



Global Business Tax Alert

Sharp Insights

In the case of JSW Steel Limited ('the taxpayer') v. ACIT, reported in ITA No. 923/Bang/2009, the Mumbai Tribunal has held that capital surplus in respect of waiver of loan amount is in the nature of capital receipt and can neither be considered as taxable income under the normal provisions of the Income Tax Act, 1961 ('the Act'), nor be included in the computation of book profit under section 115JB of the Act.

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Background

- The taxpayer, a public limited company, is engaged in the business of manufacturing hot rolled steel coils and sheets.
- During assessment year 2004-05, the taxpayer had availed rupee and foreign currency loans from various financial institutions and banks which was utilised for purchase of plant and machinery for setting up of a steel plant.
- Due to economic recession and slowdown in the steel industry, the taxpayer was unable to meet its financial commitments towards the loans availed.
- Therefore, the taxpayer entered into a 'corporate debt restructuring package' with the lenders pursuant to which, the principal and interest payable were reworked and part of the principal and interest amounts were waived. The amount waived was credited to the profit and loss account as an exceptional item with a specific mention in the 'Notes to Account'.
- While computing the book profit under section 115JB of the Act, the taxpayer had, out of abundant caution, included the amount pertaining to waiver of loans and interest payable.
- However, the taxpayer, by way of notes in the computation of income, disclosed that the same represents capital receipt and is not in the nature of profit and gains of business and therefore, cannot be included in the computation of book profit, under section 115JB of the Act. The taxpayer has accordingly reserved its right to exclude the said amount from the book profits under section 115JB of the Act during the course of assessment / appellate proceedings.
- The Assessing Officer ('AO') while computing the book profit under section 115JB of the Act included the exceptional item, being waiver of loan and interest credited to the profit and loss account, as part of the net profit while computing book profit. Further, the AO also held that the principal amount waived and written back is taxable under section 41(1) of the Act.
- The Commissioner of Income Tax (Appeals) ['CIT(A)'] upheld the order of the AO.
- Aggrieved by the order passed by the CIT(A), the taxpayer preferred an appeal before the Income Tax Appellate Tribunal ('Tribunal').

Ruling of the Tribunal

Computation of book profit under section 115JB of the Act

- The Tribunal observed that as per the provisions of the Companies Act, 1956, there is a clear distinction made for disclosing the true working result of the company during the year and disclosure of non-recurring transactions of exceptional nature. If for some reason or the other they have been accounted for in the profit and loss account, then the provisions do not stipulate that those items must necessarily be accounted for as part of the profit and loss account. Separate disclosure is intended to ensure that the reader of the profit and loss account gets a fair and clear picture of the result of the working of the company during a specified period.
- A mere disclosure of an extraordinary item in the profit and loss account does not mean that the same represents 'working results' of the company, especially when for instance, AS-9 clearly provides that remission of a liability is not to be recognised as revenue.

- The Tribunal further observed that waiver of a loan taken for acquisition of a capital asset, is a capital receipt and is within the category of capital surplus. An item of capital surplus can never be part of profit and loss account albeit it is part of capital reserve.
- As per clause (ii) of explanation 1 to section 115JB of the Act, all amounts which are exempt and are not in the nature of income, if any, credited to the profit and loss account, are to be excluded while computing the book profit. Applying the same logic it would be inconceivable that this provision intends that book profit should include something which is in the nature of a capital surplus on account of waiver of a loan.
- The provisions of section 115JB of the Act therefore cannot be interpreted to require an accounting of any amount that is capital in nature, and thereby tax being indirectly levied on such amount under book profit.
- The Tribunal further observed that there are divergent views on the issues. However, after considering the same, it held that if the taxpayer is in receipt of a 'capital receipt' which is not chargeable to tax under the Act, then the said capital receipt cannot be taxed as book profit as envisaged in terms of section 115JB of the Act as well.
- The Tribunal also considered the ruling of the Supreme Court in the case of Apollo Tyres¹ and distinguished the same on the basis of the facts.
- The Tribunal, accordingly, held that waiver of loan cannot be reckoned as working result of the company and therefore, cannot be required to be treated as part of book profit of the company. Accordingly, the Tribunal concluded that capital surplus on account of waiver of loan, is neither taxable nor can it be included in computation of book profit under section 115JB of the Act.

Taxability of principal and interest amount under section 41(1) of the Act

- As per the provisions of section 41(1) of the Act, a remission or cessation of a liability is to be considered as income if it is a trading liability for which allowance or deduction has been claimed in an earlier year.
- The Tribunal observed that a company's liability on account of the principal amount of loan borrowed for acquisition of a capital asset, cannot be reckoned as a nature of trading liability as envisaged in section 41(1) of the Act, and therefore, its remission cannot be deemed as income under section 41(1) of the Act.

The component of interest payable that has been waived, was not claimed as deduction by the taxpayer in earlier years, in view of the provisions of section 43B of the Act. Accordingly, the waiver of interest on loan amount also cannot be considered as taxable under the provisions of section 41(1) of the Act.

Taxability of depreciation claimed on capital assets

- The Tribunal observed that the decision of Bombay High Court in case of Nectar Beverages² relied upon by the AO, has been reversed by the Supreme Court. The Tribunal further observed that allowance of depreciation cannot be related to the loan amount waived for purchase of capital assets as the transaction of purchase of assets and borrowing are independent transactions. The Tribunal also relied on the decision of Supreme Court in the case of Tata Iron and Steel Company Ltd³ in this regard.
- The Tribunal accordingly, held that section 41(1) of the Act does not apply, as depreciation is neither a loss nor an expenditure. The Tribunal further held that liability incurred by the taxpayer was utilized for the purchase of capital asset and therefore, it cannot be held to be in the nature of a trading liability.

¹ Apollo Tyres Ltd v. ACIT (255 ITR 273) (SC)

² Nectar Beverages v. DCIT (139 Taxmann 70)

³ CIT v. Tata Iron and Steel Company Ltd (231 ITR 285)

Conclusion

- The Tribunal held that:
 - Waiver of loan cannot be reckoned as working result of the company and therefore, not required to be treated as part of book profit of the company. Capital surplus on account of waiver of dues is neither taxable nor can it be included in computation of book profit under section 115JB of the Act.
 - A company's liability on account of the principal amount of loan borrowed by it on a capital account, i.e. for acquisition of a capital asset, cannot be reckoned as being in the nature of trading liability as envisaged in section 41(1) of the Act. Its remission therefore cannot be deemed as income under section 41(1).
 - Further, the waiver of interest on loan amount also cannot be considered as taxable under the provisions of section 41(1) of the Act, as it was not claimed as deduction by the taxpayer in earlier years, in view of the provisions of section 43B of the Act.
 - The depreciation claimed on fixed asset is neither a loss nor an expenditure. Accordingly, as liability incurred by the taxpayer was utilized for the purchase of capital asset, the same cannot be held to be a trading liability for the purpose of section 41(1) of the Act.

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