Controversies

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Whether waiver of loan taken for acquiring Fixed Asset is taxable under the Income Tax Act, 1961? (An update)

Issue:

X Ltd acquired Fixed Asset and for the purpose obtained term loan of Rs. 5 crores in A.Y. 2001-02. However company went into financial difficulties and hence CDR was negotiated with the bank and the loan of Rs. 3 crores was waived and interest of Rs. 50 lacs were waived in A.Y. 2011-12. The waiver of interest was credited by the Assessee in P & L a/c while waiver of loan of Rs. 3 crores was credited to Capital Reserve. The AO was of the view that the waiver of loan is taxable u/s 5 or u/s 41(1) or u/s 28(iv).

Proposition:

It is submitted that waiver of loan is capital receipt not liable to tax under any of the section mentioned by the AO.

View Against the proposition:

It is submitted ed that the Hon'ble High Court of Bombay in the case of **Solid Containers Ltd. Vs. DCIT Mumbai (2009) 178 taxman 192** has dealt with exactly the similar issue and has given its decision in the favour of department and against the assessee.

The Hon'ble High Court of Bombay has given its decision after considering the decision of Hon'ble Supreme court in the case of **CIT vs. TV Sundram Iyengar & Sons Ltd., 88 Taxman 429.** The issue in this referred case of **Solid Container Ltd. Vs DCIT** was that the assessee had taken a loan from one party during the previous year for business purpose which was written back in the relevant assessment year as a result of consent terms arrived at between the party and the assessee. The assessee claimed that the said loan was the capital receipt and was not claimed as deduction form the taxable income as expenses and therefore would not come u/s. 41(1). The AO rejected the contention of the assessee on the ground that credit balance written back was income of the assessee in view of the fact that it was again directly arising out of business activity of the assesseee and was liable to tax u/s 28 of the Act. On appeal, the CIT(A) upheld the order of the AO. On second appeal the Tribunal in view of decision of Hon'ble Supreme Court in the case of CIT Vs TV Sundram Iyengar & Sons Ltd. confirmed the order of the CIT(A). The matter went to the Hon'ble High Court of Bombay. The Hon'ble High Court of Bombay decided the issue in the favour of the Department and against the assessee. As per the Hon'ble High Court of Bombay, the Hon'ble Supreme Court in the case of **Sundram Iyengar & Sons Ltd.** (supra) has held that if an amount is received in the course of a trading transaction, even though it is not taxable in the year of receipt as being of capital character, yet the amount changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right. The Hon'ble Supreme Court was of the view that when such a thing happens/ common sense demands that the amount should be treated as income of the assessee. The Hon'ble Supreme Court has further held that in view of this settled position of law and the facts of the instant case, no question of law, much less substantial question of law, arose for consideration in the instant appeal and therefore same was to be dismissed in limine. The Hon'ble High Court of Bombay in its decision in the case of Solid Container Ltd. (supra) has incorporated the decision of Hon'ble Supreme Court.

For reference, the decision of Hon'ble Supreme Court in the case of **CIT Vs TV Sundram lyengar & Sons Ltd.** is reproduced hereunder:"

" The principle laid down by Atkinson, J. applies in full force to the facts of this case. If a common

sense view of the matter is taken, the assessee, because of the trading operation, had become richer by the amount which it transferred to its profit and loss account. The moneys had arisen out of ordinary trading transactions. Although the amount received originally was not of income nature, the amounts remained with the assessee for a long period unclaimed by the trade parties. By lapse of time, the claim of the deposit became time-barred and the amount attained a totally different quality. It became a definite trade surplus, Atkinson, J. pointed out that in Morley's case (supra) no trading asset was created. Mere change of method of book-keeping had taken place. But, where a new asset came into being automatically by operation of law, common sense demanded that the amount should be entered in the profit and loss account for the year and be treated as taxable income. In other words, the principle appears to be that if an amount is received in course of a trading transaction, even though it is not taxable in the year of receipt as being of capital character, the amount changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right. When such a thing happens, common sense demands that the amount should be treated as income of the assessee.

In the present case, the money was received by the assessee in course of carrying on his business. Although it was treated as deposit and was of capital nature, at the point of time, it was received, by efflux of time the money has become the assessee's own money. What remains after adjustment of the deposits has not been claimed by the customers. The claims of the customers have become barred by limitation. The assessee itself has treated the money as its own money and taken the amount to its profit and loss account. There is no explanation from the assessee why the surplus money was taken to its profit and loss account even if it was somebody else's money. In fact, as Atkinson, J. pointed out that what the assessee did was the common sense way of dealing with the amounts." (p.437) (of Taxman)"

After considering the above decision of Hon'ble Supreme Court in the case of **TV Sundram Iyengar & Sons Ltd.**, the Hon'ble Bombay High Court has given its decision in the case of **Solid Containers Ltd. Vs DCIT** and the same is also reproduced hereunder for reference:

"The present appellant can hardly drive any advantage from the case of Mahindra & Mahindra Ltd. (supra). As in that case a clear finding was recorded that the assessee continued to pay interest at the rate of 6 per cent for a period of 70 years and the agreement for purchase of toolings was entered into much prior to the approval of loan arrangement given by the Reserve Bank of India. Therefore, the loan agreement, in its entirety, was not obliterated by such waiver. Secondly, the purchase consideration related to capital assets. The toolings were in the nature of dies and the assessee was a manufacturer of heavy vehicles. The import was that of plant and machinery and the waiver could not constitute business, The facts of the present case are entirely different inasmuch as it was a loan taken for trading activity and ultimately, upon waiver the amount was retained in business by the assessee. Thus, the principle stated by the Supreme Court in the case of T.V.Sundaram Iyengar & Sons Ltd. (supra) would be squarely applicable to the facts of the present case. The amount which initially did not fall within the scope of the provisions rendering it liable to tax subsequently have become the assessee's income being part of the trading of the assessee. Similar view was also taken by a Bench of Madras High Court in the case of **CIT v. Aries Advertising (P.) Ltd. [2002] 255 ITR 510** . The court took the view that the assessee because of trading operation became richer by the amount which had been transferred and/or retained in the Profit and Loss Account of the assessee.

In view of the above settled position of law and the facts of the present case, we are of the considered view that no question of law much less substantial question of law arises for consideration in the present appeal. Appeal dismissed in limine."

View in Favour of the proposition:

It is submitted in the following cases, it has been clearly held that except for the interest, the principal amount remitted is not taxable.

i CIT vs. Phoolchand Jivram 131 ITR 37 (Delhi)

ii Chetan Chemicals Ltd. 267 ITR 770 (Guj.) (Jurisdictional High Court)

iii CIT vs. Toosha International Ltd. (2009) 176 Taxman 187 (Delhi)

iv Mahindra & Mahindra Ltd. vs.CIT (2003) 231 ITR 501 (Bombay)

Let me now refer to the decision of their lordships of Gujarat High Court in the case of Chetan Chemicals Ltd. which reads as under:

" On a reading of the provisions, it is apparent that before the section can be invoked, it is necessary that an allowance or a deduction has been granted during the course of assessment for any year in respect of loss, expenditure or trading liability which is incurred by the assessee, and subsequently during any previous year the assessee obtains, whether in cash or in any other manner, any amount in respect of such trading liability by way of remission or cessation of such liability. In that case, either the amount obtained by the assessee or the value of the benefit accruing to the assessee can be deemed to be the profits and gains of business or profession and can be brought to tax as income of the previous year in which such amount or benefit is obtained. In the facts of the case on hand," without entering into the aspect as to whether the liability to repay the loans would be a trading liability or not it is an admitted position that there has been no disallowance or deduction in any of the preceding years and hence, there is no question of applying the provisions as such."

Summation:

Recently I.T. Dept. has started unsettling the settled issue that the waiver of loan cannot be taxed u/s. 41(1) nor u/s. 28 of the I.T. Act, 1961.

1] is only the benefit of a cessation or remission of liability received by an assessee in respect of an expenditure claimed as a deduction in the past. When an assessee takes a loan, there is no question of claiming any expenditure as deduction. So, the provisions of section 41 [1] does not come in to play, when the loan is subsequently waived by the lender.

The issue that survives is whether the benefit of the loan waiver can be taxed as business income u\s 28 [1][iv]. Section 28 [1][iv] subjects to tax as business income 'the value of any benefit or perquisite, whether convertible in to money or not, arising from business or the exercise of profession.

2] In CIT v. T.V. Sundaram Iyengar and Sons P. Ltd. [1996] 222 ITR 344 (SC) where unclaimed balances in deposits received by customers not claimed by them was credited to the profit and loss account, from such amount was held liable to tax, since these claims were barred by limitation by taking what the Supreme Court called "a common sense view of the matter" on the ground that though it did not have the character of income at the time of receipt, the lapse of time made it a "definite trade surplus". Only a few cases were discussed and the Supreme Court was more led by its own decision in Punjab Distilling Industries Ltd. v. CIT [1959] 35 ITR 519 (SC), which, however, related to a case of bottle deposit and could have, therefore, been distinguished, since the depositor was eligible for return of deposit only where the bottles, which were containers were returned.

3] Where the loan borrowed for purchase of capital asset was waived, the amount was sought to be assessed under section 41(1) in Fidelity Textiles P. Ltd. v. Asst. CIT [2008] 305 ITR (AT) 97 (Chennai). Though loan amount was not allowed as a deduction, the argument was that it could be taxable even independently of section 41(1). It was decided that since the loan was for acquiring a capital asset, it could only be a capital receipt. The purpose of loan is, however, immaterial, since waiver of loan would not have been otherwise been assessable, but the decision that it cannot be taxed accords with law. Since a loan amount on waiver does not have the character of income, as it has not been allowed as a

deduction as held in Coastal Corporation v. Jt. CIT[2008] 307 ITR (AT) 78 (Visakhapatnam).

4] It is established law that section 41(1) is intended to neutralize a liability, which had been allowed as a deduction in the computation of an assessee's income, where such liability does not become payable either due to remission on the part of the creditor or the liability itself otherwise ceases. The assessee had made a journal entry adjusting investments by Rs.50 lakhs by a provision for contingencies at the time of takeover of assets consequent on a scheme of arrangement approved by the court. But later it was squared up, as it was no longer necessary. When the amount of Rs.50 lakhs had not been charged to the profit and loss account, the question of any liability ,when the contingency did not materialize and the provision was treated as no longer required, section 41(1) could have no application as was decided in CIT v. SIEL Holdings Ltd. [2012] 348 ITR 447 (Delhi).

5] Section 41(1), would have application only in respect of an amount, which had been allowed as a deduction on cessation of liability. This established law was followed in Asst. CIT v. Rollatainers Ltd. [2011] 7 ITR (Trib) 665 (Delhi). The Assessing Officer in this case had taken the view that the assessee had not established that no interest income had been allowed in computation of income for earlier years. Such matters are not decided with reference to mere burden of proof, when the records of the Assessing Officer himself would indicate the correct position one way or the other. It cannot be said that the Assessing Officer had no responsibility in the matter. When the Commissioner (Appeals) found that there was no scope for disallowance after examining the facts, the Tribunal cannot interfere with such decision, as was decided in this case.

6] In CIT v. Chetan Chemicals Pvt. Ltd. [2004] 267 ITR 770 (Guj.), the High Court held, that section 41(1) cannot rope in remission of liability, which has not been allowed as a deduction. Where remission was not only interest, but also principal amount of borrowing, it made an observation, that the asessee was not in money lending business, so that the question of the principal amount being considered for assessment cannot arise. Probably, the impression is that for money lending, money is stock-in-trade, so that even the principal amount waived could be treated as income. But such an inference does not readily follow, because such waiver, whether of principal amount of interest would still be a windfall, which could be treated as income only if it could be deemed as income under section 41(1) of the Act. Language of section 41(1) does not make an exception for money lending business, so that it should make no difference whether the assessee was in money lending business or otherwise.

Referring to the above decisions, the Delhi High Court in the case of Logitronics P. Ltd. vs. CIT[2011] 333 ITR 386, 402 {Del}has held that the question whether waiver of loan is income or not depends on whether loan was used for capital or revenue purposes. If the loan was taken for acquiring a capital asset, the waiver thereof would not amount to any income exigible to tax u/s 28(iv) or 41(1).On the other hand, if the loan was taken for a trading purpose and was treated as such from the very beginning in the books of account, its waiver would result in income more so when it was transferred to the P&L A/c in view of Sundaram Iyengar 222 ITR 344 (SC).

Let me now refer to the decision of their lordships of Bombay High Court in the case of CIT vs. Xylon Holding Pvt. Ltd., I.T. Appeal no. 3704 of 2010 decided on 13.9.12. Their lordships of Bombay High Court held as under :

We have considered the submissions. The issue arising in this case stand covered by the decision of this Court in the matter of Mahindra & Mahindra (supra). The decision of this court in the matter of Solid Containers (supra) is on completely different facts and inapplicable to this case. In the matter of

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Solid Containers (supra) the assessee therein had taken a loan for business purpose. In view of the consent terms arrived at, the amount of loan taken was waived by the lender. The case of the assessee therein was that the loan was a capital receipt and has not been claimed as deduction from the taxable income in the earlier years and would not come within the purview of Section 41(1) of the Act. However, this Court by placing reliance upon the decision of the Apex Court in the matter of CIT v. T.V. Sundaram Iyengar and Sons Ltd. 222 ITR 344 held that the loan was received by the assessee for carrying on its business and therefore, not a loan taken for the purchase of capital assets Consequently, the decision of this Court in the matter of Mahindra and Mahindra Limited (supra) was distinguished as in the said case the loan was taken for the purchase of capital assets and not for trading activities as in the case of Solid Containers Limited (supra). In view of the above, the decision of this Court in the matter of Solid containers Limited (supra) will have no application to the facts of the present case and the matter stands covered by the decision of this Court in the matter of Mahindra & Mahindra Limited (supra). The alternative submission that the amount of loan written off would be taxable under Section 28(iv) of the Act also came up for consideration before this Court in the matter of Mahindra & Mahindra Limited (supra) and it was held therein that Section 28(iv) of the Act would apply only when a benefit or perquisite is received in kind and has no application where benefit is received in cash or money.

In view of this appeal being covered by the decision of this Court in the matter of Mahindra & Mahindra Ltd. (Supra), no substantial question of law arises and both the questions are dismissed.

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