IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

R/TAX APPEAL NO. 726 of 2019

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THE PRINCIPAL COMMISSIONER OF INCOME TAX 2

Versus

M/S GUJARAT STATE FINANCIAL CORPORATION

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Appearance:
MRS MAUNA M BHATT(174) for the Appellant(s) No. 1
for the Opponent(s) No. 1

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CORAM: **HONOURABLE MR.JUSTICE J.B.PARDIWALA**
and
HONOURABLE MR. JUSTICE BHARGAV D. KARIA

Date : 13/01/2020

ORAL ORDER
(PER : HONOURABLE MR. JUSTICE BHARGAV D. KARIA)

1. This Tax Appeal is filed under Section 260A of the Income Act, 1961 (for short the "Act-1961") at the instance of Revenue and is directed against the order dated 04.04.2019 passed by the Income Tax Appellate Tribunal, Ahmedabad Bench 'A', Ahmedabad (for short "the Tribunal")in the ITA No.1547/Ahd/2014 for the A.Y. 2009-10.

2. The Revenue has proposed following question of law as substantial question of law for consideration in its Memorandum of Appeal.

> *"2. Whether the Appellate Tribunal has erred in law and on facts by deleting the addition made by the Assessing Officer and confirmed by the CIT(A) by considering the amount of Rs.8,07,35,116/- as capital receipt without properly appreciating the facts of the case and*

the material available on record?"

3. The facts giving rise to this appeal are as under:-

3.1 The respondent-assessee filed its return of income declaring loss of Rs.(-)152,85,63,518/- for A.Y.2009-10. The Assessment Officer passed assessment order under Section 143(3) of the Act determining assessed loss at Rs.(-)91,13,70,035/-.

3.2 The Assessing officer made an addition of Rs.8,07,35,116/- amongst others, on account of cessation of liability made U/s. 41(1) of the Act, which was part of the total amount of Rs.182,87,27,185/- written off pursuant to one time settlement by the assessee with IDBI Ltd. and consortium of other banks. On verification of the details, it was found that an amount of Rs.8,07,35,116/- pertaining to PSB account of Indian Overseas Bank was credited to capital reserve and was not offered to tax on the ground that such waiver was towards outstanding principal loan amount and therefore, it was capital receipt. According to assessing officer ,the said amount could not have been credited to the capital reserve of the company and therefore, it was liable to be added to income under section 41(1) of the Act,1961.

3.3 The assessee being dissatisfied, preferred an appeal before the CIT (Appeals) challenging the said disallowance under section 41(1) of the Act,1961 .

The CIT (Appeals) relying upon the decision of the Supreme Court in the case of **T.V.SUNDARAM Iyengar and Sons Ltd. [222 ITR 344]** and the decision of the Bombay High Court in the case of **Solid Container Limited [308 ITR 417]** confirmed the addition made by the Assessing Officer pertaining to waiver of loan of Rs.8,07,35,116/-.

3.4 The assessee, therefore, preferred an appeal before the Tribunal. The Tribunal, relying upon the decision of the Madaras High Court in case of **Iskraemeco Regent Ltd. vs. CIT [(2011) 331 ITR 0317]** and the decision of the Bombay High Court in the case of **Mahindra and Mahindra Ltd. vs. CIT [(2003) 182 CTR Born 34**, allowed the appeal filed by the assessee.

4. Mrs. Mauna Bhatt, learned Standing Counsel for the appellant contended that the Tribunal ought to have taken into consideration the interest component embedded in the aforesaid sum which was written off by the concerned bank and accordingly, Section 41(1) of the Act would be applicable.

5. Learned Standing Counsel for the appellant relied upon the findings of the CIT(A), which reads as under:-

> *"4.3 I have carefully considered the facts of the case, the assessment order and the written submission of the appellant. During the year, the appellant got a waiver of principal amount of loan amounting to Rs.7,87,35,116/- by IDBI under one time settlement scheme. Another waiver of Rs.20 lakh was also obtained by the appellant towards settlement of dues by not paying to the investors of "Priority Sector Bonds" issued by the appellant*

to Indian Overseas Bank. The AO considered the waiver as revenue in nature. He held that the assessee had treated this amount as trading liability and accordingly, added the same by applying the provisions of Section 41(1). It was held by the AO that since the banks/financial institutions have written off the amount in the books of accounts and claimed the same as bed debt in their final accounts the amount should be treated as income of the appellant.

The appellant on the other hand has submitted a detailed written argument against the addition made by the AO. It has been claimed that since it was not a trading liability for which an allowance or deduction was made in the assessment year or earlier year no addition can be made under Section 41(1) for the same. Company's liability on account of principal amount of loan borrowed by it was not a trading liability for which the some deduction was claimed in earlier year and therefore its remission could not be deemed as income under the above provision. It has further been claimed by the appellant that even the interest which was claimed as deduction in the statement of total income in earlier years was offered for taxation under Section 43B of the Act. Since the amount of interest was disallowed the remission of interest also cannot be treated as income as it was never claimed as one.

To examine whether the loan waiver can be treated as income by applying the provisions of Section 41(1) of the Act, it would be useful to examine the provisions of the Section:-

"4.1 (1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (herein after referred to as the first mentioned person) and subsequently during any previous year.

(a) the first-mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed

to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or

(b) the successor in business has obtained, whether in case or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.

Explanation 1. - For the purposes of this sub-section, the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof shall include the remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) or the successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts.

Explanation 2.- For the purposes of this sub-section, "successor in business" means,

(i) Where there has been an amalgamation of a company with another company, the amalgamated company;

(ii) where the first mentioned person is succeeded by any other person in that business or profession the other person;

(iii) Where a firm carrying on a business or profession is succeeded by another firm, the other fir;"

According to the above provisions is the starting point for the section would be that the allowance of deduction should have been made in the assessment for any year in respect of loss,

expenditure or trading liability incurred by the assesses and thereafter, "of subsequently, during any year it obtains whether in cash or any other manner any amount in respect of such loss of expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof; then the amount would be treated or deemed to be profits and gains of the business or profession. In the present case any deduction has not been claimed on account of the principal amount of loan as well as the interest on such loan in earlier year. Therefore, after considering all the facts and the legal position I'm inclined to agree with the submission of the appellant's in so far as the claim of the appellant that the addition cannot be made under Section 41(1) as there is no remission or cessation of liability for which an allowance of deduction had been made in the assessment for earlier years. The claim of the appellant appears to be factually correct and therefore, the action of the AO in treating it as ceased liability under section 41(1) was unjustified. The same can therefore be not upheld.

However, it is noted that the loan taken by the appellant has been waived by the creditor and some benefit has accrued to the appellant. In order to determine what is the character of waiver of the loan in the hands of the appellant further examination is required. In the income tax act all receipts of revenue nature, unless specifically exempted are chargeable to tax. Loan taken is normally not a kind of receipt which will be treated as income. In this context it would be useful to reproduce the provisions in the act which governs the definition of income. The section 2(24) and 28(iv) defined the following

"2(24) "Income" includes -
Profits and gains;

(vd) the value of any benefit or prerequisite taxable under clause (iv) of section 28;

28 (iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession."

Therefore, the benefit received by the appellant

by waiver of loan shall be the income of the appellant if it is covered in the above provisions. For this purpose, it would be relevant to examine the facts of the case once again.

It is in undisputed fact that the appellant is a state-level development financial institution which is providing comprehensive array of financial services to entrepreneurs who set up industrial units in small scale sectors of the State of Gujarat. The appellant is providing loan and finance for various industrial sectors and is accordingly charging interest on the loan, which is its principal source of income. The capital of the company as well as the loans taken by it from from various financial institutions such as banks etc are used by it in advancing the loans to its customer. The appellant is paying interest on the loans taken by it which is claimed by it as expenditure in the profit and loss account. Therefore, the company is borrowing money on interest and advancing money on interest in the regular course of its business.

It is seen from the above discussion that the purpose for which the loan was taken was to finance the day-to-day business of the appellant assesses which was advancing money on interest. The borrowing of money was integral part of the commercial transactions of the company.

The law in this respect has been laid down down by Hon'ble Supreme Court in the case of T.V.Sundaram Iyengar & Sons. 136 ITR 444. In the said case, the assessee in the course of trading transactions had collected deposits from customers. Since the customers did not claim the amounts standing to their credit, the assessee had transferred the unclaimed deposits to the profit and loss account. The view of the Assessing Officer was that since the unclaimed deposits had arisen as a result of trading transactions, therefore, the same represented income of the assessee. The deposits were of capital in nature at the point of time of receipts of the assessee could there character change by afflux of time. The Supreme Court answered this question in the affirmative holding that under certain circumstances, the deposits even if were shown as capital receipts, had attained the character of trading receipts. The

Supreme Court relying upon its judgment in the case of Punjab Distilling Industries Ltd. Vs. CIT [1959] 35 ITR 519 did not approve the finding of the Tribunal that nature of the deposits received from the customers was capital.

The ratio of the decision of T.V.Sundaram Iyengar & Sons Ltd's case (supra) is that the proposition that the quality and nature of a receipt for income tax purposes is fixed once and for all, when the receipt is received and that subsequent operation can change its nature, is not absolute and that in given cases by reason of subsequent events, the amounts which initially were not received as trading receipts may be regarded as business income.

It is therefore clear from the above observations and findings given by the Hon'ble Supreme Court that the purpose for which the loan has been taken would be a determinative factor in deciding whether it would be a capital receipt or business receipt. If the loan was taken for acquiring the capital asset, waiver thereof would not amount to any income exigible to tax. In the other hand, if this loan was for trading purpose and was treated as such from the very beginning in the books of account the waiver thereof may result in the income. Accordingly applying these principles on the facts of present case which show that the appellant has borrowed money from the financial institutions for giving the same on interest to others during the course of its business, the benefit obtained by the appellant by way of waiver of loan should be taxable in the hands of the appellant under the provisions of section 2 (24) (vd) read with Section 28(iv) of the Act. It is held accordingly. Reliance is also placed on the judgment of Hon'ble High Court of Delhi in the case of Logitronics Private Limited 197 Taxman 394 and Bombay High Court's decision in the case of Solid Containers Limited 308 ITR 417.

The appellant has also placed reliance on certain judgments which are mentioned in the written submission reproduced above. I have carefully perused the judgment mentioned. It is noted that none of the judgment is applicable in the case as the judgment of the Hon'ble Supreme Court of India in the case of T.V.Sundaram Iyengar and Sons Ltd.

222 ITR 344 is directly on the issue. In the cases that have been relied by the appellant the facts were different and the waiver of the loan was related to capital asset which is clearly borne out by the reading of those judgments. The judgments relied by the appellant are therefore, respectfully distinguished.

The ground of appeal is accordingly dismissed."

6. It was, therefore, submitted that in view of the decision of the Supreme Court in the case of **T.V.Sundaram Iyengar and Sons Ltd [222 ITR 344]**, the CIT(A) has rightly dismissed the appeal of the respondent-assessee confirming the addition made by the Assessing Officer.

7. The Tribunal, however, relying upon the decision of the Supreme Court in the case of Mahindra and Mahindra Ltd (Supra), allowed the appeal of the respondent-assessee by observing as under:-

"2.5 Heard the respective parties, perused the relevant materials available on record. We have also considered the judgment passed by the Hon'ble Madras High Court in the matter of Iskraemeco Regent Ltd. (supra) wherein it was held by the Hon'ble Court that waiver of loan even though a receipt may be in connection with the business, every such receipt is not a trading receipt. Amount referable to the loan obtained by the assessee towards the purchase of capital asset did not constitute a trading receipt. Further, Section 28 (iv) speaks of benefit or perquisite received in Kind. The same has no application to any transaction which involved money. It was further observed that loan received for the purpose acquiring capital assets did not constitute a trading liability and hence, Section 41(-1) also has no application.

2.6 We have also considered the judgment passed in the matter of Mahindra and Mahindra Ltd. Vs. CIT reported in [2003] 182 CTR Born 34.

2.7 If the ratio of the judgment is applied to the instant case then we can safely conclude that the waiver of principal amount of loan by IDBI to the tune of Rs.8,07,35,116/- under one time settlement scheme through written off by the concerned bank does not constitute trading receipt, which was never claimed by the assessee as deduction does not give rise to profits chargeable to tax u/s. 41(1) of the Act and thus cannot be added at all to the income of the assessee. Addition of Rs.8,07,35,116/- is thus hereby deleted. Thus, this ground of appeal is allowed. ”

8. We are in agreement with the findings og the Tribunal that waiver of principle amount of loan by IDBI amounting to Rs.8,07,35,116/- under One Time Settlement Scheme does not constitute trading receipt, as such amount was never claimed by the assessee as deduction in past. Therefore, even though such amount is written off by the concerned bank, it does not give rise to the profit chargeable to tax under Section 41(1) of the Act.

9. In case of Mahindra and Mahindra Ltd (supra), in such a situation, after analyzing the provisions of Section 41(1) of the Act read with 28(iv) of the Act, it is held as under:-

“Discussion:-

10) The term “loan” generally refers to borrowing something, especially a sum of cash that is to be paid back along with the interest decided mutually by the parties. In other terms, the 9 debtor is under a liability to pay back the principal amount along with the agreed rate of interest within a stipulated time.

11) It is a well-settled principle that creditor or

his successor may exercise their "Right of Waiver" unilaterally to absolve the debtor from his liability to repay. After such exercise, the debtor is deemed to be absolved from the liability of repayment of loan subject to the conditions of waiver. The waiver may be a partly waiver i.e., waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the creditor results in the debtor having extra cash in his hand. It is receipt in the hands of the debtor/assessee. The short but cogent issue in the instant case arises whether waiver of loan by the creditor is taxable as a perquisite under Section 28 (iv) of the IT Act or taxable as a remission of liability under Section 41 (1) of the IT Act.

12) The first issue is the applicability of Section 28 (iv) of the IT Act in the present case. Before moving further, we deem it apposite to reproduce the relevant provision herein below:-

"28. Profits and gains of business or profession.— The following income shall be chargeable to income-tax under the head "Profits and gains of business profession",-- xxx

(iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;

x x x"

13) On a plain reading of Section 28 (iv) of the IT Act, prima facie, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28 (iv) of the IT Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of Rs. 57,74,064/- is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28 (iv) of the IT Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, in our view, in no circumstances, it can be said that the amount of Rs 57,74,064/- can be taxed under the provisions of Section 28 (iv) of the IT Act.

14) Another important issue which arises is the applicability of the Section 41 (1) of the IT Act. The said provision is re-produced as under:

> "41. Profits chargeable to tax.- (1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year,-
>
> (a) the first-mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or x x x"

15) On a perusal of the said provision, it is evident that it is a sine qua non that there should be an allowance or deduction claimed by the assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41 of the IT Act. The objective behind this Section is simple. It is made to ensure 12 that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability. It is undisputed fact that the Respondent had been paying interest at 6 % per annum to the KJC as per the contract but the assessee never claimed deduction for payment of interest under Section 36 (1) (iii) of the IT Act. In the case at hand, learned CIT (A) relied upon Section 41 (1) of the IT Act and held that the

Respondent had received amortization benefit. Amortization is an accounting term that refers to the process of allocating the cost of an asset over a period of time, hence, it is nothing else than depreciation. Depreciation is a reduction in the value of an asset over time, in particular, to wear and tear. Therefore, the deduction claimed by the Respondent in previous assessment years was due to the depreciation of the machine and not on the interest paid by it.

16) Moreover, the purchase effected from the Kaiser Jeep Corporation is in respect of plant, machinery and tooling 13 equipments which are capital assets of the Respondent. It is important to note that the said purchase amount had not been debited to the trading account or to the profit or loss account in any of the assessment years. Here, we deem it proper to mention that there is difference between 'trading liability' and 'other liability'. Section 41 (1) of the IT Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Hence, we find no force in the argument of the Revenue that the case of the Respondent would fall under Section 41 (1) of the IT Act.

17) To sum up, we are not inclined to interfere with the judgment and order passed by the High court in view of the following reasons:

(a) Section 28(iv) of the IT Act does not apply on the present case since the receipts of Rs 57,74,064/- are in the nature of cash or money.

(b) Section 41(1) of the IT Act does not apply since waiver of loan does not amount to cessation of trading liability. It 14 is a matter of record that the Respondent has not claimed any deduction under Section 36 (1) (iii) of the IT Act qua the payment of interest in any previous year. "

10. In view of the above position of law and the facts emerging from the record, the CIT(A) has agreed to the submissions of the respondent-assessee that addition cannot be made under Section 41(1) of the

Act. However, CIT(A) has considered that the respondent was paying interest on the loan taken by it which was claimed by it as expenditure in profit and loss account, and therefore, it was borrowing with interest which was waived. Therefore, the CIT(A) has applied the ratio of T.V.Sundaram Iyengar and Sons Ltd (supra) to hold that the quality and nature of receipt for income-tax purposes is fixed once and for all, when the receipt is received and that subsequent operation can change its nature, is not absolute and that in given cases by reason of subsequent events, the amount which initially was not received as trading receipts may be regarded as business income. It was considered by the CIT(A) that if the loan was for the trading purpose and was treated as such from the very beginning in the books of account, the waiver thereof may result in the income. It was, therefore, held that the waiver of the loan should be taxable under the provisions of Section 2(24) read with Section 28(iv) of the Act.

11. However, aforesaid findings given by the CIT(A) are contrary to the facts of the case as the amount of Rs. 8,07,35,116/- credited to capital reserve by the assessee pertains to principal amount borrowed without there being any component of interest embedded therein. In that view of the matter the dictum in case of Mahindra and Mahindra Ltd (supra) would be applicable and as such neither Section 28(iv) of the Act nor Section 41(1) of the Act would be applicable so as to tax the amount of waiver of

loan comprising of principal amount in the ends of the assessee.

12. In view of the foregoing reasons, we are in agreement with the findings given by the Tribunal. The question of law raised in this appeal cannot be termed as substantial question of law. Accordingly, this Tax Appeal stands dismissed with no order as to cost.

(J. B. PARDIWALA, J)

(BHARGAV D. KARIA, J)

GIRISH