

### **Waiver of Loan Interest Loss Tax and Accounting Effect**

Many times we heard about waiver of loan by banks and other financial institution due to various reason like business slow down, cash flow issue or loan NPA. At this situation many times bank provide OTS facility popularly known as one time settlement scheme or any other acceptable restructuring model. In both the cases either OTS or Restructuring of Loan there is waiver of certain portion of loan as well as certain portion of interest. This loan may be taken for working capital or fixed asset purpose and over the year a certain amount may have been paid on account of interest expense. This waiver results in waiver of interest liability and loan liability and as well as waiver of interest already charged into profit and loss account. This waiver brings lot of technicalities in tax & accounting matter.

To discuss this by notional figure I am dissecting the Difference as a waiver of Loan and OTS amount as per below. Suppose out of 200 Crore Loan outstanding including unpaid interest ( 100 Crore WC Loan and Interest thereon and 100 Crore Loan and Interest thereon ) there is waiver of 100 Crore amount in following manner.

#### **Total Waiver-**

- 1- On account of Principal Amount of TL- 50 CR
- 2- On Account of Principal Amount of WC Loan-20 CR
- 3- On Account of TL Interest Capitalized- 5 CR
- 4- On Account of TL Interest Expense out- 15 CR
- 5- On Account of WC Loan Interest Expense out- 10 CR
- 6- B/F Loss Adjustment and C/F issue

#### **1- Waiver of Loan of Principal Amount of TL- 50 CR**

When the loan was taken it was capital receipt and utilized for buying of assets means out of total assets , 50 CR Assets representations made by the Loan receipt and since it was not debited in to PL Account and added in to Asset Side of balance sheet, any waiver of this amount shall be treated as a capital waiver hence capital receipt. Now here two question shall be arrived

- 1- Whether this capital receipt shall be treated as a capital gain. As per me for capital gain there is two important condition, 1<sup>st</sup> it should be capital asset and 2<sup>nd</sup> it should be transferred in some hand. In this case this loan waiver was not a capital assets and not creating any right earlier or at the time of OTS in balance sheet as a receivable. It was reduction in liability and reduction in liability is not any type of right but it is giving relief from lender. There is distinction between relief and right and I think this relief does not come under the definition of Right as a Capital Assets similarly there is no transfer of any assets/rights hence no capital gain.

2- 2nd question will be if this receipt is capital receipt then it will go to capital reserve hence amount will not be taxable in plain reading. But I have little concern here because The loan at the time of given is being represented by Assets. And based on the loan obligation, Asset Value was debited on which we have claimed depreciation as business expenditure. Since Asset was debited by the vendor bill and vendor bill replaced by loan means depreciation part is based on vendor bill and vendor bill paid by loan. So whether amount of deprecation to the tune of claimed on 50 CR assets may be treated as a Income or not is a legitimate question. And as per me and also as per AS 10 any rebate shall not form a part of Assets, so department may take a view that since this 50 Cr is now waived off representing a set of assets and you are directly crediting the capital reserve and not reducing the assets, you have taken double benefit in past years on depreciation on value of this 50 Crore and in further year also you are claiming deprecation on asset without reduction of this relief which is actually rebate.

Also we have to refer any IT Order of disallowance or self disallowance made on account of Asset Decapitalization or capital advance written off and keep into consideration because any item can not be disallowed twice. If this disallowance can be allocated and traced then fine otherwise a logical computation is required.

## **2- Waiver of Loan On Account of Principal Amount of WC Loan -20 CR**

When the loan was taken it was for paying operating creditor and that operating creditor was credited by debiting operating expenditure or purchases. Means by this loan ultimately either purchase or expense has been debited. Since it was taken for paying operating expenditure so any relief on account this shall be treated as operating receipt.

Also section 41(1)a of IT Act says

*Where an allowance or deduction has been made 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.*

And as per reading of this section we find that cessation of this loan shall earlier representing the credit entry of vendor, which was credited by way of debiting the expenditure and as per me ultimately this loan liability will be treated as a trading liability and any waiver of this shall be taxable income and shall be credited in to PL account.

### **3- Waiver On Account of TL Interest Capitalized- 5 CR**

1- As stated above u/s section 41(1) it may not be treated as a Income as it was not debited as a expenditure in PL Account. But here two issues arrived

- a. 1st If it is not taxable u/s section 41(1) can it be treated as a business income u/s 28 (iv) which says the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. Here arising from the business means arising from business activity or arising from the exercise of profession and as per me this 5 Cr relief is not on account of business activity as taking loan and getting relief is not a business activity and it is a exceptional income hence as per me it should not be treated under activity of business or profession and should not treat as a part of taxable income.
- b- 2nd depreciation, on 5 CR instead of one year we are allowing expenditure over a lifetime of asset period. So whether amount of deprecation to the tune of claimed on 5 CR assets may be treated as a Income or not is a legitimate question. And as per me and also as per AS 10 any rebate shall not form a part of Assets, so department may take a view that since this 5 Cr is now waived off representing a set of assets capitalized through interest you have taken double benefit in past years on depreciation on value of this 5 Crore and in further year also you are claiming deprecation on asset without reduction of this relief which is actually rebate. Also we have to refer any IT Order of disallowance or self disallowance made on account of Asset Decapitalization and keep into consideration because any item can not be disallowed twice. If this disallowance can be allocated and traced then fine otherwise a logical computation is required.

2- In Accounting there is some concern about this capitalized interest, because earlier it was not received as a capital receipt but it was charged by bank as a business income to them, though it was representing in Capital Assets from our side, whether it should be added in capital reserve or credited in PL Account and further in IT return treated as a Capital Receipts.

I am more in to crediting in Capital Reserve account.

#### **4- Waiver On Account of TL Interest Expense out- 15 CR**

When the interest was debited it was allowed in same year as a expenditure.  
Also section 41(1)a of IT Act says

*Where an allowance or deduction has been made 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.*

And as per reading of this section we find that cessation of this interest liability will be treated as a waiver of trading liability and any waiver of this shall be taxable income and it should be credited in to PL account. However we have to refer any IT Order of disallowance made on account of Interest and keep into consideration because any interest can not be disallowed twice. If this disallowance can be allocated and traced then fine otherwise a logical computation is required.

#### **5- On Account of WC Loan Interest Expense out- 10 CR**

When the interest was debited it was allowed in same year as a expenditure.  
Also section 41(1)a of IT Act says

*Where an allowance or deduction has been made 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.*

And as per reading of this section we find that cessation of this interest liability will be treated as a waiver of trading liability and any waiver of this shall be taxable income and it should be credited in to PL account. However we have to refer any IT Order of disallowance or self disallowance made on account of Interest and keep into consideration because any interest can not be disallowed twice. If this disallowance can be allocated and traced then fine otherwise a logical computation is required.

**6- B/F Loss Set Off Adjustment and Balance Loss C/F issue**

As per IT Act in current year Inter Head Loss Can get set off subject to Long term Capital loss and in future years it can be set off only in same head of income.

Here I don't think any income treated on account of this waiver as referred above shall not be treated as a business income and B/F Loss set off issue can be raised by IT Department. Because more of the addition was due to u/s 41(1) and on account of relief in form of waiver received on business expenditure done through the loan taken hence any reversal of this loss shall also be treated in same head and not in "Other Sources" Income.