



# WRITE BACK OF LIABILITIES – TAX IMPLICATIONS

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During COVID times, where global economy is facing challenges, the waiver of liabilities under commercial arrangement is very widely seen phenomenon. When such waiver (and resultant write backs) are supposed to give financial relief to the business, one needs to be mindful of the corresponding tax implications arising from benefit obtained on account of such waiver. In this note, we have covered tax implications on benefit obtained from waiver/write back of various liabilities.

## WHAT ARE TAXATION PROVISIONS?

For tax implications on write backs/waivers, following provisions of the Income Tax Act, 1961 (“the Act”) are relevant:

- As per **section 28(iv)**, the value of any benefit/perquisite, whether convertible into money or not, arising from business/profession shall be taxable under the head "Profits and gains of business or profession".
- As per **section 41(1)**, where an allowance/deduction has been made in any year in respect of a trading liability incurred by the person and subsequently such person has obtained some benefit in respect of such trading liability by way of remission or cessation thereof, then the value of such benefit shall be taxable under the head "Profits and gains of business or profession"
- As per **section 56(2)(x)** where any person receives, from any person/s any sum of money, without consideration, the aggregate value of which exceeds INR 50,000, the whole of the aggregate value of such sum shall be taxable under the head "Income from other sources"

Considering the above provisions, let us discuss the taxability of various write backs.

## WRITE BACK OF PAYABLES U/S 28(iv) & 41(1)

### WRITE BACK OF ACCOUNT PAYABLES

If the write back of account payables relate to purchase/services availed by the person for his business and were claimed as expense in any year, then such write back amount shall be taxable as business income u/s 41(1).

### WRITE BACK OF LOAN

As per principles laid down by the Apex Court in the case of Mahindra And Mahindra Ltd<sup>1</sup>, the term 'loan' refers to borrowing something, especially a sum of cash that is to be paid back along with the interest decided mutually by the parties. The lender may exercise his 'Right of Waiver' to absolve the borrower from his liability to repay. After such exercise, the borrower is deemed to be absolved from the liability of repayment of loan subject to the conditions of waiver. The waiver may be a part waiver i.e., waiver of part of the principal or interest repayable, or a complete waiver of both the loan as well as interest amounts. Hence, waiver of loan by the lender results in the borrower having extra cash in his hand. It is receipt in the hands of the debtor/assessee.

#### **(I) Loan for acquiring capital asset**

As per decision of aforementioned Apex Court in the case of Mahindra And Mahindra Ltd<sup>2</sup>, the waiver of loan is in nature of receipt of money/cash. Therefore, the very first condition of section 28(iv) which says any benefit /perquisite arising from the business shall be in the form of benefit/perquisite other than in the shape of money, is not satisfied in case of waiver of loan.

It also cannot be taxed as a remission of liability u/s 41(1) on following grounds:

- For section 41(1) essential condition is that there should be an allowance/deduction claimed by the

<sup>1</sup> CIT vs Mahindra and Mahindra [2018] 404 ITR 1 (SC)

<sup>2</sup> CIT vs Mahindra and Mahindra [2018] 404 ITR 1 (SC)

assessee in any year in respect of trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits/waives any such liability, then the assessee is taxed u/s 41. The objective is to ensure that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability. Purchase/acquisition of capital asset is not debited to trading account/profit and loss account to claim deduction/allowance. The only deduction claimed will be towards depreciation of such capital asset due reduction in its value over time, due to wear and tear. However the same cannot be equated with claiming of deduction/allowance for principal amount of loan.

- Also, there is difference between 'trading liability' and 'other liability'. Section 41(1) particularly deals with the remission of trading liability. Whereas in the case of loan for capital asset, waiver of loan amounts to cessation of liability other than trading liability.

Pertinent to note that the interest portion of such waiver, if claimed as deduction, may be taxed u/s 41(1).

## **(II) Loan for working capital**

In case of write back of loan taken for working capital purpose, there is lack of clarity in the law and different views taken by various courts are as under:

### **Against the Assessee**

The Delhi High Court in case of Rollatainers Ltd<sup>3</sup> held that if the loan was taken for trading purpose and was treated as such from the very beginning in the books of account, the waiver thereof may result in

the income, more so when it was transferred to the profit and loss account.

Similar view was taken by Bombay High Court Solid Containers Ltd.'s case and Madras High Court in case of Aries Advertising (P.) Ltd.

### **Favourable to the Assessee**

The Apex Court in case of Compaq Electric Ltd held that waiver of unsecured loan taken from holding company for the purpose of funding the business operation amount to capital receipt and since no allowance or deduction claimed by the assessee on such loan, it is not liable to tax u/s 41(1).

### **Our Comments**

In our view the waiver of loan cannot be taxed under section 28(iv) as for the said the section the benefit should be in other form rather than in the shape of money as per the decision of the Apex court in case of Mahindra and Mahindra Ltd. With respect to taxability u/s 41(1), the pre-requisite is that there should be allowance/deduction claimed by the assessee on such loan. The judgments mentioned above, wherein such waiver is considered as taxable have majorly relied upon the judgment of the Apex Court in case of T.V. Sundaram Iyengar & Sons Ltd . The said decision of the Apex Court was in context of section 28(i). In the fact of the case, the assessee had received certain advance from its customers and since they remain unsettled for several years, were unilaterally written back by the assessee and credited to Profit & Loss account. However, assessee claimed that they were capital receipt and hence not chargeable u/s 41 or 28. In the factual background, the Apex Court held the receipt to be revenue in nature and arising from business as they were received from customers in normal course of business only. In our view, loan taken for business purpose cannot be equated to amount received from customers and hence applicability of section 41(1) to such section can be argued. However, it will be highly

<sup>3</sup> Rollatainers vs CIT [2011] 15 taxmann.com 111 (Delhi HC)

litigative when such loan is used for payment of business expenses, which were claimed as deduction.

## **WRITE BACK OF DEPOSITS**

If deposits are in ordinary course of business, then:

- Considering them in nature of “cash/money receipt” (similar to loan write back), their write back shall not be taxable under section 28(iv).
- Since the deposits/advances are not claimed as allowance/deduction the same shall not be taxable under section 41(1).
- However, it can be taxable as normal business income u/s 28(i) as normal profit/gain from business based on the judgement of the Apex Court in case of T.V. Sundaram Iyengar & Sons Ltd. The Apex court held that if assessee receives certain deposits from customers in course of its business which were originally treated as capital receipt then the said amount changes its character when amount becomes assessee's own money (when written back to profit and loss account) because of limitation or by any other statutory or contractual right and such amount should be treated as business income of assessee under section 28(i).

If the deposit is not in the ordinary course of business, then the same can be treated as loan and taxability as mentioned for loan will apply.

## **WRITE BACK OF LOAN U/S 56(2)(X)**

The Apex Court in case of Mahindra And Mahindra Ltd, held that waiver of loan is in nature of receipt of cash/Money. Due the said principle laid down by the Apex Court, though in the context of s. 28(iv), the question arises about applicability of section 56(2)(x) on waiver of loan being receipt of money. For applicability of section 56(2)(x) there should be receipt of money and such receipt should be without consideration. Now, the issue to be analysed is whether waiver of loan by the lender for One Time

Settlement or similar other commercial arrangement can be considered as without consideration. The similar issue was dealt by the Chandigarh ITAT in case of Jai Pal Gaba wherein it held that:

- If the donor firstly, gives some amount as a loan and then waive of or relinquish the right to recover the said amount, then on the date of such remission or relinquishment, the nature of such loan changes from loan to receipt.
- The loan was advanced by the banker for a consideration of interest and also with the condition that the same is to be repaid. Advancement of loan cannot be said to be without consideration.
- However, due to losses, the loan become NPA. The bank, after considering the remote possibility of recovery of the said loan, thought it prudent to go for one time settlement with the loanee. It is not just a case where the bank had simply waived or remitted the loan amount, rather the bank to secure payment of certain amount, which otherwise the bank was feeling difficult to recover, was the consideration for settlement of the loan account. Hence, the amount received by the assessee as waiver or remission of loan amount cannot be said to be without consideration. Hence, the provisions of section 56(2) could not be applicable.

In our view, the applicability of section 56(2)(x) to waiver of loan is prone to litigation and will depend upon facts of the case and its commercial substance.

## **OUR COMMENTS**

The write back issue is very prevalent in case of takeovers under Insolvency and Bankruptcy Code, wherein the Creditors are paid amounts as provided in the resolution plan in full and final settlement of their claims which results into heavy write backs. One needs to be very careful about the tax treatment, accounting and disclosures about the write backs in order to avoid unexpected tax implications.

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Website: <https://gbcaindia.com/>

GBCA & Associates LLP, Chartered Accountants

Benefice Business House, 3rd Level, 126,

Mathuradas Mill Compound, N.M.Joshi Marg, Lower Parel (West)

Mumbai 400013

India.