

TAXABILITY OF WAIVER OF LOAN

- Finance Act, 2023 had amended the provisions of section 28(iv) of the Income-tax Act, 1961 ('the Act') w.e.f. 01 April 2024 by including benefit or perquisites arising from business in form of cash or in kind or partly in cash and partly in kind thereby expanding the scope of existing provisions

BRIEF FACTS OF THE CASE

- During the assessment year (AY) 2006-07, I.G. Petrochemicals Ltd.¹ ('assessee') underwent a one-time settlement (OTS) with banks for term loans and working capital loans. The Assessee had offered interest amount waived off by the lenders as its income and considered waiver of principal amount as capital receipts not chargeable to tax as per the provisions of the Act.
- During the course of assessment proceedings, the Assessing Officer ('AO') added waiver of principal portion of loan to the income of Assessee. On further appeal, CIT(A) upheld the addition.
- Aggrieved by same, assessee preferred further appeal. Hon'ble ITAT held that the waiver of term loans used for capital assets does not yield any direct benefit / perquisite to the assessee, thus it will not be considered as benefit or perquisite. However, waiver of loans used for business purposes, resulted in funds flowing back to the assessee, thereby leading to benefit or perquisite for the assessee and accordingly, same should be taxable as benefit or perquisite. Consequently, Hon'ble ITAT allowing the appeal for statistical purposes remitted the matter back to AO for bifurcating the waiver of loan relating to day-to-day business operations vis-à-vis term loan for capital asset purchases in order to determine the amount taxable as income under section 28(iv) of the Act.
- Thereafter, assessee filled miscellaneous application under section 254(2) of the Act with the Hon'ble ITAT contending that the waiver of entire principal portion should not be treated as benefit or perquisite, since the principal amount of term loans and working capital loan constituted a capital receipt which was not taxable income. It is pertinent to note that CIT(A) upheld the said view for AY 2005-06 relying on the ruling of hon'ble Supreme Court (SC) in **CIT v. Mahindra And Mahindra Ltd.**². The miscellaneous application filed by the assessee for AY 2006-07 was partly allowed by holding that waiver of term loans used for capital asset shall not be treated as benefit or perquisite.

- Aggrieved by same, assessee filled a writ petition before the Hon'ble Karnataka High Court ('HC').

KEY OBSERVATIONS OF HON'BLE KARNATAKA HIGH COURT



- Department submitted that whether the loan was a term loan or working capital loan would be a determinative factor for ascertaining taxability of waiver under section 28(iv) of the Act relying on the judgement of Hon'ble Bombay High Court in the case of ***Solid Containers Ltd. v. DCIT***³ where it was held that any amount received as loan by the assessee for trading business and retained by the assessee upon its waiver is taxable under section 28(iv) of the IT Act.
- Assessee in its submission placed reliance on hon'ble Supreme Court's ruling in the case of ***CIT v. Mahindra And Mahindra Ltd.*** wherein it was held that the benefit of a loan waiver, being in the form of cash receipt, does not qualify as a benefit "other than in the shape of money" and thus falls outside the ambit of Section 28(iv) irrespective of utilization of loan for capital expenditure purposes or working capital purposes.
- Hon'ble HC observed that the clinching factor to bring the benefit / perquisite within the ambit of term 'income' under section 28(iv) as per hon'ble SC in ***CIT v. Mahindra and Mahindra*** was only that the 'benefit/perquisite' should be 'other than in the shape of money' i.e. other than in cash. Therefore, the purpose of loan was neither dealt with nor would be a relevant determinative factor.
- Hon'ble HC also observed that the recent amendment to Section 28 of the Act vide Finance Bill 2023, wherein the legislature has included 'benefit' even in form of 'cash' arising from business or profession as being chargeable to income tax. Such amendment substantiates the interpretation of the Apex Court in Mahindra and Mahindra (supra), wherein it was concluded that the 'benefit' not being "other than in the shape of money" i.e., 'benefit' in form of 'cash' would fall outside the ambit of Section 28(iv) of the Act.
- Basis above, hon'ble HC passed the order setting aside order of Hon'ble ITAT relying on the ruling of Hon'ble Supreme Court in Mahindra and Mahindra (supra) and concluded that the nature of loan should not be the determinative factor for the purpose of determining taxability under section 28(iv) of the Act.
- It is pertinent to note that although the ruling is in the context of erstwhile section 28(iv), Hon'ble HC while adjudicating on the issue also discussed the amendment by Finance Act, 2023 stating that purpose of loan is not a determinative factor for deciding taxability of loan waiver under section 28(iv).

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