

TAX FLASH NEWS

Since the amount of loan waived as a result of one time settlement with a bank was offered to tax, the interest amount has to be allowed as a deduction

Background

Recently, the Karnataka High Court (the High Court) in the case of KLN Agrotechs (P) Ltd.¹ (the taxpayer) held that the taxpayer cannot be subjected to tax on the principal sum waived as well as disallowance of interest paid under Section 43B of the Income-tax Act, 1961 (the Act), as they are exclusive and cannot co-exist.

In this case, the taxpayer arrived at a one time settlement of the amount of loan due to a bank, wherein it offered the waived amount as income and claimed deduction for the interest paid to the bank. The High Court held that either the interest amount has to be allowed for deduction under Section 43B of the Act or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest paid.

Facts of the case

- The taxpayer, a private limited company, is engaged in the business of manufacturing and trading of refined edible oil.
- The taxpayer had taken a term loan from Canara Bank to the tune of INR38.78 million and a working capital loan amounting to INR5.34 million, totaling to INR44.13 million. There was a default in payment of the loan amount by the taxpayer therefore, the bank declared the account of the taxpayer as a non-performing asset (NPA).

- The total interest accrued in the said account of the taxpayer was INR19.39 million and the total outstanding payable to the bank was INR63.52 million which included the principal amount as well as the interest.
- During the relevant year, the taxpayer arrived at a one time settlement with the bank and against payment of INR63.52 million, an amount of INR37.87 million, was to be paid to the bank which was paid and the account was thereafter closed.
- In the returns filed by the taxpayer, towards the total amount of INR37.87 million paid to the bank, the taxpayer provided for INR19.39 million as interest paid and claimed deduction under Section 43B of the Act.
- After deducting the said amount of interest of INR19.39 million from total payment amount of INR37.87 million, the amount of INR18.47 million was taken as repayment towards principal amount and balance of INR25.65 million would be the amount which was waived by the bank. Further, the taxpayer provided for waived amount of INR25.70 million (i.e., INR25.65 million + other amount of INR0.054 million) as income and offered it to tax.
- The tax department did not accept the plea of the taxpayer of adjusting the amount of INR19.39 million towards interest and also its claim for benefit under Section 43B of the Act, and instead held that the entire amount of INR37.87 million paid by the taxpayer as one time settlement with the bank to be adjusted towards the principal amount of INR44.13 million.

¹ CIT v. KLN Agrotechs (P) Ltd. (ITA NO.23/2014) – taxsutra.com

- The Tribunal held that the total amount had to be first adjusted towards payment of principal amount but considering the fact that the taxpayer had itself subjected the waived principal amount of INR25.70 million to tax in the return, in the interest of justice and equity, disallowance of interest under Section 43B of the Act be subsumed into the offer of INR25.70 million on waiver of principal.

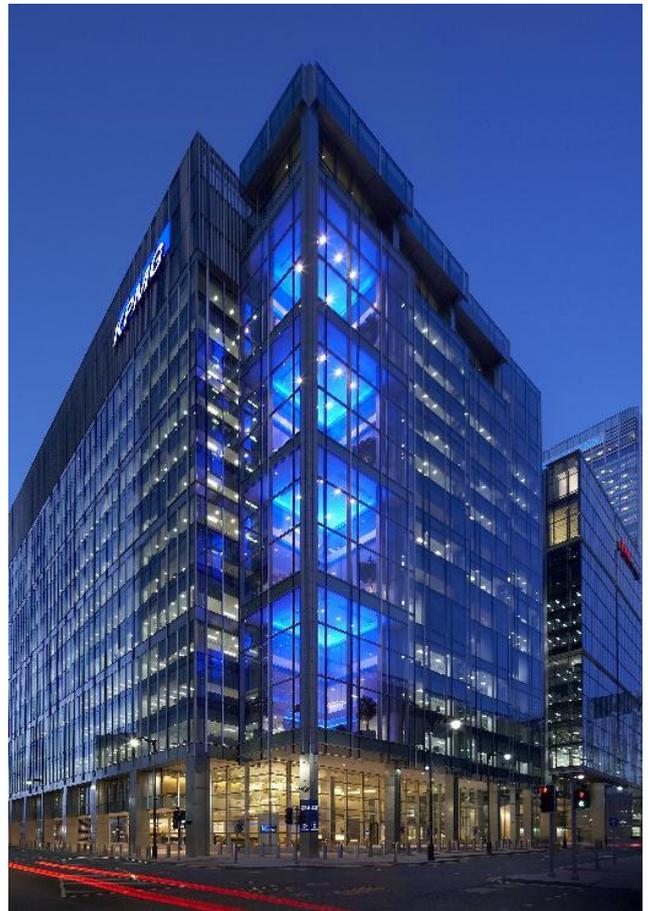
High Court's ruling

- The High Court upheld the order of the Bangalore Tribunal that the taxpayer cannot be subjected to double jeopardy i.e., it could not be subjected to tax on the waived principal sum of INR25.70 million as well as disallowance of interest under Section 43B of the Act, as the said two effects are mutual, exclusive and cannot co-exist.
- The High Court agreed with the observation of the Bangalore Tribunal in this case that the erroneous offer of tax of INR25.708 million towards waiver of principal sum is more than the erroneous claim of interest under Section 43B of INR19.39 million. Further, as both erroneous offers of waived principal sum to tax and erroneous claim of interest under Section 43B emanated from a single transaction/event i.e. one time settlement, both should be understood as to have cancelled each other.
- If out of the total sum of INR25.70 million which has been offered to tax by the taxpayer, the amount of unpaid interest of INR19.39 million is deducted then the waived principal sum would come to INR6.25 million.
- Either it is the interest which is to be waived, and if the same is not to be waived, then the waived principal amount of INR25.70 million has to be reduced by the amount of interest of INR19.39 million which is not permitted for deduction under Section 43B of the Act. In either case, the amount of deduction, as well as the amount which is subjected to tax, would come to the same.
- Either the interest amount has to be allowed for deduction under Section 43B or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest paid.
- Accordingly, the order of the Tribunal of allowing the disallowance of interest under Section 43B of the Act to be subsumed into the offer of waiver of principal amount, was accepted by the High Court.

Our comments

To recover NPAs i.e. pending loan from borrowers, very often banks/financial institutions settle the same by offering certain loan/interest amount as waiver. Taxation impact of such one time settlement cases have been a subject matter of litigation before Tribunal/Courts.

This is a welcome decision of the Bombay High Court where it has been held that since the waived amount has been offered to tax by the taxpayer, either the interest amount has to be allowed for deduction under Section 43B of the Act or the sum offered for tax (as waived by the bank) has to be reduced by the amount of interest paid.



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