IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCHES "A", MUMBAI

Before Shri J.Sudhakar Reddy, AM and Shri V.Durga Rao, JM

ITA No.60/Mum/2010 : Asst.Year 2004-2005

M/s.King Prawns Limited 229/230, Arun Chambers, 2nd Floor Tardeo, Mumbai – 400 034. **PA No.AAACK2067J.**	Vs.	The Income Tax Officer Ward 9(2)-1 Mumbai.
(Appellant)		(Respondent)

Appellant by : Shri Kishor Poddar
Respondent by : Shri S.K.Pahwa

O R D E R

Per J.Sudhakar Reddy, AM :

This is an appeal filed by the assessee directed against the order of the Commissioner of Income-tax (Appeals) – XX, Mumbai dated 20.10.2009 for assessment year 2004-2005.

2. The facts of the case in brief, are that the assessee is a company and is engaged in the business of production of salt and prawn farming. The return of income was filed on 28.10.2004 declaring total loss of Rs.1,22,25,538. The assessment was completed u/s.143(3) on 26.12.2006. In this assessment two important issues were involved – the first being put waiver of loan by State Bank of India and the second being the allowability of expenses after the stoppage of business. The Assessing Officer disallowed the claim for expenses and has also made addition on account of waver of the principal amount of loan. As far as the interest component of the loan is concerned, no addition has been made by the Assessing Officer, for the reason that the assessee has not claimed the interest as expenditure in the earlier years. Aggrieved, the assessee carried the matter in appeal. The first appellate authority for various reasons given in his order

dismissed the appeal of the assessee. Further aggrieved, the assessee is in second appeal before us. The assessee has raised following grounds:-

> *"1. The learned CIT(A) – 20 erred in law and on facts in confirming the addition of Rs.2,75,07,148.00 on account of loan waiver by bank.*
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> *2. The learned CIT(A) – 20 erred in law and on facts in confirming the said waiver of loan by bank as trading receipt and treating the same as income u/s.41(1) of the Act.*
>
> *3. The learned CIT(A) – 20 erred in law and on facts in confirming that the said waiver of loan was also covered under the provisions of sec.28 of the Act.*
>
> *4. The learned CIT(A) – 20 erred in law and on facts in confirming the addition of Rs.1,13,39,531.00 being disallowance of business expenditure incurred by the appellant company during the previous year 2003-04.*
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> *5. The learned CIT(A) – 20 erred in law and on facts in not appreciating the fact that the appellant had carried on its statutory activities.*
>
> *6. The learned CIT(A) – 20 erred in law and on facts in not appreciating the fact that the appellant's business was hampered by the operation of law and directions of Hon. Supreme Court of India.*
>
> *7. The learned CIT(A) - 20 erred in law and on facts in not appreciating the fact there was suspension of appellant's business due to Govt. restrictions and not a discontinuation thereof.*
>
> *8. The learned CIT(A) – 20 erred in law and on facts in holding that there was a complete breakdown of appellants business and it was engaged in the business of prawns/salt forming which is banned in view of CRZ restricts and it can not carry on any more.*
>
> *9. The learned CIT(A) – 20 erred in law and on facts on not allowing the claim for depreciation of Rs.11,17,300/- for the previous year 2003-04.*
>
> *10. The appellant craves leave to add, amend, alter or delete any of the grounds of appeal as advised from time to time."*

3. The learned Counsel for the assessee, Shri Kishor Poddar, referring to ground nos.1 to 3, submitted that these grounds pertain to addition made on account of waiver of loan by bank u/s.41(1) as well as u/s.28. He submitted that ground nos.4 to 8 pertain to allowability of expenses claimed by the assessee.

4. Referring to the first ground, the learned Counsel for the assessee submitted that the company's main object was to do prawn farming and dealing in other seafood products. As per the direction of the Hon'ble Supreme Court of India, restrictions were imposed on prawns farming activity in the entire country and due to that the business of the assessee-company was temporarily suspended. He submitted that there was a hope of revival as the Government of India was considering to frame legislation to regulate and promote the activity of prawn farming in India. Accordingly, the Government came out with the legislation in this regard in the year 1995 and the assessee-company commenced its original activity in the financial year 2005-2006.

5. He submitted that the assessee had taken loans from State Bank of India for its operation and due to circumstances which were beyond its control, it could not repay the loan and the bank came forward with one time settlement and settled the loan. He submitted that the amounts comprised of term loan of Rs.360.02 lakhs and export packing credit and cash credit of Rs.46.05 lakhs. He submitted that the Assessing Officer was wrong in placing reliance on the decision of the Hon'ble Supreme Court in the case of *CIT Vs. T.V.Sundaram Iyengar & Sons [222 ITR 344 (SC)]*. In that case the assessee has received deposits in the course of trading transactions and the assessee had treated them as capital receipt and not offered them to tax in the earlier years. Subsequently when the assessee forfeited the deposits on the ground that they were barred by limitation and had *suo motto* written back to its profit and loss account, the Hon'ble Supreme Court had held, that it became business income u/s.28 of the Act. He submitted that the facts of the assessee's case are entirely different as it had borrowed money from the bank in the

form of term loan and working capital loan and the loans were naturally of capital nature and also even after its waiver the nature of the loans did not change. He relied on the decision of the Bangalore bench of the Tribunal in the case of *Comfund Financial Services (I) Ltd. Vs. DCIT [(1998) 67 ITD (Bang.) 304]* wherein it has been held that the remission of loan by the bank could not be considered to constitute a revenue income in the hands of the assessee. Referring to the order of the CIT(A) wherein the first appellate authority held that the amount is not taxable u/s.41(1) nor under the provisions of section 28(iv) and argued that the finding that the amount is taxable u/s.28(i) is erroneous. He contended that the learned CIT(A) has wrongly placed reliance on the decision of the Bombay High Court in the case of *Solid Containers Ltd. DCIT [308 ITR 417]* as in the case of *Solid Containers Ltd. (supra)* the assessee had taken loan for its trading activities from its customers and this loan was finally adjusted by the assessee against the claim of the assessee which arose out of trading activities. He relied on the decision of the Gujarat High Court in the case if *CIT Vs. Chetan Chemicals (P) Ltd. [263 ITR 770]* for the proposition that even in the case of remission of unsecured loans taken during the course of business, does not constitute u/s.28(iv). Relying on the decision of the Cochin Bench of the Tribunal in *Accelerated Freez & Drying Co. Ltd. Vs. DCIT [(2009) 31 SOT 442 (Cochin)]* for the proposition that the loan waived by the bank was not a revenue receipt and there was no scope of bringing it to taxation either u/s.28(iv) or u/s.41(1). He also relied on the decision of the jurisdictional High Court in the case of *Mahindra & Mahindra Ltd. Vs. CIT [(2003) 261 ITR 501 (Bom.)]*. He, thus, prayed for the relief. On the second issue of allowability of expenses, which is contained in ground nos. 4 to 9, the learned Counsel for the assessee submitted that the assessee had closed down the business for the limited period, due to certain orders by the Apex Court imposing restriction on prawn farming and it was not the case of a permanent closure of its business. He vehemently contended that there is a temporary lull in the business and the finding of the first appellate authority that the assessee has permanently closed down its

business, is not correct. He disputed that the finding of the learned CIT(A) that no material has been placed before him, to show that there is scope of revival of the businesses. He filed papers / documents to demonstrate that the assessee has in the subsequent years, has in fact done business and declared income and filed returns and the assessment orders in this regard were passed. He, therefore, prayed for the relief. He relied on the decision of the Hon'ble Bombay High Court in the case of *Hindustan Chemical Works Ltd. Vs. CIT [124 ITR 561 (Bom.)]* for the proposition that regular business expenditure incurred during the temporary suspension of business are allowable expenditure.

6. The learned Departmental Representative, Shri S.K.Pahwa, on the other hand, relied heavily on the order of the CIT(A) and specifically drew the attention of the Bench at page 5. He submitted that the CIT(A) has agreed with the contention of the assessee that the A.O. has wrongly applied section 41(1) and provisions of section 28(iv) and at the same time he held that the waiver of loan is taxable u/s.28(i). He took this Bench through the order of the Hon'ble Bombay High Court in *Solid Containers Ltd. (supra)* and submitted that in that case the assessee had taken loan of Rs.6,86,071 during the previous year for business purposes which was written back as a result of consent terms arrived at between M/s.P.S.Jain Motors on the on hand and the assessee on the other, and in such a situation the Hon'ble High Court applied the decision of the Hon'ble Supreme Court in the case of *T.V.Sundaram Iyengar and Sons Ltd. (supra)* and held that the amount is taxable. Coming to ground no.2, he submitted that the learned CIT(A) has held that the assessee has permanently closed down its business and hence the business expenditure cannot be allowed.

7. Rival contentions heard. On the carefully consideration of the facts and circumstances of the case and on perusal the paper book and orders of the authorities below as well as the case law cited, we hold as follows.

8. Coming to the first issue of addition made u/s.28(i) on waiver of term loan raised from State Bank of India, we are unable to appreciate the finding of the first appellate authority that section 28(i) would apply in this case. Before we deal with this issue, the undisputed fact that is agreed between both the parties, is that, neither section 28(iv) nor section 41(1) applies in this case. Section 28(i) reads as follows:-

> *"the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year."*

9. In the case on hand, the principal amount received from the bank towards term loan, export packing credit and cash credit, was amounting to Rs.4,06,07,148 out of which an amount of Rs.2,75,07,178 was forfeited due to a settlement arrived at between the assessee and the bank. This bank loans, at the time of receipt, are capital in nature. Remission or reduction of liability, which is created on capital account, cannot to our mind result in a revenue receipt making it taxable u/s.28(i). The jurisdictional High Court in the case of *Mahindra & Mahindra Ltd. (supra)* held as under:-

> *"Held, (i) that there were two important facts which had been overlooked by the Assessing Officer. Firstly, the assessee continued to pay interest at 6 per cent. for a period of ten years on the loan amount. 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 agreement, in its entirety, was not obliterated by such waiver. Secondly, the purchase consideration related to capital assets. The toolings were in the nature of dies. 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) was not attracted. Lastly, the principal amount of loan had been forgone as a part of takeover arrangement to which the assessee was not a party. The waiver of the principal amount was unexpected. In the circumstances, such waiver would not constitute business income.*

(ii) That 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. The assessee had 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 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 that the assessee had got deduction on allowance section 41(1) was not applicable because such deduction was not in respect of loss, expenditure or trading liability. Lastly the toolings constituted capital assets and not stock-in-trade. Therefore, taking into account all the above facts, section 41(1) of the Act was not applicable.

Held also, (i) that for the purposes of depreciation roads are buildings and not plant."

10. The case on hand also, the term loans received were definitely on capital account and related to capital assets. The waiver of such term loan does not constitute business and the waiver cannot be held as income u/s.28(i).

11. Coming to the decision of *Solid Containers Ltd. (supra),* the facts are entirely different and the loan therein was taken for trading activity and ultimately on waiver of the amount was termed as business income of the assessee. If at all the ratio of the decision of the jurisdictional High Court in the case of *Solid Containers Ltd. (supra)* is to be applied, at best it can be restricted to waiver in connection with export packing credit and cash loan given on account of current account. Under no circumstances the ratio of this decision in the case of *Solid Containers Ltd. (supra)* can be applied to term loans wherein money was borrowed and utilized for acquisition of capital assets. The Cochin Bench of the Tribunal in the case of *Accelerated Freez & Drying Co. Ltd. (supra)* has considered a similar issue of waiver under one time settlement scheme and it held as follows :-

"It is a trite law that the nomenclature given by an assessee to a particular account in its books of account is not the sole test to decide the real character of that account. Therefore, the fact that the assessee had credited the loan waiver amount in its general reserve amount would not influence the process of determining the exact nature of the issue. [Para 21]

Section 28(iv) seeks to charge the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, as profits and gains of business or profession. Therefore, what is to be examined is whether the waiver of loan would amount to a perquisite so as to be taxable, as such, under section 28. The Bombay High Court in the case of Mahindra & Mahindra Ltd. Vs. CIT [2003] 261 ITR 501/128 Taxman 394, has explained that section 28(iv) seeks to charge the value of any benefit or perquisite, meaning thereby that the benefit must be in kind; the Court further held that waiver of loan is in respect of money transaction and, therefore, would not be in nature of any benefit or perquisite as construed in section 28(iv) [Para 23]

For the purpose of section 28(iv), the loan waiver amount credited by the assessee in its general reserve account was covered by the judgment of the Bombay High Court in the case of Mahindra & Mahindra Ltd. (supra) and, therefore, the said waiver amount could not be held as taxable [Para 29]

The Supreme Court in the case of Polyflex (India) (P.) Ltd. v. CIT [2002] 257 ITR 343/124 Taxman 374 has examined the constitution of section 41(1). The Court has pointed out that section 41(1) consists of two main ingredients: (a) loss or expenditure and (b) trading liability. The two ingredients of section 41(1) have to be read independently. As the first ingredient relates to loss or expenditure and the second ingredient relates to remission or cessation of trading liability, the Court has categorically ruled that the words `remission or cessation thereof' shall apply only to a trading liability. [Para 30]

There was no doubt that the term loans availed by the assessee from three banks were not in nature of trading liability but were in nature of capital liability. Therefore, waiver of loan liability was not waiver of any trading liability. The waiver of capital liability would not become income under section 41(1) on the ground of remission or cessation thereof. [Para 31]

The term loans availed by the assessee on capital account were also not in the nature of any loss or expenditure. There was no doubt in the instant case that the assessee never had the benefit of deduction of the term loans availed by it from the banks on capital account. Therefore, section 41(1) had no applicable to the facts of the instant case. [Para 32]

In the facts and circumstances of the case, the waiver amount of term loans availed by the assessee did not partake the character of assessable income either under section 28(iv) or under section 41(1). [Para 35]

Accordingly, the Assessing Officer was to be directed to exclude the waiver amount in computing the assessable income of the assessee. [Para 37].

In the result, the appeal filed by the assessee was to be allowed. [Para 38]"

12. This decision applies on all fours of the facts of the case. The judgement in the case of *T.V.Sundaram Iyengar and Sons Ltd. (supra)* also does not apply to the facts of the case as in that case deposits were received in the course of carrying on of trading and business of the assessee.

13. Coming to section 28(i), it is a general section, and all receipts cannot be considered as profits and gain of business. If that was the case, there was no necessity of incorporating section 28(iv), section 41(1) etc. When a receipt does not fall under any of the specific sub-section, it cannot by default be brought under the general section. In any event it is a remission of a capital liability and hence not income, much less a revenue receipt.

14. In view of the above discussion, we hold that the reduction of the liability on account of term loan and other loans payable to the bank under one time settlement scheme, does not result into income to the assessee either u/s.28(i) or u/s.28(iv) or

u/s.41(1) of the Income-tax Act, 1961. Accordingly, ground nos.1 to 3 of the assessee's appeal are allowed.

15. Coming to ground nos.4 to 9, the learned CIT(A) is factually incorrect in coming to a conclusion that the assessee has closed down its business permanently when the fact is otherwise. If the year ended on 31st March, 2005, the assessee had income of Rs.5,37,000 and for the financial year ended on 31st March, 2006, the assessee had income from sale to the extent of Rs.27.68 lakhs and other income to the tune of Rs.23.71 lakhs. This is clear from the annual accounts of the assessee and the returns filed by it. When the assessee filed returns of income before the department, wherein it is clear that the assessee had revived its business, the Revenue cannot overlook the evidences and hold that the business can never be revived. The following finding of the learned CIT(A) at para 3.3.3, that : *"No material has been placed before me to show that there is any scope of revival of these businesses. There is complete breakdown of the business of the appellant. There cannot be any question of allowing the impugned expenses."*, in our considered opinion, is against the facts of the case.

16. In view of the facts and circumstances as well as the factual position of the case, we have to necessarily allow the claim of the assessee by applying the decision of the jurisdictional High Court in *Hindustan Chemical Works Vs. CIT [124 ITR 561 (Bom.)].* In that case the facts as recorded by the Tribunal were that the assessee had complete breakdown of business and it was merely not a case of lull in business. In the case on hand, as already stated, the facts demonstrated, that it was not a complete breakdown of business but it was a case of mere lull in business due to some restrictions of prawn farming by the Hon'ble Supreme Court and also the facts demonstrate that there is revival of business. Therefore, the decision of *Hindustan Chemical Works (supra)* squarely apply to the present case.

17. In the result, the appeal of the assessee is allowed.

Order pronounced on this 14th day of December, 2010.

Sd/-	Sd/-
(**V.Durga Rao**)	(**J.Sudhakar Reddy**)
JUDICIAL MEMBER	ACCOUNTANT MEMBER

Mumbai : 14th December, 2010.
Devdas*

Copy to :
1. The Appellant.
2. The Respondent.
3. The CIT concerned
4. The CIT(A) – XX, Mumbai.
5. The DR/ITAT, Mumbai.
6. Guard File.

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By Order

Assistant Registrar, ITAT, Mumbai.