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Budget 2023: Interest free borrowing transactions now taxable- windfall for Department

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Present Scenario

Under section 2(24) (vd) of the Income tax Act , 1961, income would include the value of any benefit or perquisite taxable under clause (iv) of section 28. Until now this section/clause can be invoked only where the benefit or perquisite arising from the business or profession is other than cash going by the premise/words " whether convertible into money or not" used in section.

There are situations where interest free loans and advances are made by holding companies to subsidiaries and among sister enterprise. On reference to the interest charged and interest paid by the holding entity a question may arise whether loans advanced by the holding company were out of interest bearing loans and therefore to that extent there is often a disallowance made by the tax officer under section 36. Even otherwise a further contention is raised by authorities that if there was no interest free lending, the whole of such funds would have fetched income to the lender. The taxpayer in such a situation may demonstrate that the money lent is out of his own capital funds and not from borrowed monies to escape addition.

Delhi High Court reflects on scope of section 28

> Before the High Court in ***Ravinder Singh* v. *CIT*** **[1993] 71 Taxman 336/[1994] 205 ITR 353 (Delhi) there was a case of an** *assessee, a Hindu undivided family who happens to be a partner in a firm. During the course of assessment proceedings of the firm, the Income-tax Officer found a debit balance of Rs. 2,76,500 in the capital account of the assessee-Hindu undivided family. The Income-tax Officer, at the stage of making the draft assessment order, came to a preliminary conclusion that the assessee-Hindu undivided family utilised that amount of overdrawals disclosed in its capital account of the firm without paying any interest to the firm. The Income-tax Officer held the opinion that the assessee derived the above said benefit by virtue of its being a partner of the firm, and he, therefore, proposed application of the provisions of section 28(iv). The Income-tax Officer calculated interest at 9 per cent. of the borrowings and treated this as the benefit obtained by the assessee and*

included this amount as part of the income of the assessee-Hindu undivided family under section 28(iv) of the Act. This order was upheld by the Commissioner of Income-tax (Appeals) as well as by the Tribunal then.

The High Court however reversed the order on the basis of a finding by the Tribunal, in the case of the firm, stating the view that there was no justification on the part of the Income-tax Officer for making any disallowance of interest under section 36(1)(iii) as the non-interest-bearing funds available with the firm exceeded the non-interest-bearing advances which had been given by the firm to its partners. The High Court further found no justification on the ground that section 28(iv) can be invoked only where the benefit or perquisite is other than cash. The following observations are worth noting:(pg 359,360)

"Then there is another aspect of the matter. Section 28(iv) can be invoked only where the benefit or perquisite is other than cash. The value of a thing would be the amount of money that it is worth. Valueless is what is worthless. In *Instalment Supply (P.) Ltd.* v. *CIT*[1985] 22 Taxman 466/[1984] 149 ITR 457 (Delhi), this court examined the term "whether convertible into money or not" as appearing in section 40(a)(v) of the Act when the following question of law had been referred to it for decision for the assessment years 1969- 70 and 1970-71 (at page 458) :

" Whether, on the facts and in the circumstances and on a true interpretation of section 40(a)(v) of the Income-tax Act, 1961, reimbursement of the medical expenses to the managing director has been correctly restricted by the Tribunal to Rs. 12,000 for each of the assessment years 1969-70 and 1970-71 ? "

This court held that the use of the words "whether convertible into money or not" goes to show that the term "benefit or amenity or perquisite" cannot relate to cash payments.

In *CIT* v. *Alchemic (P.) Ltd.* [1981] 5 Taxman 55/130 ITR 168 (Guj.), the term "benefit or perquisite" arising from business as appearing in section 28(iv) fell for consideration. The court held that, if what was received either by way of benefit or perquisite was money, there was no question of considering the value of such monetary benefit or perquisite under clause (iv) of section 28. It held that it was only if the benefit or perquisite was not in cash or money that section 28(iv) would apply."

New scenario

Now in the budget document of 2023 section 28 clause (iv) is amended with following language:

"(iv) the value of any benefit or perquisite arising from business or the exercise of a profession, whether––

(*a*) convertible into money or not; or

(*b*) in cash or in kind or partly in cash and partly in kind"

This is just further to give obligatory effect to the suitable amendment apace with the brutal honest intent of the legislature to bring to tax withholding any benefit or perquisites no matter whether received in cash or partly in cash or partly in kind as introduction of explanation 2 under section 194R that reads as follows:

86. In section 194R of the Income-tax Act, the Explanation shall be numbered as Explanation 1 thereof, and after Explanation 1 as so numbered, the following Explanation shall be inserted, namely:––

"Explanation 2.—For the removal of doubts, it is clarified that the provisions of sub-section (1) shall

apply to any benefit or perquisite, whether in cash or in kind or partly in cash and partly in kind.".

Interestingly, this amendment in section 28(iv) is adumbrated unintentially beyond the pale of any doubt or controversy that it could lead to more than intended consequences since now it takes into its ambit any and every transaction of interest free borrowing under the tax and assessee may be exposed to hounding and subjected to tax even when High Court of competent jurisdiction is already in seisin no matter the argument or fact that the money is given by the lender out of its own capital and reserves. (High Court Judgement Supra)

Parallely, the department or the legislature gets bounty as it may not have conceived this idea while framing this amendment de hors being off the beaten path but only for the interpretation rendered by the Delhi High Court in loan nature of transaction between firm and its partners while being assessed under common jurisdiction.

Ergo, borrowers (intercompany) need to scan their balance sheets and books and make certain whether interest rates are commensurate with market driven rates in defence of their case against this recasted section as Abandons cautela non nocet meaning extreme caution does no harm.

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