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Waiver of Loans: Are They Taxable Post Finance Act 2023 Amendment?

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In business transactions, it is common for banks or financial institutions to waive part of a loan under a settlement. Borrowers typically credit such waiver amounts to their profit and loss accounts. This raises a key question: does such waiver amount to profits and gains of business or profession under section 28 of the Income-tax Act, 1961?

Judicial Stand Before 2023: Purpose of Loan vs. Form of Receipt

In the case facts *I.G. Petrochemicals Ltd*. v. *Income-tax Appellate Tribunal* [2023] 155 taxmann.com 45/295 Taxman 569 (Kar.) the Assessing Officer held that all waiver of loans would be taxable in hands of assessee. The Commissioner (Appeals) upheld the order of the Assessing Officer. The Tribunal however held that waiver of term loan taken for the purpose of capital assets would not result in any benefit or perquisite flowing to the assessee which could be described to be a revenue receipt and accordingly would not constitute income of the assessee. However, as regards loans taken in the course of carrying on the business and where such loans were waived, it would result in flow back of funds to the assessee which was in the nature of revenue receipt and hence liable to tax.

The assessee challenged addition of waiver of working capital loan citing section 28(iv) and Supreme Court ruling in *CIT* v. *Mahindra & Mahindra Ltd.* [2018] 93 taxmann.com 32/255 Taxman 305/ 404 ITR 1 to claim that section 28(iv) does not apply to receipts that are in the nature of cash or money.

On the other hand, the department argued before the Court that in taxation of transactions of waiver of loan it all depends on the purpose of loan, whether the loan is a term loan or a working capital loan. If the waiver is drawn out of working capital loan, then it would amount to flow back of funds to the assessee which would be in the nature of benefit u/s 28 (iv) and hence liable to tax. The waiver in this case comprised of both principal amount of term loan and working capital loan.

The High Court drawing reference from Supreme Court decision in *Mahindra and Mahindra Ltd's.* case (*supra*) held that the only test for section 28(iv) is that the 'benefit' or 'perquisite' should be other than 'in the shape of money'. On the purpose test it held that the purpose of loan was neither dealt with nor would be a relevant determinative factor and the only test is that the 'benefit' or 'perquisite' should be other than 'in the shape of money'.

Supreme Court in Mahindra & Mahindra: Waiver as Money Receipt Not Taxable

In Mahindra & Mahindra the Supreme Court observed that section 28(iv) applies only if the benefit or perquisite is not in the form of money. A waiver resulting in cash or monetary benefit does not attract section 28(iv). Therefore, a loan waiver credited as a cash receipt does not constitute taxable income under this provision.

In that case, the assessee had borrowed from Kaiser Jeep Corporation to purchase dies and tools (a capital purpose). The waiver, later granted by American Motor Corporation, was treated as a capital receipt. The Court did not examine the purpose of the loan factor but focused solely on the form of the benefit. It thus held as under:

> "16. On a plain reading of Section 28(iv) of the IT Act, prima facie, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28(iv) of the IT Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of Rs. 57,74,064 is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28(iv) of the IT Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, in our view, in no circumstances, it can be said that the amount of Rs. 57,74,064 can be taxed under the provisions of section 28(iv) of the IT Act."

The Supreme Court thus did not go into purpose of loan aspect but only looked at form of receipt or benefit accruing in cash thus technically found it out of the ambit of the provision. The Karnataka High Court also admitted that the purpose of loan was not dealt by the Supreme Court.

Conclusion: All Waivers Are Not Taxable Even Today

The 2023 amendment does not automatically render all loan waivers taxable. The Revenue has already conceded that waiver of term loans is capital in nature. Capital receipts fall outside the charging provisions unless specifically brought within the tax net by law. Thus, waiver of term loans used for acquiring capital assets should continue to be treated as non-taxable, even post-2023.

The Judgment of Supreme Court in *Mahindra and Mahindra Ltd's.* case (*supra*) was rendered in 2018 whereas the amendment in section 28(iv) was made in 2023 almost five years later to include even benefit received in cash within its fold. The amendment is focussed only to insert receipt of benefit in the form of cash and not as any attempt to tax any benefit from waiver of term loans which is a solo capital receipt.

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