



Tax alert: Waiver of deferred sales tax liability on pre-payment, taxable

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The Mumbai Bench of the Income-tax Appellate Tribunal (ITAT) has held that waiver of deferred sales tax liability [in excess of Net Present value (NPV)] holds the character of revenue under section 2(24)(xviii) of the Income-tax Act, 1961 (ITA) and thus, amounts to benefit taxable under section 28(iv) of the ITA.

In a nutshell



The wording used in section 2(24)(xviii) of the ITA 'by whatever name called' encompasses all benefits accrued to taxpayer. That is the intent of the legislature.



The character of receipt in the hands of the taxpayer has to be determined concerning the purpose for which the subsidy is granted. In other words, one has to apply the purpose test. If the object of the subsidy is to enable the taxpayer to run the business more profitably, then the receipt is on the revenue account.



The word 'income' under section 2(24) of the ITA is defined in an 'inclusive' way and not 'exhaustive' which means, unless the receipt is excluded or classified as 'exempt', the same has to be treated as 'income' only and liable to tax.



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Background:

- The taxpayer¹, an Indian company, was given a benefit or incentive by the state government (for setting up an industry in a backward area) by allowing it to keep for a period of 10 years, the sales tax collected from customers. The said amount was to be repaid in subsequent five equal installments.

The state government came out with a 'Scheme of Incentive' wherein they scientifically calculated the Net Present Value (NPV) of sales tax collected. As per the scheme, if the taxpayer prepaid i.e. before five years, they would be paying lesser amount.

The taxpayer, in the current case, opted to repay its sales tax liability at its NPV and credited the amount (i.e. differential value between the amount of sales tax retained by the taxpayer and the amount paid to state government) to profit and loss account on pre-payment of deferred sales tax liability.

- The taxpayer did not offer the differential amount (on pre-payment of deferred sales tax liability) credited to its profit and loss account in the relevant years under consideration viz. i.e. Financial Years (FYs) 2016-17 and 2017-18, corresponding to Assessment Years (AYs) 2017-18 and 2018-19. The same was on the following basis:

The taxpayer contended that no benefit accrued to it at the time of prepayment of deferred sales tax liability at its NPV, because the NPV did not provide any advantage. There was no economic benefit to the taxpayer by opting for prepayment, as it paid the same amount, which was the value of amount payable in future.

- During the course of audit proceedings, the Assessing Officer (AO) invoked section 2(24)(xviii) of the Income-tax Act, 1961 (ITA) [relating to inclusion of assistance from Central or state government in the definition of income] and held the differential value between the amount of sales tax retained by the taxpayer and the amount paid to state government as 'income' of the year under consideration i.e. FYs 2016-17 and 2017-18, corresponding to AYs 2017-18 and 2018-19.
- Aggrieved, the taxpayer filed an appeal and in the course of the appellate proceedings the matter reached before Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

- **Relevant extract of section 2(24)(xviii) of the ITA inserted by the Finance Act, 2015 w.e.f. 1 April 2016:**

"Section 2(24) income includes.....

(xviii) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the taxpayer other than, -

- a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43; or*
- b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be."*

- **Relevant extract of section 28(iv) of the ITA:**

"28. The following income shall be chargeable to income-tax under the head "Profits and gains of business or profession"-.....

(iv) the value of any benefit or perquisite arising from business or the exercise of a profession, whether-

- (a) convertible into money or not; or*

¹ Oricon Enterprises Ltd v. DCIT, (3)(3), Mumbai [ITA No. 2810/MUM/2024] (Mumbai- Trib.)

(b) *in cash or in kind or partly in cash or partly in kind.*”

Decision of the ITAT:

The ITAT acknowledged that the issue under consideration was whether the prepayment of deferred sales tax liability at NPV would get covered under the definition of ‘income’ under section 2(24)(xviii) of the ITA.

In this regard, the ITAT noted as follows:

- As per section 2(24)(xviii) of the ITA, the government intends to tax all types of subsidies, grants, cash incentives, duty drawback, waivers, concessions or reimbursement by whatever name called by the Central or state government.

The wording used ‘by whatever name called’ encompasses all benefits accrued to taxpayer and that is the intent of the legislature.

- The taxpayer opted to repay its sales tax liability during the year under consideration at its NPV and the NPV was arrived at scientifically by the state government. The taxpayer had collected and kept sales tax of say INR 500 for 10 years and repaid (prepaid) only INR 300 as final payment in the year under consideration i.e. no further payment was to be done by the taxpayer. Thus, the taxpayer had got benefit of INR 200 (i.e. INR 500 – INR 300).

The amount of benefit/ assistance / cash incentive as quantified, would come within the ambit of ‘cash incentive’ / concession / by whatever name called by Central Government / state government.

- The taxpayer had the incentive/benefit of keeping the sales tax collected from customers for a period of ten years in the first stage. Now, during the years under consideration, the taxpayer got further benefit/concession of paying lesser amount to the government than the amount collected by the taxpayer.

The taxpayer was paying reduced amounts which is tantamount to benefit/concession only in the years under consideration and hence, benefit accrued to them in these years. The Revenue authorities were correct in treating them to tax in these relevant years.

- As per earlier Supreme Court ruling², the character of receipt in the hands of the taxpayer has to be determined concerning the purpose for which the subsidy is granted. In other words, one has to apply the purpose test. If the object of the subsidy is to enable the taxpayer to run the business more profitably, then the receipt is on the revenue account.

Hence, in the present case, the incentive in the form of reduced NPV, given to taxpayer, was to run its business set up in backward area, in a more profitable way, and to not acquire any asset. Hence, the same was not a capital receipt and was to be treated as revenue receipt only.

- The word ‘income’ under section 2(24) of the ITA is defined in an ‘inclusive’ way and not ‘exhaustive’ which means, unless the receipt is excluded or classified as ‘exempt’, the same has to be treated as ‘income’ only and liable to tax. Reliance was placed on earlier rulings³ in this regard.

Reference to the dictionary meaning of ‘**assistance**’ showed that the taxpayer got ‘assistance’ of government and ‘concession’ by way of reduced payment, to come within the ambit of section 2(24)(xviii) of the ITA.

Thus, the waiver came within the ambit of section 28(iv) of the ITA taxable under the head ‘profits and gains of business or profession’ which states that the value of benefit/perquisite/whether convertible into money or not, arising from business.

² CIT(A) vs. Ponni Sugar and Chemicals Ltd. [2008] 306 ITR 392 (SC)

³ Dooars Tea Company Ltd. vs. CIT [1962] 44 ITR 6 (SC); IT v. G.R. Karthikeyan [1993] 68 Taxman 145/201 ITR 866 (SC); Aero Leather (P.) Ltd. v. Union of India [1993] 67 Taxman 486/194 ITR 7 (Delhi HC)

- Section 2(24)(viii) of the ITA uses the words ‘concession’ and ‘any name called’ to come under this section. The taxpayer got a ‘concession’ from the state government by prepaying the sales tax kept with it, and hence this section was correctly invoked. All the ‘benefits’ by whatever name they are called, will come within the ambit of ‘income’.

In view of the above the ITAT held that the waiver of deferred sales tax liability (in excess of NPV) was a benefit accrued to the taxpayer arising out of its business. Such a waiver held the character of revenue, as per the definition of income under section 2(24)(xviii) of the ITA and was a benefit in the hands of the taxpayer taxable under section 28(iv) of the ITA.

Comments:

There are various incentives provided from time to time by various state governments or the Central Government to taxpayers engaged in certain types of business for various reasons such as improving the economy in a particular industry or area, etc. Such incentives could be in any form, such as duty drawbacks, tax waivers, concessions, etc. There are schemes notified by the Central Government / state governments that provide incentives by way of reimbursement of GST paid, as prescribed. A question generally arises whether such incentives, in any form or type, would be taxable as income in the hands of the taxpayer.

The ITAT in this ruling, based on the facts of the current case wherein sales tax liability was paid at NPV, has upheld the following principles:

- The wording used in section 2(24)(xviii) of the ITA ‘by whatever name called’ encompasses all benefits accrued to taxpayer and that is the intent of the legislature.
- The character of receipt in the hands of the taxpayer has to be determined concerning the purpose for which the subsidy is granted. In other words, one has to apply the purpose test. If the object of the subsidy is to enable the taxpayer to run the business more profitably, then the receipt is on the revenue account.
- The word ‘income’ under section 2(24) of the ITA is defined in an ‘inclusive’ way and not ‘exhaustive’, which means, unless the receipt is excluded or classified as ‘exempt’, the same has to be treated as ‘income’ only and liable to tax.

It is pertinent to note that section 194R of the ITA [relating to withholding tax on benefit/perquisite] has been introduced with effect from 1st July 2022 which states as follows:

“Any person responsible for providing to a resident, any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, by such resident, shall, before providing such benefit or perquisite, as the case may be, to such resident, ensure that tax has been deducted in respect of such benefit or perquisite at the rate of ten per cent of the value or aggregate of value of such benefit or perquisite”.

Taxpayers may evaluate the impact of this ruling and also analyze the impact of the above section to the specific facts of cases.



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