Desai Saksena & Associates

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Friday Tax Alert

From:

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Mumbai Tax Tribunal holds that the premium on redemption of Non-Convertible Debentures is taxable as Interest and not Capital Gains

In recent years, a multitude of financing avenues have surfaced, adapting to the evolving demands of the economy. Among these, debt instruments such as corporate bonds, convertible debentures and Non-Convertible Debentures (NCD) are a prevalent mode for capital infusion. These instruments, with little differentiation in their characteristics, have given rise to complexities in their tax treatments. NCD may be issued at face value or discount but redeemed at premium or face value. While the Central Board of Direct Taxes (CBDT) has issued a Circular to clarify on taxability of Deep Discount Bonds, a question may arise as to the taxability of NCDs which are issued at face value but redeemable at a premium. In this regard, recently, the Mumbai Tax Tribunal had an opportunity to analyse the tax treatment on redemption of non-convertible debentures.

FACTS OF THE CASE:

a. An individual taxpayer, director of Capricorn Realty Ltd, owned certain 0% NCDs of Bhishma Realty Ltd (BRL) and Capricorn Realty Ltd (CRL).
b. BRL and CRL were offshoots from the Rehabilitation Scheme sanctioned by the Board for Industrial and Financial Reconstruction (BIFR) in the case of Hindoostan Spinning and Weaving Mills Ltd (HSWML) which was declared as a sick unit under the Sick Industrial Companies (Special Provisions) Act, 1985.
c. The taxpayer had acquired these NCDs in FY 2006-07 from the nationalised banks (being secured lenders of HSWML) who had subscribed to these NCDs for an aggregate consideration of INR 37.347 million.
d. In October 2010, the NCDs were redeemed at INR 64.997 million. The taxpayer invested the maturity proceeds in the purchase of a flat (agreement entered on 31 July 2012) under construction and in REC bonds.
e. While filing an income tax return for FY 2009-10, the taxpayer offered the gain of INR 27.65 million [INR (64.997- 37.347) million] as long-term capital gains (LTCG) and claimed exemption of INR 26.594 million under section 54F and 54EC of the IT Act.
f. The Tax Officer observed that the taxpayer had not received the possession of the flat within the prescribed period of three years.
g. Further, the Tax Officer observed that the profit obtained by the taxpayer on redemption of NCDs was in the range of 18.92% to 31.37%, while the rate of return of Mutual funds worked to 11.5% to 18% only. Therefore, the tax officer opined that the entire arrangement of the issuance of NCDs by the related companies and redemption thereof appeared to be a make-believe arrangement with an intent to shift profits to the taxpayer.
h. In light of this, the tax officer denied exemption and thereby brought the gains to tax.
i. The First Appellate Authority was of the view that the difference between the maturity proceeds and the cost of NCDs is taxable as interest income. Hence, it did not consider the question of allowing exemption under sections 54F and 54EC of the IT Act.
j. Aggrieved, the taxpayer filed an appeal before the Mumbai Tax Tribunal.

MUMBAI TAX TRIBUNAL RULING

The Mumbai Tax Tribunal held that the premium received by the taxpayer on redemption of NCDs is chargeable to tax under the head 'Income from Other Sources' and not 'Capital Gains'.

The NCDs are privately placed and not listed on the stock exchange. Further, the taxpayer has not sold the NCDs in the open market but only surrendered them to the issuer Company for redemption. Therefore, it is a case of money advanced by a creditor since debentures are debt instruments only. Thus, the question of capital gains will not arise when the debentures are redeemed by the issuing companies. Further, whatever is received by the taxpayer in the form of a premium is nothing but interest income only.

[Khushaal C. Thackersey v. ACIT (ITA No. 3679/Mum/2015) (Mumbai Tax Tribunal)]

Exemption u/s 54 allowable even if sale deed wasn't registered if assessee had executed agreement to sale: Ahmedabad ITAT

FACTS OF THE CASE:

Assessee filed its return of income for the relevant assessment year and declared long-term capital gains (LTCG) arising from the sale of a property. During the assessment proceedings, the Assessing Officer (AO) observed that the assessee did not purchase any residential property against the capital gain arising from the sale of the property. Accordingly, he disallowed the deduction claim under Section 54 of the Income Tax Act and added the same to Long Term Capital Gain.

Aggrieved by the order, the assessee preferred an appeal to the CIT(A). The CIT(A) dismissed the appeal and the matter reached the Ahmedabad Tribunal.

AHMEDABAD TAX TRIBUNAL RULING:

The Tribunal held that the assessee showed consideration in his return of income under Capital Gain. The assessee made an investment in new residential property, paid full consideration for the property, and took possession of it. The assessee furnished the bank statement and Municipal Tax bill, which specifically showed the assessee's name as the occupier. The payment of Municipal Tax and the bill to that extent is sufficient evidence of possession by the assessee.

The observation of the AO that the deed of conveyance must be duly stamped and registered by law will support the conduct of the assessee regarding the actual consideration paid by the assessee as well as the investment made by the assessee in the relevant Assessment Year and which is duly reflected in the return of income as well as books of the assessee.

Further, in *Sanjeev Lal v. CIT, 365 ITR 389*, the Supreme Court ruled that if an assessee executes an agreement to sell a house and buys a new residential property within a year of that agreement and the sale deed is delayed due to an order by a competent authority, a valid transfer under Section 2(47) of the Act is recognized.

Thus, the assessee was eligible for exemption under Section 54 of the Act for purchasing the new property, provided other conditions were met. *[Umesh Sumanlal Shah vs. Income Tax Officer - [2024] 163 taxmann.com 578 (Ahmedabad - Trib.)]*

If the taxpayer does not file an objection to the draft order before the DRP, the final order is not appealable before the Hon'ble Tax Tribunal - Hon'ble Hyderabad Tax Tribunal.

FACTS OF THE CASE:

a. The taxpayer is engaged in the business of software development and its ancillary services.

b. The taxpayer's case was selected for scrutiny for Assessment Year (AY) 2021-22. Subsequently, reference was made to the TPO to determine the ALP for transactions with AEs. The TPO proposed an upward adjustment to the taxpayer's income in the Draft Assessment Order (DAO).

c. The taxpayer was given 30 days to either accept the proposed adjustment or file objections with the Dispute Resolution Panel (DRP). However, no communication was received from the taxpayer within the stipulated timeframe. Accordingly, the Final Assessment Order (incorporating the Transfer Pricing adjustment) was passed under Section 143(3) read with Sections 144C(3) and 144B of the Act.

d. Aggrieved, the taxpayer filed an appeal before the Hon'ble Tax Tribunal. The Revenue contended that the order was not appealable before the Hon'ble Tax Tribunal as it was passed by the Assessing Officer (AO) on account of the obligation cast by virtue of Section 144C(3) of the Act, and not pursuant to any directions issued by the DRP. The taxpayer contended that the DAO passed by the AO was in pursuance of the directions issued by the DRP, therefore the appeal before the Hon'ble Tax Tribunal is maintainable.

HYDERABAD TAX TRIBUNAL RULING:

a. The provisions of Section 144C(2), 144C(3), and 144C(5) of the Act clearly mandate that, in case the taxpayer fails to raise any objection against the DAO, the assessment order is to be issued.
b. Section 253(1)(d) of the Act clearly postulates the right of the taxpayer to file an appeal before the Hon'ble Tax Tribunal in case, the AO passes any order pursuant to the directions of the DRP.
c. In the present case, the order passed by the AO was not on account of any direction of DRP but was passed on account of the obligation under Section 144C(3) of the Act.

d. Therefore, no appeal lies against such an order before the Hon’ble Tax Tribunal and the same is required to be dismissed.

The Hon’ble Tax Tribunal granted liberty to the taxpayer to file any other petition/ appeal before any forum or authority or Hon'ble High Court. [Skybridge Solutions Private Limited [TS-178- ITAT-2024(HYD)-TP]