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Waiver of loan is not taxable as income from business or profession

The Visakhapatnam Bench of the Indian Income-tax Appellate Tribunal (ITAT) and the Bombay High Court rendered decisions that waiver of loan is a monetary benefit not taxable as benefit or perquisite arising from business or profession

Case 1

Background:

- Sri Vasavi Polymers (P.) Ltd. (taxpayer)¹ during the Financial Year (FY) 2012-13, corresponding to Assessment Year (AY) 2013-14, received waiver of working capital loan / open cash credit (OCC) loan of INR 17 million from a bank, as a result of one-time loan settlement of a loan of ~INR 43 million.
- The waiver of INR 17 million was not offered to tax by the taxpayer.
- During the course of audit, the Assessing Officer (AO) taxed the said waiver as income u/s 41(1) of the Income Tax Act, 1961 (ITA).

Section 41(1) of the ITA relates to taxation of, inter alia, benefit received by way of remission or cessation of a trading liability in respect of which a taxpayer has claimed allowance or deduction in earlier years.

- On appeal, the Commissioner of Income-tax Appeals [CIT(A)] relying on various decisions² deleted the addition made by the AO.
- Aggrieved by the CIT(A)'s order, the AO filed an appeal before the Visakhapatnam Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that the AO had sought to tax the waiver under section 41(1) of the ITA and not under section 28 of the ITA (i.e. provisions providing for the nature of incomes taxable as profits and gains of business or profession).

The counsel representing the Revenue, during the proceedings before the ITAT had contended that the waiver of loan was taxable under section 28(i) of the ITA.

¹ITO v. Sri Vasavi Polymers (P.) Ltd. [2020] 117 taxmann.com 236 (Visakhapatnam – Trib.)

²SHRM Food & Allied Services Pvt. Ltd (ITA. No.657/Mum/2009, 595/Mum/2008 and 1116/Mum/2013) and Mahindra & Mahindra Ltd. v. CIT [2018] 404 ITR 1 (SC)

- Further, the ITAT noted that the Supreme Court³ in relation to waiver of loan had held that:
 - Section 28(iv) of the ITA did not apply to waiver of loan, since the receipt in such a case was in the nature of cash or money.
 - Section 41(1) of the ITA did not apply since waiver of loan did not amount to cessation of a trading liability. Further, the taxpayer had purchased capital assets from the loan, which were not debited to the trading account or to the profit and loss account in any of the assessment years.
- In view of the above, the ITAT held as follows:
 - With respect to taxability under section 41(1) of the ITA, twin conditions need to be satisfied viz. there must be a trading liability or expenditure or loss which was incurred by the taxpayer in earlier years and the same was allowed as a deduction.
 - In the current case, the trading liability or the expenditure or deduction was claimed by the taxpayer in respect of interest paid on the OCC loan. The OCC loan represented the principal which was not claimed as expenditure by the taxpayer.
 - The remission of liability was in the form of cash or money and the difference amount of principal which was settled by one-time payment was never debited to the profit and loss account by the taxpayer.

Hence, though the taxpayer had gained the benefit by way of one-time settlement, the same was not taxable under section 28(iv) or under section 41(1) of the ITA.

Case 2

Background:

- Essar Shipping Limited (taxpayer)⁴ during the FY 1983-84, corresponding to AY 1984-85, claimed a deduction of INR 25.2 million with respect to the amount of loan given by the Karnataka government which was subsequently waived.
- During the course of audit, the AO held that the waiver of loan benefited the taxpayer in carrying on its business and thus, constituted income in the hands of the taxpayer as per section 28 of the ITA.
- On appeal, the CIT(A) held that waiver of loan could not be treated as a benefit or perquisite under section 28(iv) of the ITA because it was a cash item. Further, the CIT(A) also held that only items of revenue nature (and not times of capital nature) can be taxed under section 28 of the ITA.
- On further appeal, the Mumbai Bench of the Income-tax Appellate Tribunal (Mumbai ITAT) held that loan was connected with the business of the taxpayer and therefore the benefit arose out of the

³Mahindra & Mahindra Ltd. v. CIT [2018] 404 ITR 1 (SC)

⁴ Essar Shipping Limited v. CIT [2020] 117 taxmann.com 389 (Bom HC)

business of the taxpayer. The amount written off was an incentive for the business of the taxpayer. Further, the benefit in the form of write-off of loan was not a cash benefit.

Accordingly, the Mumbai ITAT upheld AO's order and held that waiver of loan was taxable in the hands of the taxpayer.

- Aggrieved by the order of the Mumbai ITAT, the taxpayer filed an appeal before the Bombay High Court (HC).

Decision of the HC:

- The HC noted the following:
 - Section 28 of the ITA refers to the value of any benefit or perquisite whether convertible into money or not arising from the exercise of business or profession.
 - The Supreme Court⁵ has held that waiver of loan would amount to cash receipt (and not a benefit or perquisite other than in the shape of money) in the hands of the taxpayer and therefore, was not taxable under section 28(iv) of ITA.
- In view of the above and based on the following, the HC held that waiver of loan was not taxable under section 28(iv) of the ITA:
 - In the case under consideration, loan was given by the Karnataka government which was subsequently waived. Therefore, the said amount was cash receipt in the hands of the taxpayer and could not be taxed under section 28(iv) of the ITA.
 - The Supreme Court case⁶ relied on by the Revenue, was with respect to the revenue subsidy granted by the government. Loan was to be repaid with interest, whereas, subsidy was not required to be repaid back and hence, both were different. Thus, the Supreme Court case relied on by the Revenue was not applicable in the case under consideration relating to waiver of loan.

Comments:

- Taxability on waiver of loan has been a subject matter of litigation. The rulings reaffirm the principle that waiver of loan is not taxable under section 28(iv) and under section 41(1) of the ITA as income from business or profession.
- Considering that the said rulings pertain to the period prior to introduction of section 56(2)(x) of the ITA (relating to receipt of money without consideration), taxpayers may want to consider impact under the said section, if any, while relying on the said rulings.

⁵Mahindra & Mahindra Ltd. v. CIT [2018] 404 ITR 1 (SC)

⁶Sahney Steel & Press Works Ltd. v. CIT [1997] 228 ITR 253 (SC)



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