

Govt's interest relief may add to your tax liability

4 min read . Updated: 02 Nov 2020, 09:34 PM IST [Gautam Nayak](#)

Government should clarify its views on the taxability of such cashback at the earliest

The government recently announced a relief scheme for all borrowers of certain types of loans up to ₹2 crore, which were not non-performing assets as of 29 February 2020. The government will pay the borrowers the difference between the compound and simple interest for the period of six months from March to August 2020, as an ex-gratia amount.

The scheme will apply to MSME, education, housing, consumer durable and automobile loans, credit card dues, personal loans to professionals and consumption loans taken from banks, non-banking financial companies, housing finance companies and micro-finance institutions. The amounts would be credited to the borrowers' accounts by the lenders, and reimbursed by the government to the lenders. The government has stated that such payment does not constitute a contractual, legal or equitable liability of the central government. How would such ex-gratia receipt be treated for income tax purposes?

The interest on loans taken for business or profession (such as MSME or automobile loans where the vehicle is acquired for the business) is fully allowable as a deduction for tax purposes. The amount of ex-gratia in such cases would either be regarded as a reduction of the interest expenditure, or as a business or professional receipt. In either case, this would increase the taxable income and, therefore, effectively be taxable as income.

Consumer durable loans, credit card dues, consumption loans and personal loans to professionals (and often auto loans) are normally for personal purposes, and interest on such loans would normally not be deductible in computing your taxable income. Ex-gratia in such cases, therefore, can't be taxed as a salary, business or professional income. The question then arises if it amounts to a part of the interest liability being borne by the government, or it is a gratuitous receipt or a subsidy received by the borrower. If it is a receipt without consideration and exceeds ₹50,000, it would be taxable, as would a subsidy. However, if it is in substance a case of a part of the interest being borne by the government, it would reduce the interest, and would not be taxable. While the better view is that it is a case of bearing of the interest burden by the government, the matter is highly debatable.

As far as education and housing loans are concerned, the interest may be deductible up to certain limits. Therefore, only a part of the interest paid may be deductible. If the cashback is regarded as interest borne by the government, for the purposes of deduction, it is only the net interest that

should be considered as having been paid. This may or may not increase the taxable income, by impacting the amount of deduction for interest being claimed, depending upon the limit on the amount of deduction, the gross interest paid and the cashback amount. For instance, the limit on the deduction for housing loan interest for a self-occupied property is ₹2 lakh. If the gross interest paid on the housing loan is ₹2.5 lakh, while the cashback is ₹10,000, since both the gross and net interest exceed ₹2 lakh, the deduction remains unchanged at ₹2 lakh. However, if the gross interest is ₹1.8 lakh and the cash back is ₹10,000, the deduction would be lower at ₹1.7 lakh, increasing the taxable income by ₹10,000.

On the other hand, if the cashback is regarded as a subsidy or as an amount received without consideration, the entire cashback would be taxable as income, while only a part of the gross interest may be deductible. This would increase the taxable income. Considering one of the examples mentioned earlier, if gross interest is ₹2.5 lakh, the entire cashback of ₹10,000 would be treated as taxable income, while the deduction for housing loan interest would remain unchanged at ₹2 lakh, with an increase in taxable income of ₹10,000. If the gross interest is ₹1.8 lakh, there would be no change in the deduction for interest, while ₹10,000 cashback would be taxable as income.

Therefore, such cashback is not an unmixed blessing, and may be accompanied by certain tax obligations. Would it be a case of the government giving with one hand and taking back (partially) with the other? In the case of LPG subsidy, which is also a situation of the government meeting a part of the cost of a personal nature, the government had clarified that it would not be taxable, though such subsidy may otherwise have been taxable as the income of the recipient. The government should clarify its views on the taxability of such cashback at the earliest. This will enable taxpayers to decide whether to treat it as a taxable item of income or not, and facilitate payment of the proper amount of advance tax, the next instalment of which falls due on 15 December.

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