

Waiver of loan taken for purchase of a capital asset is not taxable as business income under the Income-tax Act – Supreme Court

Background

Recently, the Supreme Court in the case of Mahindra and Mahindra Ltd.¹ (the taxpayer) held that waiver of loan taken for purchase of a capital asset is not taxable as income under Section 28(iv) of the Income-tax Act, 1961 (the Act) since the benefit or perquisite arising from the business are in the form of cash or money. In order to invoke the provision of Section 28(iv) of the Act, the benefit which is received has to be in some other form rather than in the shape of money.

The Supreme Court also held that waiver of loan amounts to a cessation of liability other than 'trading liability'. However, provisions of Section 41(1) of the Act particularly deal with the remission of 'trading liability'. Further, the taxpayer never claimed a deduction for payment of interest under Section 36(1)(iii) of the Act. Therefore, waiver of loan is also not taxable as income under Section 41(1) of the Act.

Facts of the case

- During the year under consideration, the taxpayer decided to expand its jeep product line by including FC-150 and FC-170 models. Therefore, the taxpayer entered into an agreement with Kaiser Jeep Corporation (KJC) based in America wherein KJC agreed to sell the dies, welding equipments and die models to the taxpayer.
- The said toolings and other equipments were supplied by the KJC through its subsidiary Kaiser Jeep International Corporation (KJIC). However, for the procurement of the said toolings and other equipments, the KJC agreed to provide a loan to the taxpayer at the rate of 6 per cent interest repayable after ten years in installments. For this purpose, the taxpayer

addressed a letter to the Reserve Bank of India (RBI) for the approval of the said loan agreement. The RBI and the concerned Ministry approved the said loan agreement.

- Subsequently, it was informed to the taxpayer that the American Motor Corporation (AMC) had taken over the KJC and also agreed to waive the principal amount of loan advanced by the KJC to the taxpayer and to cancel the promissory notes as and when they got matured.
- The taxpayer filed its return and showing INR5.77 million as cessation of its liability towards the American Motor Corporation.
- The Assessing Officer (AO) held that with the waiver of the loan amount, the credit represented income and not a liability. Accordingly, the AO held that the sum of INR5.77 million was taxable under Section 28 of the Act. Subsequently, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.
- The Tribunal and High Court decided the case in favour of the taxpayer.

Issue before the Supreme Court

- Whether a waiver of loan by the creditor is taxable as a perquisite under Section 28(iv) of the Act or taxable as a remission of liability under Section 41(1) of the Act?

Supreme Court decision

- The term 'loan' generally refers to borrowing something, especially a sum of cash that is to be paid back along with interest decided mutually by the parties. In other terms, the

¹ The Commissioner v. Mahindra and Mahindra Ltd (Civil Appeal No. 6949-6950 of 2004) – Taxsutra.com

the debtor is under a liability to pay back the principal amount along with the agreed rate of interest within a stipulated time.

- It is a well-settled principle that creditor or his successor may exercise their 'Right of Waiver' unilaterally to absolve the debtor from his liability to repay. After such exercise, the debtor is deemed to be absolved from the liability of repayment of loan subject to the conditions of the waiver.
- The waiver may be a partly waiver i.e. waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the creditor results in the debtor having extra cash in his hand. It is a receipt in the hands of the debtor/taxpayer.

Taxability under Section 28(iv) of the Act

- On a plain reading of Section 28 (iv) of the Act, *prima facie*, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28(iv) of the Act, the benefit which is received has to be in some other form rather than in the shape of money.
- In the present case, it is a matter of record that the amount of INR5.77 million is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28(iv) of the Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, the amount of INR 5.77 million cannot be taxed under the provisions of Section 28(iv) of the Act.

Taxability under Section 41(1) of the Act

- On a perusal of the said provision, it is evident that it is a *sine qua non* that there should be an allowance or deduction claimed by the taxpayer in any assessment for any year in respect of loss, expenditure or trading liability incurred by the taxpayer. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the taxpayer is liable to pay tax under Section 41 of the Act.
- The objective behind the provision is simple. It is made to ensure that the taxpayer does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to the deduction allowed earlier in case of remission of such liability.

- It is an undisputed fact that the taxpayer had been paying interest at 6 per cent per annum to the KJC as per the contract, but the taxpayer never claimed a deduction for payment of interest under Section 36(1)(iii) of the Act.
- In the present case, the CIT(A) relied on Section 41(1) of the Act and held that the taxpayer had received amortisation benefit. Amortisation is an accounting term that refers to the process of allocating the cost of an asset over a period of time, hence, it is nothing else than depreciation. Depreciation is a reduction in the value of an asset over time, in particular, to wear and tear. Therefore, the deduction claimed by the taxpayer in previous assessment years was due to the deprecation of the machine and not on the interest paid by it. Moreover, the purchase effected from the KJC is in respect of plant, machinery and tooling equipments which are capital assets of the taxpayer. It is important to note that the said purchase amount had not been debited to the trading account or to the profit or loss account in any of the assessment years.
- There is a difference between 'trading liability' and 'other liability'. Section 41(1) of the Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to a cessation of liability other than trading liability. Hence, Supreme Court did not find any force in the argument of the tax department that the case of the taxpayer would fall under Section 41(1) of the Act.
- The Supreme Court are not inclined to interfere with the judgment and order passed by the High court in view of the following reasons:

- Section 28(iv) of the Act does not apply on the present case since the receipts of INR5.77 million are in the nature of cash or money.
- Section 41(1) of the Act does not apply since waiver of loan does not amount to cessation of trading liability. It is a matter of record that the taxpayer has not claimed any deduction under Section 36(1)(iii) of the Act *qua* the payment of interest in any previous year.

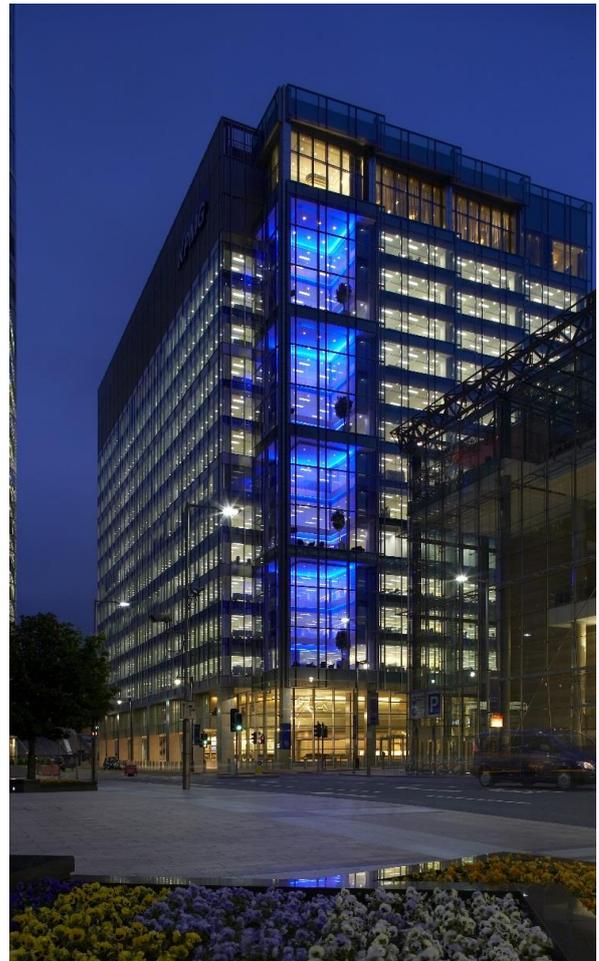
Our comments

The issue with respect to taxability of waiver of loan has been a matter of debate before the Courts.

The Courts/Tribunal in various cases² have held that waiver of loan taken for purchase of capital assets would not be taxable under Section 28(iv) since such a receipt does not have any character of an income, a loan being capital in nature. The Courts held that provisions of Section 28(iv) cannot be applied to the benefits received in cash or money.

However, the Madras High Court in Ramaniyam Homes (P.) Ltd.³ held that amount representing principal loan amount waived by a bank under the one-time settlement scheme would constitute income under Section 28(iv) of the Act.

The Supreme Court in the present case has set aside the controversy and held that waiver of loan taken for purchase of a capital asset is not taxable as income either under Section 28(iv) of the Act or under Section 41(1) of the Act.



² Iskraemeco Regent Ltd.v. CIT [2011] 196 Taxman 103 (Mad), Logitronics P Ltd [2011] 333 ITR 386 (Del), ACIT v. Spel Semiconductor Ltd [2013] 35 taxmann.com 304 (Chen)

³ CIT v. Ramaniyam Homes (P.) Ltd. [2016] 384 ITR 530 (Mad)

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur

Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara

303, 3rd Floor, Ocean Building,
Beside Center Squares Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023
Tel: +91 0265 6194200/0265 6194201