

Cit Vs. Industrlal Credit and Development Syndicate Ltd.

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Court : Karnataka

Decided On : Mar-02-2006

Reported in : (2006)203CTR(Kar)413

Appeal No. : ITRC No. 451 of 1998 2 March 2006 A.Y. 1986-87

Appellant : Cit

Respondent : industrlal Credit and Development Syndicate Ltd.

Advocate for Def. : Sri. Parthasarathy

Advocate for Pet/Ap. : MV Seshachala, *for the Revenue* S. Sarangan with S. Parthasarathi, *for the Assessee*.

Judgement :

N. Mauk J.

At the instance of revenue the Income Tax Appellate Tribunal, Bangalore Bench (hereinafter referred to as 'the Tribunal') has referred the following question of law for our opinion under section 256(1) of the Income Tax Act (hereinafter referred to as 'the Act') :

'Whether, on the facts and in the circumstances of the case, the Tribunal is right in holding that although the assessee is a financial company dealing in shares etc., the transactions of purchase of its own debentures through its nominees did not

represent transactions involving its stock-in-trade and accordingly, in holding that the surplus arising from issue and repurchase of the debentures merely represented a capital receipt not subject to tax ?'

2. The facts leading to this reference are as under :

The assessee- company is engaged in the business of acting as a finance company dealing inter alia, in securities, debentures, shares, etc. and also granting loans and advances to other parties. In the year 1973, the assessee company had issued large number of debentures of Rs. 10 each at par. These debentures were redeemable during the accounting years corresponding to assessment years 1984-85, 1985-86 and 1986-87 at the rate of 30 per cent, 30 per cent and 40 per cent, respectively of the face value thereof. During the period of redemption, the assessee- company purchased some of these debentures through a nominee at a price less than the face value thereof. The assessee credited the difference amount between the face value of the debentures purchased and the cost thereof in its books as surplus arising on redemption of debentures. The figures of such surplus credited to the P&L; a/c for the three years i.e., assessment years 1984-85, 1985-86 and 1986-87 were Rs. 80,815, Rs. 82,171 and Rs. 1,09,650, respectively. Although the assessee credited these amounts to P&L; a/c, did not form part of the income by way of capital gains receipt and hence sought for deductions of the amount from computation of the income. The assessing officer concluded that the surplus amounts held by the nominees of the assessee on behalf of the assessee- company constituted its revenue receipts and should therefore be included within its business income. Accordingly, he did not allow the deductions claimed by the assessee. In first appeal, the appellate authority held the act of redemption actually took place through book entries only and therefore as the assessee was a financial company dealing inter alia, in securities, debentures, shares, etc. and was engaged in repetitive transactions of buying and selling of such commodities, purchase of debentures through its nominees should be considered as business transaction on revenue side and therefore it is a gain arising there from and becomes part of the regular income of the assessee and accordingly dismissed the appeal. In the second appeal, the Tribunal held that the debentures of the company could not be

considered to form a part of its stock-in-trade. The purchase and sale of its own debentures was not permissible in law and hence it was not possible to consider the assessee- company as having attempted to make a business out of the purchase and sale of the said debentures. The issue of debentures initially meant receiving of loan from the debenture-holders and that by repurchasing of the debentures, before their redemption at discount, a portion of the loan to be refunded by the company was merely cut down. The loan which is ultimately not required to be paid certainly constitutes a gain in the hands of the debtor, but such transaction will not result in any revenue gain. The gain is merely of the nature of capital receipt. Though the assessee might have credited the surplus amount to its P&L; a/c for the three years,. if the department wanted to stick to its version that the gain out of the transaction arose from repurchase of debentures, such gain should have been assessed to tax actually in the years of repurchase. Therefore, the Tribunal held that the surplus amounts were not chargeable to tax either as revenue profits or even as capital gain. It is against this order of the Tribunal, as stated earlier, at the instance of the revenue, the aforesaid question of law is referred for our opinion.

3. Sri M.V. Seshachala, learned counsel appearing for the revenue submitted that admittedly the assessee was carrying on the business of purchase and sale of debentures and they have lent money through a nominee to purchase their own debentures for which their nominee has paid interest to them and therefore, the benefit accrued to the assessee by discharging the liability of the debentures at a lower rate is a benefit accrued to them is in the nature of a trading receipt and liable to tax. Relying upon section 28(iv) of the Act, he submitted that the purchase of debentures at a lower rate should be understood as a benefit arising from the business carried on by the assessee.

4. Per contra, the learned senior counsel Sri Sarangan appearing along with Sri Parthasarathy, learned counsel for the respondent, submitted that admittedly the assessee had issued debentures which in substance, is a loan borrowed by the assessee for carrying on its business which has been repaid by redemption of these debentures at a price lesser than the face value. That difference in the amount was shown in the accounts as surplus. On the date of redemption, the

said surplus amount is taken into the P&L; a/c since it was earlier shown as a liability of the assessee. On the due date of redemption, this amount was taken to the P&L; a/c and it is shown as a capital receipt and not as a trading receipt and therefore, the assessee is not liable to pay tax and the judgments relied upon by the counsel appearing for the revenue are not applicable to the facts of this case.

5. From the aforesaid rival contentions, the point that arises for our consideration is whether the amount saved by the assessee by redeeming the debentures at a lower price constitutes income for it being taxed under the Act.

6. In order to answer this question, it is better to remind ourselves as to what is meant by a debenture. The Supreme Court in the case of Reliance Industries Ltd. (2003) 113 Comp. Cas. 1 (SC), has held that a debenture is an instrument of debt executed by the company managing its receipt to repay the same at a specific rate and also carrying interest. It is in sum and substance a certificate of loan or a bond evidencing the fact that the company is liable to pay a specific amount with interest and although the money raised by the debentures becomes a part of the company's capital structure, yet it does not become share capital.

7. The term 'debenture' is not a technical term nor a term of art, but in its ordinary sense denotes one of the modes for borrowing money by any company in exercise of its borrowing powers. The instrument imports an obligation or a covenant to pay. It is a repayment of the loans of the money borrowed by issue of debentures, in the vocabulary of company law is considered as 'redemption' of debentures. In its ordinary sense redemption means repayment of debt which discharges its security (liability). Discharging the liability to the debenture holder who has sold his debentures and since a company cannot be its own debtor, in effect such purchase amounts to repayment of the loan.

8. Insofar as the word 'income' under the Income Tax Act is concerned, it is defined under section 2(24), which reads as under :

'2(24) 'income' includes-

(i) profits and gains;

(ii) dividend;

(iia) voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an association or institution referred to in clause (21) or clause (23), or by a fund or trust or institution referred to in sub-clause (iv) or sub-clause (v) of clause (23C) of section 10.'

The term income starts with the word 'includes' in the definition clause. Therefore, the list is inclusive and not exhaustive. The purpose of the inclusive definition is not to limit the meaning, but to widen its net. Though the inclusive definition adds several artificial categories to the concept of income but, on that account, the expression income does not lose its natural connotation. Income is a word, difficult and perhaps impossible to define in any precise general formula. It is a word of the broadest connotation. Even though the definition of income is inclusive the same shall be construed as comprehending only such things which are income according to the natural import of the term. This definition of income under the Act was the subject-matter of interpretation by the Supreme Court on several occasions. The Supreme Court in the case of CIT v. Chamanlal Mangaldas & Co. : [1960]39ITR8(SC) (sic-CIT v. Shoorji Vallabhdas & Co. : [1962]46ITR144(SC) has held as under :

'Income-tax is a levy on income. No doubt, the Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a 'hypothetical income', which does not materialise. Where income has, in fact, been received and is subsequently given up in such circumstances that it remains the income of the recipient, even though given up, the tax may be payable. Where, however, the income can be said not to have resulted at all, there is obviously neither accrual nor receipt of income, even though an entry to that effect might, in certain circumstances, have been made in the books of account.'

The Supreme Court in the case of CIT v. Shiv Prakash Janak Raj : [1996]222ITR583(SC) dealing with the concept of income has approved the

judgment of the Supreme Court in the case of Morvi Industries Ltd. v. CIT : [1971]82ITR835(SC) (sic-State Bank of Travancore v. CIT : [1986]158ITR102(SC) . where the legal principles have been set out as under :

'(1) It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation. (2) The concept of real income would apply where there has been a. surrender of income which in theory may have accrued but in the reality of the situation, no income had resulted because the income did not really accrue. (3) Where a debt has become bad, deduction in compliance with the provisions of the Act should be claimed and allowed. (4) Where the Act applies, the concept of real income should not be so read as to defeat the provisions of the Act. (5) If there is any diversion of income at source under any statute or by overriding title, then there is no income to the assessee. (6) The conduct of the parties in treating the income in a particular manner is material evidence of the fact whether income has accrued or not. (7) Mere improbability of recovery, where the conduct of the assessee is unequivocal, cannot be treated as evidence of the fact that income has not resulted or accrued to the assessee. After debiting the debtor's account and not reversing that entry-but taking the interest merely in suspense account cannot be such evidence to show that no real income has accrued to the assessee or been treated as such by the assessee. (8) The concept of real income is certainly applicable in judging whether there has been income or not but, in every case, it must be applied with care and within well-recognised limits.

Again the Supreme Court in the case of CIT v. T.V. Sundaram Iyengar & Sons Ltd. : [1996]222ITR344(SC) after reviewing the entire case-law on the point has approved the principle of law stated in Morely (H.M Inspector of Taxes) v. Tattersall : [1939]7ITR316(Cal) where it was laid down that the taxability of a receipt was fixed with reference to its character at the moment it was received and that merely because the recipient treated it subsequently in his income account as his own that did not alter that character. Though it was observed that in some cases, this principle has not been followed because of special facts, but the principle as such has not been doubted.

9. From the foregoing what emerges is that income-tax is a levy on income. The Income Tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt. It is the income which has really accrued or arisen to the assessee that is taxable. Whether the income has really accrued or arisen to the assessee must be judged in the light of the reality of the situation. Income is what comes in from outside. Given its ordinary and natural meaning, the word income will take in any monetary return 'coming in'. When in reality there is neither accrual nor receipt of income by the assessee, even though an entry to that effect might, in certain circumstances have been made in the books of account, it would not constitute income for the purpose of levy of tax. In other words, income means real income and not fictional one. This involves really two aspects. One is that the receipt should connote a real or tangible coming and not something notional or fictional. A rebate obtained by the purchaser or remission of debt by a creditor would not result in the creation of income in the hands of the purchaser or debtor. As in those instances the assessee does not receive any income to his nets though by such rebate or remission he is benefited to the extent of the rebate or remission.

9.1 Next, reliance was placed by the revenue to substantiate their contention on section 41(1) of the Act which reads as hereunder :

'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 's 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 years.'

10. This provision was also the subject-matter of interpretation by various Courts. The Bombay High Court in the case of Mahindra & Mahindra Ltd. v. CIT : [2003]261ITR501(Bom) was dealing with a case where assessee had borrowed loan and paid interest at the rate of 6 per cent per annum for 10 years being the period of contract and he never got deduction for payment of interest under section 36(1)(iii) or under section 37 of the Act and the said loan was waived. In that context, assessing officer held that credits became part of business income and prior to such waiver credit representing the said liability and accordingly, the same was taxable as business income, which finding was affirmed by both the appellate authorities. The High Court set aside the said order holding that the prerequisite of section 41(1) was not applicable. In order to apply section 41(1), the 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 waiver of principal amount was unexpected. Therefore, such waiver would not construe business income and it would not constitute a trading liability and accordingly section 41(1) was not attracted.

In the case of Protos Engineer Co. (P) Ltd. v. CIT : [1995]211ITR919(Bom) , the assessee was in possession of amounts deposited by the customers as advance for purchase of pumps, excess commission received from the parties which was never claimed back by them, certain amounts collected by the assessee on behalf of the principals who never claimed the same from the assessee and savings from remittances received from the foreign company towards the expenses of the directors in India which was not claimed back by the foreign company. The authorities held that the aforesaid amounts represented the value of benefits

received by the assessee in the ordinary course of business carried on by it and hence it was a trading receipt includible in the computation of the income of the assessee.

11. On the facts of those cases the High Court held that the aforesaid amount represented unclaimed old credit balances which were not claimed by the creditors as according to them they were not due to them. The amounts therefore, represented amounts payable to the assessee for the services rendered by it to the creditors in course of business or reimbursement of expenses incurred by it in the past on their account in course of business which was not appropriated to the P&L; a/c in the year of receipt for one reason or the other. The assessee had appropriated these amounts, which were appearing in its account as amounts due to others, to its own account as profit by crediting the same to its P&L; a/c. No benefit in cash as such had arisen to the assessee during the year under consideration. The benefit received by the assessee by appropriation of this amount to its P&L; a/c is definitely a benefit convertible into money. Section 28(iv) of the Act will squarely apply to such benefit.

12. Therefore, it is clear that in the aforesaid case the assessee had really received those amounts which were not claimed back by the persons who paid it and when the said amounts were so not claimed back, it was the benefit received by the assessee by appropriation of the said amount in its P&L; a/c, to the extent the aforesaid amount was trading receipt and therefore, rightly includible in the income of the assessee. The said case has no application to the facts of this case as the amount involved in this case is not an amount received by the assessee or the amount coming into the nets of the assessee and as such the said judgment has no application.

13. In the instant case, admittedly the assessee had issued debentures which are redeemable after a period of ten years at a face value thereof. Though debenture-holders sold the debentures before the stipulated period at a discounted price to the nominee of the assessee, the consideration paid to those debenture-holders was paid by the assessee as reflected in the books of account by a loan advanced to the nominee. Thereafter, on the due dates, the assessee has redeemed those

debentures. For the purpose of accounting, the entire liability was shown as a liability at the price paid by the nominee of the assessee. In the balance sheet, the entire amount due under debentures was shown as a liability. After redemption, the difference in the amount was transferred to the P&L; a/c and it was shown as surplus. It is obviously on the ground that after redemption so much liability is saved by the assessee and actually the same has to be shown as surplus though there is no real income or profit derived. Notwithstanding the no nomenclature adopted in the balance sheet to depict that amount and the place where it is shown, in reality the assessee did not receive the said amount as income. The assessee was only able to discharge its liability at a lesser amount as against the face value of the debentures. It is well recognised that in revenue cases, regard must be had to the substance of the transaction rather than to its mere form. It is wholly unreal and artificial to separate the business from its owner and treat them as if they were separate entities trading with each other and then by means of a fictional sale introduce a fictional profit which in truth and in fact did not 'exist. Cut away the fictions and you reach the position that the man is supposed to be selling to himself and thereby making a profit out of himself which on the face of it is not only absurd but against all canons of mercantile and income-tax law. Merely because the aforesaid amount was shown as a surplus amount in the P&L; a/c, when the assessee did not actually receive any income, we are unable to accede to the submission of Sri Seshachala that it constitutes income under section 2(24) of the Act. Having regard to the reality of the situation, as the assessee has not derived any income, he is entitled not to treat it as an income. Therefore, the Tribunal was fully justified in its conclusion that the said surplus amount reflected in the balance sheet cannot be treated as an income of the assessee. We do not find any error in the said conclusion reached by the Tribunal.

14. Therefore, for the aforesaid reasons, we answer the question in the affirmative in favour of the assessee and against the revenue. Accordingly, the reference is disposed of. However, no order is made as to costs.