Waiver of Term Loan, Working Capital Loan: Taxability under Income-tax Act, 1961

With globalisation, business in India has expanded manifold. While existing units have expanded their footprint, new entities have entered the booming Indian business arena by availing of various types of finances such as term loans and working capital loans from public institutions, banks, private parties, etc. Due to various reasons such as stiff global competition, new inventions and global recession, among others, the financial position of many units has deteriorated and, as a result, their accounts with financial institutions or banks have become non-performing assets (NPA). Such units enter into a one-time settlement with banks or financial institutions by paying a stipulated amount against the loan amount, while the balance is waived-off. A pertinent question that arises is the taxability under the Income-tax Act, 1961 of the sum waived-off term loans and working capital loans by banks, financial institutions or depositors. This article analyses the issue in the light of the latest decision of the Delhi High Court in the case of *Logitronics Pvt. Ltd. vs. CIT* [333 ITR 386 (Delhi)].

CA. Kirit Priyakant Shah

(The author is a member of the Institute. He can be reached at kpshahca@yahoo.com)

The latest decision of the Delhi High Court in the case of *Logitronics Pvt. Ltd. vs. CIT* [333 ITR 386 (Delhi)] has provided a totally new dimension to the issue. The facts of the case (I.T.A. No. 1623 of 2010) before the Delhi Court were as under:

"The issue in this case relates to the treatment, which is to be given to the extent of amount of loan and interest waived-off by financing institutions from where the loan was raised. The appellant is the assessee-company, which is engaged in the business of manufacturing of electronic products. It was enjoying a loan facility from State Bank of India (SBI). As the appellant could not discharge its liability for a specific period of time, keeping in view guidelines/directions of the SBI, it categorised this loan as non-performing. The loan due to the bank was ₹4,76,92,213, while the outstanding interest was ₹1,90,42,295. The issue of recovery of

the loan was referred to the Debt Recovery Tribunal in 2000. During the pendency of these proceedings, the assessee had settled the matter with the SBI. Pursuant to a one-time settlement with the bank, on payment of ₹1,85,00,000 against the loan of ₹4,76,92,213 (principal amount), the remaining sum of ₹1,90,42,295 was waived-off. In the tax return filed by the assessee, it showed the interest waived off as income, but not the amount of loan waived off by the SBI, though the amount of interest written off, i.e., ₹1,90,42,295 was credited to the profit and loss account and was offered for taxation. However, relying upon the decision of this court in the case of *CIT vs. Tosha International Ltd*. [2011] 331 ITR 440 (Delhi) [2009] 176 Taxman 187, the principal amount written off, i.e., ₹2,91,42,213 that was directly taken to the balance sheet under the head, capital reserve, was not offered for taxation".

The Assessing Officer, on the following ground, held that even the waiver of the principal amount of loan was also taxable:

"Income was taxable under the head Profit and Gains of Business or Profession, because the loan was taken for the purpose of business, and a one-time settlement was an integral part of the business."

In the first appeal, the commissioner of Income Tax (Appeals) deleted the addition, holding that the provisions of Sections 2(24), 28(i), 28(iv) and 41(1) of the Act were not applicable, and as such the Assessing Officer was not justified in making addition being the waiver of the principal amount of loan.

On second appeal filed by the Revenue, the Income Tax Appellant Tribunal reversed the order of the CIT (Appeals).

Against the order of the Tribunal, the following substantial questions of law were raised before the High Court for consideration:

"(1) Whether the Tribunal was right in law in holding that taxability of waiver of loan would be governed by the purpose for which the loan was taken, as much as, though the waiver of loan taken/utilised for acquiring capital asset does not constitute income. However, the waiver of loan taken for the purpose of business/trading activity gives rise to income taxable under the Act?

(2) Whether the waiver of loan, a subsequent event has the effect of changing the nature and character of loan, a capital receipt into a trading receipt and therefore the ratio of the judgement of the Supreme Court in *CIT vs. T. V. Sundaram Iyengar and Sons Ltd*. [1996] 222 ITR 344, wherein, unclaimed deposits received in the course of trading transaction were held to be taxable is applicable to the waiver of loan? "

The Delhi High Court in the case of Logitronics Pvt. Ltd. (supra) and Bombay High Court in the case of *Solid Containers Ltd. vs. Deputy CIT* 308 ITR 417, by applying the decision of *CIT vs. T.V. Sundaram Iyengar and Sons Ltd.* 222 ITR 344 (SC), held that in the case of the Bank loan used as working capital for trading purpose and waived by the bank. The loan so waived-off, which has been transferred to the profit and loss account, shall be assessed as business income.

The High Court considered the findings brought on record by the Tribunal that the assessee had obtained the loan or the credit facility by way of hypothecation of finished goods, semi-finished goods, raw material, book-debts, receivable claims, securities and rights by way of first charge, which indicated that the assessee had obtained the loan facility for its business activity or trading operations.

On page 402, vide para 23, the High Court has laid down as under:

"In the context of waiver of loan amount, what follows from the reading of the aforesaid judgement is that the answer would depend upon the purpose for which said loan was taken. If the loan was taken for acquiring the capital asset, waiver thereof would not amount to any income eligible to tax. On the other hand, if this loan was for trading purpose and was treated as such from the very beginning in the books of account, as per *T.V. Sundaram Iyengar and Sons Ltd.* [1996] 222 ITR 344 (SC), the waiver thereof may result in the income more so when it was transferred to the profit and loss account."

With due respect to the High Court, we may now proceed to analyse and understand whether the view taken by the High Court is plausible or not with respect to the prevalent legal precedence and the provisions of the Income-tax Act, 1961. Therefore, let us analyse the statutory provisions laid down under Section 2(24), 28(iv), and 41(1) of the Act.

(A) Applicability of Section 28(i)

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

(i) the profits and gains of any business or profession, which was carried on by the assessee at any time during the previous year;

(a) As per Section 28(i) only the profits and gains arising from carrying on the business by the assessee is chargeable to tax. In *Universal Radiators vs. CIT* (201 ITR 800), the Supreme Court observed that for being taxable, the income should have accrued out of the business carried on by the assessee. The Supreme Court has laid down that the word "from" according to dictionary means "out of". The income thus should have accrued out of the business carried on by the assessee. An income directly or ancillary to the business may be an income from business, but any income to an assessee carrying on business does not become an income from business unless the necessary relationship between the two is established.

(b) The observation of Madras High Court in the case of *Iskraemeco Regent Ltd. vs. CIT*, 331 ITR 317 (Mad.), as regards to the nature of bank loan in the business are worth nothing. The High Court has laid down as under:

"It is a well-established principle of law that every deposit of money would not constitute a trading receipt. Broadly, though a receipt may be in connection with the business, it cannot be said that every such receipt is a trading receipt. Therefore, the amount referable to the loans obtained by the assessee towards the purchase of its capital asset would not constitute a trading receipt. The said issue has been fortified by the judgement of this court in *CIT vs. A.V.M. Ltd.* [1984] 146 ITR 355."

The High Court has further held as under:

"In the present case on hand, admittedly the assessee was not trading in money transactions. A grant of loan by a bank cannot be termed a trading transaction and hence it cannot also be construed in the course of business. Indisputably, the assessee obtained the loan for the purpose of investing in its capital assets. A part of this loan amount, along with this interest, was waived-off by way of an agreement between the parties. Therefore, the facts involved in the present case are totally different to the facts involved in *CIT vs. T.V. Sundaram Iyengar and Sons Ltd.* [1996] 222 ITR 344 (SC). In the said case, admittedly there was a trading transaction, whereas in the present case it is not so. *What has been done in the present case is a mere waiver of loan. It is only a mere waiver, which has been effected by the bank in favour of the assessee. There is no change of character with regard to the original receipt, which was capital in nature into that of a trading transaction. It is further seen that there is a marked difference between a loan and a security deposit." (emphasis supplied)*

It can be argued that waiver of working capital loan cannot be termed a trading transaction, and it cannot also be construed to be flowing out the income (revenue) stream of transactions during the course of business. Hence, the waiver of working capital loan by the bank cannot be taxed under Section 28(i) of the Income-tax Act, 1961.

In the above referred case, the High Court was concerned with the waiver of the term loan utilised for purchase of capital assets. However, what applies to the term loan also equally applies to the working capital loan. Ultimately, both term loan and working capital loan are on capital account. As per the accounting principles, loan is always considered a capital receipt, and the waiver of the same would also be on capital account. Hence, the character of the loan remains the same at the time of receipt as well as at the time of the waiver of loan.

(c) As far as waiver of term loan is concerned, the High Court, as mentioned below, unanimously agreed that waiver of the term loan utilised for the purchase of capital asset is not chargeable to tax under Section 28(i).

(i) *Iskraemeco Regent Ltd. vs. CIT* 331 ITR 317 (Mad.)

(ii) *Mahindra & Mahindra Ltd. vs. CIT* 261 ITR 501 (Bom.)

(iii) *Logitronics Pvt. Ltd. vs. CIT* 333 ITR 386 (Delhi)

However, the Delhi High Court in the case of *Logitronics Pvt. Ltd.* (supra) and Bombay High Court in the case of *Solid*

Containers Ltd. vs. Deputy CIT 308 ITR 417, by applying the decision of *CIT vs. T.V. Sundaram Iyengar and Sons Ltd.* 222 ITR 344 (SC), held that in the case of the Bank the loan used as working capital for trading purpose and waived off by the bank. The loan so waived off has been transferred to the profit and loss account and shall be assessed as business income.

Both the above referred High courts have decided on the basis of the purpose for which the bank loan is utilised. The courts held that if the loan was utilised for acquiring capital asset, waiver thereof would not amount to any income exigible to tax. However, if the loan was utilised for trading purpose, relying on *T.V. Sundaram's case* (supra), the waiver thereof shall be charged to tax as trading receipt. In the author's opinion, the purpose for which the loan is obtained is irrelevant consideration for deciding the character of the receipt either as capital or revenue. (60 ITR 52)(SC).

(d) For ages the principle that has been well settled in this regard is that the quality and nature of a receipt for income-tax purposes is fixed once and for all when the subject receipt is received and no subsequent operation could change the nature of the receipt. It means that the taxability of a receipt is fixed with reference to its character at the moment it was received and merely because the recipient subsequently treats the receipt as his own that does not become income character. Thus, if a receipt is of capital nature it does not become income merely because subsequently the receipt is treated as his own money by the recipient due to various reasons. The mother decision for this theory has an early English decision in *Morley (Inspector of Taxes) vs. Tattersall* (1939) 7 ITR 315 (CA), which has been followed in India also by the courts and the Tribunal in numerous cases in a variety of contexts, more prominently in the context of forfeiture of loans, forfeiture of security deposits from customers, etc. For example, one may see *CIT vs. Motor & General Finance Ltd.* (1974) 94 ITR 582 (Delhi) and *CIT vs. A.V.M. Ltd.* (1984) 146 ITR 355 (Mad.)

The Supreme Court in the case of *CIT vs. Kerala Estate Mooriad Chalapuram* (166 ITR 155) has held: "What was returned to the assessee has nothing to do with activities of the assessee, it does not arise from business nor does it arise from agricultural operation when the assessee is an agriculturist.

However, an exception to the principal was carved out by the Supreme Court in the decision of *CIT vs. T.V. Sundaram Iyengar & Sons Ltd.* (222 ITR 344).On the basis of this decision one is required to find out whether waiver of working capital loan is an event which would convert the capital receipt into income taxable under the Act?

Now, the above decision of the Supreme Court does not lay down a universal principle that in every case a capital receipt when appropriated by an assessee to himself necessarily becomes income; it would again depend on the facts and circumstances of each case. The point to be noted is that this Supreme Court decision dealt with a situation where the amounts of deposits were received from the customers during the course of trading transactions and they were adjusted against the sale price of goods receivable from the customers; and, therefore, this decision is to be understood and confined in its application in the light of the specific facts obtaining in this case. This is established and illustrated by a later decision of the Supreme Court in *Travancore Rubber & Tea Company Ltd. vs. CIT* (2000) 243 ITR 158. In this case, the assessee was in the business of growing rubber and tea. It entered into an agreement with a purchaser to sell its old and unyielding rubber trees and received a certain amount as earnest money and advance. But, subsequently, the purchaser failed to pay up the balance money. Thereupon, the assessee cancelled the agreement and forfeited the amount of earnest money/advance paid by the purchaser.

The question was whether the amount so forfeited by the assessee was its income liable to tax. The assessee contended that the quality and nature of receipt for income tax purpose were fixed once and for all when the subject receipt was received and that no subsequent operation could change the nature of the receipt. The assessee had relied on the decision of the *Morley (Inspector of Taxes) vs. Tattersall* (1939) 7 ITR 315 (CA). As against this, the Department had relied on the Supreme Court decision of *Karam Chand Thappar* (222 ITR 212). However, the Supreme Court held that the amount of advance money paid by the purchaser was a capital receipt in the hands of the assessee since the assessee was not carrying on the business of selling trees which constituted capital assets of the assessee, and that the amount forfeited related directly to capital assets of the assessee. The Supreme Court categorically observed that the cancellation of the sale of capital assets would not be such a subsequent event as to change the nature of the receipt of the forfeited amount. The decision of the Supreme Court (243 ITR 158) is followed in number of decisions where the amount received is not during the course of business but in the capital filed. For example, *Deputy CIT vs. Lotus Finance and Investment (P.) Ltd.* (2004) 82 TTJ (Asr) 559.

On the basis of the above referred analysis, it can be argued that waiver of working capital loan cannot be termed as a trading transaction and it cannot also be construed to be flowing out the income (revenue) stream of transactions during the course of business. Hence, the waiver of working capital loan by bank cannot be taxed under Section 28(i) of the Income-tax Act, 1961.

The tribunal in the case of *Deepak Fertlisers and Petrochemicals Corporation Ltd. vs. Deputy CIT* (2008) 304 ITR (AT) 167 (Mum.) has held that the amount of debenture application money forfeited by the company on non-payment of call money by the debenture holders constituted a capital receipt and could not be taxed.

The Gujarat High Court in the case of *CIT. vs. Alchemic Pvt. Ltd.* (130 ITR 168) has held that the amount received by way of cash or money cannot be brought to tax under Section 28(iv) as any benefit or perquisite, as the section applies only to non-monetary benefit or perquisite. It is submitted that the judgement of Gujarat High Court has been approved by the apex court in *CIT vs. Mafatlal Gangabhai & Co. Pvt. Ltd.* (219 ITR 644).

One may also rely on the following decisions to strengthen the argument that waiver of working capital loan is not a trading receipt:

(i) The Tribunal in the case of *Comfund Financial Services (I) Ltd. vs. Dy. CIT* (67 ITD 304) (Bom.), has held that loan transaction between the assessee and bank is on capital account and remission of loan by bank could not be considered to constitute a revenue income in the hands of the assessee. The loans from credits stand completely on a different footing from the transaction in which the assessee indulged by utilising such loan.

(ii) The Supreme Court in the case of *CIT vs. Kerala Estate Mooriad Chalapuram* (166 ITR 155) has held: "what was returned to the assessee has nothing to do with the activities of the assessee, it does not arise from business nor does it arise from agricultural operation when the assessee is an agriculturist."

(iii) The company had issued NCDs for raising capital for setting up of cement business and the amounts received were initially shown as loan liability. NCDs were forfeited for non- payment of call money. The Tribunal held that since the NCDs were issued in order to borrow the funds to raise the capital, the amount received is lien thereof has assumed the character of capital receipt if at all not treated to be a loan liability, is as much as issuance of NCDs was not a business of the assessee. [*Prism Cement Ltd. vs. JCIT* 103 TTJ63 (Mum.)].

(iv) As per the facts of the case before the Tribunal in the case of *Comfund Financial Services (I) Ltd. vs. Dy. CIT* 37 ITD 304

(Bom.) the assessee was dealing in shares and securities making payment of shares out of its overdraft account. The assessee had incurred heavy losses hence, the bank loan was waived by the bank. The tribunal held that the loan transaction between the assessee and the bank were on the capital account and the remission of loan by the bank could not be considered to constitute a revenue income in the hands of the assessee.

(v) The fact that there is a difference between an amount received in the course of a trading transaction and other deposit or loan is evident from the decision of the Supreme Court in the case of *K.M.S. Lakshmanier & Sons vs. CIT* 23 ITR 202(SC), where trade advances were not treated as loans, whereas security deposits were treated as loans.

(vi) The company had received a loan under order of BIFR as a measure of restructuring its business. The loan was renounced by the lender and the amount was transferred to profit and loss account. Hon'ble Tribunal in the case of *APR Ltd. vs. Dy. CIT* 87 ITD 618 (Hyd.) held that the loan does not lose its capital nature even where it is renounced by the lender and becomes the money of the assessee. It was further held that the amount received by the company is a capital receipt and does not become chargeable revenue receipt by such fact of transfer to profit and loss account. The Tribunal had relied on the decision of apex court in *K.M.S. Lakshmanier & Sons vs. CIT* (supra). [Also refer: *Helios Food Improvers (P) Ltd*. vs. *Dy. CIT,* 14 SOT 546 (Mum.) & *Smartalk (P) Ltd. vs. ITO*, 122 TTJ 782 (Mum.)]

(vii) As regards to forfeitures of shares held by the shareholder for non payment of calls, the Lahore High Court categorically held that such sum was neither a revenue receipt nor profit on the working of the company but in the nature of a capital receipt and not assessable to income tax at all. (*Multan Electric Supply Company Ltd.,* In re (1945) 13 ITR 457)

(viii) The tribunal in the case of *Deepak Fertlisers and Petrochemicals Corporation Ltd. vs. Deputy CIT* (2008) 304 ITR (AT) 167 (Mum.) has held that the amount of debenture application money forfeited by the company on non payment of call money by the debenture holders constituted a capital receipt and could not be taxed.

All the courts have unanimously decided that whether it is term loan or working capital or private deposits, the amount waived-off is not taxable under Section 41(1).

(B) Applicability of Section 28(iv)

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

It provides that the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, is changeable as part of the profits under the head of "Profits and Gains of business or profession" and it is deemed to be income under Section 2(24).

The Gujarat High Court in the case of *CIT. vs. Alchemic Pvt. Ltd.* (130 ITR 168) has held that amount received by way of cash or money cannot be brought to tax under Section 28(iv) as any benefit or perquisite, as the section applies only to non-monetary benefit or perquisite. It is submitted that the judgement of Gujarat High Court has been approved by the apex court in *CIT vs. Mafatlal Gangabhai & Co. Pvt. Ltd.* (219 ITR 644)

As regards to the waiver of the principal amount of loan, the Division Bench of the Bombay High Court in the case of *Mahindra & Mahindra Ltd. vs. CIT* (261 ITR 501) has held that Section 28(iv) does not apply to benefits in cash or money. Hence, the waiver of loan amount would not constitute business income under Section 28(iv).

The decision of the *Alchemic Pvt. Ltd*. has been followed in the case of *Dy. CIT vs. Garden Silk Mills Ltd.* [320 ITR 720 (Guj.)]

On the basis of the decision of the Supreme Court, one can easily argue that there cannot be disallowance of depreciation under Section 41(1), with reference to capital assets against which there is a waiver of loan by banks, financial institutions or private parties.

As regards the waiver of bank loan, the Madras High Court in the case of *Iskraemeco Regent Ltd. vs. CIT* (331 ITR 386) and Delhi Court in the case of *Logitronics Pvt. Ltd. vs. CIT* (333 ITR 386) has held that the same is not taxable under Section 28(iv).

(C) Applicability of Section 41(1)

Section 41(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 (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*] ----------

[*Explanation 2*] ----------

(i) Section 41(1) enacts adjustment provisions whereby the Revenue taken back what it has already allowed, "Section 41(1) creates a fiction. What is not income in the ordinary sense of the term is deemed to be the income under this provision." *CIT vs. Sahney Steel Pvt. Ltd.* [152 ITR 39 (AP)]

(ii) "From the very opening part of the provision, it is apparent that it applies to a case 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 and subsequent thereto during any previous year, if the assessee obtains any amount in respect of such loss or expenditure or some benefit in respects of such trading liability by way of remission or cessation thereof, the same is to be deemed to be profits and gains of business or profession and accordingly chargeable to income tax as the income of that previous year. The *sine qua non* of invoking Section 41 is that in any earlier assessment year the allowance or deduction ought to have been made in computing the income chargeable under the tax. It obviously concerns the computation of taxable income made in accordance with the provisions of the Income-tax Act, 1961 in the assessment and not merely on the basis of treatment of such amount in the books of account"

[*CIT vs. Bhawan Va Path Nirman (Bohra) & Co*. (No.2)258 ITR 444 (Raj)]

[*C.I.T. vs. Chetan Chemicals Pvt.Ltd*. 188 CTR 572 (Guj)]

(iii) Conditions precedent of for applicability of sub-section (1) of Section 41 are:

(a) An allowance or deduction had been made, in the computation of profits and gains of a business or profession in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and

(b) Subsequently, during any previous year the assessee had 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.

(iv) By keeping in mind the above-referred statutory provisions of Section 41(1), let

From the discussion in this article, it can be submitted that waiver of working capital loan cannot be taxed under Section 28(i), 28(iv) and 41(1) of the Income Tax-act, 1961.

us decide whether waiver of term loan or working capital loan by the bank or financial institution or waiver of private loans by the private parties is chargeable to tax under Section 41(1)?

All the courts have unanimously decided that whether it is term loan or working capital or private deposits the amount waived off is not taxable under Section 41(1).

Madras High Court in the case of *Iskraemeco Regent Ltd. vs. CIT* (331 ITR 316) has held that Section 41(1) is inapplicable.

"Similarly, in so far as the applicability of Section 41(1)(a) of the Income-tax Act is concerned, the same also cannot have any application in as much as the said provision would be applicable only to a trading liability. Accordingly, it was held that a loan received for the purpose of capital asset would not constitute a trading liability and hence Section 41(1) has no application. The said issue has also been considered in *Mahindra & Mahindra Ltd. vs. CIT* [2003] 261 ITR 501(Bom), wherein it has been held as follows:

"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% over a period of ten years to KJC ₹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 the assessee got depreciation allowance of ₹27,29,858 and, therefore, the amount of ₹27,29,585 should be set-off against ₹57,74,064. We do not find any merit in this argument. The Department's case is that the assessee got remission of ₹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 ₹57,74,064. In the circumstances, we cannot direct set off of ₹27,29,585 against ₹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 vs. CIT* (1948) 16 ITR 183 (Bom) and *Orient Corporation vs. CIT* (1950) 18 ITR 28 (Bom) had laid down that remission was not income and in order to get over those judgements Section 41(1) came to be enacted. In the case of *CIT vs. Phoolchand Jiwan Ram* (1981) 131 ITR 37 (Delhi), the assessee-firm had purchased goods. They had also obtained loans from a party, accounts were settled and the balance was credited to the partner's account. It was held by the Delhi High Court that the amount referable to loans was not a trading liability. Thus, only amounts allowed as deduction in earlier years could be treated as 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 vs. A.V.M. Ltd.* (1948) 146 ITR 355 (Mad), it has been held by the Madras High Court that every deposit money does not constitute trading

receipt. 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."

The Madras High Court has also relied on the decision of the Division Bench of the Gujarat High Court in *CIT vs. Chetan Chemicals (P.) Ltd*. 267 ITR 770.

(D) Disallowance of Depreciation Under Section 41(1)

Disallowance of depreciation under Section 41(1), with reference to capital assets against which bank has waived term loan:

(i) In the case of *Mahindra & Mahindra Ltd.* (Supra); with reference to the waiver of principal amount of loan the Department had taken alternative argument that the loan was used to buy capital asset on which assessee had got depreciation allowance of ₹27,29,585 and, therefore, the depreciation allowance shall be taxed under Section 41(1). *Hon'ble High Court held that we do not find any merit in this argument.* The Department's case is that the assessee got remission of depreciation allowance. However, remission for depreciation is not in issue before us. In short, the High court did not consider this issue and no decision was given on the same.

(ii) In the case of *Nectar Beverages Pvt. Ltd. vs. Dy. CIT* [267 ITR 385 (Bom.)] it was held by the Bombay High Court that "expenditure" in Section 41(1) includes depreciation. Hence, the assets in respect of which depreciation had been granted and on sale of the asset as scrap, amount received shall be taxable under Section 41(1).

However, the Supreme Court has reversed the decision of the Bombay High Court [*Nectar Beverage Pvt. Ltd. vs. Dy. CIT* (314 ITR 314)].

The Supreme Court has held that prior to April 1, 1988, both sub-section(1) and sub-section(2) of Section 41 existed in the statute book. Section 41(2) specifically brought to tax the balancing charge as a deemed income under the Act. The necessity to keep Section 41(2) as provision in addition to Section 41(1) arose from the fact that in its very nature depreciation is neither a loss, nor expenditure, nor a trading liability referred to in Section 41(1).

On the basis of the above-referred decision of the Supreme Court, one can easily argue that there cannot be disallowance of depreciation under Section 41(1), with reference to capital assets against which there is a waiver of loan by banks, financial institutions or private parties.

From the discussion in the preceding paras, it can be submitted that waiver of working capital loan cannot be taxed under Section 28(i), 28(iv) and 41(1) of the Income-tax Act, 1961. Before concluding let us also analyse the applicability of Section 2(24) to the facts of the case of *Logistronics Pvt. Ltd*. (supra):

Applicability of Section 2(24):

The word income is formidably wide and vague in its scope. It is word of elastic import. Unless otherwise the context requires, the word "Income" should be given its ordinary natural meaning. The apex court held so in the case of *CIT vs. G.R. Kartikeyan* (reported in 201 ITR 866). The court also held that a receipt not falling within the ambit of any specific clause may yet be income. In such cases though the various conditions like capital *vs.* revenue, etc. still needs to be passed through to call a particular receipt as income. Another aspect of the definition of "income" is that the definition incorporated some of the specific incomes within the ambit of the purview of the term "income". Such incomes are to be understood as incomes because of the deeming fictions prescribed by the law. In other words, even if such deeming receipt may not fall within the ambit of any of the clauses mentioned in Section 2(24), or may not be of the nature of income in general, it may still be income. As far as the case of waiver of working capital loan is concerned, the nature of loan as a capital receipt remains intact even after the waiver of the loan and it does not take the nature of income. And if it is neither in the nature of income in general nor fictionally provided in the act to be income then in that case it would be outside the scope of charging Section 4 of the Income-tax Act, 1961. Wherever legislature wanted to treat any item which is not in the nature of income, the same is artificially treated as income by adding to the definition of Section 2(24) of the Income-tax Act, 1961. For example, Section 2(24)(vi) provides that income includes "any capital gains chargeable under Section 45," and, thus, it is clear that a capital receipt simplicitor cannot be taken as income. [*Kushal K. Bangia vs. ITO* (2012) 18 taxmann.com 31 (Mum. Tribunal)]

From the discussion in the above para, it can be submitted that waiver of working capital loan may not be treated as income as per Section 2(24) of the Act and therefore in view thereof the issue partakes an important dimension in the wholesome issue in this regard. ■