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### SUPREME COURT RELIEVES BORROWERS FROM TAX ON WAIVER OF PRINCIPAL PORTION OF LOAN

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In the recent case of *Commissioner v Mahindra and Mahindra Limited* (Judgment) [Civil Appeal Nos. 6949-6950 of 2004], a division bench of the Supreme Court of India (SC) has ruled that waiver of principal portion of loan (which was taken for capital account transaction) by a creditor is not taxable in borrower's hands under section 28(iv) or section 41(1) of the Income-tax Act 1961 (Act). Taxability of loan waiver has been a matter of debate and the relevant provisions under normal income-tax computation provide as under:

- Section 28(iv) of the Act provides, *inter alia*, the value of any benefit or perquisite arising from business, whether convertible into money or not, should be taxed as business income.
- Section 41(1) of the Act provides, *inter alia*, that if an allowance or deduction has been claimed by an assessee in respect of a trading liability and subsequently, obtains some benefit in respect of such trading liability by way of remission or cessation thereof in cash or in any other manner, such amount is deemed to be business income of the borrower.

#### Background

In the instant case, Mahindra and Mahindra Limited (Taxpayer) borrowed a loan from Kaiser Jeep Corporation. The Taxpayer utilised the loan to purchase certain capital assets on which it claimed depreciation in computing its taxable income. Apart from this, the Taxpayer did not claim any deduction in respect of the loan amount in computing its taxable income. Subsequently, the principal amount of loan was waived by the lender (Loan Waiver).

In its income-tax return, the Taxpayer disclosed the same as cessation of its liability towards the lender, and did not offer the same as taxable income. On the contrary, the Assessing Officer concluded that the Loan Waiver represented income, thereby being taxable under section 28(iv) of the Act.

Being aggrieved, the Taxpayer filed an appeal with the first appellate authority [CIT(A)] which was dismissed by the CIT(A). Thereafter, the second appellate authority (Tribunal) as well as the jurisdictional High Court, the Hon'ble Bombay High Court (HC) ruled in favour of the Taxpayer that the Loan Waiver did not constitute taxable income for the Taxpayer. The income-tax department (Tax Department) challenged the HC order before the SC.

In the appeal before the SC, while the Taxpayer contended that Loan Waiver amounts to a capital receipt and thus, not taxable; the Tax Department claimed that the Loan Waiver is taxable under section 28(iv) of the Act. The Tax Department also claimed that alternately, the Loan Waiver is taxable in the hands of the Taxpayer under section 41(1) of the Act.

## Judgment

### Re: Section 28(iv) of the Act

Given that section 28(iv) of the Act seeks to tax only those benefits which are in some other form, rather than money, i.e. non-monetary benefits, the SC held that the Loan Waiver is not taxable under section 28(iv) of the Act as it is a cash receipt and not a non-monetary benefit.

### Re: Section 41(1) of the Act

For section 41(1) to apply in relation to cessation of a trading liability, it is a *sine qua non* that the assessee should have claimed an allowance or deduction in any year in respect of such trading liability.

In the instant case, since the Taxpayer had not claimed any deduction in respect of the Loan Waiver, the SC held that it is not taxable under section 41(1) of the Act. The SC held that even though the Taxpayer had claimed depreciation on the capital assets acquired from the amount of loan, section 41(1) of the Act was not applicable in the instant case. In arriving at this conclusion, the SC also noted that section 41(1) applies, *inter alia*, in respect of a 'trading liability'; whereas in the instant case, the Loan Waiver amounted to cessation of liability other than trading liability.

## Comment

The taxability of waiver of principal portion of loan has been a highly debated issue. This is a welcome judgment by the Apex Court as it seeks to settle this issue in favour of the Taxpayer – in terms of section 28(iv) as well as section 41(1) of the Act, especially where the loan is utilised on capital account.

However, implications, if any, under Minimum Alternate Tax (MAT) – which is a tax based on book profits of a company – will need to be still considered. Additionally, if the loan is for trading liability, then income-tax implications on its waiver would also need to be evaluated.

Having said so, one can presume that this judgment will act as a guiding precedent in the corporate restructurings involving debt waivers. Moreover, it would be interesting to note how it would impact the corporate insolvency resolution plans under the Insolvency and Bankruptcy Code regime.

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