
(2011) 10 KAR CK 0101
In the Karnataka High Court
Case No : ITA No. 172 of 2011

CIT and Another

APPELLANT

Vs

Compaq Electric Ltd.

RESPONDENT

Date of Decision : 18-10-2011

Acts Referred:

Income Tax Act, 1961 — Section 10 B, 143 (3), 148, 41 (1)

Citation : (2012) 249 CTR 214 : (2012) 204 TAXMAN 58

Hon'ble Judges : Ravi Malimath, J;N. Kumar, J

Bench : Division Bench

Advocate : K.V. Aravind, for the Appellant; Sriyuths S. Parthasarathi, P. Dinesh and K. Malla Rao, for the Respondent

Final Decision : Dismissed

Judgement

1. The revenue has preferred this appeal challenging the order passed by the Income Tax Appellate Tribunal, Bangalore Bench-A, which has declined to interfere with the order passed by the Appellate Commissioner, who treated the waiver of the loan liability of the assessee as a capital receipt and not a revenue receipt, and consequently, there is no liability to pay tax under the Act. The assessee-company was engaged in the business of manufacture and sale of halogen lamps. It filed its return of income declaring a loss of Rs. 1,72,71,763 for the assessment year 2003-04. The case was taken up to scrutinize the assessment u/s 143(3) of the income tax Act (for short hereinafter referred to as the Act) for determining the loss at Rs. 1,72,71,763. Thereafter, an order came to be passed on 4-1-2008 for reopening the assessment. Notice was issued u/s 148 of the Act. The reasons assigned for reopening was that the assessee had written back unsecured loan of Rs. 2,94,81,265 which had not been offered as income for the relevant assessment year. The amount written back is essentially an unsecured loan, which is in the nature of capital receipt resulting in liability and it is not a trading liability, against any supplies or expenditure which are in the nature of current liability. Therefore, the assessee contended that it was not

taxable u/s 41(1) of the Act. He further contended that the assessee had claimed an amount of Rs. 2,64,74,072 as extra-ordinary income in its profit and loss account, and the same is not taxable in the computation of income as it is capital in nature. Explaining the nature of the receipt, the assessee submitted that the assessee-company was a wholly owned subsidiary company of Dr. Reddys Laboratories Limited and it was manufacturing and trading in halogen lamps, and was established as a 100% EOU. The assessee was eligible for deduction u/s 10B of the Act on its profits earned from export, but as it was incurring losses due to various business factors it was not in a position to claim such benefit up to the current assessment year. Therefore, they did not claim the benefit by giving a notice along with the computation. In view of huge losses suffered by the company, operations of the company had been funded by way of unsecured loans from DRL from year to year and such loans accumulated to about Rs. 11,64,74,072 during the years. In view of the mounting losses and doubtful viable operations, the assessee-company proposed, and DRL accepted a request to agree for conversion of the unsecured loan party into equity share capital and waive the balance as not recoverable. Accordingly, the assessee-company converted unsecured loan into equity to the extent of Rs. 9.00 crores and wrote back the balance amount of Rs. 2,64,74,072 as not payable. However, the assessing authority was not satisfied with the explanation, and held that these loans were received during the course of assessee's business with DRL, and that the liability of the assessee is a trading liability and held that section 41(1) of the Act is attracted and tax is leviable. Aggrieved by the said order, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals). Relying on the judgment of the Apex Court in the case of CIT v. T. V. Sundaram Iyengar, the Appellate Commissioner accepted the case of the assessee by holding that the amount representing waiver constitutes capital receipt, and therefore, not liable to tax, and allowed the appeal. Aggrieved by the same, the revenue preferred an appeal to the Tribunal. The Tribunal after hearing both the parties held that the only issue before them is whether the waiver of the unsecured loan by DRL is a capital receipt or a revenue receipt. After taking notice of the decision relied on by both the parties, it held that, if a capital liability has been discharged or reduced, the courts have held that the same, is not taxable as the income of the assessee, but it is a capital receipt and not taxable as such. Therefore, the loan liability of the assessee has been waived and therefore, the gain is nothing but a capital receipt. Therefore, the Tribunal declined to interfere with the well-considered order passed by the Appellate Commissioner. Aggrieved by the said order, the revenue is in appeal.

2. The learned counsel for the revenue assailing the impugned order contends that Explanation 1 to section 41 makes it clear that 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.

3. In the instant case, the creditor has written off such liability, and therefore, the said amount in the case of the assessee constitutes revenue income and therefore, it is taxable u/s 41(1) of the Act.

4. Per contra, the learned counsel for the assessee supported the impugned order.

5. Section 41 of the Act reads as under :

41.(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

(b) the successor in business has obtained, whether in cash 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 purpose 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.

6. For the application of this Act, the condition precedent is that there should be an allowance or deduction in the 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 u/s 41. The whole object is to avoid double benefit to the assessee. In the instant case, the amount claimed as capital receipt is in respect to which there was no allowance or deduction claimed by the assessee for the previous year. Therefore, when his creditor has waived the repayment of the said amount, it amounts to a capital receipt and not a revenue

receipt. As the assessee did not have the benefit of any allowance or deduction in respect of the said amount, section 41 is not attracted. In that view of the matter, we do not see any merit in this appeal. No substantial question of law arises for consideration. Accordingly, the appeal is dismissed.