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INTEREST-FREE BORROWERS OUT OF TAX NET

ITAT Ruling Major Boost For Individuals

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IN a first-of-its-kind judgment, the Income Tax Appellate Tribunal (ITAT) recently ruled that a recipient of an interest-free loan from a non-relative is not liable to pay tax. The judgment will come as a major relief for people who borrow money from friends and colleagues and later grapple with notices from tax authorities.

Section 56 (2)(v) of the I-T Act provides for the taxing of any sum of money in excess of Rs 25,000 received without consideration by an individual or a Hindu Undivided Family (HUF) from any source other than a relative; occasions where the recipient is exempted from tax are during a marriage, or in cases where the amount is received under a will, or by way of inheritance or in contemplation of death of the payer.

Applying this section, an income tax assessing officer treated interest-free loans amounting to Rs 54.7 lakh received by one Chandrakant Shah from nonrelatives as a sum without consideration and taxed it. **Assessee shows amount as unsecured loan**

THE assessee approached the Commissioner of IT (Appeals) but was not granted relief. He then appealed before the Mumbai ITAT, where his legal counsel said that the lower authorities had “misinterpreted” the new section, which came into effect on September 1, 2004.

Furthermore, Mr Shah’s counsel stated that the sum of interest-free loans taken by him even before that date (September 1, 2004) did not fall within the ambit of the amended section.

Mr Shah’s counsel, Bhupendra Shah, argued before a division bench comprising Madhavi Devi and VK Gupta that an interest-free loan could not be taxed under Sec 56 (2) (v) as the repayment of a loan itself is treated as consideration between two parties and not a sum without consideration.

Counsel said the amounts were shown in the balance sheet by the assessee as unsecured loan liabilities and hence could not be treated as an addition to capital as in the case of a gift.

Counsel contended that the term “loan” meant delivery by one party to and receipt by another party of a sum of money upon agreement expressed or implied condition, to repay it with or without interest.

He maintained that it was inessential for an interest component to make a transaction of lending of money, a loan transaction, by referring to a decision of the Court of Appeal of State of California. The US court had observed that a loan of money was a contract by which one delivered a sum of money to another and the latter agreed to return at a future time without interest that sum which he borrowed.

The bench upheld the counsel’s argument and said: “We hold that a transaction of loan can be without interest and a transaction of loan implies an agreement to repay the money, ie, borrowed, which also gives reply to the revenue’s query regarding existence of the obligation to repay the money at the time of taking such loan.”

Sec 56 (2) (v) was introduced to fill up the vacuum created by abolition of the Gift Tax Act in 1997, which was donor based, meaning the giver of a gift was taxed. After the abolition, both the donor and the donee were exempt from paying tax, which led to several non-genuine gifts being introduced from non-relatives on a large scale.