IN THE INCOME TAX APPELLATE TRIBUNAL
AHMEDABAD BENCH "B" AHMEDABAD

Before **Shri P.K.BANSAL, ACCOUNTANT MEMBER** and
Shri MAHAVIR SINGH, JUDICIAL MEMBER

ITA No.1675/Ahd/2009 Assessment Year:2005-06

Date of hearing:14.9.09 Drafted:27.10.09

Shri Govindbhai C Patel, 2ndFloor, Municipal Building, Pathar Kuva, Relief Road, Ahmedabad **PAN No.AEHPP8754K**	**V/s.**	Dy. Commissioner of Income-tax, Circle-9, Ahmedabad
(Appellant)	..	(Respondent)

Appellant by :-	Shri Dhiren Shah, AR
Respondent by:-	Smt. Neeta Shah, Sr. DR

O R D E R

PER Mahavir Singh Judicial Member:-

This appeal by the assessee is arising out of the order of Commissioner of Income-tax (Appeals)-XV, Ahmedabad in appeal No. CIT(A)-XV/DCIT/CCir.9/167/07-08 dated 04-03-2009. The assessment was framed by the DCIT, Circle-9 Ahmedabad u/s.143(3) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') vide his orders dated 28-12-2007 for the assessment year 2005-06.

2. The only issue in this appeal of the assessee is:-

"Whether the amount received from Saumya Construction Pvt. Ltd. on account of development rights is business income u/s.28(va) of the Act or the same is assessable u/s.41(1) of the Act or a non-taxable capital receipt"

For this, the assessee has raised the following effective grounds:-

1 *"The Ld. CIT(A) has erred in law and on facts in confirming the addition of Rs.2,93,00,000/- on account of accretion to capital account as made by the AO while making an observation that it is very clear that the ownership of the appellant on Rs.2,93,00,000/- crystallized in the year under consideration as per Agreement dated 13-08-2004 when it became clear that this amount was not to be demanded by anybody from him rather it was to be deemed to have been paid by Miraj Impex P. Ltd. who acquired the development rights and this is a clear cut revenue receipt taxable as business income u/s 28(va) of the Income Tax Act.*

2 *The Ld. CIT(A) has grossly erred in law and on facts in treating the amount of Rs.2,93,00,000/- as revenue receipt taxable as business income u/s 28(va) of the Income Tax Act.*

3 *The Ld. CIT(A) has failed to consider the fact that the said amount of Rs.2,93,00,000/- received from Saumya Construction Pvt. Ltd. and written off by appellant is in respect of relinquishment of appellant's right to sue in a Court of law and the appellant's right to sue in a Court of law cannot be treated as revenue receipt taxable as business income u/s 28(va) of the I.T. Act, 1961."*

3. The brief facts leading to the above issue are that the Assessing Officer during the course of assessment proceedings noticed from scrutiny of return of income that there is a credit entry appearing in the capital account and for this, AO issued a scrutiny letter No. DCIT / Circle-9/GCP/2007-08 dated 10/12/2007 vide which he specifically required a question (v), which reads as under:-

> *"(v) There appeared a credit of rs.2,93,00,000/- in the capital a/c. After going through the details filed with the return the payments were received by cheque as under:*
> *(1) Rs.1,00,00,000/- by cheque dated 24/08/1996*
> *(2) Rs.1,00,00,000/- by cheque dated 29/08/1996*
> *(3) Rs. 93,00,000/- by cheque dated 11/09/1996*
>
> *Please explain how the total amount of rs.2,93,00,000/- which was dated August & September 1996 could be credited in F.Y. 2004-05."*

The assessee replied that these payments are received by cheque from Saumya Construction Pvt. Ltd., which was shown as a liability in the assessee's balance-sheet in the financial year 1996-97 relevant to assessment year 1997-98 and stated that the same was not a trading liability and the same has not been claimed as a deduction and / or expenses by the assessee in financial year 1996-97 relevant to assessment year 1997-98. During the financial year 2004-05 relevant to assessment year 2005-06 it was decided by the assessee that the liability standing in books of account for an amount of Rs.2.93 crores received by account payee cheque from Saumya Construction Pvt. Ltd. is not to be repaid by the assessee in pursuance of the understanding with Saumya Construction Pvt. Ltd. as the same is required to be written off by assessee towards the compensation / damages for relinquishment of assessee's right to sue it in the court of law. The assessee further submitted that the liability of Rs.2.93 crores standing in assessee's balance-sheet which has been credited as capital is a capital receipts not subject to income tax as per the provisions of the Act. That the said credit in financial year 1996-97 relevant to assessment year 1997-98, which has been credited into the capital account of the assessee in assessment year 2005-06 and the provisions of Section 41(1) of the Act does not apply for the reason that the said liability was not allowed as business expenses or liability in earlier assessment year and accordingly the provisions of section 41(1) is not applicable to the writing off liability of Rs.2.93 crores in the capital account. Further, it is also submitted by the assessee that the said liability has not been credited in the profit and loss a/c. but the same has been shown and taken as capital receipt in the capital a/c. in the books of account. Further, it is also submitted that the said liability which has been credited in the capital a/c. is a capital receipt as the same is on account of compensation / damages for breach of agreement by Saumya Construction Pvt. Ltd. and it is in respect of right to sue of the assessee not pursued in the court of law to challenge the breach of agreement by Saumya Construction Pvt. Ltd. The assessee further contended that now u/s 6(e) of Transfer of Property Act (T.P.

Act for short) right to sue is not a property. The assessee further stated the fact that the compensation / damages received by way of appropriation of liability of Rs.2.93 crores by cheque payment in the year 1996 against assessee's right to sue in the court of law being not pursued by the assessee against Saumya Construction Pvt. Ltd. is not a capital receipt or a property as right to sue which is not a property which cannot be transferred and as such there would be no tax liability in respect of said capital receipts and the provisions of capital gains tax and provisions of section 41(1) of the Act are not applicable. The assessee further contended that the cheque payments received Rs.2.93 crores in the year 1996, how it could be credited in the financial year 2004-05 relevant to assessment year 2005-06 the assessee submitted said amount cannot be subject to tax in assessment year 2005-06. The Assessing Officer after discussing the various case laws referred by the assessee made addition by giving following finding in **para-4** of his assessment order as under:-

> *"In the return of income the assessee has annexed a note no.3 wherein the assessee ha an agreement dated 2113/8/2004 and other related earlier agreements, MoU, the assessee became entitled for an amount of Rs.29300000/- by way of compensation / damages etc. and the assessee credited his capital account equal to the same amount i.e. Rs.29300000/-. During the course of assessment proceedings the assessee was asked to furnish the exact nature of the transaction which took place in 1996 during which the assessee received this amount i.e. Rs.29300000/- b three cheques as under:*

Sl No.	*Name of the payer*	*Ch. No.*	*Date*	*Amount Rs.*
1.	*Miraj Implex Pvt. Ltd.*	*610000*	*01/08/1996*	*1000000*
2.	*Miraj Impex Pvt. Ltd.*	*618083*	*29/08/1996*	*1000000*
3.	*MIraj Impex Pvt. Ltd.*	*6118098*	*11/09/1996*	*9300000*

> *As such the assessee received total amount of Rs.29300000/- as shown above in the year 1996 (F.Y. 1996-97). It is not known how this amount which was received by the assessee in F.Y. 1996-97 from MIraj Impex Pvt. Ltd. can be the capital of the assessee in F.Y. 2004-05 (A.Y. 2005-06). In fact that amount is liability in the lands of the assessee or he might have purchased one assets*

from MIraj Impex Pvt. Ltd. full and complete detail regarding the facts which resulted in this transaction Rs.29300000/- have not furnished by the assessee in spite of several remainders, discussion during the course of assessment proceedings. It is appears flimsy that a person getting an advance of a sum and directly credited in his capital account either the assessee should not written the amount to MIraj Impex Pvt. Ltd. or if he intends to use that amount for himself, obviously he should honestly credit the same as his income and should pay the tax on it otherwise it is not logical or even lawful that a person a right to change the nature of amount at his own fancy. The assessee has got so many decisions but these amount of Rs.29300000/- is not windfall, the amount to the MIraj Impex Pvt. Ltd. and as a natural course the assessee does not intend to go further in the contract whatsoever (which said to be executed in 1996), he at, at the most, should return the money to MIraj Impex Pvt. Ltd. with interest. As far as relinquishment is concerned the same is also taxable as per I.T. Act. Further, the compensation or damaged received as taxable as per reproduced.

The Assessing Officer re-produced the relevant provisions of Section 41 and finally observed as under:-

"Considering all the facts of the case and also considering the fact that the issue regarding taxability of the amount of Rs.2,93,00,000/- can be decided as per the provision as per I. T. Act and that can not be settled by any other person or group or person who may their own interest unless, it is decided by some court of law which could be a binding for the persons who were involved in the transaction. Accordingly the action of the assessee to take this amount of Rs.2,93,00,000/- in his own capital account will certainly tantamount to accretion /addition to his income in the financial year relevant to A.Y. 2005-06. In which the assessee intends to use the money as his own by crediting the same in his capital account. Therefore, in the present case the assessee has tiled a copy of capital a/c. (ledger a/c.) wherein he has credited Rs.2,93,00,000/- on 13/08/2004 as capital receipt account. The act of the assessee is blatantly wrong and without any basis. Therefore the capital receipt of Rs.2,93,00,000/- shown by the assessee in the capital account is nothing but the assessee's own income from undisclosed sources and the reason behind claiming such capital receipts directly in the capital account is also against the accounting principles. Considering all he facts the assessee' claim is proved to the false and concocted. Accordingly the same is deemed as not allowable as per the provisions of I.T. Act particularly section 40(1)(i) of the Act, the excerpts have already been reproduced in the preceding para. Therefore, the addition of Rs.2,93,00,000/- is made u/s 68 as unexplained credit in the capital account and accordingly an addition of Rs.2,93,00,000/- is made to the total income of the assessee."

4. Aggrieved, the assessee preferred an appeal before the CIT(A). The CIT(A) confirmed the addition by reproducing certain facts and submissions made by the assessee before him. The relevant extract from the CIT(A)'s order is as under:-

> *"This addition has been discussed by the AO from page 2 to 13 and then from page 15 to 17 of the assessment order. The AO treated amount of Rs.2,93,00,000 credited in the capital account of the appellant as a taxable receipt.*
>
> *6. Facts in brief of this case as evident from the latest agreement dated 13.8.2004 furnished by the appellant are as under:*
> *1. Through Development Agreement dated 28.12.77 executed between Harsh Enterprise and Silver Arc Members Association all the rights relating to the development of property admeasuring 10585 sq. yards were entrusted to Harsh Enterprise.*
>
> *2 Vide Assignment Deed dated 18.3.96 Harsh Enterprise assigned Development Rights in favour of Ganesh Housing Corporation.*
>
> *3. Vide Memorandum of Understanding dated 25.3.96 Ganesh Housing Corporation assigned Rights of Development in favour of Saumya Construction P. Ltd.*
>
> *And at the instance of Ganesh Housing Corporation, Saumya Construction P. Ltd. gave vide three cheques amount totaling to Rs.2,93,00,000 to Govindbhai C.PateL (as per last lines of clause - 12 of Agreement dated 13.8.2004).*
>
> *4. As per clause - B of the Agreement Saumya Construction P. Ltd. would not ask for this amount from Govindbhai C. Patel.*
>
> *5. As per clause - C of the Agreement Rs.2,93,00,000 would be henceforth considered as the payment made by Miraj Impex P. Ltd. to Govindbhai C. Patel.*
>
> *6. As per clause-D it was stated that Rs.2,93,00,000 shall be considered to have been paid by Miraj Impex P. Ltd. to Govindbhai C.Patel towards damages I compensation.*
>
> *Thus in FY 2004-05 the Development Rights of the property in question were acquired by Miraj Impex Pvt. Ltd. vide Agreement dated 13.8.04 signed in between four parties:*
>
> *1. Miraj Impex P. Ltd.*

2. Ganesh Housing Corporation
3. Saumya Construction Pvt. Ltd.
4. Govindbhai Patel

Whereas the appellant was under this impression that he would acquire Development Rights and would pass them over to Saumya Construction P. Ltd. for which he had received Rs.2,93,00,000 from Saumya Construction P. Ltd. in the year 1996-97, which he was showing as a liability in balance-sheets of his I.T. returns since AY 1997-98. However it is only in AY 2005-06 it became clear that Rs.2,93,00,000 could be treated as solely owned by the appellant because of agreement dated 13.8.2004. And this amount was credited in the capital account by the appellant in AY 2005-06 on which no tax has been paid, the AO has treated it taxable and has added it back in the assessment order, treating it as a revenue receipt.

Submissions of the appellant:

It was explained by the AR that that Govindbhai C.Patel was not required to return Rs.2,93,00,000 to Saumya Construction rather it was to be treated as paid by Miraj Impex to Govindbhai C.Patel vide agreement dated 13.8.2004 in lieu of NOT initiating any litigation for acquiring Development Rights, with respect to the said property and recognizing the Development Rights to be that of Miraj Impex P. Ltd only in the said property.

It was stated that the compensation / damages received by way of appropriation of liability of Rs.2,93,00,000 by cheque payment in the year 1996 against assessee's right to sue in the courts of law being not pursued by the assessee in the courts of law against Saumya Construction P. Ltd. cannot be taxed as capital gains because right to sue is not a property with any cost of acquisition. It was stated that provisions of section 41(1) were also not applicable and neither section 68 because identity of Saumya Construction P. Ltd. was well established. It was also stated that Rs.2,93,00,000 credited in the capital account did not attract provisions of section 28 (va) because it was not the amount received in respect of not competing the business activity with any other party. In the present case it was argued that the appellant was proceeding to acquire the rights in immovable property and the appellant had received the compensation for right to sue being not pursued in courts of law and it was not in respect of not competing the business of any other party.

Several case laws were also cited but they are not being discussed here because all these case laws have been cited before the AO also and have been dealt in the assessment order.
Decision:

After going through rival submissions I am of the opinion that section 41(1) is not applicable for taxing Rs.2,93,00,000 because as per 41(1) only that liability can be added back or taxed which has ceased but which has been allowed as a deduction in any earlier financial year, which is not the case here, The AO also on page 17 has mentioned section 41(1)(due to typographical error section has been mentioned as 40(1) (i)) but has

proceeded to taxed it u/s.68 stating it to be unexplained credit in the capital account. Section 68 can also not be applied because the identity of the payer Saumya Construction P. Ltd. is not doubtful. PAN has been given and it was informed that returns are being filed in the same charge. Further Agreement dated 13.8.2004 clarifies the point that no addition u/s 68 can be made.

Interesting point is that earlier agreements for example agreement dated 22.3.96 entered between Ganesh Housing Corporation and the appellant and agreement dated 25.3.96 entered between Ganesh Housing Corporation and Saumya Construction P. Ltd according to which Rs.2,93,00,000 were paid to the appellant by Saumya Construction P. Ltd. at the instance of Ganesh Housing Corporation in the year 1996-97 have dissolved or in other words have culminated or merged in the final Agreement dated 13.8.2004 entered among four parties namely Miraj Impex as the first, Ganesh Housing Corporation as the second, Saumaya Construction as the third and Govindbhai C.Patel as the fourth. And according to various clauses of this Agreement like for example clause-B of the Agreement dated 13.8.2004 Saumya Construction P. Ltd. would not ask for the amount (Rs.2,93,00,000) from Govindbhai C.Patel and as per clause-C of the agreement Govindbhai C. Patel was to understand this amount received from Miraj Impex P. Ltd.

It is very clear that the ownership of the appellant on Rs.2,93,00,000 crystallized in the year under consideration as per Agreement dated 13.8.2004 when it became clear that this amount was not to be demanded by anybody from him rather it was to be deemed to have been paid by Miraj Impex P. Ltd. who acquired the Development Rights. This is a clear cut revenue receipt taxable as business income uls.28(va) of the Income-tax Act reproduced below:

*"**any sum, whether received or receivable, in cash or kind, under an agreement for** -*

*(a) **not carrying out any activity in relation to any business……"** is chargeable as business income.*

The language of the Act is very clear. Rs.2,93,00,000 as per the appellant himself was received by him for not attempting to acquire Development Rights by way of litigation etc. in the said property. And was to understand this amount received from Miraj Impex P. Ltd. in the year under consideration for recognizing Miraj Impex P. Ltd as the sole owner with Development Rights and for not creating any litigation. The addition of Rs.2,93,00,000 is therefore confirmed uJs.28(va) of the I.T. Act."

5. Aggrieved, the assessee preferred second appeal before us. Before us the Ld counsel for the assessee, Shri Dhiren Shah, CA stated that the Assessing Officer has made addition by considering that the amount as liability in the hands of the

assessee or he might have purchased some assets from Miraj Impex Pvt. Ltd. According to the AO, the Ld. counsel argued that there is no full and complete disclosure of details regarding these transactions during the course of assessment proceedings. Accordingly, the AO noted that it appears flimsy that a person getting an advance of a sum and directly credited in his capital a/c., either the assessee has not returned the amount to Miraj Impex Pvt. Ltd. or intends to use that amount, i.e. he should honestly credit the same as his income and should pay the tax on it. The Ld. counsel further stated that the AO has considered the amount as not a windfall and as a natural course, the assessee do not intend to go further in the contract, whatsoever, he at the most, should return the money to Miraj Impex Pvt. Ltd. with interest. Finally, the Ld. counsel stated that the Assessing Officer has discussed the provision of Section 41(1) of the Act and observed that this amount is his own capital which certainly tantamount to accretion / addition to his income in the relevant assessment year, in which the assessee intends to use the money as his own by crediting the same in his capital a/c. The Ld. counsel for the assessee further stated that the assessee has received cheques from Saumya Construction Pvt. Ltd. was shown as a liability in balance-sheet in the financial year 1996-97 relevant to assessment year 1997-98 and it was also stated that the same was not a trading liability and the same has not been claimed as a deduction and / or expenses in financial year 1996-97 relevant to assessment year 1997-98. The Ld counsel stated that during the financial year 2004-05 relevant to assessment year 2005-06 it was decided by the assessee that the liability standing in the books of account by account payee cheque from Saumya Construction Pvt. Ltd. is not repaid in pursuance of the understanding with that party, as the same is required to be written off towards compensation / damages for relinquishment of right to sue in the court of law. According to the Ld. counsel, the liability standing in assessee balance-sheet and credited in capital a/c. is a capital receipt not subject to tax as per the provisions of the Act. According to him, the provisions of Section 41(1) of the Act does not apply for the reason that the said liability was not allowed as business expenses of the liability in earlier assessment years and accordingly the provisions of Section 41(1) is not applicable to the writing off liability of Rs.2.93 crores in the capital account. It was state that the said liability has not been credited in the profit and loss a/c. but the same has been taken as capital receipts in the books of account by crediting the capital a/c. and the said liability is credited on account of compensation

/ damaged for breach of agreement by Saumya Construction Pvt. Ltd. and it is in respect of right to sue not pursued in the court of law for breach of agreement.

6. The Ld. counsel, Shri Shah further stated that that the CIT(A) has entirely went wrong in treating the receipt as ' revenue receipt' taxable as business income u/s.28(va) of the Act. He stated that the same amount received from Saumya Construction Pvt. Ltd. is in respect of relinquishment of assessee's right to sue in a court of law and the right to sue in a court of law cannot be treated as revenue receipt taxable as business income u/s.28(va) of the Act. The Ld. counsel argued that for making any receipt income chargeable to tax under the head, "Profits and gains of business or professions u/s.28(va) of the Act, there should be any sum whether received or receivable in cash or kind under an agreement for not carrying out any activity in relation to any business or not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services. He stated that the provisions of Section 28(va) of the Act are very clear that the compensation received in lieu of right to sue does not fall under this provisions reason being the receipt does not fall under the head business or the same is not related to business. The Ld. counsel further relied the case laws, i.e. in the case of *Baroda Cement & Chemicals Ltd. v. CIT* (1986) 53 CTR 260 (Guj), *CIT v. Ashoka Marketing Ltd.* (1986) 53 CTR 152 (Cal), *CIT v. J. Dalmia* (1984) 42 CTR 168 (Del) and in the case of *CIT v. Hiralal Manilal Mody* (1981) 25 CTR 275 (Guj).

7. On the other hand, Ld. Sr. DR, Smt. Neeta Shah argued on behalf of the Revenue and stated that The Development Agreement dated 28.12.77 executed between Harsh Enterprise and Silver Arc Members Association all the rights relating to the development of property admeasuring 10585 sq. yards were entrusted to Harsh Enterprise and Vide Assignment Deed dated 18.3.96 Harsh Enterprise assigned Development Rights in favour of Ganesh Housing Corporation She stated that Vide Memorandum of Understanding dated 25.3.96 Ganesh Housing Corporation assigned Rights of Development in favour of Saumya Construction P. Ltd. and at the instance of Ganesh Housing Corporation, Saumya Construction P. Ltd. gave vide three cheques amount totaling to Rs.2,93,00,000 to Govindbhai C.

Patel. She further stated that as per clause - B of the Agreement Saumya Construction P. Ltd. would not ask for this amount from Govindbhai C. Patel and as per clause - C of the Agreement Rs.2,93,00,000 would be henceforth considered as the payment made by Miraj Impex P. Ltd. to Govindbhai C. Patel and also as per clause-D it was stated that Rs.2,93,00,000 shall be considered to have been paid by Miraj Impex P. Ltd. to Govindbhai C.Patel towards damages in compensation. Thus in FY 2004-05 the Development Rights of the property in question were acquired by Miraj Impex Pvt. Ltd. vide Agreement dated 13.8.04 signed in between four parties:

1. Miraj Impex P. Ltd.
2. Ganesh Housing Corporation
3. Saumya Construction Pvt. Ltd.
4. Govindbhai Patel

In view of these facts, she stated that the assessee was under this impression that he would acquire Development Rights and would pass them over to Saumya Construction P.Ltd. for which he had received Rs.2.93 crores from Saumya Construction P. Ltd. in the year 1996-97, which he was showing as a liability in balance-sheets of his I.T. returns since AY 1997-98. According to her, this amount only in AY 2005-06 became clear that Rs.2.93 crores could be treated as solely owned by the assessee because of agreement dated 13-80-2004 and this amount was credited in the capital account by the assessee in AY 2005-06 on which no tax has been paid. She stated that the AO has rightly treated it taxable and has added it as a revenue receipt. She further argued that the CIT(A) has rightly applied the provisions of Section 28(va) of the Act as the receipt is a revenue receipt relating to business directly in view of the above facts.

8. We have heard the rival contentions and gone through the facts and circumstances of the case. We have also perused the case records including the assessment order, the order of CIT(A) and the assessee's paper book. We have also gone through the case laws relied on. We find that the assessee has received an amount of Rs.2.93 crores from Soumya Construction Pvt. Ltd. and shown the same as liability in balance-sheet for assessment year 1997-98. The assessee has not shown the same as trading liability and nor claimed any deduction or expense in that assessment year. During the relevant assessment year 2005-06, the liability standing in assessee's books was written off towards the compensation / damages

for relinquishment of right to sue in the court of law and the liability was credited as capital receipt in the assessee's capital a/c. Now, first of all, we have to ascertain whether the transaction falls under the provisions of Section 41(1) or not. We find that the Assessing Officer has treated this receipt as income falling under provisions of Section 41(1) of the Act. The CIT(A) has deleted the addition on this count by stating that Section 41(1) is not applicable because under this Section only that liability can be added or taxed which has seized but which has been allowed as a deduction in any earlier year, which is not the case here. According to the CIT(A), the Assessing Officer after mentioning Section 41(1) has proceeded to tax u/s.68 of the Act stating this to be unexplained credit. According to the CIT(A), even Section 68 of the Act cannot be applied because the identity of the payer, i.e. Somuya Construction Pvt. Ltd. is not doubted and the PAN No. has been given and it is assessed to tax. Even these payments are received in the year 1996, as the dates narrated above, hence, at no point of time addition can be made u/s.68 of the Act. We find that these findings of CIT(A) are not challenged by the Revenue in appeal as informed by Ld. Sr. DR. Accordingly, the findings of CIT(A) on these two provisions, i.e. Section 41(1) and Section 68 of the Act have become final. Even otherwise Sub-section (1) of section 41 deals with profits chargeable to tax and Clause (a) of this sub-section provides that where an allowance or a deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee, and subsequently during any previous year, the assessee 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 or the value of benefit accruing to him shall be deemed to be the profits, and accordingly chargeable to income-tax as 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. Clause (b) of this sub-section makes similar provision in the case of successor in business in regard to any amount in respect of which loss or expenditure, etc., was incurred by the predecessor. Further, it was found that a number of assessee were escaping tax liability under this sub-section in regard to the credit of trading liabilities to profit and loss account, even when the recovery of the debt had become barred by limitation or when there was no likelihood of the liability being enforced against them and this was on account of the fact that some

courts held that the liability can remit or cease only by a bilateral or a multilateral act between the creditor(s) on the one side and the debtor on the other and not by a unilateral act. By an amendment the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof", occurring in this sub-section, has been defined to include the remission or cessation of any liability by a unilateral act by the first mentioned person under clause (a) or the successor in business under clause (b) of this sub-section by way of writing off such liability in his accounts. We further find that **Section 41(1) concerns a trading liability and not other types of liability.** Section 41(1), in a way, enacts statutory fictions. Therefore, the operation of such fictions should be limited to the language of the section. It is, *inter alia,* where the assessee has incurred a trading liability, and this trading liability has been allowed deduction in an earlier year, and something has, later on, been recovered in respect of such liability or such liability has either been remitted or has ceased to exist, that section 41(1) comes into operation. Furthermore, whether or not a liability is a trading liability depends on the facts and circumstances of a particular case. A liability created for purchase of stock-in-trade on credit is certainly a trading liability. Where A purchases his stock-in-trade from B on credit, the liability of A to B is a trading liability. But if A borrows money from C in order to pay off his liability to B, A's liability to C on such borrowing is not a trading liability. It is thus clear that section 41(1) cannot be invoked if C remits a part or whole of his loan to A. Where the assessee had not claimed nor obtained a deduction in respect of a security deposit treating it as a trading liability, section 41(1) cannot be invoked when such security deposit is refunded to the assessee. In the present case, none of the above probabilities existed and this is a case of amount received from assessee-firm shown as a liability in the shape of cash credit in assessment year 1997-98. The assessee has not claimed the same as deduction or expenses in any of the years till date. The assessee has written off the same as compensation / damages for relinquishment of right to sue in court of law and credited the same in the capital a/c as capital receipt. In view of the above, we are of the considered view that the provisions of Section 41(1) or Section 68 of the Act will not apply to the writing off this liability in the capital a/c and the liability has not been credited in the profit and loss a/c but the same has been taken as capital basis in the capital a/c in the books of account of the assessee.

9. We find that, exactly on similar facts, the Hon'ble jurisdictional High Court in the case of *Baroda Cement & Chemicals Ltd.* (supra) has stated that the compensation received by the assessee was not for consideration for the transfer of capital assets, however, the damages are in capital in nature. For this, the Hon'ble jurisdictional High Court held as under **(para 18):-**

> *"18. The assessee had undoubtedly a right to sue M/s. K.C.. Ltd. for damages for breach of contract. Instead of litigating in a Court of law, the parties arrived at a settlement whereunder compensation in the sum of Rs.1,40,000 came to be paid in full and final satisfaction to the assessee. Counsel for the Revenue contends that the compromises / arrangement resulted in extinguishment of the assessee's right to sue for damages within the meaning of s.2(47) of the Act . While accepting this contention the Tribunal has placed reliance on the decision of this court in R.M. Amin's case (supra). In that case this Court observed that the use of the word 'include' in the definition of the word 'transfer' in s. 2(47) was intended to enlarge the meaning of 'transfer' beyond its natural import so as to include extinguishment / relinquishment of rights in the capital asset for the purpose of s. 45 of the Act. Since the transfer contemplated by s.45 is one as a result whereof consideration has passed to the assessee or has accrued to him, extinguishment of transfer of a capital asset in order to attract liability to tax under the head 'capital gains' must be 'transfer' as a result whereof some consideration is received by or accrues to the assessee. If the transfer does not yield any consideration, the computation of profits or gains as provided by s.48 of the Act would not be possible. If the transfer takes effect on extinguishment of a right in the capital asset, there must be receipt of consideration for such extinguishment to attract liability to tax. Now, in legal parlance, the terms 'consideration' and 'compensation' or 'damages' have distinct connotations. The former in the context of ss. 45 and 48 would connote payment of a sum of money to secure transfer of capital asset; the latter would suggest payment to make amends for loss or injury occasioned on the breach of contract or tort. Both ss. 45 and 48 postulate the existence of a capital asset and the consideration received on transfer thereof. But, as discussed earlier, once there is a breach of contract by one party and the other party does to keep it alive but acquiesces in the breach and decides to receive compensation therefore, the injured party cannot have any right in the capital asset which could be transferred by extinguishment to the defaulter for valuable consideration. That is because a right to sue for damages not being an actionable claim, a capital asset, there could be no question of transfer by extinguishment of the assessee's rights therein since such a transfer would be hit by s. 6(e) of the Transfer of Property Act. In any view of the matter, it is difficult to hold that the sum of Rs.1,40,00 received by way of compensation by the assessee was consideration for the transfer of a capital asset."*

The Hon'ble court discussed the concept of breach of contract as discussed by Hon'ble Bombay High Court in the case of *Iron & Hardware Co. v. Shamlal & Bros.* AIR 1954 (Bom) 423 as under(**in para-10 to 12)**:-

"10. Chagla C.J. had an occasion to consider this aspect of the law in Iron & Hardware Co. vs. Shamlal & Bros. AIR 1954 Bom 423. The learned Chief Justice observed as under:

"It is well settled that when there is a breach of contract, the only right that accrues to the person who complains of the breach is the right to file a suit for recovering damages. The breach of contract does not give rise to any debt and, therefore, it is has been held that a right to recover damages is not assignable because it is not a chose-in-action. An actionable clam can be assigned, but in order that there should be an actionable claim there must be a debt in the sense of an existing obligation. But inasmuch as a breach of contract does not result in any existing obligation on the part of the person who commits the breach, the right to recover damages is not an actionable claim and cannot be assigned."

Proceeding further, the learned Chief Justice stated:

"In my opinion, it would not be true to say that a person who commits a breach of the contract incurs any pecuniary liability, nor would it be true to say that the other party to the contract who complains of the breach has any amount due to him from the other party.

As already sated, the only right which he has is the right to go to a Court of law and recover damages. Now, damages are the compensation which a Court of law gives to a party for the injury which he has sustained. But, and this is most important to note, he does not get damages or compensation by reason of an existing obligation on the part of the person who has committed the breach. He gets compensation as a result of the fiat of the Court, Therefore, no pecuniary liability arises till the Court has determined that the party complaining of the breach is entitled to damages. Therefore, when damages are assessed, it would not be true to say that what the Court is doing is ascertaining a pecuniary liability which already existed. The Court in the first place must decide that the defendant is liable and then it proceeds to assess what that liability is. But till that determination there is no liability at all upon the defendant."

It would appear from the above observations that no breach of contract the defaulter does not incur any pecuniary liability nor does the injured party become entitled to any specific amount, but he only has a right to sue and claim damages which may or may not be decreed in his favour. He will have to prove (i) that the opposite part had committed breach of contract and (ii) that he had suffered pecuniary loss on account thereof.

11. The above observations of Chagla, C.J .were quoted with approval by the Supreme Court in Union of India vs. Raman Iron Foundry AIR 1974 SC 1265. In paragraph 9 of the judgment, the Supreme Court considered the claim for liquidated damages for breach of contract between the parties. Pointing out that so far as the law in India is concerned, there is no qualitative difference in the nature of the claim, whether it be for liquidated damages or unliquidated damages, the Supreme Court proceeded to state the law as under:

> "When there is a breach of contract, the party who commits the breach does not eo instanti incur any pecuniary obligation, nor does the party complaining of the breach become entitled to a debt due from the other party. The only right which the party complaining of the breach become entitled to a debt due from the other party. The only right which the party aggrieved by the breach of the contract has, is the right to sue for damages. That is not an actionable claim and this position is made amply clear by the amendment in s.6(e) of the Transfer of Property Act, which provides that a mere right to sue for damages cannot be transferred."

Quoting the statement of law enunciated by Chagla, C.J., which is extracted earlier, the Supreme Court stated : " This statement in our view represents the correct legal position and has our full concurrence."

12. It would seen well-settled from the above discussion that after there is a breach of contract for sale of goods, nothing is left in the injured party save the right to sue for damages or specific performance which cannot be transferred under s.6(e) of the Transfer of Property Act since it is a mere right to sue and not an actionable claim."

In view of the above facts, discussion carried above and the case laws relied on, we decide this issue in favour of the assessee and confirmed the order of CIT(A).

10. Now coming to the issue decided by the CIT(A) whether this receipt is a revenue receipt taxable as business income u/s.28(va) of the Act. We find that the CIT(A) has discussed the agreement dated 22-03-1996 entered between Ganesh Housing Corporation and the assessee and agreement dated 25.3.96 entered between Ganesh Housing Corporation and Saumya Construction P. Ltd according to which Rs.2,93,00,000 were paid to the assessee by Saumya Construction P. Ltd. at the instance of Ganesh Housing Corporation in the year 1996-97 have dissolved or in other words have culminated or merged in the final Agreement dated 13.8.2004 entered among four parties namely Miraj Impex as the first, Ganesh Housing Corporation as the second, Saumaya Construction as the third and Govindbhai C. Patel as the fourth. And according to various clauses of this Agreement like for example clause-B of the Agreement dated 13.8.2004 Saumya Construction P. Ltd. would not ask for the amount (Rs.2.93 crores) from Govindbhai C. Patel and as per clause-C of the agreement Govindbhai C. Patel was to understand this amount received from Miraj Impex P. Ltd.I In view of this, the CIT(A) has stated the ownership of this amount crystallized in the year under consideration as per the year

dated 13-08-2004. But we find the fact that M/s Harsh Enterprises was seized and possessed to an immovable property situated at Chhadavad (sim), aluka City, in the Registration Dist. Ahmedabad and sub Dist. Ahmedabad-4 (Paldi), bearing Final plot No.560/1, admerasuring about 11637.67 sq. mts. From the records, we find that M/s Harsh Enterprises evolved and organized a scheme for development of the said entire property by constructing thereon buildings consisting of various residential and other premises and the scheme was known as "Silver Arc". Out of total land admeasuring about 11637.6 sq. mt. part of the land was already developed by M/s. Harsh Enterprises by putting up construction of building thereon and remaining part of the land of possession No.B admeasuring about 5600 sq.mt. that by assignment agreement dated 22-03-1996, the assessee Shri Govindbhai C Patel was entitled to acquire the said property or development rights of the said property from M/s Harsh Enterprises and in the event of default by M/s. Harsh Enterprises, the assessee Shri Govindbhai C Patel was entitled to specific performance for acquisition of the said property. In pursuance of anticipation that Shri Govindbhai C Patel will acquire the rights in the aforesaid property from M/s. Harsh Enterprises, he received three cheques of an aggregate amount of Rs.2.93 crores from Saumya Construction Pvt. Ltd. and the particulars of which are as under:-

i) Rs.1 crore by cheque dated 24/8/1996
ii) Rs.1 crore by cheque dated 29/8/1996
iii) Rs.93 lakhs by cheque dated 11/9/1996

The amount of Rs.2.93 crores received from Saumya Construction Pvt. Ltd. was shown as a liability of the assessee in financial year 1996-97 relevant to assessment year 1997-98 and the same was disclosed in the return of income filed for assessment year 1997-98 and thereafter in subsequent assessment years still 2004-05. We find that the amount of Rs.2.93 crores was shown as a liability by the as in his balance-sheet as the assessee did not get the rights of the said property from M/s. Harsh Enterprises and therefore, could not transfer it to Saumya Construction Pvt. Ltd. and accordingly, the assessee shown the amount of Rs.2.93 crores received from Saumya Construction Pvt. Ltd. as a liability being payable back to Saumya Construction Pvt. Ltd. We further find that the said property which was under consideration for acquiring the rights by the assessee from M/s. Hash Enterprises was a disputed property and the court litigation was going on in respect

of the said property, the assessee did not get the rights into the said property as well as possessions of the said property. That the assessee shown in his balance-sheet, the liability of Rs.2.93 crores payable to Saumya Construction Pvt. Ltd. and in all the returns of income filed for assessment year 1997-98 till assessment years 2004-05 and the said liability was duly reflected in the balance-sheet of the assessee and the copy of balance-sheets were filed with the return of income and the said liability shown by the assessee in his balance-sheet has been duly accepted by the Revenue for assessment year 1997-98 and till assessment year 2004-05. That in the assessment year 2005-06, ultimately the rights of the said property was acquired by Miraj Impex Pvt. Ltd. and therefore, the assessee was entitled to file a suit in the court of law for specific performance for acquiring the rights of the said property, but the assessee realizing that the legal system in the court of law of the country are such that whereby if a suit is filed by him in the court of law for specific performance. It may take number of years, and therefore, the assessee decided not to repay the liability of Rs.2.93 crores to Saumya Construction Pvt. Ltd. which was standing as a liability in his balance-sheet. We further find that when Miraj Impex pvt. Ltd. who ultimately acquired the rights of the said property and Saumya Construction PVt. Ltd. who are entitled to recover the amount of Rs.2.93 crores from assessee Shri Govindbhai C Patel approached to the assessee and requested for not to pursue his rights of specific performance while filing a suit in the court of law and the assessee informed the said two companies that the assessee may not file a suit in the court of law for specific performance only if the amount of Rs.2.93 crores is not repayable back by him to Saumya Construction Pvt. Ltd. and the same is required to be treated as compensation for not enforcing his rights to sue in the court of law and accordingly in pursuance of the agreement entered into between the Miraj Impex Pvt. Ltd., Saumya Construction Pvt. Ltd., assessee and other parties vide agreement dated 13-08-2004, the assessee appropriated the said liability of Rs.2.93 crores payable to Saumya Construction Pvt. Ltd., while crediting in his capital account being compensation for rights to sue being not enforced in the court of law.

11. First of all, we have to go to the provisions of Section 28(va) of the Act. By section 13 of the **Finance Act, 2002** (20 of 2002) in section 28 of the 1961 Act, after clause (v), the following clause (va) has newly been inserted with effect from 1-4-2003, i.e. for and from assessment year 2003-04, namely:-

'(va) any sum, whether received or receivable, in cash or kind, under an agreement for –

(a) not carrying out any activity in relation to any business; or

(b) not sharing any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services:

Provided that sub-clause (a) shall not apply to –

(i) an sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any business, which is chargeable under the head "Capital gains";

(ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on Substances that Deplete the Ozone Layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation – For the purposes of this clause,-

(i0 "agreement: includes any arrangement or understanding or action in concert,-

(A) whether or not such arrangement, understanding or action is formal or in writing; or

(B) *whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;*

(ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging."

Subsequently, the Central Board of Direct Taxes has clarified this provisions vide Circular No. 8/2002, dated 27th August, 2002 (reported in 258 ITR (St.) 13, 32 particularly clause 26, it has been explained as under:-

26. New provisions for taxing the receipts in the nature of non-compete fees and exclusivity rights.

26.1 For the purpose of giving certainty to taxation of receipts in the nature of non-compete fees and fees for exclusivity rights, the Finance Act, 2002, has included within the scope of "profit and gains of business or profession", any sum received or receivable in cash or in kind under an agreement for not carrying out activity in relation to any business; or not to share an know-how,

patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services. However, the provisions clarify that receipts for transfer of right to manufacture, produce or process any article or thing or right to carry on an business, which are chargeable to tax under the had "Capital gains", would not be taxable as profits and gains of business or profession.

26.2 With a view to facilitate the implementation of the Montreal Protocol for the phasing out of the business of manufacture of Chloro-Fluoro Carbons (CFC) and Hydro Chloro-Fluoro Carbons (HCFC), the provision lays down that any sum received as compensation from the multilateral fund of the Montreal Protocol under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India, will not be taxable as profits and gains of any business or profession.

26.3 This amendment shall be effective from 1st April, 2002 and will, accordingly, apply in relation to the assessment year 2002-2003 only.

Similarly, the provisions were explained in the note on clauses to Finance Bill, 2002 (254 ITR (St.) 118, 120), as under:-

Clause 3 seeks to amend section 2 of the Income-tax Act relating to definitions. It is proposed to insert a new clause (vii) in section 28 of the Income-tax Act vide clause 13 of the Bill so as to provide that any sum whether received or receivable in cash or kind, under an agreement for not carrying out any activity in relation to any business; or not to share any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature, or information or technique likely to assist in the manufacture or processing of goods or provision for services, shall be chargeable to income-tax under the had "Profits and gains of business or professions".

It is proposed to insert a new sub-clause (xii) in clause (2A) of section 2 so as to provide that the said sum received or receivable shall be included within the definition of income as defined in that clause.

This amendment will take effect from 1st April, 2003 and will, accordingly, apply in relation to the assessment year 2003-2004 and subsequent years.

Furthermore, the provisions were explained in Memo. explaining provisions in the Finance Bill, 2002 (254 ITR (St.) 190, 219 as under:-

MEASURES TO CURB TAX AVOIDANCE

New provisions for taxing the receipts in the nature of

Non-compete fees and exclusivity rights

This amendment proposes to insert a new provision in the Income-tax Act, 1961, for charging to tax any sum received or receivable in cash or in kind under an

agreement for not carrying out activity in relation to any business; or not to share any know-how, patent, copyright, trade-mark, lincence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services, under the head "Profits and gains of business or profession".

The proposed amendment will take effect from 1st April, 2003, and will, accordingly, apply in relation to the assessment year 2003-2004 and subsequent years.

12. In view of the above provisions, the sum received or receivable in cash or kind under an agreement for not carrying out any activity in relation to any business or not sharing the receipts from know-how etc., the value of any benefit will be taxable under Section 28(va) of the Act. But from the facts of the present case, it cannot be said that the assessee was carrying on business of obtaining loans or was in the business of money-lending or any other related business, but the transaction was out of the amount standing as liability in earlier years credited to the capital a/c by the assessee in the books of account as compensation for not enforcing his rights to sue in the court of law on account of full and final settlement. The assessee has not received any benefit in cash or kind which could be valued in the nature of income arising from the business for not competing. The provisions of Section 28(va) of the Act provides that any sum whether received or receivable in cash or kind under an agreement for not carrying out any activity in relation to any business or not to share any know-how, patent, copyright, trade-mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services, shall be chargeable to income-tax under the had "Profits and gains of business or professions. In view of the above facts and discussions, the compensation received in lieu of foregoing a right to sue does not fall under provisions of Section 28(va) of the Act. We further find from the facts of the case that the assessee has not received this amount under an agreement for not carrying out activity in relation to any business or not to share anyknow-how, patent, copy right, trademark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services, under the head "Profit & gains of business or profession". This provision is for taxing the receipt by the assessee in the nature of non-compete fee and exclusivity rights and not the receipt as received by the assessee.

The receipt received by the assessee has written off the same as compensation / damages for relinquishment of right to sue in court of law and credited the same in the capital a/c as capital receipt. Accordingly, we are of the considered view that this provision of section 28(va) of the Act will not apply to the facts of the present case. Accordingly this appeal of the assessee is allowed.

13. **In the result, assessee's appeal is allowed.**

Order pronounced in Open Court on 30/10/2009

Sd/-	Sd/-
(P.K.Bansal)	(Mahavir Singh)
Accountant Member	Judicial Member

Ahmedabad,
Dated : 30/10/2009
*Dkp
Copy of the Order forwarded to :
1. The Appellant.
2. The Respondent.
3. The CIT(Appeals)- XV, Ahmedabad
4. The CIT concerns.
5. The DR, ITAT, Ahmedabad
6. Guard File.

BY ORDER,

/True copy/

Deputy/Asstt.Registrar
ITAT, Ahmedabad