आयकर अपीलीय अधिकरण “सी” न्यायपीठ पुणे में ।
IN THE INCOME TAX APPELLATE TRIBUNAL “C” BENCH, PUNE

(Through Virtual Court)

BEFORE SHRI R.S.SYAL, VP AND
SHRI PARTHA SARATHI CHAUDHURY, JM

आयकर अपील सं. / ITA No. 772/PUN/2018

निर्धारण वर्ष / Assessment Year : 2013-14

M/s. Amanora Future Towers Pvt. Ltd.
917/9A, City Chambers, FC Road,
Shivajinagar, Pune-411004
PAN : AAKCA3074H

.......अपीलार्थी / Appellant

बनाम / V/s.

The Deputy Commissioner of Income Tax,
Circle-1(1), Pune.

......प्रत्यर्थी / Respondent

Assessee by	:	Shri Chetan A. Karia & Shri Suhas P. Bora
Revenue by	:	Shri Sangram Gaikwad

सुनवाई की तारीख / Date of Hearing	:	17.12.2020
घोषणा की तारीख / Date of Pronouncement	:	18.12.2020

आदेश / ORDER

PER PARTHA SARATHI CHAUDHURY, JM:

This appeal preferred by the assessee emanates from the order of the Ld. CIT(Appeals)-13, Pune dated 21.03.2018 for the assessment year 2013-14 as per the following grounds of appeal on record.

"*The Appellant would like to object to the impugned order of the Hon Commissioner of Income Tax Appeal-13, Pune on the following grounds of Appeal, which are raised without prejudice to each other on the facts and in law.*

1. *The learned Commissioner of Income Tax Appeal - 13, Pune erred in confirming an addition of Rs.16,88,23,507/- u/s.92CA on the basis of the order passed by the learned TPO by disallowing the interest paid by the Assessee company to its AEs treating this as a shareholder's activity.*

2. *The learned Commissioner of Income Tax Appeal -13, Pune erred in holding that the real character of the debentures issued by the Assessee company to its AEs was equity and not debt and the Assessee had adopted a colourable device and hence, the ALP of the interest paid on such debentures was to be determined at Rs. NIL.*

3. *The learned Commissioner of Income Tax Appeal -13, Pune erred in holding that the debentures issued by the Assessee company to its AEs was in substance investment in equity by the AEs and hence, the Assessee company was not required to pay any interest on these debentures and accordingly, the learned Commissioner of income Tax Appeal- 13, Pune erred in confirming the entire interest expenditure of Rs 16,88,23,507/-.*

4. *The learned Commissioner of Income Tax Appeal -13, Pune failed to appreciate that the interest paid at 17.5% to the AEs on the debentures issued was at ALP and hence, there was no reason to make any adjustment in respect of the said interest paid by the Assessee company.*

5. *The learned Commissioner of Income Tax Appeal -13, Pune erred in holding that the Arm's length Price(ALP) of the interest paid by the Assessee company to its AEs was Rs. NIL and thereby, erred in making an adjustment of Rs.16,88,23,507/-.*

6. *Without considering law and ignoring the relevant facts & circumstances of the matter under consideration, in it's true sense, The Learned Commissioner of Income Tax (Appeal-13), Pune has erred in confirming the addition of Rs.16,88,23,507/- in respect of interest on debentures, paid to IIRF (Cyprus) V Holding Ltd (i.e. international transaction) amounting to Rs.8,24,26,247/- and City Corporation Limited (i.e. domestic transaction) amounting to Rs 8,63,97,259/-.*

7. *The Appellant urges herewith that, any unjust in this matter will cause Irreparable loss of Appellant.*

8. *The Appellant prays for admission of Additional grounds /additional evidence if any required to support the case.*

9. *The appellant craves to leave or add, amend or alter any of the grounds for appeal. In view of all these and other grounds which may be produced during the hearing of appeal the appeal, may be allowed and justice rendered"*

2. At the very outset, the Ld. Counsel for the assessee submitted that the multiple grounds of appeal taken in this appeal cater to two main issues **(i)** grounds pertain to treatment of optionally and Compulsory Convertible Debentures issued by the assessee company as Equity Share Capital and **(ii)** determination of ALP of the assessee company.

3. The brief facts of the case are that the assessee is a domestic company in which public is not substantially interest and engaged in the business activities of Real Estate projects. The assessee company is developing a township a township projects named as Future Tower at Amanora, Pune. The project consists of developing of residential apartments and size of project is around 15 lakhs Sq. Ft. The assessee filed return of income declaring loss of (-) Rs.2,43,92,018/-. The case was selected for scrutiny and assessment was completed u/s.143(3) r.w.s. 144C(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'). The Assessing Officer made a disallowance of debenture interest of Rs.16,88,23,507/- in respect of debentures issued to IIRF (Cyprus) V Holding Ltd. (i.e. international transaction) amounting to Rs.8,24,26,247/- and City Corporation Limited (i.e. domestic transaction) amounting to Rs.8,63,97,259/- based on the order passed by the Transfer Pricing Officer (TPO). The TPO made upward adjustment of interest paid on debentures amounting to Rs.16,88,23,507/- holding that the debentures issued by the assessee are in essence Equity and no interest is payable on the same. The assessee is a subsidiary of City Corporation Limited and was incorporated on 29.02.2012 for a specific project in Amanora Township called Amanora Future Towers. During the year the shareholding structure of the assessee company is as follows:

Sr. No.	Name	Consideration charged/paid for issue of Equity Share	Consideration charged/paid for compulsorily convertible debentures	Interest paid on Debenture
1	*M/s. City Corporation Limited*	*4,08,000 Number of shares for total consideration of Rs.2,00,00,000 (i.e. 51% of shareholding)*	*53,00,00,000*	*8,63,97,260/- (Covered under Specific domestic transaction)*
2	*IIRF India Realty XXIV Ltd.*	*3,89,256/- Number of share for total consideration of Rs.58,66,47,718/- (i.e. 48.66% of share Holding)*	*Nil*	*Nil*
3	*IIRF (Cyprus) V Holding Limited.*	*Nil*	*50,56,40,000*	*8,24,26,247/- (Covered under international transactions)*

4. That with regard to the issue pertains to treating optionally and Compulsorily Convertible Debentures as Equity Share Capital, the Ld. Counsel for the assessee submitted that this issue is covered by the decision of the Pune Bench of the Tribunal in the case of M/s. Kolte Patil Developers Ltd. Vs. DCIT in ITA No.1980 & 2111/PUN/2017 dated 08.12.2020 for the assessment year 2013-14 in favour of the assessee.

5. The Ld. DR conceded to these submissions made by the Ld. Counsel for the assessee.

6. We have perused the relevant documents on record and heard the rival contentions. We have also considered the judicial pronouncement placed before us. We find that the Pune Bench of the Tribunal in **ITA No.1980 & 2111/PUN/2017** (supra) had an occasion to deal with these issues. The relevant paragraphs of the said decision are extracted for the sake of completeness as follows:

"5. We have heard the rival submissions through the Virtual Court and scanned through the relevant material on record. The issue espoused by the Revenue currently under consideration is against the reversal by the ld. CIT(A) of the view of the AO/TPO in treating the transactions of issue of OCDs and CCDs into Equity capital. Central facts leading to the dispute are that the assessee was in need of funds because of certain on-going projects on a large scale basis. It issued OCDs to KPDL and CCDs to Lobrenco Ltd. in 2009 and continued to pay interest @15% thereon. KPDL holds 50.01% shares in the assessee company and Lobrenco Ltd. is a subsidiary of Portman holdings (Hyderabad) Ltd., which, in turn, holds remaining 49.99% of the assessee's equity. CCDs issued to Lobrenco Ltd. were purchased by KPDL in January, 2013 and thereafter the same were converted into Non-convertible debentures and ultimately redeemed. The OCDs issued to KPDL were not converted into equity shares and were redeemed by the assessee in January, 2013. Thus, the debentures issued by the assessee to both the related parties were never converted into equity and stood redeemed as such. The case of the TPO is that OCDs/CCDs issued by the assessee to its AEs were in true nature of equity shares. Their depiction as debentures and not as shares, in the opinion of the TPO/AO, was aimed at screwing the tax bill by claiming deduction of interest on debentures. On page 9 of his order, the TPO relied on the Thin capitalization and the GAAR rules to support his point of view.

6. At this juncture, it is pertinent to note that both the borrowing and raising of equity share capital are well recognized modes of funding business requirements. Every businessman has to take several circumstances into consideration before deciding as to whether he needs to borrow or issue capital. There is no legal bar in accepting loans from shareholders/related concerns in the same way in which it is open to issue fresh shares to its existing lenders who are non-shareholders. Thin capitalization is a state of financial position of a company in which proportion between its capital and borrowings is unevenly poised towards debts. Thin capitalization can also be loosely called as thick borrowings. There are advantages and disadvantages of both the streams of funding, namely, capital and debts. However, in tax regime, their consequences are varying. Por una parte, a debt entails its service by interest, which is deductible in the computation of total income of payer, por otra parte an equity requires its service by payment of dividend, which is not only an application of income and hence not deductible but also requires the payer company to pay dividend distribution tax. The BEPS Action plan 4 notified the device of thin capitalization as a measure adopted by some related companies to erode taxation base from the concerned countries by unnecessarily opting for borrowings rather than capital so as to reduce its burden of taxation. Giving effect to the BEPS Action plan 4 and with an aim to reduce the needless claim of deduction of interest, India has introduced thin capitalization rule for the first time by means of a direct provision in the shape of section 94B by the Finance Act, 2017. This section provides a limit of deductible interest at 30% of earnings before interest, taxes, and depreciation where payment of interest exceeds Rs.1.00 crore. In the pre-insertion era, there was no direct statutory provision for making any transfer pricing adjustment on this score. Side by side, Chapter X-A of the Act containing GAAR has also been made applicable from the 1st day of April, 2018. Starting with a non-obstante clause, section 95(1) provides that an arrangement entered into by an assessee may be declared an impermissible avoidance arrangement and the consequence in relation to tax arising therefrom may be determined subject to the provisions of this Chapter. An Impermissible Avoidance Arrangement (IAA) has been defined in section 96(1) of the Act to mean an

arrangement, the main purpose of which is to obtain a tax benefit in certain situations subject to certain conditions. One of the requisites of an IAA is an arrangement lacking commercial substance, which has further been explained in section 97. Clause (a) of section 97(1) states that an arrangement shall be deemed to lack commercial substance, if `the substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part'. In other words, where the form of an arrangement differs from its substance, it can be declared as IAA. Similarly clause (d) states that an arrangement shall be deemed to lack commercial substance, if `it does not have a significant effect upon the business risks or net cash flows of any party to the arrangement apart from any effect attributable to the tax benefit that would be obtained (but for the provisions of this Chapter).' On declaring an arrangement as IAA, the consequences, as set out in section 98 follow, as per which the transaction can be, inter alia, recharacterized. It is apposite to note that the AO cannot simply at his sweet will declare a transaction as an IAA. There is a strict procedure enshrined in section 144BA, which needs to be followed for taking recourse to the GAAR. Thus it is overt that the legislation has been provided with teeth to tackle the excess payment of interest in case of transactions of borrowing and lending between two associated enterprises specifically with section 94B and generally with the GAAR. However, it is pertinent to note that both these provisions have been brought in the statute prospectively w.e.f.1.4.2018. The TPO, for treating the assessee's debt as equity, drew support from the assessee's debt equity ratio in the light of the RBI's debt equity ratio for ECBs. However, section 94B, even after insertion at a later point of time, does not prescribe any debt equity ratio as a thin capitalization rule, thereby rendering the action of the TPO meritless. Whatever is not prohibited under the Act - generally or specifically - is impliedly permissible. In the absence of any existing provision under the Act at the relevant point of time, the TPO could not have ventured to recharacterize the transaction of debt into equity.

7. At this stage, it is befitting to note that there are different thin capitalization rules adopted by various countries depending upon host of factors, including their financial requirements. Whereas, some countries like Austria provide for a specific debt equity ratio (4:1) only as a thin capitalization rule, others like Norway and Poland only limit the amount of interest on debts not exceeding a particular percentage of earnings before interest, taxes and depreciation etc. if deduction on account of interest exceeds a particular amount. While still some others countries like Denmark have a combination of both the debt-equity ratio as well as a cap on the deductibility of interest subject to maximum of certain percentage of a defined base, such as, profit before interest and depreciation etc. India has enshrined thin capitalization rule u/s 94B by providing a limit on the amount of deductible interest at 30% of earnings before interest, taxes, depreciation, where payment of interest exceeds Rs.1.00 crore. India has chosen not to statutorily provide any debt equity ratio as a thin capitalization rule.

8. The TPO in the extant case made a transfer pricing adjustment by disallowing the interest paid to the related concerns. Here it is pertinent to mention that Chapter–X of the Act having, inter alia, transfer pricing provisions is a special anti-avoidance tax measure. It mandates computing income of an assessee from the transactions with related parties at arm's length. Section 92 of the Chapter, which is the first section begins with sub-section (1) providing that: ` Any income arising from an international transaction shall be computed having regard to the

arm's length price.' Computation of arm's length price has been set out in section 92C. Sub-section (1) of this section states that: ` The arm's length price in relation to an international transaction or specified domestic transaction shall be determined by any of the following methods.....'. Throughout the Chapter there is a focus on determining the arm's length price of the international transaction, as has been entered. In other words, if transaction X has been entered at price A, then the emphasis is on ascertaining if the price A is at arm's length by finding suitable comparables. There is no mandate for changing the colour of transaction from X to Y. This Chapter does not call for redetermining the nature of transaction in a way different from what has been actually entered into between two related enterprises. It simply requires redetermining the price of the transaction actually entered into. Thus, save and except a case falls within the purview of specific or general tax avoidance provision, the authorities cannot dub a genuine transaction as sham or anti-avoidance and proceed to disregard or recharacterize the same.

9. Reverting to the facts of the case it is seen that the assessee issued debentures to its AEs, which were eventually redeemed. The TPO/AO changed the complexion of the transaction from borrowing to equity by resorting to the Thin capitalization rule and the GAAR. We have noticed supra that section 94B containing specific thin capitalization rules and GAAR came into force w.e.f. 1.4.2018. The assessment year under consideration is 2013-14. Obviously, these provisions are not applicable and resultantly the TPO could not have altered the form of the transaction. Our view is fortified by the judgment dated 30.08.2012 of the Hon'ble jurisdictional High Court in DIT(IT) vs. M/s Besix Kier Dabhol SA (ITA No. 776 of 2011), copy placed at page 1 of the paper book laying down that the Tribunal was right in holding that in the absence of any specific thin capitalization rules in India, the AO could not disallow the interest payment on debt capital after having observed the abnormal thin capitalization.

10. The TPO has also harped on the concept of `Shareholder activity' and dubbed the financing by the AEs as a shareholder activity. For this proposition, he relied on definition of the term `Shareholder activity' given in the OECD Guidelines, 2010 that has been reproduced at page 8 of his order. The definition refers to an activity that a group member (usually Parent Company or Regional Holding Company) performs solely because of its ownership interest in one or more group members, i.e. in its capacity as shareholders. Thereafter, para 7.10 of the OECD guidelines 2010 gives certain examples constituting shareholding activity, some of which have been quoted by the TPO as under :

" (a) Costs of activities relating to the juridical structure of the parent company itself, such as meetings of shareholders of the parent, issuing of shares in the parent company and costs of the supervisory board;

(b) Costs relating to reporting requirements of the parent company including the consolidation of reports;

(c) Costs of raising funds for the acquisition of its participations."

11. On going through the ambit of "Shareholder activity" as given in the OECD guidelines on a general perspective, it becomes imminent that these activities are in the nature of certain acts performed by a parent company SOLELY because of its shareholding in other group companies, which is obviously not the case here. Then the TPO has listed 3 examples of the activities constituting shareholder activities albeit the OECD

guidelines outline 5. We will limit ourselves in examining the shareholding activity from the TPO's point of view only with the help of 3 examples that he has quoted.

12. The first activity relates to juridical structure of the parent company such as conducting shareholders' meetings and cost of supervisory board. Second example is anent to reporting requirements of the parent company including the consolidation of reports. These two activities are obviously not relevant in the present context. The third activity talks of costs of raising funds for the acquisition of its participations. This applies where a parent company borrows money for introducing equity in another group concern. This example also is far away from the situation under consideration because here the AEs of the assessee have not borrowed any money for investing in the shares of the assessee company but the assessee company has borrowed money from its related enterprises through debentures. Ex consequenti, it is simple and plain that the transaction of subscribing by the related companies to the debentures issued by the assessee does not fit into the description of a "Shareholder activity". Thus, the view point canvassed by the TPO in this regard cannot be countenanced.

13. In the like manner, the ld. DR has referred to Securities Subscription Agreement dated 16-10-2009 to accentuate the point that Lobrenco Ltd. has been referred to in this Agreement as "Investor". In his opinion, the nomenclature used for describing Lobrenco Ltd. in the Agreement depicts the intention of the parties to consider Lobrenco Ltd. as Investor in shares. This argument is sans merits. Primarily, the term "Investor" from the stand point of the person investing does not confine itself to investment in shares only but equally to debentures also. Secondly, hardly any authority is needed to emphasize that nomenclature given in any agreement cannot be decisive of the true nature of the transaction.

14. It is interesting to note that both the authorities as well as the rival counsel have heavily relied on the judgment of Hon'ble Delhi High Court in the case of EKL Appliances Ltd. (supra) for buttressing their respective points of view, viz., the TPO/AO as well as the ld. DR for justifying the recharacterization of the transaction and the ld. CIT(A) and the ld. AR for otherwise. Let us examine that case in a little more detail. The assessee in that case made payment of Brand fee/Royalty to its Sweden Associate Enterprise. The TPO observed that the assessee was incurring huge losses year after year. Considering such perpetual losses, the payment of Royalty to the AE was held to be not justified more so because the Technical Knowhow/Brand fee did not accord any benefit the assessee. The order of the AO was reversed by the Tribunal. When the Revenue brought the matter finally before the Hon'ble High Court for consideration, their Lordships accorded their imprimatur to the Tribunal order by observing that Rule 10B(1)(a) did not authorize disallowance of any expenditure on the ground that it was not necessary or was un-remunerative. That is how, the Hon'ble High Court set to naught the rule of `necessity' resorted to by the authorities for making the disallowance. In the passing, it also dealt with the transfer pricing guidelines issued by the OECD providing for recharacterization of transactions only in two exceptional circumstances. Insofar as the issue before the Hon'ble High Court on transfer pricing addition was concerned, that was not made by the AO/TPO on recharcterizing the transaction of payment of brand fee/royalty. Thus the ratio decidendi of the decision is that the AO/TPO cannot determine Nil ALP of a transaction of payment of an expenditure by holding that the assessee-company did not require the service etc. for which payment was made as expenditure. On the other hand, the discussion regarding OECD transfer pricing guidelines is obiter dictum.

15. Now we turn to the obiter in the case of EKL Appliances (supra) at a little length. The general rule is to recognize the actual transaction undertaken as such and not to rewrite it. The first exception is where the economic substance of a transaction differs from its form. An example of it, as given in the Guidelines is: 'an investment in an AE in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way.' In such a case, the tax administration can recharacterize the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. The focus of the Revenue in the instant case is on such first exception. It goes without saying that the obiter of a judgment of a higher forum also needs utmost respect. The first exception, which the ld. DR has vigorously accentuated, applies where the amount is, in fact, taken as equity but because of close relation between the assessee and its lender, the same has been reflected in the accounts as a borrowing or vice-versa so as to take home some tax advantage. It is in such circumstances that the apparent transaction of loan can be altered so as to bring on record the real or intended transaction of equity. It does not say that in all cases of borrowings made from related entities, it must be invariably taken as equity. If a certain sum of money was understood and accepted as a loan and also reflected in the same way, the case will not fall within the ambit of the first exception. On the facts of the extant case, we find that there is no difference in the form and substance of the transaction. The amount was raised through debentures, reflected in the same way in its accounts and then such debentures also got redeemed by the assessee company. The position would have been different, if the assessee had taken the amount as equity but reflected it only as a debenture and also eventually converted into equity after some time. All the cases relied by the Department fall in such category where the amounts were, in fact, taken as equity but not declared as such and the intention behind the apparent transaction got unearthed due to surrounding circumstances. On the other hand, we are confronted with a situation in which the assessee was in need of funding for its ongoing projects. It took loan through debentures, which were eventually redeemed. So the instant case falls in the general provision of accepting the transaction as such and not in the exception requiring recharacterization of the transaction of debt into equity. De hors the provisions of section 94B and the GAAR in the period anterior to their applicability, the obiter in the case of EKL Appliances (supra) also supports the view canvassed by the ld. CIT(A) in not approving the recharacterization of the transaction of debt into equity. Thus, the first issue raised by the Revenue in its appeal is determined against it."

7. The parties herein have agreed that the issue stands covered in favour of the assessee and after analyzing this issue and perusing the findings of the Pune Bench of the Tribunal, we allow these grounds of appeal of the assessee. Thus, **grounds pertaining to treatment of optionally and Compulsory Convertible Debentures issued by the assessee company as Equity Share Capital are allowed.**

8. With regard to the ground for "determination of Arm's Length Price (ALP) of the assessee company", we are of the considered view after analyzing the relevant documents on record, going through the orders of the sub-ordinate Authorities that the ALP of the assessee has to be freshly determined and in view thereof, we set aside the order of the Ld. CIT(Appeals) on this matter and restore the issue to the file of TPO/AO for fresh determination of ALP of the assessee after complying with the principles of natural justice. Thus, **the ground of appeal raised by the assessee is allowed for statistical purposes.**

9. In the result, **appeal of the assessee is partly allowed for statistical purposes.**

Order pronounced on 18th day of December, 2020.

Sd/- **R.S.SYAL** **VICE PRESIDENT**	Sd/- **PARTHA SARATHI CHAUDHURY** **JUDICIAL MEMBER**

पुणे / Pune; दिनांक / Dated : 18th December, 2020.
SB

आदेश की प्रतिलिपि अग्रेषित / Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant.
2. प्रत्यर्थी / The Respondent.
3. The CIT(Appeals)-13, Pune.
4. The Pr. CIT-5, Pune.
5. विभागीय प्रतिनिधि , आयकर अपीलीय अधिकरण, **"सी"** बेंच, पुणे / DR, ITAT, "**C**" Bench, Pune.
6. गार्ड फ़ाइल / Guard File.

आदेशानुसार / BY ORDER,

// True Copy //

निजी सचिव / Private Secretary
आयकर अपीलीय अधिकरण, पुणे / ITAT, Pune.

		Date	
1	Draft dictated on	17.12.2020	Sr.PS/PS
2	Draft placed before author	17.12.2020	Sr.PS/PS
3	Draft proposed and placed before the second Member		JM/AM
4	Draft discussed/approved by second Member		AM/JM
5	Approved draft comes to the Sr. PS/PS		Sr.PS/PS
6	Kept for pronouncement on		Sr.PS/PS
7	Date of uploading of order		Sr.PS/PS
8	File sent to Bench Clerk		Sr.PS/PS
9	Date on which the file goes to the Head Clerk		
10	Date on which file goes to the A.R		
11	Date of dispatch of order		