Advanced Diploma in Corporate Taxation, NALSAR

Paper-2: Determining tax base of corporate income- Revenue Receipts and Capital Receipts

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Cap & revenue receipts

It would be fallacious to assume that every receipt has to be either income or capital. Receipts which are not income are sometimes erroneously called 'capital receipts' as if all receipts must necessarily fall within either of the two categories. Some receipts may be just not income, although they may not be on capital account either

Examples of such receipts are testimonials and personal gifts, and some categories of voluntary payments and regular allowances, which are dealt with under s 10(3), 'Voluntary payments: Testimonials and personal gifts: Regular allowances'.

CIT v Sri Vanamamalai 231 ITR 632

Cap & revenue receipts

The distinction between a capital and revenue receipt has often been illustrated by the hen and egg analogy. In the words of the Rajasthan High Court in *CIT* v. *Rao Raja Kalyansingh* [1974] 97 ITR 690. "If we are to employ an age old simile that if the compensation is for the hen that lays the egg and not for the egg itself then it cannot be but capital." Or, it could be illustrated by the "tree and fruit" analogy cited by Sankey J. in *Pool* v. *Guardian Investment Trust Co. Ltd.* (8 TC 167). Hen is the source and egg, income; or the tree is the source and fruit, income. To constitute income, there must be a source and there is a connection between the two. Compensation for the source is a capital receipt. In order to decide whether or not a payment is a revenue receipt its nature and substance may be looked into. If the payment is received in the ordinary course of business, for loss of stock in trade, it is revenue receipt. If on the other hand, the payment received is towards compensation for extinction or sterilization, partially or fully of a profit earning source, such receipt, not being in the ordinary course of business, is a capital receipt [*CIT* v. *Barium Chemicals Ltd.* [1987] 168 ITR 164 (AP)].

Cap & revenue receipts

. There is no principle of universal application. The matter is decided sometime upon the nature of the business, or the nature of the outlay or the nature of the receipt or the combination of these factors [*Senairam Doongarmall* v. *CIT* [1961] 42 ITR 392 (SC). One principle is well set as laid down by the Supreme Court in *CIT* v. *Prabhu Dayal* [1971] 82 ITR 804]. Where payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business or deprive him of what in substance is his source of income, termination of contract being the normal incident of the business, and such cancellation leaves him free to carry on his trade though freed from the contract terminated, the receipt is revenue; where the cancellation of the contract the trading structure of the assessee is impaired or such cancellation results in loss of what may be regarded as the source of income, the payment made to compensate for cancellation of the agreement is normally a capital receipt.

For the application of the above general principle, it is necessary to find out why the payment has been made. It is not the motive of the person who pays that is relevant. What is more relevant is the nature of the receipt in the hands of the person who receives it though in trying to find out the quality of the receipt one may have to examine the motive out of which the payment was made [*P. H. Divecha* v. *CIT* [1963] 48ITR222 (SC)]. The amount involved is large, or that it is periodic in character, or the manner of its measurement, or its nomenclature has no decisive bearing upon the matter [*Eklingji Trust* v. *CIT* [1986] 158 ITR 810 (Raj.)]

Cap & revenue receipts

The problem of discriminating between capital receipts and income receipts, and between capital disbursements and income disbursements, has very frequently engaged the attention of the courts. In general, the distinction is well recognised and easily applied, but from time to time cases arise where the item lies on the borderline and the task of assigning it to income or capital becomes one of much refinement. As the Act does not define income except by way of adding artificial categories, it is to the decided cases that one must go in search of light. While each case is found to turn upon its own facts and no infallible criterion emerges, nevertheless the decisions are useful as illustrations and as affording indications of the kind of considerations which may relevantly be borne in mind in approaching the problem

Where a single amount received by the assessee is partly on capital account and partly on income account, it should be apportioned and the part which is of a revenue nature should be brought to charge - *CIT v Best* 60 ITR 11 (SC)
Even if there be any difficulty in making such apportionment, it cannot be a ground for rejecting the claim either of the revenue or of the assessee.

Cap & revenue receipts

"It is a cardinal principle of law that the difference between capital recovery and interest or finance income is essential for accounting for such a transaction with reference to its substance. If the same was not carried out, the Respondent would be assessed for income tax not merely on revenue receipts but also on non-revenue items which is completely contrary to the principles of the IT Act and to its Scheme and spirit."

[CIT v. Virtual Soft Systems Ltd., Civil Appeal No. 4358 of 2018]

Cap & revenue receipts

Distinction is to be made between stock-in-trade/circulating capital, and fixed capital - Distinction between revenue and capital in the law of income-tax is fundamental. Tax is ordinarily not levied on capital profits; it is levied on income. It is well-settled that sale of stock-in-trade or circulating capital or rendering service in the course of trading results in a trading receipt; sale of assets which the assessee uses as fixed capital to enable him to carry on his business results in capital receipt - *CIT* v. *Maheshwari Devi Jute Mills Ltd.* [1965] 57 ITR 36 (SC).

Decided cases are not totally helpful - No infallible criterion or test can be, or has been, laid down and the decided cases are only helpful in that they indicate the kind of consideration which may relevantly be borne in mind in approaching the problem. The character of the payment received may vary according to the circumstances. Thus, the amount received as consideration for the sale of a plot of land may ordinarily be a capital receipt but if the business of the recipient is to buy and sell lands, it may well be his income - *CIT/CEPT* v. *South India Pictures Ltd.* [1956] 29 ITR 910 (SC).

Cap & revenue receipts

Few Immaterial considerations/factors for determining – Cap v. Revenue

(a) Payment Measured by Estimated Profits - The fact that a certain payment is measured (as is usually done in computing damages) by the estimated annual yield or profits, does not make the payment an income receipt. There is no relation between the measure that is used for the purpose of calculating a particular result and the quality of the figure that is arrived at by means of the application of that test' - *CIT v MB Tyres* 137 ITR 295

(b) Lump Sum and Periodic Sums.—That the receipt is a periodic receipt or a single receipt is immaterial for the purpose of determining its nature. 'There is no magic…in the distinction between a lump sum and a periodical sum'. An income receipt is not necessarily recurring, nor a capital receipt necessarily single. A single or an occasional receipt may be an item of income and an annual receipt recurring over a number of years may be capital. [*CIT v Presidency* 216 ITR 321; *CIT v Vardhini* 165 ITR 342]

(c) Magnitude of Receipt.—The magnitude of a sum is not material for the purpose of determining its nature,for magnitude is a relative term. *Divecha v CIT* 48 ITR 222 (SC)

Cap & revenue receipts

Few Immaterial considerations/factors for determining – Cap v. Revenue

(d) Accounting classification is not relevant - The classification of the receipts in the form of accounts is not of any importance in considering whether the receipt is taxable as revenue receipt - *Hoshiarpur Electric Supply Co.* v. *CIT* [1961] 41 ITR 608 (SC).

(e) Non-reflection in account books is not relevant - It is the true nature and the quality of the receipt and not the head under which it is entered in the account books which would prove decisive. If a receipt is a trading receipt, the fact that it is not so shown in the account books of the assessee would not prevent the assessing authority from treating it as a trading receipt - *Chowringhee Sales Bureau (P.) Ltd.* v. *CIT* [1973] 87 ITR 542 (SC).

(f) Form and nomenclature are not relevant - It may be broadly stated that what is received for loss of capital is a capital receipt and what is received as profit in a trading transaction is taxable income. The form in which the transaction which gives rise to income is clothed and the name which is given to it are irrelevant in assessing the eligibility to tax, of a receipt arising from a transaction. It is again not predicated that the income must necessarily have a recurrent quality - *Kettlewell Bullen & Co. Ltd.* v. *CIT* [1964] 53 ITR 261 (SC).

Cap & revenue receipts

Few Immaterial considerations/factors for determining – Cap v. Revenue

(g) Disallowance to Payer.—The fact that the payment is not allowed as a revenue deduction to the person making it, does not lead to the conclusion that it is a capital receipt in the hands of the recipients - *Lakshmi Rajyam v CIT* 40 ITR 340

Cap & revenue receipts

Nature of receipt in recipient's hands is more relevant than motive of payer - To constitute income, profits or gains, there must be a source from which the particular receipt has arisen, and a connection must exist between the quality of the receipt and the source. If the payment is by another person, it must be found out why the payment has been made. It is not the motive of the person who pays that is relevant. More relevance attaches to the nature of the receipt in the hands of the person who receives it though in trying to find out the quality of the receipt one may have to examine the motive out of which the payment was made. The periodicity of the payment does not make the payment a recurring income because periodicity may be the result of convenience and not necessarily the result of the establishment of a source expected to be productive over a certain period - *P.H. Divecha* v. *CIT* [1963] 48ITR222 (SC).

Distinction must be drawn between payments for services and compensation - It is now well-settled that a distinction has to be drawn between a payment made for past services or discharge of past liabilities, and that made for compensation for termination of an income-producing asset. The former does not lose its revenue nature, but the latter being a payment for destruction of a capital asset, must be considered as capital receipt - *CIT* v. *Prabhu Dayal* [1971] 82 ITR 804 (SC).

Cap & revenue receipts

Character of recipient's business is relevant - Whether a sum is received on capital or revenue account depends or may depend upon the character of the business of the recipient and upon other factors related thereto - *CIT* v. *Ashok Leyland Ltd.* [1972] 86 ITR 549 (SC).

Hon'ble Supreme Court in the case of *CIT v. Kamal Behari Lal Singha [1971] 82 ITR 460,* observed *"it is now well settled that, in order to find out whether it is a capital receipt or revenue receipt, one has to see what it is in the hands of the receiver and not what it is in the hands of the payer".*

Determining factors - It is well-settled that what is capital asset in the hands of one person may be trading asset in the hands of another. The determining factor is the nature of the trade in which the asset is employed. If forest leases are merely stock-in-trade and payments are made for taking over the stock-in-trade, then no question of capital receipt arises. The sum would represent payment of revenue nature or trading receipts. But compensation received for immobilisation, sterilisation, destruction or loss, total or partial, of a capital asset would be capital receipt. If a sum represents profit in a new form, then that is income but where the agreement relates to the structure of the assessee's profit-making apparatus and affects the conduct of the business, the sums received for cancellation or variation of such agreement would be capital receipt - *CIT* v. *Bombay Burmah Trading Corpn.* [1986] 161 ITR 386 (SC).

Cap & revenue receipts

Sale receipts prior to commencement of business - Where the assessee's business has not commenced, amounts realised by assessee by sale of tender forms and empty bags would be capitalreceipts and cannot be brought to tax in the assessee's hands as 'income from other sources' - *CIT* v. *Rassi Cement Ltd.* [1998] 232 ITR 554 (AP).

Restrictive covenant - Sum received by assessee-employee from erstwhile employer under a restrictive covenant not to take employment with competitor could not be treated as perquisite but is a capitalreceipt - *B.K. Kotru* v. *CIT* [2006] 282 ITR 1 (Bom.)/*CIT* v. *A.K. Khosla* [2010] 191 Taxman 439 (Mad.).

Insurance compensation for loss of raw materials is a trading receipt- Where the assessee incurred loss of raw materials in a fire accident and received compensation from the insurance company in excess of its value, the excess amount received is clearly a trading receipt and not a capitalreceipt. The mere fact that the assessee was charging the actual quantity of raw materials consumed to the manufacturing account is not relevant to decide whether the raw material is capital asset or not. Further, the definition of 'capital asset' in section 2(*14*) specifically excludes raw materials from its purview - *CIT* v. *Needle Industries (India) Ltd.* [2000] 108 Taxman 524 (Mad.).

Cap & revenue receipts

Reimbursement of loss to stock-in-trade by bank is trading receipt- Where on account of damage to assessee-company's stock-in-trade pledged with bank to obtain overdraft, bank agreed to adjust overdraft amount against assessee's claim for damages, since amount so received represented compensation for loss or damage to stock-in-trade, it constituted a trading receipt and was assessable to tax irrespective of fact whether assessee had or had not claimed loss or damage to stock-in-trade, as and when it occurred - *Ramesh Narain Saxena* v. *CIT* [1996] 86 Taxman 65 (SC).

Compensation received from unilateral termination of construction agreement is trading receipt- Where agreement entered into by assessee-company to develop and construct buildings on land owned by another company was unilaterally terminated by land owner company and under a settlement agreement compensation was paid to assessee for annulment of its rights to carry on business and for being deprived of potential income which would have arisen to it from carrying on such business, said compensation would constitute trading receipt in hands of assessee - *Ansal Properties & Industries Ltd.* v. *CIT* [2011] 196 Taxman 45/[2010] 8 taxmann.com 86 (Delhi)

Cap & revenue receipts

Profits from exchange operations connected with business operations are business receipts- If by virtue of exchange operations profits are made during the course of business and in connection with business transactions, the excess receipts on account of conversion of one currency into another would be revenue receipts. But if the profit by exchange operations comes in, not by way of business of the assessee, the profit would be capital profit - *CIT* v. *Canara Bank Ltd.* [1967] 63 ITR 328 (SC).

Devaluation gains on business receipts retained abroad are business receipts- Where the assessee was allowed to retain a sum in UK for business purposes, the accretion in its value in terms of Indian currency due to devaluation of the Indian rupee, was held to be a business profit and assessable as such even though it was not remitted to India - *Indo-Burma Petroleum Co. Ltd.* v. *CIT* [1982] 136 ITR 251 (Cal.)

Cap & revenue receipts

Unclaimed deposits and time-barred deposits are trading receipts- If an amount is received in course of trading transaction, even though it is not taxable in the year of receipt as being of capital character, the amount changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right. Where assessee received deposits in the course of trade transactions, amounts of such credit balances which were barred by limitation and which were written back by assessee to profit and loss account were to be assessed as assessee's business income - *CIT* v. *T.V. Sundaram Iyengar & Sons Ltd.* [1996] 88 Taxman 429 (SC).

Excess of sales tax collections over payments is a trading receipt- If the sales tax collected by the assessee from his buyers during the year of account is in excess of his actual liability towards sales tax for that period such excess would go only for his benefit. Therefore, the excess collections are trading receipts of the assessee - *CIT* v. *E.A.E.T. Sundararaj* [1975] 99 ITR 226 (Mad.)/*Deccan Hides & Skins Co.* v. *CIT* [1983] 142 ITR 175 (Bom.).

Cess collections are trading receipts- Where the amount collected by the assessee as cess from its customers on sale of oil was not paid to the Government, but was kept in an 'Amanath' Account pending settlement of dispute regarding the levy of cess, it was a trading receipt of the assessee - *CWT* v. *Shree Bhagpatia Food Industries* [1994] 207 ITR 1045 (Raj.).

Cap & revenue receipts

The assessee-company was in process of constructing and erecting its plant and had not started any business during relevant assessment years. It received certain amounts through (*i*) rent charged by assessee from its contractors for housing workers and staff employed by contractor for construction work of assessee, (*ii*) hire charges for plant and machinery given to contractors for use in construction work of assessee, (*iii*) interest from advances made to contractors for purpose of facilitating work of construction, and (*iv*) royalty for excavation and use of stones lying on assessee's land for construction work. First three receipts had been adjusted against charges payable to contractors and, thus, had gone to reduce cost of construction. The Supreme Court held that first three receipts being intrinsically connected with construction of assessee's plant, would be capitalreceipt and not income of assessee from any independent source. Similarly royalty received for stone excavated from assessee's land would go to reduce cost of plant and could not be taxed as income - *CIT* v. *Bokaro Steel Ltd.* [1999] 102 Taxman 94 (SC).

Cap & revenue receipts

When business premises are compulsorily requisitioned - Where the assessee's business premises were compulsorily requisitioned by Government on payment of compensation, such compensation would constitute a capital receipt only if injury caused was to the assessee's capital assets; if the injury was to the assessee's trading, it would be a revenue receipt - *CIT/CEPT* v. *Shamsher Printing Press* [1960] 39 ITR 90 (SC).

Where under master agreement between Coca Cola and Parle group, assessee-subsidiary was to be formed for bottling soft drinks for Coca Cola but as a result of breach of contract by Coca Cola, assessee's fundamental right for starting bottling business was taken away, compensation received by assessee from Coca Cola would be treated as capital receipt - *CIT* v. *Parle Soft Drinks (Bangalore (P.) Ltd.)* [2017] 88 taxmann.com 24/[2018] 252 Taxman 147 (Bom.) [SLP dismissed in *CIT* v. *Parle Soft Drinks (Bangalore) (P.) Ltd.* [2018] 97 taxmann.com 136/258 Taxman 61 (SC)].

Cap & revenue receipts

Non compete fees

On this issue the Court referred to its earlier judgement in GifficChem (P.) Ltd v. CIT [2011] 4 SCC 254, which involved the question of taxability of receipt of non-compete fee u/s 28(ii)(a). In this case, it was held that there is a dichotomy between receipt of compensation by an assessee for the loss of agency and receipt of compensation attributable to the negative/restrictive covenant. The compensation received for the loss of agency is a revenue receipt whereas the compensation attributable to a negative/restrictive covenant is a capitalreceipt.

The above dichotomy has been clearly spelt out by the Supreme Court in an earlier Gillanders Arbuthnot & Co. Ltd. v. CIT [1964] 53 ITR 283, which also involved taxability of two amounts – one as compensation for loss of agency and the other for not carrying on a competitive business. In this case the Court has stated in unequivocal terms that the compensation received by the assessee for loss of agency was a revenue receipt whereas compensation received for refraining from carrying on competitive business was a capitalreceipt.

In the case of GifficChem (P.) Ltd.(supra), the Court further highlighted that the non-competition fee received under a negative covenant was always treated as a capitalreceipt till A.Y. 2003-04 and it became taxable with the insertion of section 28(va) vide Finance Act, 2002 w.e.f. 1.4.2003.

Cap & revenue receipts

From the foregoing discussion it can be easily noticed that if the receipt is to make good actual or prospective loss in a particular trading transaction or set of transactions, it is a revenue receipt liable to tax. ***However, any receipt towards loss of source of income is a capital receipt. Loss of source of income does not necessarily mean that it must absolutely extinguish. If the source of income has been severely beaten thereby causing serious damage to the income-earning apparatus itself, it will also be construed as the loss of source of income.*** *Such indentation to the source can be caused in different ways. One of such ways may be maligning the name of the business, resulting in tarnishing the reputation and causing damage to the goodwill of business. So if goodwill of the business is damaged and later on some compensation is awarded in lieu of that, it will also fall in the same category of loss to the source of income and consequently such a receipt will also qualify to be characterized as a capital receipt. It is imperative that the receipt should be, in fact, towards loss of goodwill in general and no part of it should relate to make good the loss in a particular trading transaction or set of transactions. If such a receipt cannot be identified with the loss in a particular transaction(s) but to make good the injury caused to the reputation of business which had the effect of impairing the source of income, it will be a capital receipt.*

Inter Gold (India) (P.) Ltd. v. JCIT, (2010) 37 SOT 45 (Mum),

Cap & revenue receipts

Income is something which flows from the property. ***Something received in place of the property will be capital receipt.*** *The amount of interest received by the company flows from its investments and is its income and is clearly taxable even though the interest amount is earned by utilizing borrowed capital -* **Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT, (1997) 93 Taxman 502 (SC)]**

Distinction between revenue and capital in the law of income-tax is fundamental. Tax is ordinarily not levied on capital profits: it is levied on income. It is well-settled that sale of stock-in-trade or circulating capital or rendering service in the course of trading results in a trading receipt: ***sale of assets which the assessee uses as fixed capital to enable him to carry on his business results in capital receipt.***
[CIT v. The Maheshwari Devi Jute Mills, AIR 1965 SC 1974,(1965) 3 SCR 765 (SC)]

Cap and Revenue receipts

Amounts received on encashment of bank guarantee would be assessable as trading receipt - *CIT v. State Trading Corporation* [2000] 112 Taxman 117 (Delhi).

CIT v. Saurashtra Cement Ltd., (2010) 325 ITR 422 (SC)

We have considered the matter in the light of the afore-noted broad principle. It is clear from clause No. 6 of the agreement dated 1-9-1967, extracted above, that the liquidated damages were to be calculated at 0.5 per cent of the price of the respective machinery and equipment to which the items were delivered late, for each month of delay in delivery completion, without proof of the actual damages the assessee would have suffered on account of the delay. The delay in supply could be of the whole plant or a part thereof but the determination of damages was not based upon the calculation made in respect of loss of profit on account of supply of a particular part of the plant. It is evident that the damages to the assessee was directly and intimately linked with the procurement of a capital asset, i.e., the cement plant, which would obviously lead to delay in coming into existence of the profit-making apparatus, rather than a receipt in the course of profit-earning process. ***Compensation paid for the delay in procurement of capital asset amounted to sterilization of the capital asset of the assessee as supplier had failed to supply the plant within time as stipulated in the agreement and clause No. 6 thereof came into play. The afore-stated amount received by the assessee towards compensation for sterilization of the profit-earning source, not in the ordinary course of their business, in our opinion, was a capital receipt in the hands of the assessee***

EID Parry Ltd. v. CIT, (1998) 233 ITR 335 (Mad)… *In the final settlement, the Japanese company agreed to pay Rs. 9.5 lakhs as per the memorandum of settlement, dated July 25, 1968. The Japanese company agreed to pay compensation for delay in completion of the work and failure to produce the guaranteed results. … Therefore out of Rs. 9.5 lakhs, a portion would relate to delay in procurement of the capital assets. Delay in procurement of capital assets would lead to delay in coming into existence of the profit-making apparatus. Compensation paid for such delay in procurement of capital assets would amount to sterilisation of the capital assets of the assessee in that the Japanese company failed to erect the machinery and plant according to the agreement dated July 25, 1968. The sterilisation of assets need not be in toto in order to make a payment a capital receipt. … If the payment is received in the ordinary course of the business of the assessee for loss of stock-in-trade, it is a revenue receipt.* ***If, on the other hand, the payment received is towards compensation for extinction or sterilisation, partly or fully, of a profit-earning source, such receipt, not being in the ordinary course of the assessee's business, is a capital receipt.*** *Thus, considering the final settlement arrived at between the assessee and the Japanese company dated July 25, 1968, and clauses 28, 32, 34, 34(i), 34(vi) and 40, in the agreement dated July 14, 1965, and February 28, 1967,* ***we are of the opinion that a portion of Rs. 9.5 lakhs paid by the Japanese company should be treated as capital in nature and such portion is determined by us as l/3rd of Rs. 9.5 lakhs, which related to delay in procurement of capital assets.*** *In so far as 2/3rds of Rs. 9.5 lakhs is concerned, we are not disturbing the order passed by the Tribunal holding that such quantum of compensation is revenue in nature, since the said sum relates to erection and construction of the works and the performance of all other duties.*

Cap and Revenue receipts

It is well settled that a receipt is not taxable when it is a fixed capital. It is taxable as a revenue item when it is referable to circulating capital or stock-in-trade [*CIT v. Mahindra & Mahindra Ltd.*, (1973) 91 ITR 130 (Bom)]. Fixed capital is what the owner turns to profit by keeping it in his own possession; circulating capital is what he makes profit by parting with it and letting it change masters: In other words, circulating capital is capital which is turned over, and in the process of being turned over yields profit or loss [John Smith & Son v. Moore, (1921) 12 TC 266 , (HL). Circulating capital is, accordingly, the same as stock-in-trade or trading asset. At the same time, what is capital asset in the hands of one person may be a trading asset in the hands of another. "The determining factor must be the nature of the trade in which the asset is employed" [Romer LJ, in Golden Horse Shoe (New) Ltd. v. Thurgood, (1933) 18 TC 280 , (CA); Bombay Burmah Trading Corporation Ltd. v. CTT, (1971) 81 ITR 777 ,(Bom) affirmed in CIT v. Bombay Burmah Trading Corporation, (1986) 161 ITR 386 (SC)]. Whether an asset is a capital asset or a trading asset must be determined on the facts of each case [Addl. CIT v. Poddar Auto Dealers, (1975) 101 ITR 14 (Pat)].

Cap and Revenue receipts

It cannot be laid down as a matter of law that an amount, which was initially not received as a trading receipt, can never become a trading receipt. A trading receipt arising in the course of business, though treated as a deposit and of capital nature when received can, nevertheless, become the assessee's own money by efflux of time and will be assessable as a trading receipt when it is credited to the profit and loss account and there is no existing liability to repay. *CIT v Karam Chand* 222 ITR 112 (SC); *CIT v Sundaram* 222 ITR 344 (SC); *CIT v Lakshmi Vilas Bank* 220 ITR 305 (SC)

A contribution to the corpus of the assessee is a capital receipt (*CIT v Apparels Export Council* 190 ITR 163)

Sale of trade marks in consideration of fixed monthly payment for life time of the vendor was held to be a revenue receipt [*CIT v. Lal Chand Jain*, (1968) 69 ITR 65 (Delhi)].

Damages received from the otherparty for non-performance of the non-business agreement—held, capital receipt [*CIT v. Ashoka Marketing Ltd.*, (1987) 164 ITR 664 (Cal)]

Cap and Revenue receipts

Subsidy

It is the object with which the subsidy or incentive is given that determines whether it is revenue or capital in nature. The Supreme Court called this the “purpose test” and ruled that the time when the subsidy was paid, the source and the form of the subsidy was immaterial. If the object of the subsidy or incentive is to enable the assessee to run its business more profitably, then it is revenue in nature. On the other hand, if the subsidy or incentive is for setting up a new unit or expanding the existing unit, the receipt would be capital in nature. Applying the purpose test, a scheme that provided for rebate of excise duty and remission of purchase tax for setting up new sugar unit or for expansion of existing unit was held to be capital in nature - *CIT v Ponni Sugars and Chemicals Ltd.* 306 ITR 392 (SC)

Subsidy given by way of assistance for carrying on trade or business to meet recurring expenses and not for acquiring capital assets would be revenue in nature - *Sahney Steel Press Works Ltd. v CIT* 228 ITR 253 (SC)

Amendment by Finance Act– sec 2(24)(xviii) - Finance Act, 2015 had amended the definition of income by inserting section 2(*24*)(*xviii*) so as to provide that income shall include assistance in the form of a subsidy, grant, etc., by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee.

Cap and Revenue receipts

Way forward – Capital gains and IFOS?

Observations in **[2014] 50 taxmann.com 300 (Bom)**

25. *But we have examined the issue afresh. The word income for the purpose of the Act has a well understood meaning as defined in Section 2(24) of the Act. This even when the definition in Section 2(24) of the Act is an inclusive definition. It cannot be disputed that income will not in its normal meaning include capital receipts unless it is so specified, as in Section 2(24) (vi) of the Act. In such a case, Capital Gains chargeable to tax under Section 45 of the Act are, defined to be income. The amounts received on issue of share capital including the premium is undoubtedly on capital account. Share premium have been made taxable by a legal fiction under Section 56(2)(viib) of the Act and the same is enumerated as Income in Section 2(24)(xvi) of the Act. However, what is bought into the ambit of income is the premium received from a resident in excess of the fair market value of the shares. In this case what is being sought to be taxed is capital not received from a non-resident i.e. premium allegedly not received on application of ALP. Therefore, absent express legislation, no amount received, accrued or arising on capital account transaction can be subjected to tax as Income.* This is settled by the decision of this Court in *Cadell Weaving Mill Co.* v. *CIT* [2011] 249 ITR 265/116 Taxman 77 was upheld by the Apex Court in *CIT* v. *D.P Sandu Bros. Chember (P.) Ltd*. [2005] 273 ITR 1/142 Taxman 713. This Court has in *Cadell Weaving Mills Co*. (*supra*) inter alia, observed as under:—

Cap and Revenue receipts

'It is well settled that all receipts are not taxable under the Income tax Act. Section 2(24) defines "income". It is no doubt an inclusive definition. However, a capital receipt is not income under section2(24) unless it is chargeable to tax as capital gains under Section 45. It is for this reason that under section 2(24)(vi) that the Legislature has expressly stated, inter alia, that income shall include any capital gains chargeable under section 45. Under Section 2(24)(vi), the Legislature has not included all capital gains as income. It is only capital gains chargeable under Section 45 which has been treated as income under Section 2(24). If the argument of the Department is accepted then all capital gains whether chargeable under section 45 of not, would come within the definition of the word "income" under section2(24). Further, under section 2(24)(vi) the Legislature has not stated that "any capital gains" will be covered under the word income. On the contrary, the Legislature has advisedly stated that only capital gains which are chargeable under Section 45 of the Act could be treated as income. In other words, capital gains not chargeable to tax under section 45 fall outside the definition of the word "income" in section 2(24) of the Act. It is true that section 2(24) of the Act is an inclusive definition However, in this case, we are required to ascertain the scope of Section 2(24)(vi) and for that purpose we have to read the sub section strictly. We cannot widen the scope of sub section by saying that the definition as a whole is inclusive and not exhaustive. In the present case, the words "chargeable under section 45" are very important. They are not being read by the Department. These words cannot be omitted. In fact, the prior history shows that capital gains were not chargeable before 1946. They were not chargeable between 1948 and 1956. Therefore, whenever an amount which is other wise a capital receipt is to be charged to tax, section 2(24) specifically so provides.'

Cap and Revenue receipts

In view of the above, we find considerable substance in the Petitioner's case that neither the capital receipts received by the Petitioner on issue of equity shares to its holding company, a non-resident entity, nor the alleged short-fall between the so called fair market price of its equity shares and the issue price of the equity shares can be considered as income within the meaning of the expression as defined under the Act.

....

38. If the above provision is contrasted with the provisions of Chapter X of the Act and in particular Section 92 thereof, it would be noticed that the crucial words "shall be chargeable to income tax" which are found in Section 42(2) of the 1922 Act are absent in Chapter X of the Act. We pointed out this difference in the two provisions to the learned Solicitor General and he agreed that the above difference exists. However, according to him this was in view of the fact that Sections 4, 5, 14 and 56 of the Act does create a charge to income tax on deemed income earned from International taxation. Therefore, it is clear that the deemed income which was charged to tax under Section 42(2) of the 1922 Act was done away with under the Act. The charge of Income now has to be found in Section 4 of the Act. If it is income which is chargeable to tax, under the normal provision of the Act, then alone Chapter X of the Act could be invoked. Sections 4 and 5 of the Act brings /charges to tax total income of the previous year. This would take us to the meaning of the word income under the Act as defined in Section 2(24) of the Act. The amounts received on issue of shares is admittedly a capital account transaction not separately brought within the definition of Income, except in cases covered by Section 56(2) (viib) of the Act. Thus such capital account transaction not falling within a statutory exception cannot be brought to tax as already discussed herein above while considering the challenge to the grounds as mentioned in the impugned order.

Cap and Revenue receipts

42. It was contended by the Revenue that in any event the charge would be found in Section 56(1) of the Act. Section 56 of the Act does provide that income of every kind which is not excluded from the total income is chargeable under the head income from other sources. However, before Section 56 of the Act can be applied, there must be income which arises. As pointed out above, the issue of shares at a premium is on Capital Account and gives rise to no income. The submission on behalf of the revenue that the shortfall in the ALP as computed for the purposes of Chapter X of the Act give rise to income is misplaced. The ALP is meant to determine the real value of the transaction entered into between AEs. It is a re-computation exercise to be carried out only when income arises in case of an International transaction between AEs. It does not warrant re-computation of a consideration received/given on capital account. It permits re-computation of Income arising out of a Capital Account Transaction, such as interest paid/received on loans taken/given, depreciation taken on machinery etc. All the above would be cases of income being affected due to a transaction on capital account. This is not the revenue's case here. Therefore, although Section 56(1) of the Act would permit including within its head, all income not otherwise excluded, it does not provide for a charge to tax on Capital Account Transaction of issue of shares as is specifically provided for in Section 45 or Section 56(2)(viib) of the Act and included within the definition of income in Section 2(24) of the Act.

Cap and Revenue receipts

In our considered view, it is only elementary that the connotation of income howsoever wide and exhaustive, take into account only such capital receipts are specifically taxable under the provisions of the Income-tax Act. 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. Hon'ble Supreme Court in the case of Padmaraje R. Kardambande v. CIT [1992] 195 ITR 877/ 62 Taxman 456 has observed that "..,, we hold that the amounts received by the assessee during the financial years in question have to be regarded as capital receipts, and, therefore, (emphasis supplied by us), are not income within meaning of section 2(24) of the Income-tax Actâ€¦." This clearly implies, as is the settled legal position in our understanding, that a capital receipt in principle is outside the scope of income chargeable to tax and a receipt cannot be taxed as income unless it is in the nature of revenue receipt or is brought within the ambit of income by way of a specific provision in the Act. - **[Kushal K Bangia v. ITO, (2012) 18 taxmann.com 31 (Mum) cited in Jitendra Kumar Soneja v. ITO, (2016) 72 taxmann.com 318 (Mum Trib)]**

Section 45 does not make all capital receipts capital gains. There must be a profit or gain in the commercial sense and a profit or gain in the commercial sense would only accrue if one has got money more than one had paid for or spent - **[CIT v. Anglo India Jute Mills Co. Ltd., (1981) 129 ITR 352 (Cal)]**For the purpose of section 45 of the Income-tax Act, 1961

MAT on Cap receipts??

Controversy – whether MAT applicable on Capital Receipts or not?

Resolution - PCIT v. Ankit Metal & Power Ltd., (416 ITR 591)(Cal HC)

ICDS implication on Cap receipts??

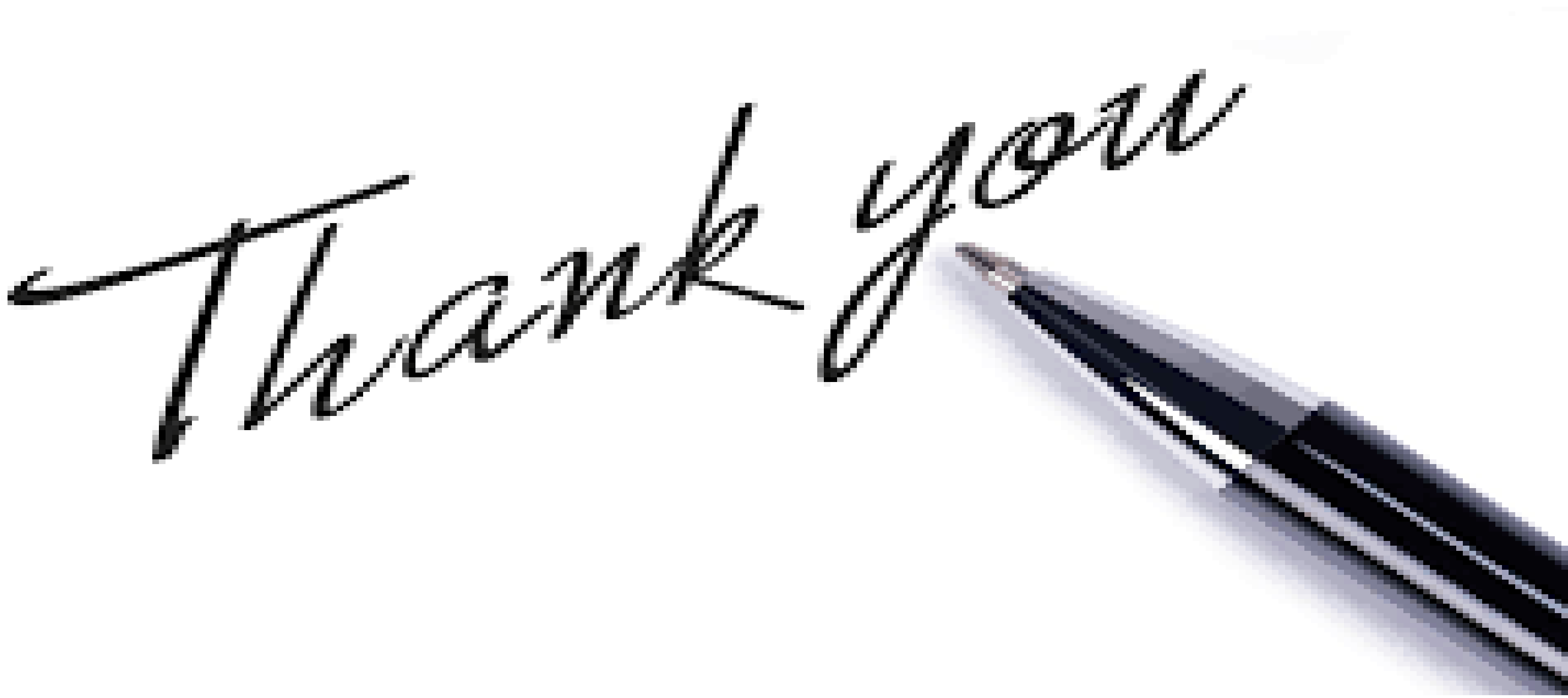
Whether on account of ICDS – whether Capital Receipts shall become taxable?

Whether part of receipts?

Threshold of Tax audit impacted?

TDS on capital payments?


Questions?



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