Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon)?

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Introduction

1.1 The nationwide lockdown, on account of the COVID-19 virus, has paralysed various businesses and has resulted in large-scale losses throughout India, which has had a direct impact on the repayment ability of the borrowers. In order to provide some relief to the borrowers or to reduce the probability of default in re-paying the loans or to receive at least part of the loan lent, the lenders may waive the full or part of the loan, including working capital loan given by them.

1.2 The Hon'ble Supreme Court in **CIT v. Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)** while dealing with taxation of loan borrowed for acquiring certain capital assets, has held that waiver of the said loan would not be taxable u/s 28(iv) nor under 41(1) of the Income Tax Act, 1961 (the Act). However, the issue which arises for consideration is whether a working capital loan can be considered as a trading liability, the waiver of which (along with outstanding interest accrued thereon) would lead to taxability u/s 41(1) of the Act, more so in light of the following observations of the Hon'ble Apex Court in **Mahindra and Mahindra Ltd. (supra)** – *"16…..Here, we deem it proper to mention that there is difference between 'trading liability' and 'other liability'. Section 41 (1) of the IT Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability."*

1.3 Further, with respect to taxability of a trading liability (being in nature of unclaimed deposits from customers), transferred to the Profit and Loss A/c of the taxpayer, the Hon'ble Supreme Court in **CIT v. T.V. Sundaram Iyengar & Sons Ltd. [1996] 88 Taxman 429 (SC)** has held the same to be taxable by holding – *"The assessee itself treated the amount as its trade receipt by bringing it to its profit and loss account. If a common sense view of the matter was taken, the assessee, because of the trading operation had become richer by the amount which it transferred to its profit and loss account."*

1.4 Following the judgement of the Hon'ble Apex Court in **T.V. Sundaram Iyengar & Sons Ltd. (supra)**, the Hon'ble Delhi High Court in **Logitronics (P.) Ltd. v. CIT [2011] 197 Taxman 394 (Delhi)** has held *"If the loan was taken for acquiring the capital asset, waiver thereof would not amount to any income exigible to tax, but on the other hand, if the loan was taken for trading purpose and was treated as such from the very beginning in the books of account, the waiver thereof may result in the income, more so when it was transferred to the profit and loss account.".* Subsequently, following the aforesaid judgement, the Hon'ble Delhi High Court in **Rollatainers Ltd. v. CIT [2011] 203 Taxman 31 (Delhi)** has held that waiver of working capital loan is taxable u/s 41(1) of the Act. Also, the Hon'ble Bombay High Court in **Solid Containers Ltd. v. DCIT [2009] 178 Taxman 192 (Bombay)** has upheld the taxability of waiver of loans taken for business purposes u/s 28(iv) / 41(1) of the Act by distinguishing the judgement of Hon'ble Bombay High Court in case of **Mahindra & Mahindra Ltd. v. CIT [2003] 261 ITR 501 (Bom)** and following the judgement of Hon'ble Apex Court in **T.V. Sundaram Iyengar & Sons Ltd. (supra)** held *"3. The present appellant can hardly drive any advantage from the case of Mahindra & Mahindra Ltd. (supra)…….the purchase consideration related to capital asset…. The facts of the present case are entirely different in as much 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 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."

1.5 Recently, the Hon'ble Tribunal in well-reasoned orders, **in ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib)** and **Jai Pal Gaba v. ITO [2019] 178 ITD 357 (Chandigarh - Trib.)** have held that waiver of working capital loan would not be taxable u/s 28(iv) and 41(1) of the Act. However, the said cases have not dealt with the adverse judgements of the Hon'ble Bombay High Court in **Solid Containers Ltd. (supra).** Further, in the case of **Jai Pal Gaba (supra),** the decisions of Hon'ble Delhi High Court in case of **Logitronics (P.) Ltd. (supra)** and **Rollatainers Ltd. (supra)** were not even cited by the Revenue.

1.6 In view of the above, an attempt is being made in this article to examine taxability of waiver of Working Capital loan (and outstanding interest accrued thereon in respect of which no deduction has been allowed in any assessment years, hereinafter referred to outstanding interest):

A. U/s 28(iv) of the Act
B. U/s 41(1) of the Act
C. In light of the observations of the Hon'ble Supreme Court in **CIT v. Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)**
D. In light of the observations of the Hon'ble Supreme Court in **CIT v. T.V. Sundaram Iyengar & Sons Ltd. [1996] 88 Taxman 429 (SC)**
E. By evaluating the correctness of the adverse decision of the Hon'ble High Courts of Bombay and Delhi, post the judgement of the Hon'ble Apex Court in **CIT v. Compaq Electric Ltd. [2019] 101 taxmann.com 400 (SC)** following its own judgement in Mahindra and Mahindra Ltd. (supra)
F. In light of the decisions of the Hon'ble Tribunal in case of **Vasavi Polymers Pvt. Ltd. (supra)** and **Jai Pal Gaba (supra)**
G. U/s 56(2)(x) of the Act
H. In light of Relevant Case Laws

<u>Analysis</u>

A. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – u/s 28(iv) of the Act

2.1 Section 28(iv) of the Act provides

"The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession",
(iv) the value of any benefit or perquisite, <u>whether convertible into money or not, arising from business</u> or the exercise of a profession…."

2.2 It is submitted that the words "whether convertible into money or not" used after the words "the value of any benefit of perquisite" in section 28(iv) would imply that the "benefit of perquisite" must be other than a monetary benefit or perquisite e.g. the value of rent-free residential accommodation secured by an assessee from a company in consideration of the professional services as a lawyer rendered by him to that company or, the value of the benefit derived by a partner from the use of the firm's car, telephone, residential premises etc will be assessable in the hands of the assessee as his income under the head 'Profits and Gains of business or profession'. As self-evident from the aforesaid provisions, the two important conditions for a "benefit" or "perquisite" to be taxable under section 28(iv) of the Act are :-

i. it should not be in the form of cash or money and
ii. it should arise from the business or the exercise of a profession

Thus, only when both aforesaid the conditions are satisfied cumulatively would the benefit or perquisite come within the ambit of the section 28(iv) of the Act. In other words, if only one condition is satisfied the benefit cannot be taxed under section 28(iv) of the Act.

2.3 It is submitted that clearly, the "benefit" obtained by a taxpayer in the form of waiver of any loan (including a working capital loan) as well as waiver of the unpaid interest accrued thereon is a monetary benefit and thus, the same in my humble view, would not come within the purview of 28(iv) so as to be taxable under the said provisions. Further, I may add that it may also be possible to contend that if the assessee is not carrying on the business of banking or money lending, the benefit in the form of the waiver of the bank loan for working capital purposes (or otherwise) as well as unpaid interest accrued thereon cannot even be said to be a "benefit" or perquisite arising from business (such as advances or deposits received from customers etc.) even though the said loan was taken for business purposes and consequently, the same should not be taxed u/s 28(iv) of the Act.
Reference may be made to

- **CIT v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC) (w.r.t loan taken for purchase of capital asset)**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**
- **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib) (w.r.t working capital loan)**
- CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with CIT v. Mahindra And Mahindra Ltd [2018] 93 taxmann.com 32 (SC)
- other case laws enumerated in the paras 9.1 and 9.2 below.

B. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – u/s 41(1) of the Act

3.1 Section 41(1) of the Act provides

"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 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

b. the successor in business has obtained, whether in cash or in any other manner whatsoever, any amount in respect of which loss or expenditure was incurred by the first-mentioned person or some benefit in respect of the trading liability referred to in clause (a) by way of remission or cessation thereof, the amount obtained by the successor in business or the value of benefit accruing to the successor in business shall be deemed to be profits and gains of the business or profession, and accordingly chargeable to income-tax as the income of that previous year.

Explanation 1. – For the purposes of this sub-section, the expression "loss or expenditure or some benefit in respect of any such trading liability by way of remission or cessation thereof" shall include the remission or cessation of any successor in business under clause (b) of that sub-section by way of writing off such liability in his accounts
……."

3.2 As self-evident from above, there are three pre-requisites for chargeability u/s 41(1) of the Act which need to be cumulatively satisfied viz.

i. an allowance or deduction has been made in the assessment of the assessee for any year and
ii. such an allowance or deduction is in respect of loss, expenditure or trading liability incurred by the assessee and
iii. the assessee 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.

3.3 It follows from above that the benefit in respect of a trading liability by way of remission or cessation thereof can be taxed u/s 41(1) of the Act only if an allowance or deduction has been made in the assessment of any year in respect of the said trading liability. Thus, in my humble view irrespective of whether or not a working capital loan liability is a trading liability, it is obvious that no allowance or deduction would ever have been made in the assessment of any year in respect of the said working capital loan liability and therefore, the question of taxing the waiver of the said working capital loan liability should not arise. Further, in all probability the interest expenditure on the said working capital loan being unpaid would have been disallowed u/s 43B of the Act and thus, the pre-requisite for chargeability u/s 41(1) of the Act i.e. that "an allowance or deduction has been made in the assessment of any year in respect of loss, expenditure for trading liability incurred by the assesseee…" would not have been satisfied. Therefore, in my humble view, the question of even taxing / charging waiver of the accrued interest liability in respect of working capital loan should not arise. (However, if deduction has been allowed in respect of the said interest in any assessment year, the waiver of the same would lead to taxability u/s 41(1) of the Act.)

Reference may be made to

- **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC) (w.r.t loan taken to fund the operations of the assessee)**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**
- **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib) (w.r.t working capital loan)**
- CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)
- CIT v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC) (w.r.t loan taken for purchase of capital asset)
- other case laws enumerated in the paras 9.1 and 9.2 below.

3.4 Thus, in light of the above, in my humble view, the question as to whether or not the working capital loan liability is a trading liability would really be an academic question in a case where no deduction has been allowed in respect of the said working capital loan liability. Thus, without entering into the aspect as to whether or not a working capital loan liability is a trading liability, it is submitted that, if no deduction has been claimed in respect of the same, its waiver would not result into chargeability u/s 41(1) of the Act

Reference may be made to

- CIT v Chetan Chemicals (P.) Ltd. [2004] 139 TAXMAN 301 (Guj) [Followed in CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)

3.5 However, for the sake of completeness, I would like to touch up on the aforesaid issue i.e whether or not a working capital loan is a trading liability. To the best of my knowledge, the term "trading liability" has neither been defined in the Act or even otherwise. Therefore, in my

humble view, a trading liability on a plain reading would be a liability which arises from carrying on of trade eg. payments due to suppliers, advances received from customer etc . Thus, it is very possible to strongly contend that though the working capital loan is taken for the purpose of trading activity, the same does not arise out of the trading activity and even more so for an assessee who is not engaged in a business of banking / money lending, and that consequently, the same is a capital receipt / liability and not a "trading liability" or "trade advance" or a "revenue receipt" so as to come within the purview of the provisions of section 41(1) of the Act.

Reference may be made to

- **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by Revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC) (w.r.t loan taken to fund the operations of the assessee)**
- **CIT v. Velocient Technologies Ltd. – [2015] 60 taxmann.com 353 (Delhi) (w.r.t loan taken to further the business of the assessee)**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**

C. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) –In light of the observations of the Hon'ble Supreme Court in CIT v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)

4.1 As regards the provisions of section 28(iv), the Apex court held that in order to invoke the provisions of section 28(iv), the "benefit" which is received has to be in some form other than in the shape of money. The assessee therein had received the loan in cash and, waiver of the said loan resulted in a "benefit" or perquisite in the shape of money. Thus, the Apex court held that, the very prerequisite of section 28 (iv) i.e. that the benefit or perquisite arising from the business should be in the form of benefit or perquisite other than in the shape of money, was not satisfied. It is submitted that whether the loan received is for acquisition of a capital asset or whether it is a working capital loan, waiver of the loan would result in a "benefit" or perquisite in the form of "money "and consequently, the provisions of section 28 (iv) of the Act would not be applicable in either of the cases. Thus, the judgement of Hon'ble Apex court in the case **Mahindra and Mahindra Ltd. (supra)** would be equally applicable in a case of waiver of working capital liability qua the non-applicability of the provisions of section 28(iv) to the said waiver.

Reference may be made to

- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**
- **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib) (w.r.t working capital loan)**

4.2 With regard to the applicability of the judgement of the Hon'ble Apex court **in Mahindra and Mahindra Ltd. (supra)** to waiver of working capital loan, vis-à-vis non applicability of the provisions of section 41 (1) of the Act, a doubt may arise as to whether a working capital loan liability can be treated as a trading liability and consequently its waiver can be taxed u/s 41(1) of the Act. This doubt has arisen due to the following observation of the Honourable apex court in the case of **Mahindra and Mahindra Ltd. (supra)**

"16. Moreover, the purchase effected from the Kaiser Jeep Corporation is in respect of plant, machinery and tooling equipments which are capital assets of the Respondent. 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. Here, we deem it proper to mention that there is difference between 'trading liability' and 'other liability'. Section 41 (1) of the IT Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Hence, we find no force in the

argument of the Revenue that the case of the Respondent would fall under Section 41 (1) of the IT Act."

4.3 To address the above doubt, it would be imperative to refer to para 15 of the aforesaid judgement which is reproduced herein under for sake of convenience

"15. 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 assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41 of the IT Act. The objective behind this Section is simple. It is made to ensure that the assessee 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 deduction allowed earlier in case of remission of such liability. It is undisputed fact that the Respondent had been paying interest at 6 % per annum to the KJC as per the contract but the assessee never claimed deduction for payment of interest under Section 36 (1) (iii) of the IT Act. In the case at hand, learned CIT (A) relied upon Section 41 (1) of the IT Act and held that the Respondent had received amortization benefit. Amortization 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 Respondent in previous assessment years was due to the deprecation of the machine and not on the interest paid by it."

4.4 Thus, as evident from para 15 reproduced above, the primary reason of the Honourable Apex court to hold that waiver of loan was not chargeable under section 41 (1) of the Act was that no DEDUCTION was claimed even in respect of the interest on loan which is a sine qua non for chargeability u/ s 41(1). Thus, the ratio decidendi of the said judgement is that an assessee must 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 years with reference to deduction allowed earlier in case of remission of such liability.

4.5 However, the additional or second reason given by the apex court in para 16 which begins with the word "Moreover" is that if there is remission of liability other than a trading liability the provisions of section 41 (1) would not be applicable. Since in the case before the apex court, waiver of loan for purchase or assets amounted to cessation of liability other than a trading liability, it was further held that the provisions of section 41(1) were not applicable.

4.6 In my humble view, if the primary condition enumerated in para 15 of the aforesaid judgement of the Honourable Apex Court in **Mahindra and Mahindra Ltd (supra)** is fulfilled i.e. that no deduction has been claimed in respect of any loan or liability, the subsequent remission of the said loan would not lead to chargeability under section 41(1) of the Act irrespective of whether the waiver is of a loan taken for a) acquisition of a capital asset or b) working capital purposes or a loan taken c) to fund the operations of the business of the assessee. So long as no deduction has been claimed in respect of the said loan liability, waiver of the same would not result in chargeability u/s 41(1) of the Act. Further, as elucidated in para 3.5 above it would also be possible to strongly contend that the working capital liability is not even a trading liability particularly for an assessee who is not engaged in the business of money lending/banking and consequently the waiver of the said loan would not be chargeable to tax u/s 41(1) of the Act. Thus, it is submitted that, the judgement of the Honourable Apex court in **Mahindra and Mahindra Ltd (supra)** qua the non-taxability u/s 41(1) would be equally applicable to waiver of working capital loan or a loan for funding the operations of the company.

4.7 The aforesaid view expressed in para 4.6 above is supported by the judgement of the Hon'ble Karnataka High Court in the case of **CIT v Compaq Electric Ltd (supra)** for which the

Revenue's SLP has been dismissed by the Hon'ble Apex Court by applying the decision of **Mahindra and Mahindra Ltd. (supra)** to a case of waiver of loan taken to fund the operations of the company (which in my humble view is akin to a working capital loan). In the said case, operations of the assessee company were funded by way of unsecured loans, part of which was converted into capital and the balance was waived. The assessing officer held that the aforesaid loan liability was a "trading liability" and assessed the waiver of the said loan under section 41 (1) of the Act. The Tribunal deleted the addition by holding that the waiver of the said loan amounted to a capital receipt. The High Court held that

" 7. For the application of this Act, the condition precedent is that there should be an allowance or deduction in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41. The whole object is to avoid double benefit to the assessee. In the instant case, the amount claimed as capital receipt is in respect to which there was no allowance or deduction claimed by the assessee for the previous year. Therefore, when his creditor has waived the repayment of the said amount, it amounts to a capital receipt and not a revenue receipt. As the assessee did not have the benefit of any allowance or deduction in respect of the said amount, Section 41 is not attracted."

Against the aforesaid judgement of the Honourable Karnataka High Court, the Revenue filed SLP which was dismissed by the Honourable Apex court by holding that "the matter is also covered against the petitioners as per the judgment of this Court in the case of **Commissioner v. Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32/255 Taxman 305/404 ITR 1 (SC)."**

4.8 I may add that the SLP dismissal in the above case i.e. **Compaq Electric Ltd. (supra)** is by a reasoned order (though brief) by the Hon'ble Apex court and thus it is law of the land in India and binding on all Courts and Tribunals {See **Khoday Distilleries Ltd and others v Sri Mahadeshwara Sahakara Sakkare Karkhane Ltd [2019] 104 taxmann.com 25 (SC)**}. Consequently, any judgment of the Hon'ble High Court or Tribunal contrary to judgement of the Hon'ble Apex court in Compaq (supra) would now be bad in law and impliedly overruled.

4.9 Thus, what follows from above is that notwithstanding the type / purpose / utilization of loan, the waiver of the same would not lead to a taxable event u/s 41(1) of the Act, if no deduction or allowance was made or claimed in respect of the said loan. Reference may be made to the following judgments wherein waiver of loan in respect of which no deduction was claimed was held to be not taxable u/s 41(1) of the Act where

a. the loan was taken for - funding operations of the company/ furtherance of the business/ working capital and the same was thus not a revenue receipt/ trade advance/ trading liability

- **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) { SLP filed by Revenue was dismissed by Hon'ble Supreme Court [SLP (Civil) 19981/2012]**
- **Velocient Technologies Ltd v ITO [2010] 123 ITD 188 (Del Trib)) { upheld by Delhi High Court in case of CIT v Velocient Technologies Ltd [2015] 60 taxmann.com 353 (Delhi)]**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.)**
- **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib)**

b. the loan was taken for acquisition of capital assets

- CIT v. Mahindra And Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)
- CIT v Jindal Equipments Leasing & Consultancy Services Ltd [2010] 325 ITR 87 (Delhi)

c. Loan was taken but its purpose or utilisation was not known/ discussed

- CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with CIT v. Mahindra And Mahindra Ltd [2018] 93 taxmann.com 32 (SC)
- CIT v Dholgiri Industries (P) Ltd [2014] 48 taxmann.com 279 (Madhya Pradesh)

D. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – In light of the observations of the Hon'ble Supreme Court in CIT v. T.V. Sundaram Iyengar & Sons Ltd. [1996] 88 Taxman 429 (SC)

5.1 It is well accepted that normally capital receipts, remission of debt, relief from expenses is not income chargeable to tax under the Act. (Reference may be made to the commentary of **"Kanga and Palkhivala's on The Law and Practice of Income Tax - 11th Edition", pages 234 and 252).** However, if the aforesaid are explicitly brought within the net of taxation, via specific provisions, the same would certainly be taxable e.g. capital receipts resulting from transfer of a capital asset would become taxable u/s 2(24)(vi) read with section 45 of the Act. No doubt, remission of a debt or a relief from an expense would certainly result in a "benefit" to any person / assessee. Now, the issue for consideration is whether remission of a debt in the form of waiver of working capital loan (and outstanding interest accrued thereon) would result in a "benefit" which is taxable under the specific provisions of the Act. It is submitted that, the taxability of waiver of working capital loan and interest accrued thereon will have to be determined in the light of provisions of section 28(iv) and 41(1) of the Act. The judgement of Hon'ble Apex Court in **CIT v T.V. Sundaram Iyengar & Sons Ltd (supra)** was rendered strangely without considering the aforesaid provisions. Reference may be made to commentary of **Kanga and Palkhivala's The Law and Practice of Income Tax (11th edition Volume I – Page 1272)** revised by the learned author Mr Arvind P Datar, wherein the learned author has commented on the aforesaid judgement of **CIT v T.V. Sundaram Iyengar & Sons Ltd (Supra)** as under :

"The Supreme Court erroneously held that crediting deposits that had been given by parties to a profit and loss account after they had remained unclaimed for a long period of time, would definitely be trade surplus and part of assessee's taxable income. Surprisingly, the court did not even refer to the statutory provisions of section 41(1). It failed to note that unless the assessee had claimed an allowance or deduction in respect of a loss of expenditure or trading liability, the subsequent cessation of liability would not attract section 41(1)"

5.2 Be that as it may, it is submitted that the aforesaid judgement of **CIT v T.V. Sundaram Iyengar & Sons Ltd (supra)** in any case is distinguishable and cannot be applied to waiver of working capital loan and unpaid accrued interest thereon particularly in case of an assessee who is not engaged in the business of banking / money lending as explained hereunder :

In the aforesaid case, deposits were taken by the assessee during the course of trade from customers and adjustments were made against these deposits in the course of trade. The unclaimed surplus retained by the assessee was treated as trade receipt. The Hon'ble Supreme Court noted the receipts were received by the assessee in course of its business or to say trading operations and the assessee by way of transfer of the said amount into the profit and loss account had become richer by that amount. However, unlike as in the aforesaid case, in the case of a working capital loan received particularly by an assessee who is not engaged in the business of banking / money lending, it would be possible to contend that the loan amount though received for trading operations does not arise out of the trading operations (such as an advance from customers) and that consequently, the aforesaid judgement of the Hon'ble Apex Court is clearly distinguishable and would not be applicable to the case of waiver of working capital loan (and outstanding interest accrued thereon).

5.3 Further, reference may be made to case laws mentioned hereunder wherein after considering the aforesaid judgement of the Hon'ble Apex court in **T.V. Sundaram Iyengar & Sons Ltd (supra)** it was held that the waiver of working capital loan or loan obtained to fund the operations of the company or a loan to inter alia further the business of the company was not

taxable u/s 41(1) of the Act and that the aforesaid loans could not be treated as trading liability/ trade advance/ revenue receipt.

- **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) { SLP filed by Revenue was dismissed by Hon'ble Supreme Court [SLP (Civil) 19981/2012] (w.r.t loan taken to fund the operations of the assessee)**
- **CIT v Velocient Technologies Ltd [2015] 60 taxmann.com 353 (Delhi)] (w.r.t loan taken to further the business of the assessee)**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**

E. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – By evaluating the correctness of the adverse decisions of the Hon'ble High Courts of Bombay and Delhi, post the judgement of the Hon'ble Apex Court in Compaq Electric (supra) following its own judgement in Mahindra and Mahindra Ltd. (supra)

6.1 It is most humbly and respectfully submitted that the judgments of Hon'ble Bombay High Court and the Hon'ble Delhi High Court in **Solid Containers Ltd. (supra), Logitronics (P.) Ltd. (supra) and Rollatainers Ltd. (supra)** have held that waiver of working capital loan would be chargeable u/s 28(iv) of the Act, without appreciating that the said provisions apply only to non-monetary benefits and that thus the same would not be applicable to waiver of loans (whether taken for the purpose of working capital or for acquiring capital assets) which would clearly be a monetary benefit as subsequently held by the Hon'ble Apex Court in **Mahindra and Mahindra Ltd. (supra)** (though with respect to waiver of loan taken for purchase of capital asset). In my humble view, the aforesaid view of the Hon'ble Apex Court would be equally applicable to cases of waiver of working capital loan also and thus waiver of working capital loan would also not be taxable u/s 28(iv) of the Act [Reference may be made to decision of the Hon'ble Tribunal in case of **Vasavi Polymers Pvt. Ltd. (supra)**].

6.2 It is most humbly and respectfully submitted that the Hon'ble Bombay High Court and Delhi High Court in the abovementioned cases have held that waiver of working capital loans / loans taken for business purposes would be taxable u/s 41(1) of the Act without appreciating that the pre-requisite condition for taxability u/s 41(1) i.e. that a deduction ought to have been allowed in respect of the said trading liability, was not fulfilled in those cases. However, the Hon'ble Karnataka High Court in **Compaq Electric Ltd. v. CIT [2011] 16 taxmann.com 385 (Karnataka)**, has held that waiver of loans taken to fund the operations of the company (which in my view is akin to a working capital or a loan taken for trading purposes) would not be taxable u/s 41(1) of the Act since no allowance / deduction was ever claimed by / allowed to the assessee in respect of the said loan. Further, the judgement of the Hon'ble Karnataka High Court has been upheld by the Hon'ble Supreme Court in **CIT v. Compaq Electric Ltd. [2019] 101 taxmann.com 400 (SC)** wherein it has followed its own judgment in case of **Mahindra & Mahindra Ltd. (supra).**

6.3 Thus, in my most humble and respectful view the judgements of the Hon'ble Bombay High Court and Hon'ble Delhi High Court being contrary to the judgements of the Hon'ble Apex Court in **Mahindra and Mahindra Ltd. (supra) and Compaq Electric Ltd. (supra)** are no longer good law.

F. **Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – In light of the decisions of the Hon'ble Tribunal in case of Vasavi Polymers Pvt. Ltd. (supra) and Jai Pal Gaba (supra)**

7. In light of the detailed analysis given above, in my humble and respectful view, the judgements of the Hon'ble Tribunal vide their extremely well-reasoned orders in **Vasavi Polymers Pvt. Ltd. (supra) and Jai Pal Gaba (supra),** holding that waiver of working capital loan would not be taxable u/s 28(iv) / 41(1) of the Act, lay down the correct position in law, notwithstanding

the contrary views expressed by the Hon'ble Bombay High Court and Hon'ble Delhi High Court in **Solid Containers Ltd. (supra), Rollatainers Ltd. (supra) and Logitronics (P.) Ltd. (supra),** which in my respectful and humble view, are no longer good in law as elaborated in para 6 above.

G. Taxability of waiver of Working Capital loan (and outstanding interest accrued thereon) – U/s 56(2)(x) of the Act

8.1 Section 56(2)(x) of the Act provides that *'where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,— (a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum; ……..'* the said sum of money would be taxable. As evident from the above, a receipt of any sum of money exceeding Rs. 50,000 without consideration, may be taxable u/s 56(2)(x) of the Act and thus it may be possible for the Revenue to contend that a complete waiver of working capital loans may lead to taxability in the hands of the borrower under the aforesaid provisions. It is submitted that, if the waiver of the loan is partial in as much as, that the lender waives a part of the loan subject to a condition that the borrower pays the balance amount of loan within a stipulated period of time or subject to any other conditions/formalities as agreed, then a plausible view may be taken that payment of the balance amount of loan by the borrower represents the consideration for the loan waived by the lender and that consequently the provisions of section 56(2)(x) of the Act are not applicable. Reference may be made to the decision of **Jai Pal Gaba (supra)** wherein the Hon'ble Tribunal held "…*It was not a simple case of waiver without consideration, rather, the consideration of the waiver was the condition of depositing immediately the remaining part of the loan i.e. Rs. 140 lakhs and performance of certain other formalities as per the agreement. It is not just a case where the bank had simply waived or remitted the loan amount, rather the bank to secure payment of Rs. 140 lakhs, which otherwise the bank was feeling difficult to recover, was the consideration for settlement of the loan account. Hence, the amount received by the assessee as waiver or remission of loan amount cannot be said to be without consideration. Hence, the provisions of section 56(2)(vi) could not be applicable."*

8.2 Further, in case of a complete waiver of loan also, it may be possible to contend that the consideration for the complete waiver of loan is the mental peace and avoidance of the future expenditure for recovery of the loan and that consequently the provisions of section 56(2)(x) of the Act are not applicable. However, on a strict interpretation of section 56(2)(x) of the Act, a view may be taken that there is no consideration at all and consequently, the amount of loan waived by the lender would become taxable u/s 56(2)(x) of the Act. Here it would be pertinent to note that Finance Act, 2017 had enlarged the scope of applicability of section 56 to extend it to all the assessees (and not just to individuals or HUF or a company not being a company in which the public are substantially interested) who received any property or sums of money for inadequate or no consideration, by introducing section 56(2)(x) to the Act and making sections 56(2)(vii) [applicable only to an individual or a HUF] and (viia) [applicable only to a company not being a company in which the public are substantially interested] inoperative from 1st April, 2017. It is obvious that the provisions of section 56(2)(x) take the same colour and flavour from the erstwhile provisions of section 56(2)(vii) and (viia), which have been described as 'anti-abuse' provisions in the Memorandum explaining the Finance Bill 2010. Thus, in my humble view, bonafide transactions (i.e. waiver of loan for genuine reasons) should not be hit by the provisions of section 56(2)(x) of the Act. Taxing a genuine waiver of loan u/s 56(2)(x) by adopting a strict interpretation would be contrary to the intention of the legislature. Reference may be made to the decision of the Hon'ble Supreme Court in case of **CIT v. J H Gotla [1985] 23 Taxman 14j (SC)** wherein it was held "*Now where the plain literal interpretation of a statutory provision produces a manifestly unjust result which could never have been intended by the Legislature, the Court might modify the language used by the Legislature so as to achieve the intention of the Legislature and produce a rational construction.*" In light of the above, in my view humble view, it would be possible to strongly

and rightly contend that the provisions of section 56(2)(x) of the Act should not be applied to genuine cases of waiver of loans. However, in my most respectful and candid view it would require not just a FAIR but a very BOLD judge, to accept the aforesaid view and decide in favour of the assessee.

8.3 In light of the above and considering these exceptional times caused due to the unprecedented COVID-19 pandemic, I would sincerely urge the CBDT to provide relief in genuine cases of waiver of loans, by prescribing under clause (XI) of the 4th provisio to section 56(2)(x) of the Act, *"such class of persons"* from whom the waiver of the loans would not result in any taxability for the borrower u/s 56(2)(x) of the Act.

H. Relevant Case Laws

9.1 **Case Laws wherein waiver of loan was held to be not taxable u/s 28(iv) as**

a. the same amounted to a monetary benefit

- **CIT v. Mahindra And Mahindra Ltd [2018] 93 taxmann.com 32 (SC) (w.r.t loan taken for purchase of capital asset)**
- **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib) (w.r.t working capital loan)**
- Essar Shipping Ltd. v. CIT [2020] 117 taxmann.com 389 (Bombay)
- PCIT v. SICOM Ltd. [2020] 116 taxmann.com 410 (Bombay) (HC)
- CIT v. Santogen Silk Mills Ltd. [2015] 231 Taxman 525 (Bombay) (HC)
- Ravinder Singh v.CIT [1993] 71 Taxman 336 (Delhi)
- CIT v Jindal Equipments Leasing & Consultancy Services Ltd [2010] 325 ITR 87 (Delhi)

b. the same had not arisen from business

- CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with Mahindra and Mahindra [2018] 93 taxmann.com 32 (SC)
- CIT v Chetan Chemicals (P.) Ltd. [2004] 139 TAXMAN 301 (Guj)
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.) (w.r.t working capital loan)**

9.2 **Case Laws wherein waiver of unpaid interest accrued on loan was held to be not taxable u/s 28(iv) as**

a. the same amounted to a monetary benefit

- ACIT v Spel Semiconductor Ltd. [2013] 35 taxmann.com 304 (Chennai - Trib.)

b. the same had not arisen from business

- D. S. Narayana & Co. v ITO [1986] 16 ITD 511 (Hyderabad Tribunal)

9.3 **Case Laws wherein waiver of loan was held to be not taxable u/s 41(1) as**

a. **no allowance or deduction had been granted in the earlier years in respect of the said loans where the**

- **Loan was taken to fund the operations of the company / for working capital purposes**
  - **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by Revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC)**
  - **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.)**
  - **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib)**

- **Loan was taken for acquisition of capital assets**
  - CIT v. Mahindra And Mahindra Ltd [2019] 93 taxmann.com 32 (SC)
  - CIT v Tosha International Ltd [2009] 176 Taxman 187 (Delhi) { SLP filed by Revenue was dismissed by Hon'ble Supreme Court [SLP (Civil) 8426/2009] dated 24-07-2009}
  - CIT v. V. S. Dempo & Co. Ltd [2015] 233 Taxman 417 (Bombay) (HC)

- **Loan was taken but its purpose or utilisation was not known/ discussed**
  - CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)
  - PCIT v. SICOM Ltd. [2020] 116 taxmann.com 410 (Bombay) (HC)
  - CIT v Chetan Chemicals (P.) Ltd. [2004] 139 TAXMAN 301 (Guj)
  - CIT v Dholgiri Industries (P) Ltd [2014] 48 taxmann.com 279 (Madhya Pradesh)

b. the loan was taken to fund the operations of the company/ to further the business/ for working capital purposes is not a revenue receipt / trading advance / trading liability
  - **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by Revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC)**
  - **CIT v. Velocient Technologies Ltd. – [2015] 60 taxmann.com 353 (Delhi)**
  - **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.)**
  - **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib)**

9.4 **Case Laws wherein waiver of unpaid interest accrued on loan was held to be not taxable u/s 41(1) as**

a. no allowance or deduction had been granted in the earlier years in respect of the unpaid accrued interest on the said loans
  - ACIT v Spel Semiconductor Ltd. [2013] 35 taxmann.com 304 (Chennai - Trib.)
  - D. S. Narayana & Co. v ITO [1986] 16 ITD 511 (Hyderabad Tribunal)

9.5 **Case Laws wherein partial waiver of working capital loan (and outstanding interest accrued thereon) was held to be not taxable u/s 56(2)(vi) of the Act as the waiver was subject to the condition of part payment of loan and thus the waiver / receipt was not without consideration**
- **Jai Pal Gaba v ITO [2019] 108 taxmann.com 494 (Chandigarh - Trib.)**

<u>Conclusion</u>

In light of the above analysis, in my most humble and respectful view, the waiver of a working capital loan (and outstanding interest accrued thereon);

10.1 <u>Should not be taxable u/s 28 (iv) of the Act:</u> since the said provisions apply only to monetary benefits arising from business whereas the waiver of a working capital loan would result in the monetary benefits, and thus, would not be covered u/s 28(iv) of the Act. The above proposition is supported by the judgement of the Hon'ble Apex court in **Mahindra and Mahindra Ltd. (supra).** Though the said case dealt with waiver of a loan taken for purchase of a capital asset, it would equally apply to a working capital loan as well. [Reference may be made to the decision of Hon'ble Tribunal in **ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib)**]. Also, it may be possible to contend that though a working capital loan is taken for the purpose of business, the same, as such would not arise from a business activity in case of an assessee who is not engaged in the business of taking / lending of loans and thus, consequently the same cannot be treated as a benefit arising out of

business of the assessee so as to result in taxability u/s 28(iv) of the Act. [Reference may be made to **Jai Pal Gaba v. ITO [2019] 178 ITD 357 (Chandigarh - Trib.)**]

10.2 Should not be taxable u/s 41(1) of the Act: since the said provisions come into play only if a deduction has been allowed in respect of loss, expenditure or a trading liability in any assessment year, whereas in the case of a working capital loan, no deduction would have ever been allowed on receipt of the said loan and consequently the provisions of section 41(1) of the Act would not be applicable to waiver of the said working capital loan. The above proposition is supported by the judgement of the Hon'ble Apex Court in **Mahindra and Mahindra Ltd. (supra).** Though, the said judgement dealt with the case of waiver of loan taken for purchase of a capital asset, it would equally apply to the waiver of loans taken for the purposes of business or to fund the operations of the assessee or for working capital purposes.[Reference may be to the judgement of the Hon'ble Karnataka High Court in **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC) ; ITO v. Vasavi Polymers Pvt. Ltd. (2020) 183 ITD 0586 (Visakhapatnam-Trib), Jai Pal Gaba v. ITO [2019] 178 ITD 357 (Chandigarh - Trib.) and CIT v. Velocient Technologies Ltd. – [2015] 60 taxmann.com 353 (Delhi)**]

In light of the above, the issue as to whether or not, a working capital loan liability is a trading liability would really become academic [Reference may be made to **CIT v Chetan Chemicals (P.) Ltd. [2004] 139 TAXMAN 301 (Guj), followed in CIT v Gujarat State Fertilizers & Chemicals Ltd [2013] 36 taxmann.com 557 (Gujarat) affirmed by Hon'ble Supreme Court along with Mahindra and Mahindra Ltd. [2018] 93 taxmann.com 32 (SC)].** Nevertheless, it may be possible to strongly contend that working capital loan liability does not amount to trading liability though it is taken for the purpose of business or trading as the same does not arise out of trading activity. [Reference may be made to **Jai Pal Gaba v. ITO [2019] 178 ITD 357 (Chandigarh - Trib.)]**

Further, the judgement of the Hon'ble Apex Court in C**IT v T.V. Sundaram Iyengar & Sons Ltd (supra)** (dealing with taxability of unclaimed deposits received from customers) seems to have been erroneously rendered without considering the provisions of section 28(iv) and section 41(1) of the Act [reference may be made to commentary of Kanga and Palkhivala's The Law and Practice of Income Tax (11th edition Volume I – Page 1272)] and in any case the said judgement is distinguishable on facts and would not be applicable to waiver of a working capital loan [Reference may be to the decision of the Hon'ble Karnataka High Court in **CIT v Compaq Electric Ltd [2011] 16 taxmann.com 385 (Karnataka) (SLP filed by revenue was dismissed by Hon'ble Supreme Court vide order dated January 03, 2019 reported in [2019] 101 taxmann.com 400 (SC) ; CIT v. Velocient Technologies Ltd. – [2015] 60 taxmann.com 353 (Delhi) and Jai Pal Gaba v. ITO [2019] 178 ITD 357 (Chandigarh - Trib.)]**

Further, the contrary views expressed by the Hon'ble Bombay High Court and the Hon'ble Delhi High Court in S**olid Containers Ltd. (supra), Logitronics (P.) Ltd. (supra) and Rollatainers Ltd. (supra)** that waiver of working capital loan would be chargeable u/s 28(iv) / 41(1) of the Act, are no more good law, being contrary to the decisions of the Hon'ble Apex Court in **Mahindra and Mahindra Ltd. (supra) and Compaq Electric Ltd. (supra)**

10.3 Should not be taxable u/s 56(2)(x) of the Act: since the said provisions apply to receipt of money without any consideration, whereas in the case of a partial waiver of working capital loan on the condition that the balance loan would be re-paid, it cannot be said to be a transaction without consideration (the consideration being recovery of the balance amount of loan without resorting to litigation). Even as regards complete waiver of working capital loan, it may be possible to contend that peace of mind by closing the accounts of the borrower without resorting to expenditure on litigation may amount to a reasonable consideration for

the lender and that even in such a scenario, the provisions of section 56(2)(x) of the Act would not be applicable. Further, the provisions of section 56(2)(x) of the Act are anti-abuse provisions. However, strict interpretation of the same may lead to taxability in genuine cases of waiver of working capital loan, even where there is no intention to evade taxes. This would clearly be contrary to the intention with which the said provisions were enacted and therefore by applying the ratio of the Hon'ble Apex Court in **CIT v. J H Gotla [1985] 23 Taxman 14j (SC),** waiver of working capital loan as such, should not be taxable u/s 56(2)(x) of the Act. Having said that, I must confess that one would really need not just a FAIR but a very BOLD judge to uphold the non-taxability u/s 56(2)(x) of the Act especially in case of complete waiver of loan. Thus, the author most humbly prays to the CBDT to prescribe in pursuance of clause (XI) to the fourth proviso to section 56(2)(x) of the Act *"such class of persons"* from whom the waiver of loans would not result into any chargeability in the hands of the recipient / borrowers.

Prayer

11. Notwithstanding the complexity involved in the aforesaid issue w.r.t taxability of waiver of working capital loan, the adverse judgements of the Hon'ble High Courts which are no longer good law, the adverse judgement of the Hon'ble Supreme Court which is distinguishable, the taxpayers namely Vasavi Polymers Pvt. Ltd. and Jai Pal Gaba have been rendered justice by the Hon'ble Income Tax Appellate Tribunal. Not just in the above cases, but the Hon'ble Income Tax Appellate Tribunal (referred to as the 'Mother Tribunal' being the oldest Tribunal in the country) has always stood out for its uniqueness of imparting speedy and impartial justice to the litigants, through an inexpensive and easily accessible forum vide its expert knowledge on the subject of Direct Taxes. In fact, while the Hon'ble Tribunal may be the third level, wherein the income of the assessee is determined or the second appellate authority, but in my humble opinion it is de facto really the "First Forum" for justice. The question that arises is, would this justice continue to be delivered by this "First Forum" on becoming faceless and without hearing the litigants [in pursuance of the faceless scheme announced in the Finance Bill, 2021 (which is yet to be notified)]. To my mind, the answer is a CLEAR AND OBVIOUS NO! The Author, thus takes thus opportunity, to urge and pray to the Government to restore the smile back on the face of the tax litigants by not making this "First Forum" of justice – "Faceless"! Jai Hind!