

Waiver of loan taken for procuring assets not taxable as business income

May 9, 2018

In brief

In a recent decision,¹ the Supreme Court (SC) upheld the ²Bombay High Court (HC) order holding that waiver of the principal portion of loan by the lender is neither taxable under section 28(iv) nor under section 41(1) of the Income-tax Act, 1961 (the Act).

In detail

Facts

- The taxpayer decided to expand its product line by including two different business models. For this purpose, an agreement was entered into with an American Company (A Co.) which agreed to supply tooling and other equipment.
- A Co. supplied dies, tooling and equipment to the taxpayer through its subsidiary (SA Co.).
- To procure tooling, A Co. agreed to provide loan to the taxpayer at the rate of

6%, repayable after 10 years on instalment basis.

- Later, B Co. took over A Co. Subsequent to such takeover, B Co. agreed to waive-off the principal amount of loan advanced by A Co. to the taxpayer.
- The taxpayer filed its return claiming such waiver of loan to be capital receipt, not chargeable to tax.
- The tax officer (TO) concluded that the waiver of the loan represented income and not liability, and held that the same would be taxable under section 28(iv)³ of the Act.

- On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] taxed such waiver under section 41(1)⁴ of the Act, rather than section 28(iv), and upheld the addition made by the TO.
- On appeal the Income-tax Appellate Tribunal (Tribunal) set aside CIT(A)'s order and deleted the addition made by the TO. This was subsequently upheld by the HC.

Issue before the Supreme Court

Whether the waiver of loan by creditor was taxable as perquisite under section 28(iv)

¹ Civil Appeal nos. 6949-6950 of 2004

² R.A. No. 1561 (Bom.)/1982 and R.A. No. 5161/B/80

³ Sec. 28 (iv) the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession ;

⁴ Sec. 41 (1) Where an allowance or deduction has been made in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first-mentioned person) and subsequently during any previous year,—

(a) the first-mentioned person 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 by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to income-tax as the 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; or ... ,...

or as a remission of liability under section 41(1) of the Act?

Revenue's contention

Since the amount for which the taxpayer was claiming deduction was waived-off, the same would be income within the ambit of section 28(iv) of the Act, and or within section 41(1) of the Act.

Taxpayer's contention

- The transaction of loan and purchase were independent transactions. The only relationship that survived after the purchase of dies, tool and equipment was that of the lender and borrower.
- The loan had been shown in the balance sheet under the heading "Loans-unsecured" and interest was being paid regularly on the same. Hence, the waiver of loan liability was capital in nature and not in the nature of income.

Supreme Court's decision

- On the applicability of section 28 of the Act it was held that income to be taxed

under clause (iv) should have been in some form other than money.

- The waiver of loan resulted in extra cash in the hands of the debtor and the condition of benefit received in form other than money was not satisfied. Hence, provisions of section 28(iv) of the Act did not apply.
- The taxpayer was paying interest but did not claim deduction under section 36(iii) of the Act for such interest payments, as the equipment purchased were capital assets in the hands of taxpayer and was not debited to its Profit and Loss account. Therefore, they could not be classified as a trading liability.
- Section 41(1) of the Act deals with the remission of trading liability, whereas the waiver of loan amounts to cessation of liability other than trading liability. Hence, the provisions of section 41(1) of the Act shall not be

applicable.

- Therefore, neither does section 28(iv) of the Act, nor does section 41(1) of the Act applies to waiver of the principal portion of the loan taken on capital assets.

The takeaways

- This ruling supports the view that the provisions of section 28(iv) shall only apply in cases where the benefit or perquisite was in a form other than that of money, and waiver of a loan does not satisfy this requirement.
- This ruling reaffirms that provisions of section 41(1) applies only in case of cessation of trading liability and does not apply in case of cessation of any liability other than trading liability.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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