted the stand of

the Revenue that the transaction was between the assessee and its subsidiary, namely, the assessee purchased the industrial unit from Sarabhai Chemicals Pvt. Ltd., of which the assessee was wholly owned subsidiary and the unit had been transferred to Ambalal Sarabhai Enterprise Pvt. Ltd., which was another subsidiary of Sarabhai Chemicals Pvt. Ltd., because the properties were transferred under an agreement of purchase which was legally permissible and the circumstances of the transaction being between different subsidiaries was of no relevance. The Tribunal has also noted that though the Commissioner (Appeals) was of the opinion that the transactions constituted a scheme of tax planning once the Revenue had treated the transactions as real transactions, legal consequence of such transactions had to be given effect to. In Paragraph No.29 of the order of the Tribunal the documentary evidence on which reliance has been placed has also

been noted and appreciated by the Tribunal. It is on a cumulative effect of the aforesaid findings of the Tribunal that the Tribunal has come to the conclusion that the reduction in liability by way of commutation did not result in any profit under Section 28 of the Act.

(12) In light of the aforesaid findings of fact recorded by the Tribunal, after appreciation of evidence on record, and considering the law laid down by this Court in the case of Kailash Investment Pvt. Ltd., it is not possible to find any infirmity in the order of the Tribunal so as to warrant any different view of the matter. If, as held by this Court, in case of Kailash Investment Pvt. Ltd. (supra) a debt due to Kailash Investment Pvt. Ltd. on capital account (towards call monies due from a shareholder) could not be regarded as either business loss admissible under Section 28 of the Act, or a deduction admissible under Section 57(iii) of the Act, or a business expenditure deductible under Section 37 of the

Act, the very same amount which constitutes the outstanding liability in hands of the present assessee cannot assume characteristic of income under Section 28 of the Act merely because there is reduction of liability.

(13) The contention based on provisions of Section 28 (iv) of the Act does not merit acceptance – Firstly, because the same was never the case of the Revenue at any stage up to the Tribunal and hence, the said issue does not arise out of the order of the Tribunal in light of the question raised and referred for the opinion of this Court. Secondly however, even if the said contention is examined independently, it becomes apparent that in the first instance there has to be a business and only then the question of any benefit or perquisite arising from such business is required to be considered. At the cost repetition it is required to be noted that consistently the transaction in question has been treated in hands of the recipient company as a receivable

in the form of call monies payable towards shares issued and, therefore, can never constitute a business. The stand of the Revenue that there was business or an adventure in nature of trading towards purchase and sale of industrial undertakings looses sight of this basic issue, namely, that the transaction in question had its genesis in shares issued and outstanding call monies payable for shares issued. Hence, in any view of the matter, even provisions of Section 28(iv) of the Act cannot be pressed into service by the Revenue in the present case.

(14) In the case of Commissioner of Income-Tax Vs. Bhavnagar Bone and Fertiliser Co. Ltd., (1987) 166 ITR 316 (Guj.) the facts were:

> "... One Jodhpur Bone and Fertiliser Company, a partnership firm (hereinafter referred to as the "firm") carried on business at Jodhpur. The partners of the firm are directors of the assessee-company which is a private limited company. The firm was having a current account with the assessee-company. The firm sold its entire plant, machinery, furniture, etc., to M/s. P. Lenier

& Sons Ltd., London, on March 20, 1950. As a result of the sale, the firm had to wind up its business activities and the only activity which it carried on thereafter was realisation of debts and payments of various expenses. On March 31, 1957, there was a credit balance of Rs.3,82,905 in the firm's account in the books of the assessee-company. Initially, it was decided to issue shares of the assessee-company to the partners of the firm in lieu of the said credit balance as per the resolution of the board of directors of the assessee-company passed on April 21, 1954. However, the shares were not issued and on June 22, 1970, the board of directors of the assessee-company resolved that the aforesaid credit balance be transferred to the Profit & Loss Appropriation Account. Later on, on the advice of the auditors of the assessee-company, by another resolution, the board of directors of the assessee-company resolved that the aforesaid credit balance which was transferred to the Profit & Loss Appropriation Account be transferred to Capital Reserve Account. The question which arose before the Income-tax Officer in the course of assessment proceedings for the assessment year 1971-72, the year under consideration, was whether the amount of Rs.3,82,905 which was transferred to Capital Reserve Account was a revenue receipt in the hands of the assessee-company. The contention of the assessee-company was that the amount

presented the outstanding credit balance in the current account of the firm and was not a revenue receipt. The Income-tax Officer, however, rejected the assessee's contention and held that the amount was income of the assessee-company under section 28(iv) of the Act. ...”

“The Tribunal, dealing with the above controversy, observed : “monetary benefits not partaking of the character of income under fundamental concept of income have been now made taxable by the extended definition of income under section 2(24)(va) as a corollary by treating the said income taxable under the head 'Profits and gains of business or profession', the essential pre-requisite of taxability of such benefit or perquisite is that it must arise from the business of the assessee”. In other words, observed the Tribunal, there must be a nexus between the business of the assessee and the benefit which the assessee has derived. ...”

The High Court upheld the findings of the Tribunal by stating:

“We do not find any infirmity in the reasoning of the Tribunal. The amount of Rs.3,82,905 which stood to the credit of the firm in the books of account of the assessee-company was first transferred to the Profit & Loss Appropriation Account of

> the assessee-company and, later on, it was transferred to Capital Reserve Account of the company. The amount of Rs.3,82,905 was not received by the assessee-company as a result of any business transaction or transaction with the firm. As rightly observed by the Tribunal, this amount had no connection or nexus with the business of the assessee-company. It did not represent the value of any benefit or perquisite arising from the business of the assessee-company. This amount, therefore, would not partake of the character of income. We broadly agree with the reasoning and conclusion reached by the Tribunal and confirm its view that the amount of Rs.3,82,905 was not includible in the total income of the assessee-company under section 28(iv) of the Act. ...”

(15) Hence, for invoking Section 28(iv) of the Act the prerequisite conditions are: (**a**) the benefit/perquisite must arise from the business of an assessee; (**b**) there must be a nexus or connection between the business of an assessee and the benefit/perquisite sought to be taxed. In the present case both the conditions are absent.

(16) In the aforesaid facts and circumstances of the case the Tribunal was justified in holding that the profits arising on reduction of liabilities was not trading profits liable to be taxed as business income. The question referred for each of the assessment years, at the instance of the Revenue, is answered in the affirmative, i.e. in favour of the assessee and against the Revenue.

(17) The reference stands disposed of accordingly with no order as to costs.

Sd/-
[D.A. MEHTA, J]

Sd/-
[Z.K. SAIYED, J]

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Bhavesh*