Waiver of loan - Tax implications

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Introduction:

A loan is basically borrowing something; especially a sum of money, that is to be paid back with interest. In a loan, the borrower initially receives or borrows an amount of money called the 'principal' from the lender, and is obligated to pay back the principal along with the interest specified to the lender at a later time. Typically, the money is paid back in regular installments. Loan is different from debt and deposit. Debt is the amount owed by one or the state of owing money. In **Central Bank of India Vs JCIT[1],** it was held that *"…(i) though every loan creates a debt in favour of lender but every debt is not a loan, (ii) in case of loan, the money passes from lender to borrower for use of the borrower with or without interest. On the contrary, the liability to pay a debt may arise from diverse sources….*" The Tribunal in this judgment also referred to **Oriental Insurance Co. Ltd. vs. Dy. CIT[2]** wherein, after considering various judgments of the Courts, a distinction has been made between loan or deposit by observing at p. 525 as under :

"The terms 'loans' and 'deposits' are not mutually exclusive terms. There are a number of common features between the two. In a sense a deposit is also a loan with this difference that it is a loan with something more. Both are debts repayable. But, the question as to when the repayment is to be made furnishes the real point of distinction between the two concepts. A loan is repayable the minute it is incurred. But this is not so with a deposit. Either the repayment will depend upon the maturity date fixed, therefore, or the terms of the agreement relating to the demand, on making of which the deposit will

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[1] 99 ITD 34 (Mum)

[2] (2004) 82 TTJ (Del) 1084

become repayable. In other words, unlike a loan there is no immediate obligation to repay in the case of a deposit. That is the essence of the distinction between a loan and a deposit."

Similarly, the Hon'ble Supreme Court in the case of **Bombay Steam Navigation Co. (1953) (P) Ltd**[3] held that "*An agreement to pay the balance of consideration due by the purchaser does not in truth give rise to a loan. A loan of money undoubtedly results in a debt, but every debt does not involve a loan. Liability to pay a debt may arise from diverse sources. Every creditor who is entitled to receive a debt cannot be regarded as a lender"*. Therefore, it is clear that there is a difference between the terms 'debt', 'loan' and 'deposit'.

The concept dealt with in this article is taxability of waiver of a loan. Waiver of a loan is voluntarily waiving the liability of the borrower by the lender. By waiving the loan, the borrower is absolved from repaying the loan. The waiver may be a part waiver (waiver of a part of the principal or interest repayable) or a complete waiver of both the loan and interest amounts. Waiver of loan results in the borrower having extra cash in his hand. It is a receipt in the hands of the borrower/assessee. The issues whether waiver of loan is taxable as a perquisite under Section 28(iv) or taxable as a remission of liability under Section 41(1) is analysed.

In this connection, let us analyse 'business income' under Section 28(iv)

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<u>Business Income:</u>

Section 2(24)(vd) read with section 28(iv) of the Income-tax Act, 1961 deem the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, as income of the recipient, taxable as business income.

Section 2 is a definition section and clause (24) of the section defines income. Sub-clause (vd) reads as under:

[3] (1965) 56 ITR 52 (SC)

"(vd) the value of any benefit or perquisite taxable under clause (iv) of section 28."

Therefore, the value of any benefit or perquisite taxable u/s 28(iv) is to be treated as 'Income'.

Looking at the definition of perquisite in IT Act which is given in Sec. 17(2), it may be seen that it is in essence, non-cash benefits given by an employer to employees in addition to cash salary or wages.

Section 28 of the Income Tax Act (I.T.Act) lays down that income will be charged as 'Profits and Gains of Business or Profession' if they fall under any of its clauses. Clause (iv) of the said section is as follows:

"(iv) *the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;"*

Sec. 28(iv) lays down that the value of any benefit or perquisite, ***whether convertible into money or not***, shall be considered as income from business or profession and taxed as such.

The term 'whether convertible into money or not' makes it clear that the benefit or perquisite must be in kind (ie) the question of including the value of benefit or perquisite would arise only if the benefit or perquisite is not in cash or money[4]. In **Ravinder Singh Vs CIT[5],** the High Court of Delhi held that Se. 28(iv) does not apply to cash payments. The relevant para reads as under:

".. Section 28(iv)....can be invoked only where the benefit or ***perquisite is other than cash****. If what was received either by way of benefit or perquisite was money, there would be no question of considering the value of such monetary benefit or perquisite under clause (iv) of section 28".*

<u>Is waiver of loan a perquisite?</u>

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[4] CIT Vs Alchemic (P) Ltd – 130 ITR 168 (Guj)

[5] 113 CTR (Del) 183

Now, the question which arises is whether waiver of loan taken is a benefit/perquisite falling u/s 28(iv). In **ITO Vs. Ahuja Graphic Machinery (P) Ltd**[6]**,** a three member bench held that:

"The value of any benefit or perquisite arising from business or the exercise of a profession is chargeable to income-tax as part of the income from business/profession under s. 28(iv) and it is deemed to be income under s. 2(24). ***This clause does not apply to the receipts in cash.*** *To apply these provisions the assessee should have appropriated the sums in question to its P&L a/c."*

As a loan is a debt: a borrowal of cash, it is not covered by Sec. 28(iv). In **Mahindra & Mahindra Ltd. Vs. CIT**[7], the ITO sought to charge the waiver of loan as it represented an income and not a liability. The Bombay High Court rejected the Revenue's stand and held that:

- The income which can be taxed under s. 28(iv) must not only be referable to a benefit or perquisite, but it must be arising from business[8];
- Sec. 28(iv) does not apply to benefits in cash or money – relying on the **Alchemic (P) Ltd.'s** case[9];
- The loan amount was used to purchase machinery, therefore, it was on capital account; its waiver cannot be treated on revenue account; and
- The waiver of the principal amount was unexpected and hence such waiver would not constitute business income.

We can on the basis of the above decisions come to a conclusion that as a loan is a debt/ a borrowal of cash, it is not covered under Sec. 28(iv)

<u>Section 41(1):</u>

[6] 111 TTJ (Mumbai)(TM) 445
[7] 261 ITR 501 (Bom)
[8] also see CIT Vs. Chetan Chemicals (P) Ltd. 267 ITR 770 (Guj)
[9] 130 ITR 168 (Guj)

Having concluded that a waiver of loan is not a perquisite taxable under Section 28(iv) as income, let us look at the provisions of section 41(1). Would the waiver of loan be considered as a remission of liability and therefore taxable under Section 41(1)?

As seen above, waiver of loan is voluntarily waiving the liability of the borrower by the creditor. The House of Lords in the classic case of **British Mexican Petroleum Co. Ltd. Vs. IRC** (1932) 16 Tax Cases 570 (HL) held that "a debt forgone by the creditors does not become the income of the debtor". In this connection, a look at Sec. 41(1) of the Act is necessary. The relevant part of this section reads as under:

> *"(1) **<u>Where an allowance or deduction has been made</u>** in the **assessment** for any year in respect of loss, expenditure or trading liability incurred by the assessee (hereinafter referred to as the first- mentioned person) and subsequently during any previous year,-*
> *(a) the first- mentioned person has obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such **trading liability** by way of **remission or cessation thereof**, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be **profits and gains of business or profession** and accordingly chargeable to income- tax as the income of that previous year, whether the business or profession in respect of which the allowance or deduction has been made is in existence in that year or not; or…."*

> Examples of such deduction can be seen in Section 36(1)(iii) and 37. The relevant part of the sections read as follows:
> *"36. (1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28 –*
> …………….
> *(iii) the amount of the **interest paid** in respect of capital borrowed for the purposes of the business or profession:*

> ***Provided*** *that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.:*
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> *"37. (1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and Gains of business or profession""*

Therefore, interest paid on the loan and any other expense incurred wholly and exclusively for the purposes of the business can be claimed as a deduction if the loan is taken for trading purposes; ie it is a revenue receipt.

In short, section 41(1) says that the benefit which accrues by way of remission or cessation of trading liability will be taxable under the head 'Profits and Gains of business or profession' **only** when an allowance or deduction has been made with respect to such trading liability.

In order to apply Sec. 41(1), the Supreme Court in **CCIT Vs. Kesaria Tea Co. Ltd**[10] held that the following points are to be kept in view:

(1) in the course of assessment for an earlier year, **allowance** or deduction has been made in respect of **trading liability** incurred by the assessee;
(2) subsequently, a **benefit is obtained** in respect of such trading liability by way of **remission or cessation** thereof during the year in which such event occurred;
(3) in that situation the value of benefit accruing to the assessee is deemed to be the profit and gains of business which otherwise would not be his income; and

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[10] 254 ITR 434 (SC)

(4) such value of benefit is made chargeable to income-tax as the income of the previous year wherein such benefit was obtained.

The Karnataka High Court held that for the application of s. 41(1), the condition precedent is that ***there should be an allowance or deduction*** in the ***assessment*** for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under s. 41. The whole object is to avoid double benefit to the assessee. In the instant case, the amount claimed as capital receipt is in respect to which there was no allowance or deduction claimed by the assessee for the previous year. Therefore, ***when the creditor waived the repayment*** of the said amount, it amounts to a capital receipt and not a revenue receipt. ***As the assessee did not have the benefit of any allowance or deduction in respect of the said amount, s. 41 is not attracted[11].***

In **CIT Vs. Tosha International Ltd[12],** the amount of loan and interest due by assessee to banks and financial institutions was waived. The same having never been claimed by assessee as deduction, the Court held that the waiver of interest and part of principal by banks/financial institution did not give rise to profits chargeable to tax under Sec. 41(1).

In **CIT Vs. Rayala Corporation (P) Ltd.[13],** the returns of income, in which the assessee had claimed deduction for interest expenditure, were treated as 'non est' by the income tax department. On the issue whether claim of deduction of interest in the return, which is allowed to become non-est by opting not to rectify the defects, can be treated as disallowance of deduction, the Madras High Court held that:

> *"14. As far as the present case is concerned, in the context of Section 139(9) of the Act, with the return filed treated as non est in the eye of law, we hold that the expression "where an allowance or deduction has been made in the assessment for any year" has to be read as any allowance or deduction considered in the*

[11] CIT & Anr. Vs. Compaq Electric Ltd 66 DTR (Kar) 38
[12] 331 ITR 440
[13] dt 18.06.2013

assessment for the purpose of invoking Section 41(1) of the Act. For the applicability of Section 41(1) of the Act, the ***prerequisite condition is that an allowance or deduction has been made in the assessment*** *for any of the years in respect of an expenditure, loss or trading liability incurred by the assessee and subsequently during any previous year, the assessee has received remission or obtained refund of the said amount. Thus Section 41(1) creates a legal fiction and hence, has to be strictly complied with if any addition to the income is sought to be made by the Revenue - (Refer [2005] 277 ITR 426 (Narayanan Chettiary Industries v. Income-tax Officer).* ***Thus unless the amount had been allowed as a deduction in the earlier years, the question of invoking Section 41(1) does not arise."***

In short, according to the Madras High Court, the word 'assessment' in section 41 (1) contemplates a passing of an order by the Assessing Officer determining the income of the assessee. The provisions of section 41 (1) prescribe a pre-condition that a deduction for expenditure must have been obtained by an assessee in an 'assessment. In the instant case before the High Court, there was no 'assessment' because the returns filed by assessee were treated as 'non-est". The ***remission received*** by the assessee has therefore held as ***not taxable u\s 41 (1)*** because the deeming provisions failed to operate ***in absence of an assessment.***

Therefore, in order to apply the provisions of section 41(1) of the IT Act, the conditions mentioned above should cumulatively exist and that too in respect of the trading liability. This view is supported by the decision of the Hon'ble Supreme Court in the case of **Polyflex (India) (P) Ltd. (257 ITR 343).**

Section 41(1) and Section 115JB

One other issue which is to be considered with respect to Sec 41(1) is whether the income will be taxable when the loan waiver has been written back and credited to P&L A/c and subjected to tax as part of book profit under s. 115JB. The Delhi High Court in **CIT Vs**

Goyal M.G.Gases Ltd[14] has held that it will not be taxable. The relevant part of the judgment is as follows:

> *". We have considered rival submissions. In the original assessment order which is now sought to be revised under s. 263, there is no discussion about write back of liability. Though the assessee in the notes on accounts appended to the balance sheet has made proper disclosure about write back of the loan liability and the circumstances in which the amount was adjusted. However, the fact remains that what is adjusted is part of the term loan received from Citi Bank which was guaranteed and paid by the creditor, namely, Messer Griesheim GmbH. The assessment is framed by adopting the book profit under s. 115JB as basis for computing the tax liability. In the assessment so framed, the amount of Rs. 100 lacs is already included as credit to the P&L a/c.* ***Since the amount of write back of the loan liability already forms part of book profit on which tax is levied, the assessment order cannot be branded as erroneous*** *insofar as it is prejudicial to the interest of Revenue. There is no dispute about the fact that the sum of Rs. 100 lacs forms part of book profit computed under s. 115JB.."*

Therefore, assessee having not been allowed any deduction or benefit of allowance in respect of the loan liability by way of allowable expenditure or trading liability and the amount written back having been credited to P&L A/c and subjected to tax as part of book profit under s. 115JB, Sec. 41(1) has no application to the loan amount written back.

<u>Course of decisions as it stands today</u>

We have seen that the waiver of loan will not be taxable. However, presently, Courts are taking a view that the assessee has obtained some benefit from the waiver and this would be taxable under Section 28. In this context we would need to study the nature of loan, situations where the assessee treats it as his own income, and appropriation of part payment.

[14] 321 ITR 437

Nature of loan:

If one were to accept that waiver of loan is taxable we need to look at the

(i) purpose of the borrowing

(ii) accounting treatment of the waived amount

(iii) Remission of principal and interest amounts

(i) Purpose of the borrowing

A loan can be taken for the purchase of a capital asset, for expansion of the business, for working capital, for investment in shares etc. The accounting treatment of the loan taken varies as it depends on the purpose for which it is taken. Therefore, the chargeability of waiver of loan also depends on the nature for which the loan was taken. If the loan is taken for the purchase of a capital asset, waiver of the loan would not be taxable. However, when a borrowing is made for carrying on regular business activity, such borrowing is called as working capital borrowing. It forms part of the trading liability of the borrower. When the lender of such trading facility waives the amount either fully or in part such amount so waived or foregone is chargeable to tax as income as held in **Solid Containers Ltd v. Dy.CIT**[15].

The observations of the Madras High Court in the case of **Iskraemeco Regent Ltd. vs. CIT**[16] as regards to the nature of bank loan in the business are worth noting. The High Court has laid down as under:

> "*It is a well-established principle of law that every deposit of money would not constitute a trading receipt. Broadly, though a receipt may be in connection with the business, it* ***cannot be said that every such receipt is a trading receipt****. Therefore, the amount referable to the loans obtained by the assessee towards the purchase of its capital asset would not constitute a trading receipt. The said issue has been fortified by the judgement of this court in CIT vs. A.V.M. Ltd. [1984] 146 ITR 355."*

[15] 308 ITR 417 (Bom)
[16] 331 ITR 317 (Mad)

The Delhi High Court has held that if loan is taken for acquiring capital asset, waiver thereof would not amount to any income eligible to tax. Whereas, if loan is for trading purpose and was treated as such from the very beginning in the books of account, waiver thereof may result in income: more so when it was transferred to profit and loss account. The relevant para is as under:

> *8……… "In the context of waiver of loan amount, what follows from the reading of the aforesaid judgment is that **the answer would depend upon the purpose** for which the said **loan was taken**. If the loan was taken for acquiring the capital asset, waiver thereof would not amount to any income exigible to tax. On the other hand, if this loan was for trading purpose and was treated as such from the very beginning in the books of account, as per T.V. Sundaram Iyengar and Sons Ltd. (1996) 222 ITR 344 (SC), the waiver thereof may result in the income more so when it was transferred to the profit and loss account…"*[17]

In **Comfund Financial Services (I) Ltd. Vs. DCIT**[18], the **a**ssessee was dealing in shares and securities, making payment for purchase of shares out of its overdraft account with the bank. The assessee incurred huge losses and consequently, there was a remission of this loan along with interest by the bank. The Court held that:

> *a) "…The assessee had incurred expenses in past or even in this year towards the purchase price of shares and securities brought from other parties and that the payments in that regard were made by the assessee out of its overdraft account with Deutsche Bank (DB). When DB remitted or waived the principal amount of such loan, it cannot be said that any portion of the purchase price was waived by recipients of such prices. The expenses towards purchases had already been incurred and there was no remission from the side of the said sellers of securities, etc., in favour of the assessee out of such purchase prices. The transactions between the assessee and DB (apart from those relating to direct purchases and*

[17] CIT Vs. ICC India P. Ltd 83 CCH 074 DelHC

[18] 67 ITD (BANG) 304

sales of shares and securities between the two parties) are ***mostly of the nature of loan transactions****. These transactions are therefore on* ***capital account****. The waiver or remission of the liability towards loan incurred by the assessee cannot, therefore, be considered to constitute a revenue income in the hands of the assessee…"*

In **CIT Vs M/s. Xylon Holdings Pvt. Ltd.**[19]**,** the Court held that the nature of the loan should be looked into and the decision of Solid Containers would not apply in the present case, as it is covered by the Mahindra case (supra).

In **Rollatainers Ltd vs. CIT**[20], the Court held that when the money/loan was received in the course of carrying on business and treated as loan at the time of receipt which was of capital nature, on waiver it had become assessee's own money which was even taken to P&L A/c. This benefit was therefore in the revenue field as the money had been borrowed for day to day affairs and not for the purchase of machinery. Thus, the loans were for the circulating capital and not the fixed capital. In any case, ***even if s. 28(iv) is not applicable, s. 41(i) is clearly applicable***

(ii) The accounting treatment of the waived amount

Situations where the assessee treats it as his own income:

The accounting treatment of the waived amount is important. The character of the loan taken generally depends on the purpose for which it is taken. However, it also depends on how the borrower or assessee treats it. If the money is treated as own income and taken to the P&L A/c, its character changes. The courts have laid down the various situations in which this happens. Some of the important judgments are as below:

[19] ITA No. 3704 OF 2010
[20] 339 ITR 54 (Del)

In **CIT Vs. T.V. Sundaram Iyengar & Sons Ltd**[21]**,** the Court held that if an amount is received in the course of trading transaction, even though it is not taxable in the year of receipt as being of revenue character, the amount changes its character when the amount becomes the assessee's own money because of limitation or by any other statutory or contractual right. The relevant para reads as under:

> *"….the money was received by the assessee in the course of carrying on his business. Although it was treated as deposit and was of capital nature at the point of time it was received, by efflux of time the money has become the assessee's own money. What remains after adjustment of the deposits has not been claimed by the customers. The claims of the customers have become barred by limitation. The assessee itself has treated the money as its own money and taken the amount to its P&L a/c. There is no explanation from the assessee why the surplus money was taken to its P&L a/c even if it was somebody else's money...."*

However, in **Morley (H.M. Inspector of Taxes) Vs. Tattersall**[22], it was laid down by Lord Greene that the taxability of a receipt was fixed with reference to its character at the moment it was received and that merely because the recipient treated it subsequently in his income account as his own that did not alter that character.

The principle of Morley Vs. Tattersall was applied in **CIT vs. Sandersons & Morgans**[23] In that case, the question was whether interest received by a solicitor on the amounts belonging to his clients was taxable as his income. This Court held that amounts received from his clients by a solicitor were not trading receipts, but were in fiduciary capacity. Therefore, the principle laid down in Tattersall's case (supra) will apply.

In **Punjab Steel Scrap Merchants' Association Ltd. vs. CIT**[24], the assessee-company was a dealer in scrap iron. Its unclaimed credit balances, after a period of three years were transferred by the company to its P&L a/c. The amounts so transferred to the P&L

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[21] 222 ITR 344 (SC)
[22] (1939) 7 ITR 316 (CA) : TC 13R.264
[23] (1970) 75 ITR 433 (Cal) : TC 19R.262
[24] (1961) 43 ITR 164 (Punj)

a/c were held by the Punjab High Court to be trading receipts and liable to be included in the computation of the assessee's taxable income. It was held that the amounts in question were payments towards price of the scrap iron which was to be supplied to the constituents. They were essentially trading receipts. The case of ***Morley vs. Tattersall*** (supra) was ***distinguished*** on the ground that in that case the moneys received by Tattersall were never the moneys of the firm but moneys of the customers

In **Rollatainers Ltd vs. CIT**[25], the Court held that when the money/loan was received in the course of carrying on business and treated as loan at the time of receipt which was of capital nature, on waiver it had become assessee's own money which was even taken to P&L A/c. This benefit was therefore in the revenue field as the money had been borrowed for day to day affairs and not for the purchase of machinery. Thus, the loans were for the circulating capital and not the fixed capital. In any case, ***even if s. 28(iv) is not applicable, s. 41(i) is clearly applicable***

In **Helios Food Improvers (P) Ltd. Vs. DCIT**[26]**,** the CIT had held that the loan amount, being capital in nature, changed its nature to revenue by the positive act of remission. On appeal, the Tribunal allowed the appeal and held that:

> "*…. If this view is accepted then there can be some* ***other consequences*** *in the sense that concept of capital receipt vs. revenue receipt and capital loss vs. revenue loss would become* ***meaningless*** *and also the scheme of the Act to tax receipts of revenue nature as income except capital receipt as capital gains in specified case would also become meaningless……In the present case also the assessee has created* ***capital reserve*** *which itself is indicative of nature of this amount even at the time of such a write-off as being of* ***capital nature****. No material has been brought on record to say that loan so received was in the nature of revenue grant or subsidy or assistance originally or it was convertible into such type of receipts in the situation of the assessee not being in position of*

[25] 339 ITR 54 (Del)
[26] 14 SOT 546 (Mumbai)

*paying back the same, hence, its **character of loan** at all points **cannot be doubted**. …"*

In **Logitronics (P) Ltd. Vs. CIT & Anr**[27] **,** the Delhi High Court held that if a loan is taken for acquiring a capital asset, waiver thereof would not amount to any income exigible to tax. On the other hand, if the loan is taken for trading purpose and is treated as such from the very beginning in the books of account, waiver thereof may result in income, more so if it is transferred to P&L a/c. In the instant case, the issue as to whether the whole amount of loan obtained by the assessee was utilised for the purpose of acquiring capital assets or for the purpose of business or trading activity has not been looked into or examined by the authorities below. Therefore, Tribunal was justified in restoring the case to the AO for fresh adjudication.

We can see from the above decisions, that though there is a divergent view, the courts are more inclined to taking the view that the treatment of the receipt would determine its character and that the nature of loan is to be looked into in each case so as to bring it under the tax net.

(iii) Remission of principal and interest amounts

One other issue which arises is the appropriation of part payment. The general principle is that the payment is to be appropriated towards the repayment of the interest and then the principal amount. This is more so when the lender and borrower have entered into an agreement in this regard. This principle has been laid down quite early by the Privy Council and has been reiterated by the Supreme Court and various High Courts.

In **CIT Vs. Maharajadhiraja Kameshwar Singh of Darbhanga**[28]**,** the Privy Council has held that when an amount is received by the creditor from debtor without appropriation as between interest and principal by either debtor or creditor, the

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[27] 333 ITR 386
[28] (1933) 1 ITR 94 (PC))

presumption is that payment is attributable in the first instance towards the outstanding interest and chargeable as income. This principle has been explained and reiterated by the **Supreme Court** in **CIT Vs. T. S. PL. P. Chidambaram Chettiar**[29].

In **CIT Vs. Modest Enterprises Ltd**[30]**,** the High Court held that it is only where neither the debtor nor the creditor makes any appropriation either to capital or interest, that it would be open to the Revenue to treat the payment as applicable to outstanding interest. This is the settled position of law.

In **IFB Securities Ltd. Vs. ITO**[31]**,** the AO and CIT(A) while holding that payment first to be apportioned against the outstanding principal amount, have not rebutted or disputed the genuineness of the agreement which clearly lays down that the payment by the assessee was first to be apportioned against the outstanding interest and the assessee has accordingly offered the balance interest amount for taxation and has transferred the entire principal amount of loan to the capital reserve being out of the purview of the s. 41(1). The Court held that it is well evident that the principal loan amount cannot be taken under the purview of s. 41(1). The action of AO in first apportioning the payment towards outstanding principal amount was not tenable as the assessee has apportioned the payment towards outstanding interest as per the settlement deed with NGL.

Therefore, we see that when a loan taken for the purpose of business is waived, the taxability would depend on the nature of the loan or the purpose for which it is taken. Moreover, the appropriation of the amount part paid, if any, would generally go towards the payment of interest first. This leads to the logical conclusion that each case has to be looked into independently as the circumstances in which the loan is taken vary.

Conclusion:

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[29] (1971) 80 ITR 467 (SC).
[30] 207 ITR 618 (Cal)
[31] 101 TTJ (Kol) 829

Under Section 4 of the Act, the charging Section, the charge of income tax is upon the “total income of the previous year”. The term 'income' is defined under Section 2(24) of the Act. In general, all receipts of revenue nature, unless specifically exempted are chargeable to tax. The value of any benefit or perquisite arising from business, as contemplated by section 28(iv), could accrue in numerous ways. The income which can be taxed under section 28(iv) must not only be referable to a benefit or perquisite, but it must be arising from business. Secondly, section 28(iv) does not apply to benefits in cash or money (see CIT v. Alchemic Pvt. Ltd.). Loan taken is not normally a kind of receipt which will be treated as income under section 28(iv)

However, Courts are leaning towards the view that when a part of a loan is waived by the creditor that some benefit accrues to the assessee and such waiver amounts to gains of business liable to be taxed under Section 28 of the Act;

As far as taxation u/s 41(1) is concerned, it is clear that the said section is applicable only if an allowance or deduction has been made, in the computation of profits and gains of a business or profession, in the assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee and subsequently, during any previous year the assessee had obtained, whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof.