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Cessation of loan taken for purchase of capital asset not taxable: SC

Summary

Taxation of cessation of a debt claim has been an issue of intense debate, where the tax officers have sought to tax it either as a benefit received in non-monetary terms from business[1] or as cessation of a trading liability[2]. The Supreme Court (SC) in a recent ruling[3] has held that waiver of loan taken for purchase of a capital asset would constitute a capital receipt and would not be taxable either as a benefit arising from business or as cessation of a trading liability.

Facts of the case

- The taxpayer entered into an agreement with Kaiser Jeep Corporation USA (KJC) for purchase of dies, welding equipment and die models. The aforesaid toolings and equipment were supplied by KJC through its subsidiary Kaiser Jeep International Corporation (KJIC).
- For procurement of the said toolings and other equipment, KJC provided a loan at an interest of 6 per cent repayable in instalments after 10 years.
- Subsequently, the taxpayer was informed that KJC had been taken over by American Motor Corporation (AMC), which agreed to waive the principal amount of loan advanced by KJC to the taxpayer.
- The tax officer added the waiver of the loan amount as income received in non-monetary terms.
- Upholding the tax officer's order, the Commissioner of Income-tax (Appeals) (CIT(A)) took an alternate view that the waiver of loan amount resulted in remission of trading liability and consequently the said amount would be taxable under the provisions of the Income-tax Act, 1961 (Act).
- On further appeal, the Income Tax Appellate Tribunal (ITAT) held the said waiver as not taxable. The order of ITAT was further affirmed by the Bombay High Court (HC). The tax department preferred an appeal before the SC against the Bombay HC ruling.

[1] Section 28(iv) of the Income-tax Act, 1961
[2] Section 41(1) of the Income-tax Act, 1961
[3] CIT v Mahindra & Mahindra Ltd. (Civil Appeal Nos 6949-6950 of 2004)

Taxpayer’s contention

- The taxpayer stated that the loan was given by KJC whereas the toolings were supplied by KJIC. Therefore, the two transactions were independent of each other.
- The purchase of toolings could not be equated with the purchase of goods on credit in the ordinary course of business, nor could it be equated with unpaid purchase consideration to be liquidated over a period of time.
- The taxpayer submitted that the said sum could not be brought to tax as it represents the waiver of a loan liability which was on the capital amount and is not in the nature of income.

Revenue’s contention

- The Revenue contended that the taxpayer had taken the loan to purchase the dies, tools and other equipment. Its waiver amounts to income in the sense that an amount which ought to be paid by the taxpayer is now not required to be paid.

SC ruling

- The SC held that waiver of loan by the creditor results in extra cash in the hands of the debtor (ie the taxpayer in this case). Therefore, it is a receipt in the hands of the taxpayer.
- As regards the taxability of loan waiver as a benefit received in non-monetary terms, the SC held that in order to invoke the said provision, the benefit has to be in some form other than money. Since in the present case it has held the waiver to be a monetary receipt, the waiver cannot be taxed as benefit received in non-monetary terms.
- As regards the taxability of the waiver as cessation of a trading liability, the SC held that the purchase effected from the KLC was in respect of plant, machinery and tooling equipment, which are capital assets. 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. Further, there is a difference between ‘trading liability’ and ‘other liability’. The Act particularly deals with the remission of trading liability, whereas in the present case, waiver of loan amounts to cessation of liability other than trading liability.
- Further, as regards the argument that the taxpayer has claimed benefit of amortisation of the capital asset acquired from KJC, the SC held that amortisation 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 but depreciation. Depreciation is a reduction in the value of an asset over time, in particular due to wear and tear. Therefore, the deduction claimed by the respondent in the previous assessment years was due to the depreciation of the machine and not on the interest paid by it.

Our comments

The above decision puts to rest the issue of non-taxability of waiver of loan taken for acquiring capital assets. This ruling would be helpful for companies undergoing insolvency proceedings or debt-restructuring where financial institutions are taking a haircut on the principal amount.

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