



# Tax Alert – SC upholds capital loan waiver not a perquisite under section 28(iv) nor cessation of a trading liability under section 41(1)

Tax Alert  
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Dear All,

Recently, the Hon'ble Supreme Court ('SC'), collectively dismissing various appeals<sup>1</sup>, ruled on the taxability of waiver of a loan acquired for capital purposes under section 28(iv) and section 41(1) of the Income Tax Act, 1961 ('Act').

The point for consideration before the SC was whether under the facts and circumstances of the case, the waiver of loan obtained by the taxpayer constituted taxable income of the taxpayer or not. Relying on the facts of the matter, the SC held as under:

## BRIEF FACTS:

1. The taxpayer, Mahindra and Mahindra Ltd entered into an agreement on 18.06.1964 with Kaiser Jeep Corporation ('KJC') based in America wherein KJC agreed to sell dies, welding equipments and die models to the taxpayer. The said tools and other equipments were supplied by KJC through its subsidiary Kaiser Jeep International Corporation ('KJIC').
2. For the procurement of the said toolings and other equipments, KJC agreed to provide a loan to the taxpayer at the rate of 6% interest repayable after 10 years in instalments.
3. Subsequently, American Motor Corporation ('AMC') took over KJC and also agreed to waive the principal amount of loan advanced by KJC to the taxpayer.
4. The taxpayer claimed the said waiver as cessation of its liability towards AMC in the return of income filed for the relevant year. However, revenue concluded that the waiver of loan amount represented income under section 28(iv) of the Act and not a liability.
5. The Mumbai bench of the Income Tax Appellate Tribunal ('ITAT'), ruled in favour of the taxpayer and even the Hon'ble Bombay High Court ('HC') confirmed the findings of the ITAT in favour of the taxpayer.

## ARGUMENTS BEFORE THE SC:

6. Revenue argued that waiver of loan actually amounts to income in the hands of the taxpayer in the sense that an amount which ought to be paid by it is now not required to be paid. Hence, it contented that the amount be held taxable under section 28(iv) and alternatively under Section 41(1) of the IT Act.
7. The taxpayer argued that KJIC supplied the toolings and equipments, whereas the loan was given by KJC, hence, these transactions were independent transactions. It contented that the purchase of toolings and equipments was not a transaction for purchase of goods on credit in the ordinary course of business nor could it be equated to unpaid purchase consideration to be liquidated over a period of time.
8. Further, this loan had been shown in the Balance Sheet of the taxpayer under the heading "Loans-unsecured" and hence, it represented waiver of a loan liability which was on the capital amount and not in the nature of income.

## DECISION OF SC:

9. In the present case, the SC observed that waiver amount represented cash receipt from AMC and therefore, it concluded that since the very first condition of Section 28 (iv) of the Act which says any benefit or perquisite arising from the business in the '*form other than in the shape of money*', is not satisfied, the said waiver cannot be taxed under section 28(iv) of the Act.

<sup>1</sup> The Commissioner v/s Mahindra and Mahindra Ltd. Thrg. M.D. (Civic Appeal No. 6949-6950 of 2004)

10. Further, on analyzing the provisions of section 41(1) of the Act, held that it is a sine qua non that there should be an allowance or deduction claimed by the taxpayer in any year in respect of loss, expenditure or trading liability incurred by the taxpayer. However, it was observed by SC that the taxpayer never claimed deduction for payment of interest under section 36(1)(iii) of the Act.
11. SC also rejected Revenue's claim that taxpayer obtained amortization benefit, by concluding that the deduction claimed by taxpayer in earlier years was on account of depreciation of machines and not on account of interest payment.
12. Thus, SC held that the loan was acquired for capital purposes and not for trading purposes and that the provisions of section 41(1) of the Act particularly deal with remission of 'trading liability'.
13. In light of the above, SC concluded that waiver of loan acquired for capital purposes is neither a benefit or perquisite arising from the business in the 'form other than in the shape of money' nor it amounts to cessation of a trading liability. Accordingly, the provisions of section 28(iv) as well as section 41(1) of the Act does not apply on waiver of loan acquired for capital purposes.

#### ELP COMMENTS:

The above decision of the SC provides much needed clarity on the position of law regarding taxability of waiver of loan acquired for capital purposes which has been the subject matter of litigation over the years.

In recent years, many businesses have undergone (and are undergoing) Corporate Debt Restructuring / Strategic Debt Restructuring / Insolvency and Bankruptcy Code proceedings which may have resulted in waiver of loan. The above ruling settles the taxability of such waiver of loan thereby putting rest to likely income-tax litigation.

Having said the above, the above SC decision only covers taxability of waiver of loan under the normal provisions of the Act. Taxability of such waiver of loan under Minimum Alternate Tax provisions are not covered by the above ruling.

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## ECONOMIC LAWS PRACTICE | ADVOCATES & SOLICITORS

#### MUMBAI

[mumbai@elp-in.com](mailto:mumbai@elp-in.com)

#### NEW DELHI

[delhi@elp-in.com](mailto:delhi@elp-in.com)

#### BENGALURU

[bengaluru@elp-in.com](mailto:bengaluru@elp-in.com)

#### AHMEDABAD

[ahmedabad@elp-in.com](mailto:ahmedabad@elp-in.com)

#### PUNE

[pune@elp-in.com](mailto:pune@elp-in.com)

#### CHENNAI

[chennai@elp-in.com](mailto:chennai@elp-in.com)

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