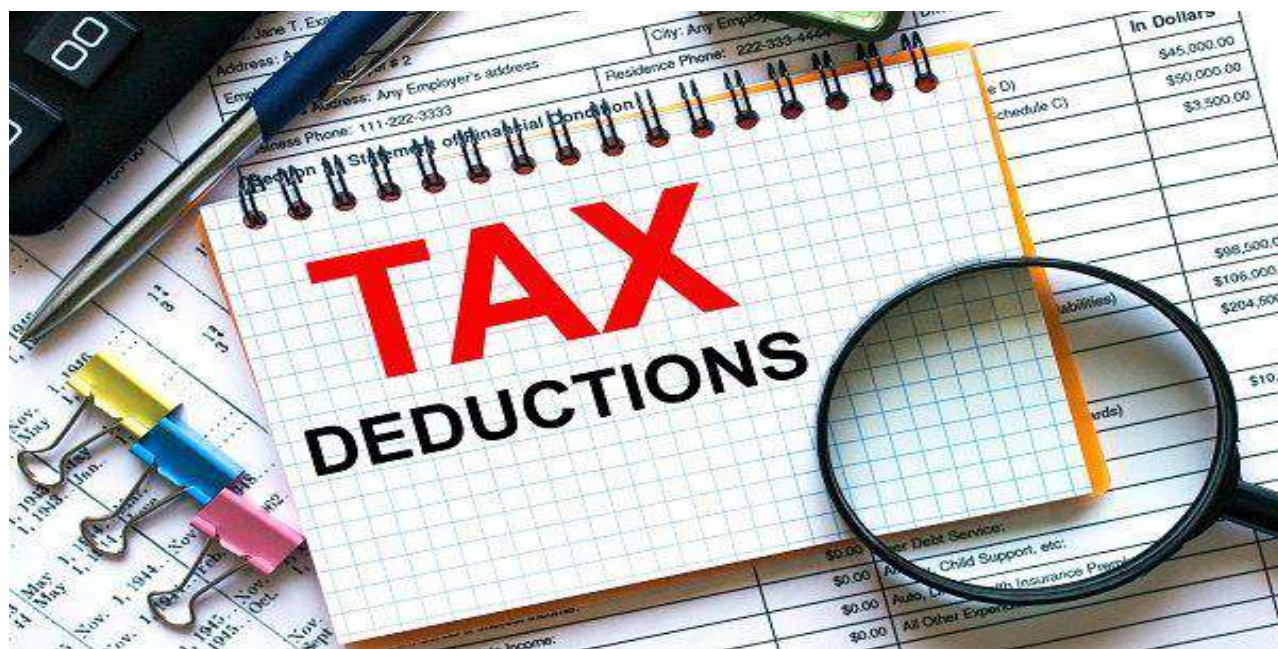


Analysis of Taxability of Loan Waiver Transactions after Amendments in Finance Act 2023



*If the value of the approved Resolution Plan is less than the total value of Admitted Claims against the Corporate Debtor (CD), the difference is referred to as a Haircut. The Finance Act 2023 has brought whether intentionally or unintentionally the controversy of taxing write-back of amounts in the books of accounts under which Haircut may also become a taxable item. In this context, the author has presented an analysis of the taxability of 'Hair Cut' in the hands of the CD with respect to various provisions of the Finance Act 2023, Income Tax Act, 1961, and other related provisions. In conclusion, he suggests amendments in Section 28 (iv), Section 41(1), Section 56 (2) (X) (a), and Section 115JB of the Income Tax, to nip in the bud any possible legal dispute which may derail the objectives of the IBC, 2016. **Read on to Know More...***

1. Introduction

Finance Act 2023 has brought whether intentionally or unintentionally controversy of taxing write-back of amounts in the books of accounts, which is popularly known in the IBC regime as "Hair Cut".

The memorandum explaining the Finance Bill stated, "Section 28 of the Income-Tax Act, 1961(hereinafter called as 'Act') provides for income that shall be chargeable to income-tax under the head "profits and gains of business or profession".

Sub-section (iv) of this section brings to chargeability the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession.

This provision was inserted through the Finance Act 1964 and the Circular No. 20D dated July 07, 1964 issued to explain the provisions of this Act stated clearly that the benefit could be in cash or in kind.

Therefore, the intention of the legislation while introducing this provision was also to include benefit or perquisite whether in cash or in kind.

However, Courts have interpreted that if the benefit or perquisite are in cash, it is not covered within the scope of this clause of Section 28 of the Act.



Manoj Kumar Anand

The author is an Insolvency Professional (IP) Member of IIPCI. He can be reached at anandmanoj@gmail.com

In order to align the provision with the intention of legislature, it is proposed to amend sub-section (iv) of section 28 of the Act to clarify that provisions of said clause also applies to cases where benefit or perquisite provided is in cash or in kind or partly in cash and partly in kind”.

In this context let us also analyse the taxability of 'Hair Cut' in the hands of Corporate Debtor with respect to applicable sections being Section(s) 28(iv), 41(1), 56 (2) (x) & 115JB of the Act along with the right of Government to tax such transactions u/s 3,4 & 2(24) of Act read with relevant judicial decisions. Along with I-Tax provisions, we shall also analyze Ind AS 117 & AS 30 of Institute of Chartered Accountant of India (ICAI) parent accounting body of India and the opinion of Expert advisory committee of ICAI in this regard also.

2. Effect of amendments in Sec 28(iv) read with Sec 194R by Finance act 2023

Under section 28(iv) any benefit in the course of business or profession is treated as Income from Business & Profession. Since Loan/Creditor/Interest waiver is a benefit and hence it ought to be taxable under the I-Tax act 1961.

3. Under Income Tax, the relevant chargeability is governed by Sec 4 & 2(24) which stipulates as follows:

- (a) Sec 4 says Income-Tax is charged on “total income of the previous year”.
- (b) Sec 2(24) defines the term 'income' which means all the receipts, unless specifically exempted are chargeable to tax.

4. Controversies

(a) Hon'ble SC in the case of *Commissioner Vs. Mahindra & Mahindra Ltd.* (2018) interpreted that sec 28(iv) is applicable only to Non-Cash Transactions. Hence, loan waiver being cash transaction (includes banking channel transactions), taxes weren't applicable on haircuts. Finance Act, 2023 plugged this loophole/interpretation and taxed all transactions (Cash & Non-Cash) u/s 28(iv). CBDT Circular No. 18/2022 dated 16-06-2022 from the A.Y. 2023-24 already provides specific exemption from TDS deduction u/s 194R for the banks, financial institutions, NDFCs, and other financial service providers for waivers given by them to lenders.

The Supreme Court in the case of *Commissioner Vs. Mahindra & Mahindra Ltd.* (2018) said that Section 28(iv) is applicable only to non-Cash transactions. Hence, loan waiver being cash transaction, taxes weren't applicable on haircuts. However, amendments in Financial Act 2023 plugged this loophole and taxed transactions also.

(b) Taxability of Loan/Creditor/Interest (Hair Cut) waiver provisions from Accountant's perspective are as follows: -

(i) Ind As 109 deals with Derecognition of any Financial Liability' and para 3.3.3 is as follows:

“The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognized as profit or loss”.

(ii) Further, the Expert Advisory Committee of the ICAI in its various opinions regarding the waiver of loans has stated that waiver of loans should be credited to the statement of Profit & Loss. It means Successful Resolution Applicant while preparing first balance sheet after acquisition can not net off all balances & transfer the same to capital reserve may be a wrong treatment from Accountant's perspective?

5. Interpretation of Relevant Sections Under I-Tax Act 1961 for Taxability of Hair Cut

(a) Section 28 (iv) of the Act provides, inter alia, that the value of any benefit or perquisite arising from business, whether convertible into money or not, should be taxed as business income.

(b) 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 the business income of the borrower.

(c) Section 115JB of the Act, inter alia charges tax on Book Profits @ 18.50%. The methodology to arrive at the book profit is provided in the Explanation to the section. A safeguard is provided for companies undergoing insolvency or wherein Central Government has suspended board of directors, whereby the aggregate amount of

unabsorbed depreciation and brought forward losses would be allowed as deduction while arriving at book profit for the purpose of taxing u/s 115JB.

6. Planning Tools or Arguments to mitigate such taxability

Can benefit of overarching section 238 of IBC 2016 be obtained?

The answer is 'No' as no future benefits are permitted under the Insolvency and Bankruptcy Code, 2016 (IBC) and regulations made thereunder. The tax on remission and cessation of liability is an event post approval of resolution plan by Adjudicating Authority and is not covered as relief or concession permissible under IBC. In the past no Adjudicating Authority authority has allowed this concession sought through resolution plans. (b) However, a caution is warranted as the following transactions have been held taxable u/s 28(iv) despite they look like to be not taxable as per above discussion:

The tax on remission and cessation of liability is an event post approval of resolution plan by Adjudicating Authority and is not covered as relief or concession permissible under the IBC.

(i) Earnest money of buyer forfeited *Ramesh Babulal Shah v. CIT [2015] 53.*

(ii) One Time Settlement Benefit given. *CIT v. Ramaniyam Homes (P) Ltd [2016] 68.*

(iii) Value of rent-free accommodation, furniture, and fixtures given to the director. *CIT v. Subrata Roy [2016] 385 ITR 547 (All.)*

(iii) Car received from disciple by preacher *CIT (Addl) v. Ram Kripal Tripathi [1980] 125 ITR 408 (All.)*

(iv) Shares received by the director. *D. M. Neterwala v. CIT [1986] 122 ITR 880 (Bom.).*

(v) Value of gift of land was held as a receipt by the assessee in carrying on of his vocation. *Amarendra Nath Chakraborty v. CIT [1971] 79 ITR 342 (Cal.)*

7. Concept of TDS deduction @10% by Operational Creditors u/s 194 R

Section 194R was brought into statute by the Finance act 2022 to tax those transactions which provided a benefit or perquisite to the beneficiary and remained untaxed. Examples being incentives in the form of foreign holidays

package, cars, etc given to dealers were claimed as an expense by the provider but was never declared by such dealers as a benefit or a perquisite. In other words, the purported objective of TDS deduction under Section 194R as envisaged was to detect tax evasion for transactions that are not in the nature of loan waiver or bad debts. Hence, the section can't be applied to transactions under IBC 2016 companies, especially when Banks vide CBDT Circular No. 12/2022 dated 16-06-2022 is exempted. Also for operational creditors as for them amount not recoverable is bad debt in their books of account and bad debts are not taxable u/s 41(1) or 28(iv).

8. Concept of taxability Under Section 41(1)

It is attracted if any benefit arises from remission or cessation of trading liability. The difference in Trading & Non-Trading liability is understood by dividing Loan/interest in following parts:

- Capital Loan popularly known as Term Loan
- Cash Credit\Working Capital Loan,
- Interest on Loan Capitalised and
- Interest on Loan claimed as an expense.

8.1. Let's understand the taxability of all these with the following Judicial Judgements:

(a) Hon'ble Supreme Court in the case of *Commissioner v. Mahindra and Mahindra Ltd. [2018] 302 CTR 213* held that waiver of loans taken for capital assets amounts to the cessation of liability other than trading liability. Hence not taxable.

(b) Similarly in *Mahindra & Mahindra Ltd. v. CIT [2003] 261 ITR 501 (Bombay)* it was held that as Tooling constituted capital asset and not stock-in-trade, section 41(1) was not applicable.

(c) However, Hon'ble Delhi HC in the case of *Logitronics (P) Ltd. v. CIT [2011] 333 ITR 386* held that waiver of loan taken for trading purposes is taxable, that means working capital borrowings are taxable if waived by banks or financial service providers.

(d) Similarly, in *Rollatainers Ltd. v. CIT [2011] 339 ITR 54*, the Delhi High Court by referring to the judgment of the Bombay HC in the case of *Mahindra & Mahindra (supra)* held that writing off loans on a cash credit account is to be treated as "income" in the hands of the assessee.

Based on the above judgments the following conclusion for taxability u/s 41(1) is drawn:

(i) Not claimed as an expense earlier – Not taxable. However, it may be taxable u/s 28 (iv) wef. AY 2024-25.

(ii) Claimed as an expense earlier :- Taxable: working capital borrowings are considered as claimed as expense earlier when liability was created.

9. Concept of taxability Under Section 56 (2) (x)

It is apt to reproduce the relevant portion of the section 56(2)(x). as follows:

“56. (2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head “Income from other sources”, namely:—

.....

(x) 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 above section is applicable when the assessee receives any sum of money, 'without consideration' and in case of the waiver of the loan, no money is received in that particular year & hence not taxable.

10. 115JB (Minimum Alternate Tax)

(a) MAT 115JB says Notwithstanding anything contained in any other provision of this Act,is less than eighteen and one-half percent of its book profit, such book profit shall be deemed to be the total income of the assessee

(i) Please note Ind AS 109/AS 30 as mentioned in detail at Para 5 above clearly states that extinguishment of liability should be recognised in the profit & loss account. In case the gains are transferred to Capital Reserve, this treatment is not in consonance with relevant provisions of Companies Act 2013 (Sec 129(1) 2nd Proviso) read with Annual Accounts Schedule III and Capital Reserve (Ind AS 109).

In CIT Vs. T.V. Sundaram Iyengar & Sons Ltd (222 ITR 344 (SC) it has been held that time barred trading loans are taxable.

(ii) In other words, MAT u/s 115JB is payable for any Book Profit that arises from loan waivers as they are required to be routed through P & L a/c.

(b) Since we have discussed at great length, the taxability of loan/interest waiver, let's discuss another two practical situations also which we invariably encounter:

(i) **Taxability of time-barred Loans:** - In *CIT Vs. T.V. Sundaram Iyengar & Sons Ltd (222 ITR 344 (SC))* it has been held that time barred trading loans are taxable.

(ii) **Underlying presumption in loan waiver: - Whether Interest first or Principal later or Vice Versa :-** In *CIT Vs. T. S. PL. P. Chidambaram Chettiar ((1971) 80 ITR 467 (SC))* it has been held that payment is attributable in the first instance towards the outstanding interest. The same, has also been held in *CIT Vs. Maharajadhiraja Kameshwar Singh of Darbhanga [(1933) 1 ITR 94 (PC)]* the Privy Council).

Planning:- Thus, it is to be stated clearly that it is the Principal amount of loan waiver for all partial/full waiver of loans.

11. Conclusive Remarks: Thus, the following Income Tax sections need to be amended, in the spirit of IBC, to nip in the bud any future controversies or uncalled for additions to the income :-

(a) Sec 28(iv) to further provide that value of any benefit or perquisite is not taxable for companies resolved under IBC 2016.

(b) Sec 41(1) to further provide that remission or cessation of any allowances or deduction made in respect of loss, expenditure or trading liability as incurred earlier years is not taxable for companies resolved under IBC 2016.

(c) Sec 56 (2) (X) (a) to further provide that any benefit accruing to Company (Corporate Debtor) resolved under IBC 2016 shall not be taxable herein.

(d) Sec 115JB must provide full exemption to companies resolved under IBC 2016.