IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'I-1' BENCH, NEW DELHI

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND MS. SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No. 1459/DEL/2016
[A.Y 2011-12]
&
ITA No. 263/DEL/2016
[A.Y 2012-13]

Cairn India Ltd., DLF Atria Building, Jacaranda Marg, N Block, DLF City Phase II, Gurgaon.	Vs.	The A.C.I.T, Circle-1(1), Gurgaon.

[PAN: AACCC 8799D]

[Appellant] [Respondent]

Date of Hearing : 17.10.2018
Date of Pronouncement : 24.10.2018

Assessee by : Shri Ajay Vohra, Sr. Adv
Shri Ravi Sharma, Adv

Revenue by : Shri Srinivasa Rao, Sr. DR

ORDER

PER N.K. BILLAIYA, ACCOUNTANT MEMBER,

The above two appeals by the assessee preferred against two separate orders dated 12.01.2016 and 12.01.2017 framed u/s 143(3) r.w.s 144C(4) of the Income-tax Act, 1961 [hereinafter referred to as

'the Act]' pertaining to A.Y 2011-12. Since both these appeals were heard together, they are being disposed of by this common order for the sake of convenience and brevity, though the quantum may differ.

2. The common grievance in both these appeals relates to the addition being Arm's Length Interest on Redeemable Preference Shares [RPS] on Cairn India Ltd recharacterized as unsecured loan/advance to the AE.

3. In the first round of litigation, the Tribunal in ITA No. 1459/DEL/2016 has restored this issue to the file of the Assessing Officer/TPO for deciding it afresh in conformity with the view of the higher appellate authority for the preceding year available before them at the time of decision. The findings of the Tribunal read a under:

> "79. The next challenge in this appeal is to an addition of Rs.154,53,28,255/-, being, arm's length interest on redeemable preference shares of Cairn India Ltd. re-characterised as unsecured loan advanced to the AE. Facts apropos this ground are that during the Financial year 2009-10, the assessee invested in 1,75,560 Redeemable preference shares of face value of GBP 1000 each of Cairn India Holding

Ltd. (CIHL). Total investment of Rs. 1343,76,37,000/- was made in the Jersey based 100% subsidiary of the assessee by way of the preference shares. CIHL is an Investment company. The Preference shares were carrying 0% coupon rate and the assessee stated in its TP study report for the Financial year 2009- 10 that CIHL did not declare dividend on any category of share capital ITA No.1459/Del/2016 including the Redeemable preference shares. While determining the ALP of the international transactions for the assessment year 2010-11, the TPO re-characterised the investment in Redeemable preference shares as unsecured loan advanced to CIHL. Interest @ 14.88% was treated as arm's length rate which should have been charged on such re-characterised transaction. Resultantly, a transfer pricing adjustment of Rs.84,36,33,259/- was made in the preceding year.

80. Adopting the view taken for the immediately preceding assessment year, the TPO for the instant year also charged interest @ 11.69% on the re-characterised investment in redeemable preference shares as deemed loan. This resulted into the instant transfer pricing addition. The assessee remained unsuccessful before the DRP and the AO made such addition in the computation of income under the normal provisions. The assessee is aggrieved against such addition.

81. We have heard both the sides and perused the relevant material on record. It is noticed that the origin of the instant addition is from the proceedings for the immediately preceding year, in which the transaction of investment in redeemable preference shares in the ITA No.1459/Del/2016 assessee's 100% subsidiary company was re-characterised as loan. On a specific query, it was stated that the order of the AO making such addition for the preceding assessment year is still pending in appeal before the CIT(A) and there is no finality to the issue. Since the instant transfer pricing addition has its foundation in the immediately preceding assessment year in which re-characterisation of the transaction of investment in Redeemable preference shares was done, we are handicapped to independently decide the issue before us unless the preceding year on the same issue is decided. It is for the reason that if the re-characterization is held to be valid, then the addition will be required to be made in this year as well. If on the other hand, the re-characterization is held to be invalid, this addition will have to be deleted. Under these circumstances, we set aside the impugned order on this issue and remit the matter to the file of AO/TPO for deciding it afresh in conformity with the view of the higher appellate authority for the preceding year, available before them at the time of decision. Needless to say, the assessee will be allowed a reasonable opportunity of being heard in such proceedings."

5. The quarrel travelled upto the Hon'ble High Court of Delhi and the Hon'ble High Court in ITA No. 310 of 2018 held as under:

> "7. The last question urged by the assessee is with respect to the investment in redeemable preference shares that was treated as international transaction and subjected to adjustment. The Tribunal remitted the matter for fresh consideration by the Assessing Officer (AO) after decision of the CIT(A) on that issue in respect of pending appeal for AY 2010-11; the present appeal pertains to AY 2011-12.
>
> 8. This Court is of the opinion that the Tribunal need not have felt constrained by the pendency of appeal (for another year before the CIT (A)) and could have proceeded to decide the issue on merits since it did not involve elaborate fact finding. As the highest appellate authority, it has jurisdiction in its own right to decide such question. Accordingly, the direction of remand is hereby modified; the Tribunal shall decide this issue in accordance with law, after hearing parties afresh. It is clarified that the Tribunal does not need to await the decision of CIT(A) in regard to AY 2010-11 on this issue."

6. Pursuant to the direction of the Hon'ble High Court, representatives of both the sides were heard at length, case records carefully perused and judicial decisions relied upon carefully examined.

7. As mentioned elsewhere, the assessee invested 1,75,560 RPS of face value of GBP 1000 each of Cairn India Holding Ltd [CIHL]. Total investment was made in the Jersey based 100% subsidiary of the assessee by way of preference shares.

8. We would like to mention here that we are considering the facts of assessment year 2011-12.

9. The total investment was 1343.7637 Crores. While determining the ALP of international transactions, the TPO recharacterized the investment in RPS as unsecured loan advanced to CIHL. Interest @ 14.88% was treated as Arm's Length rate which resulted into a transfer pricing adjustment of Rs. 1,54,53,28,255/- in assessment year 2011-12. While making the transfer pricing adjustment, the TPO observed as under:

"9. 6 From the various submissions filed by the taxpayer (during the course of transfer pricing proceedings] with regard to the investment in 'Redeemable Preference Shares' of CIHL, Jersey, following salient features/points are noted:

a] Preference Shares carry Zero % Coupon rate.

b] Preference Shares were Non Cumulative

c] Preference Shares were redeemable at the option of CIHL, Jersey and at Par.

d] Redemption was to be done at Par and in tranches starting from 2.5 years to 6.5 years.

e] However, redemption of Rs. 1234.385 Cr. was done on 07.10.2011 and balance Rs. 208.47 Cr. on 18.01.2012 i.e. before the minimum period of 2.5years as stated in the Board Resolution of CIL (dated 22.10.2009] and agreed to by the CIHL, Jersey Board of Directors.

f] Preference Shares did not carry any voting right

g) Preferences Shares had no right to share in the surplus assets of Company in the event the company is wound up.

h) In substance, the preference shares were non convertible. As per CIL Board resolution, they were convertible only on the happening of certain events and in reality they were never converted.

i) *Taxpayer had not received any dividend from the CIHL, jersey on account of Preference Shares.*

j) *In fact, the taxpayer company had raised a loan of Rs. 1345 Cr. on 28.10.2009 from SBI, New Delhi @ 10.5% p.a. and it was stated that the same was sanctioned for the purpose of Rajasthan Project However, an equivalent amount of Rs. 1343.7637 Cr. was transferred by the taxpayer to CIHL, jersey on 28.10.2009 from the same bank account in which loan amount was credited and it has been stated that same was investment in Redeemable Preference Shares of CIHL, jersey. No. of securities were also furnished by the taxpayer for availing this loan.*

k) *In F.Y. 2010-11, the taxpayer repaid the SBI loan in total, however simultaneously (i.e. on 12.10.2010), Non-Convertible & Redeemable at par debentures of different terms (rating, tenure, rate of interest) and carrying a maximum interest rate of 8.5% were issued for an amount of Rs. 1350 Cr.*

l) *The amount was transferred to CIHL on 28.10.2009 in pursuance to taxpayer company (CIL) board resolution dated 22.10.2009, however corresponding resolution was passed by the Board of Directors of CIHL only on*

03.11.2009 i.e. 6 days after the amount had been received by it

m) No specific reasons were given in the Board resolution of CIHL regarding early redemption of shares (before the agreed redemption period of 2.5 years to 6.25 years).

n) Two directors are common in the Board of Directors of CIL and CIHL. In fact Mr. Rahul Dhir who was the M.D. and CEO of CIL during F.Y. 2009-10 was also a director of CIHL, jersey.

o) As per Income Tax Law of Jersey, the AE CIHL was exempt from tax till year 2008 and from year 2009, it became liable to tax at standard rate of 0%.

p) During the year 2009, the AE, CIHL made investments amounting to 560 million $ (USD) in equity capital of its step down subsidiaries whereas amount of 291 million $ was raised by it from the taxpayer by way of issuance of 'RPS'.

q) CIHL also had loans of 318.247 million $ outstanding against its AE's as on 31.12.2009 (loan given to the group companies by CIHL) on which interest was chargeable.

9.7 *From the perusal of terms and conditions of the investment in 'RPS' of CIHL and the circumstances surrounding the same as brought out in para 9.5 above and summarized in para 9.6 and from perusal of OECD, Guidelines (paras 9.1 & 9.2 of this order) and the judicial guidance and case laws referred to in paras 9.3 & 9.4 of this order, it becomes clear that the invest of Rs. 1347.7637 was although made in the form of 'Redeemable Preference Shares of CIHL, Jersey, but in substance the same was a deemed loan extended to it. The said transaction was so structured so as to avoid taxes on the interest income earned in India. In view of the discussion made above, the transaction of investment in Rdeeemable Preference Shares of the subsidiary ClHL, Jersey is being recharacterized as a deemed interest free unsecured loan extended to the AE by the taxpayer. Vide showcause that interest @ 14.88% would be an Arm's Length interest on the same and methodology for calculating the same was provided in the show cause notice itself. The tax payer has raised various objections with regard to be application of SBI PLR and markup of 3% on the sale."*

10. The reasons for recharacterising the investment in RPS as unsecured loan/deemed loan advanced to the subsidiary [AE in Jersey] was given by the TPO as under:

Re***asons for re-characterizing the investment*** in Redeemable Preference Shares (RFS) as unsecured (deemed) loan advanced to the Subsidiary (AE in Jersey)

9.8.1 From the details furnished by the taxpayer during the course of Transfer Pricing Proceedings, it was observed that besides investing an amount of Rs. 990.0285 Cr. in the equity capital of CIHL, Jersey (@ face value 1 GBP, the taxpayer had also invested an amount of Rs. 1347.7637 Cr. in the RPS of CIHL, Jersey at face value of GBP 1,000 during the F.Y. 2009-10. These RPS were eligible for NIL Preference Dividend (0% Coupon Rate). It was also observed that total amount of Rs. 1343.7637 Cr. was invested by the taxpayer in CIHL on 28.10.2009 from Bank account No. 16257001. In lieu of this amount invested on 28.10.2009, the taxpayer was allotted 1,75,560/- Redeemable Preference Shares by CIHL on 05.11.2009. It was mentioned in the Board Resolution of CIL dated 22.10.2009, that RPS will be redeemable at the option of CIHL and was to be done in tranches starting from 2.5 years upto 6.25years. However, it was observed that Redemption of Preference Shares of CIHL was done on the following dates (much before the 2.5 years agreed period):

Sl. No	***Date of Redemption***	***Amount of Redemption***	***Amount of Redemption***
1	*07.10.2011*	*250000000*	*12,34,38,50,000*
2	*18.01.2012*	*41000000*	*2,08,47,37,250*
3	*Total*	*291000000*	*14,42,85,87,250*

95.2 It was also seen that the taxpayer had raised a loan of Rs. 1345 Cr. on 28.10.2009 from State Bank of India, New Delhi @ 10.5% per annum and it was stated that the same was sanctioned for the purpose of Rajasthan Project However, on the said date an equivalent amount of Rs. 1343.7637 Cr. was transferred by the Taxpayer to CIHL, Jersey from the same bank account in which the loan was credited and it was stated that the same was an investment in Redeemable Preference Shares of CIHL-Jersey."

11. For coming to such conclusion, reliance was placed on the relevant OECD Guidelines, 2010 which are reproduced as under:

"However, there are two particular circumstances in which it may exceptionally appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. *The first circumstance arises where the economic substance of a transaction differs from its form. In such a case the tax administration may disregard the parties' characterization of the transaction and re-characterize it in accordance with its substance.* An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances oj the borrowing company the investment would not be expected to be structured in this way. In this case it

might be appropriate for a tax administration to characterize the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. *The second circumstances arises where, while the form and substance of the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.* An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of the contract [as indicated in paragraph 1.11). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of the transfer in their entirety [and not simply by reference to pricing) to those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

1.66 In both sets of circumstances described above, the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions

and may have been structured by the taxpayer to avoid or minimize tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm's length transactions. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties transacting at arm's length transactions. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties transacting at arms length.

1.67 Associated enterprises are able to make a much greater variety of contracts and arrangements than can independent enterprises because the normal conflict of interest which would exist between independent parties is often absent Associated enterprises may and frequently do conclude arrangements of a specific nature that are not or are very rarely encountered between independent parties. This may be done for various economic, legal, or fiscal reasons dependent on the circumstances in a particular case. *Moreover, contracts within am MNE could be quite easily altered, suspended, extended, or terminated according to the overall strategies ,of the MNE as a whole, and such alterations may even be made retroactively.* In such instances tax administrations

would have to determine what the underlying reality is behind a contractual arrangement in applying the arms length principle"

12. After analyzing the OECD Guidelines, the TPO finally concluded by holding that investment in RPS is nothing but a deemed loan in disguise and accordingly, made addition of Rs. 1,54,53,28,255/- in A.Y 2011-12.

13. Before us, the ld. AR vehemently stated that the TPO/Assessing Officer has no authority to recharacterise a legitimate transaction. It is the say of the ld. AR that the TPO/Assessing Officer has grossly erred in wrongly interpreting the guidelines of OECD. In support of his contention, strong reliance was placed on the decision of the Hon'ble High Court of Delhi in the case of EKL Appliances Ltd 345 ITR 241.

13. We have extracted the OECD Guidelines elsewhere. The relevant findings of the Hon'ble High Court of Delhi in the case of EKL Appliances [supra] read as under;

"17. The significance of the aforesaid guidelines lies in the fact that they recognise that barring exceptional cases, the tax administration should not disregard the actual transaction

or substitute other transactions for them and the examination of a controlled transaction should ordinarily be based on the transaction as it has been actually undertaken and structured by the associated enterprises. It is of further significance that the guidelines discourage re-structuring of legitimate business transactions. The reason for characterisation of such re-structuring as an arbitrary exercise, as given in the guidelines, is that it has the potential to create double taxation if the other tax administration does not share the same view as to how the transaction should be structured.

18. Two exceptions have been allowed to the aforesaid principle and they are (i) where the economic substance of a transaction differs from its form and (ii) where the form and substance of the transaction are the same but arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner.

19. There is no reason why the OECD guidelines should not be taken as a valid input in the present case in judging the action of the TPO. In fact, the CIT (Appeals) has referred to and applied them and his decision has been affirmed by the Tribunal. These guidelines, in a different form, have been

recognized in the tax jurisprudence of our country earlier. It has been held by our courts that it is not for the revenue authorities to dictate to the assessee as to how he should conduct his business and it is not for them to tell the assessee as to what expenditure the assessee can incur. We may refer to a few of these authorities to elucidate the point. In Eastern Investment Ltd. v. CIT, (1951) 20 ITR 1, it was held by the Supreme Court that "there are usually many ways in which a given thing can be brought about in business circles but it is not for the Court to decide which of them should have been employed when the Court is deciding a question under Section 12(2) of the Income Tax Act". It was further held in this case that "it is not necessary to show that the expenditure was a profitable one or that in fact any profit was earned". In CIT v. Walchand & Co. etc., (1967) 65 ITR 381, it was held by the Supreme Court that in applying the test of commercial expediency for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, reasonableness of the expenditure has to be judged from the point of view of the businessman and not of the Revenue. It was further observed that the rule that expenditure can only be justified if there is corresponding increase in the profits was erroneous. It has been classically observed by Lord Thankerton in Hughes v. Bank of New Zealand, (1938) 6 ITR 636 that "expenditure in the course of the trade which is unremunerative is none the less a proper

deduction if wholly and exclusively made for the purposes of trade. It does not require the presence of a receipt on the credit side to justify the deduction of an expense". The question whether an expenditure can be allowed as a deduction only if it has resulted in any income or profits came to be considered by the Supreme Court again in CIT v. Rajendra Prasad Moody, (1978) 115 ITR 519, and it was observed as under: -

"We fail to appreciate how expenditure which is otherwise a proper expenditure can cease to be such merely because there is no receipt of income. Whatever is a proper outgoing by way of expenditure must be debited irrespective of whether there is receipt of income or not. That is the plain requirement of proper accounting and the interpretation of Section 57(iii) cannot be different. The deduction of the expenditure cannot, in the circumstances, be held to be conditional upon the making or earning of the income."

It is noteworthy that the above observations were made in the context of Section 57(iii) of the Act where the language is somewhat narrower than the language employed in Section 37(1) of the Act. This fact is recognised in the judgment itself. The fact that the language employed in Section 37(1) of the Act is broader than Section 57(iii) of the Act makes the position stronger.

20. In the case of Sassoon J. David & Co. Pvt. Ltd. v. CIT, (1979) 118 ITR 261 (SC), the Supreme Court referred to the legislative history and noted that when the Income Tax Bill of 1961 was introduced, Section 37(1) required that the expenditure should have been incurred "wholly, necessarily and exclusively" for the purposes of business in order to merit deduction. Pursuant to public protest, the word "necessarily" was omitted from the section.

21. The position emerging from the above decisions is that it is not necessary for the assessee to show that any legitimate expenditure incurred by him was also incurred out of necessity. It is also not necessary for the assessee to show that any expenditure incurred by him for the purpose of business carried on by him has actually resulted in profit or income either in the same year or in any of the subsequent years. The only condition is that the expenditure should have been incurred "wholly and exclusively" for the purpose of business and nothing more. It is this principle that inter alia finds expression in the OECD guidelines, in the paragraphs which we have quoted above.

22. Even Rule 10B(1)(a) does not authorise disallowance of any expenditure on the ground that it was not necessary or prudent for the assessee to have incurred the same or that in the view of the Revenue the expenditure was unremunerative

or that in view of the continued losses suffered by the assessee in his business, he could have fared better had he not incurred such expenditure. These are irrelevant considerations for the purpose of Rule 10B. Whether or not to enter into the transaction is for the assessee to decide. The quantum of expenditure can no doubt be examined by the TPO as per law but in judging the allowability thereof as business expenditure, he has no authority to disallow the entire expenditure or a part thereof on the ground that the assessee has suffered continuous losses. The financial health of assessee can never be a criterion to judge allowability of an expense; there is certainly no authority for that. What the TPO has done in the present case is to hold that the assessee ought not to have entered into the agreement to pay royalty/ brand fee, because it has been suffering losses continuously. So long as the expenditure or payment has been demonstrated to have been incurred or laid out for the purposes of business, it is no concern of the TPO to disallow the same on any extraneous reasoning. As provided in the OECD guidelines, he is expected to examine the international transaction as he actually finds the same and then make suitable adjustment but a wholesale disallowance of the expenditure, particularly on the grounds which have been given by the TPO is not contemplated or authorised.

23. Apart from the legal position stated above, even on merits the disallowance of the entire brand fee/ royalty payment was not warranted. The assessee has furnished copious material and valid reasons as to why it was suffering losses continuously and these have been referred to by us earlier. Full justification supported by facts and figures have been given to demonstrate that the increase in the employees cost, finance charges, administrative expenses, depreciation cost and capacity increase have contributed to the continuous losses. The comparative position over a period of 5 years from 1998 to 2003 with relevant figures have been given before the CIT (Appeals) and they are referred to in a tabular form in his order in paragraph 5.5.1. In fact there are four tabular statements furnished by the assessee before the CIT (Appeals) in support of the reasons for the continuous losses. There is no material brought by the revenue either before the CIT (Appeals) or before the Tribunal or even before us to show that these are incorrect figures or that even on merits the reasons for the losses are not genuine.

24. We are, therefore, unable to hold that the Tribunal committed any error in confirming the order of the CIT (Appeals) for both the years deleting the disallowance of the brand fee/ royalty payment while determining the ALP. Accordingly, the substantial questions of law are answered in the affirmative and in favour of the assessee and against the

Revenue. The appeals are accordingly dismissed with no order as to costs.

14. The decision of the Hon'ble High Court [supra] is directly on the point of dispute under consideration in the present appeal.

15. The question that arises is that whether preference share can be held to be a loan or advance. Section 85 of the Companies Act, 1956 provides for two kinds of share capital of a company, namely, preference share capital and equity share capital. Section 80 makes detailed provisions for the issue by a company of redeemable preference shares. Clause (a) of the proviso to sub-section (1) thereof says that no such share shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of share capital made for the purpose of redemption.

16. The Hon'ble High Court of Delhi in the case of Globe United Engineering and Foundry Co. Ltd Vs. Industrial Finance Corporation of India Ltd 44 Comp. Cases 347 has held that "*The Preference Shares are really part of the company's share capital, they are not loans*".

Drawing support from this observation of the Hon'ble High Court, redeemable preference shares cannot be treated as loans.

17. The Hon'ble Supreme Court in Civil Appeal No. 9813 of 2011 with Civil Appeal No. 9833 of 2011 had the occasion to consider the issue which has a direct bearing on the facts of the case in hand. The Hon'ble Supreme Court was considering the Civil Appeal in the case of Sahara India Real Estate Corporation Limited & Ors Vs. SEBI. The dispute before the Hon'ble Supreme Court reads as under:

> "We are, in these appeals, primarily concerned with the powers of the Securities and Exchange Board of India (for short 'SEBI') under Section 55A(b) of the Companies Act, 1956 to administer various provisions relating to issue and transfer of securities to the public by listed companies or companies which intend to get their securities listed on any recognized stock exchange in India and also the question whether Optionally Fully Convertible Debentures (for short 'OFCDs') offered by the 2 appellants should have been listed on any recognized stock exchange in India, being Public Issue under Section 73 read with Section 60B and allied provisions of the Companies Act and whether they had violated the Securities and Exchange Board of India (Disclosure and

> Investor Protection) Guidelines, 2000 [for short 'DIP Guidelines'] and various regulations of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 [for short 'ICDR 2009'], and also whether OFCDs issued are securities under the Securities Contracts (Regulation) Act, 1956 [for short 'SCR Act']".

18. At para 88 of its order, the Hon'ble Supreme Court observed:

> "In view of the above it is clear, that "hybrids" are included within the term "securities" not only for the purposes of Companies Act, but also, under the SEBI Act. SEBI therefore, would have jurisdiction even over "hybrids", even under the provisions of the SEBI Act."

19. The coordinate bench in the case of Sahara India Commercial Corporation Ltd in ITA No. 5772/DEL/28 ITR [TRIB] 108 had the occasion to consider whether Optionally Fully Convertible Debentures Scheme [OFCD] are loans or deposits. The relevant findings of the Tribunal read as under:

"We have heard the parties and have perused the material on record. Undisputedly, the terms 'loan' and 'deposit' have nowhere been defined in the IT Act. Therefore, recourse has to be taken to the definition of these terms in cognate Acts. For the purposes of the Income Tax Act, as such, in various decisions, reference has been made, inter alia, to the Companies Act, 1956, the Companies (Acceptance of Deposit) Rules, 1975, the SEBI Act, the Securities & Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000, the Securities Contracts (Regulation) Act, 1956, etc. In Sahara India Real Estate Corpn. Ltd. (supra), inter alia, the assessee had contended that OFCDs issued by it were convertible bonds falling within the scope of Section 28(1)(b) of the SCR Act and that they were not 'securities'; and that at any rate, the provisions of the SEBI Act and Section 67 of the SCR Act were not applicable to such OFCDs, which had been found to be 'hybrid' (in para 106 of the judgement). It was observed by the Hon'ble Supreme Court (in para 112) that the OFCDs issued had the characteristics of shares and debentures and fell within the definition of Section 2 (h) of the SCR Act, such OFCDs continuing to remain debentures till they were converted; that in other words, the OFCDs issued by the assessee were debentures in presenti and became shares in future; that even if the OFCDs were hybrid securities as defined in Section 2(19A) of the Companies Act, they shall remain within the purview of the definition of 'securities' in

Section 2 (h) of the SCR Act; that the assessee had treated the OFCDs only as debentures in the IMRHP. application forms and also in their balance sheets; that the term 'securities' defined in the Companies Act has the same meaning as that in the SCR Act, which would also cover the species of 'hybrid' u/s 2(19A) of the Act; that since the definition of 'securities' u/s 2 (45AA) of the Companies Act includes 'hybrid', SEBI has jurisdiction over hybrids like OFCDs issued by the assessee, since the expression 'securities' has been specifically dealt with under Section 55A of the Companies Act; and that the assessee had contended that SEBI had no jurisdiction over the hybrids and that 'hybrids' would be treated as 'securities' within the meaning of the Companies Act, but cannot be treated as 'securities' within the meaning of the SEBI Act. Dwelling upon the issue as to whether 'hybrids' can also be included in the definition of the term 'securities' for the purposes of the SEBI Act. the Hon'ble Supreme Court observed (paras 87 and 88) as follows:—

> 87. An attempt shall now be made to determine whether "hybrids" can also be included in the definition of the term "securities" for the purposes of the SEBI Act. For the aforesaid analysis reference may first be made to section 2(I9A) of the Companies Act which is being extracted hereunder:

"2(19A) "hybrid" means any security which has the character of more than one type of security, including their derivatives;"

The term "hybrid" is not defined under the SEBI Act, and consequently it may be appropriate to accept the same, as it has been defined in the Companies Act, specially with reference to an issue arising ii respect of a public company. Of course, it would not have been apt to rely on section 2(1 9A) of the Companies Act. if the term "hybrid" had also been defined in the SEBI Act or had even been defined in the SC(R) Act on the Depositories Act, 1996, because section 2(2) of the SEBI Act postulates, that words and expressions used but not defined under the SEBI Act, but defined in the SC(R) Act or in the Depositories Act, 1996 would be attributed the meaning given to them in the said Acts. But the term "hybrid" has also not been defined in either of the aforesaid enactments. The term "hybrid" as defined in the Companies Act means "any security" having "the character of more than one type of security" and "includes their derivatives". For the purposes of the SEBI Act, the term "securities" is accepted as it is defined in section 2(h) of the SC(R) Act. Section 2(h) of the SC(R) Act does not define the term "securities" exhaustively, because clauses (i) to (iia) thereof, only demonstrate what may be treated as included in the definition of the term

"securities". And. clause (i) of section 2(h) of the SC(R) Act. includes within the definition of the term "securities" inter alia, "bonds", "debentures" and "other marketable securities of a like nature". For the present controversy it is sufficient to notice, that the appellant-companies through their respective RMPs had invited subscription to, Optionally Fully Convertible "Debentures" (OFCDs). On receipt of subscription amounts from investors, the appellant- companies had issued different kinds of "bonds" (described as Abode Bonds. Nirman Bonds and Real Estate Bonds, by SIRECL; and Multiple Bonds, Income Bonds and Housing Bonds, by SH1CL). Since the term "hybrid" has been expressed as "...means any security..." there can be no doubt that a "hybrid" is per-se a security. Moreover, the term "security" in its definition includes "...other marketable securities of a like nature...". Therefore, even if for one or the other reason, the OFCDs issued by the appellant-companies may not strictly fall within the terms "debentures" or "bonds" (referred to in the definition of the term "securities") they would nonetheless fall within the ambit of the expression "securities of a like nature". For this, the reasons are as follows. The definition of the term "hybrid" also explains that a "hybrid" has the character of more than one kind of "security" or their "derivatives". The term "securities" also includes "derivatives". Therefore, even if the definition of the term "hybrid" is construed

strictly, it would fall in the realm of "securities of a like nature". And if, "securities of a like nature" are "marketable", they would clearly fall within the expanse of the term "securities" defined in section 2(h) of the SC(R) Act (and therefore also, section 2(1)(i) of the SEBI Act). The OFCDs/bonds issued by appellant-companies were also clearly marketable, because the RFIPs issued by the two companies provided, that the subscribers would be at liberty to transfer the OFCDs/bonds, to any other person. Although, the transfer of OFCDs/bonds was to be subject to the terms and conditions prescribed, and the approval of the appellant-companies. In the absence of any prescribed terms and conditions barring transfer, the OFCDs/bonds were clearly transferable, and therefore, "marketable". The term "marketable" simply means, that which is capable of being sold. Allowing the liberty to subscribers to transfer the OFCDs/bonds made them "marketable". There is therefore, no room for any doubt, that the term "hybrid", as defined in the Companies Act, would squarely fall within the term "securities" as defined under section 2(1) (i) of the SEBI Act (i.e., Section 2(h) of the SC(R) Act).

88. In view of the above it is clear, that "hybrids" are included within the term "securities" not only for the purposes of Companies Act, but also, under the SEBI Act.

SEBI therefore, would have jurisdiction even over "hybrids", even under the provisions of the SEBI Act.'

15. Thus, it has been held that 'hybrids', i.e., hybrid securities, i.e., OFCDs are 'securities' under the Companies Act as well as under the SEBI Act.

16. Now, Undisputedly, the OFCDs of the assessee before us are no different from those of Sahara India Real Estate Corpn. Ltd. (supra), i.e. the assessee before the Hon'ble Supreme Court in the aforesaid case, and once such OFCDs are securities, they are neither 'loans', nor 'deposits'. Further, it is seen that as per Explanation 2 to Section 2 (42) of the Income Tax Act. the expression 'security' shall have the meaning assigned to it in Section 2 (h) (i) of the Securities Contracts (Regulation) Act. 1956. Section 2 (h) (i) of the Securities Contracts Regulation) Act, 1956 defines 'securities' to include, inter alia, debentures or other marketable securities of a like nature in or of any incorporated company or other body corporate.

Hence, in keeping with the decision of the Hon'ble Supreme Court in Sahara India Real Estate Corpn. Ltd. (supra), the OFCDs of the assessee before us are neither 'loans', nor 'deposits'.

20. A conspectus of the aforesaid judicial decisions clearly show that RPS cannot be categorised as loans and advances and, therefore, conclusion of the TPO/Assessing Officer that the assessee has given loans/advances to its AE in the disguise of RPS does not hold water.

21. In our considered opinion, “Real Income” means profits arrived at on commercial principles subject to provisions of the Act. For this proposition, we derive support from the decision of the Hon'ble Supreme Court in the case of Pune Electricity Supply Co. Ltd Vs. CIT 57 ITR 521 wherein it has been held as under:

> *“Profits and gains should be true and correct profits and gains, neither under nor over stated. Arm’s length price seeks to correct distortion and shifting of profits to tax the actual income earned by a resident/domestic AE. The profit which would have accrued had arm’s length conditions prevailed is brought to tax. Misreporting, if any, on account of non-arm’s length conditions resulting on lower profits, is corrected.”*

22. Decision of the Hon'ble Delhi High Court in the case of Ramgreen Solutions Pvt. Ltd Vs. CIT 377 ITR 533 is the case in point. The relevant observations read as under;

"12. At the outset, it is necessary to bear in mind that the object and purpose of introducing provisions relating to transfer pricing adjustment in the Act. By virtue of Finance Act, 2001, Section 92 of the Act was substituted by Sections 92 ITA 102/2015 Page 10 of 42 ensure that there is no avoidance of tax by transfer of income from India to other tax jurisdictions. Circular no. 14 of 2001 issued by the CBDT indicates that the provisions of Section 92 to 92F of the Act were introduced "With a view to provide a detailed statutory framework which can lead to computation of reasonable, fair and equitable profits and tax in India".

13. The heading of Chapter X also clearly indicates that it contains "special provisions relating to avoidance of tax". The object of Chapter X of the Act is not to tax any notional income but to ensure that the real income is brought to tax under the Act. This has also been explained by a Division Bench of this Court in Sony Ericsson Mobile Communications India Pvt. Ltd. and Ors. v. Commissioner of Income Tax-III and Ors. 374 ITR 118 in the following words:-

> *"77. As a concept and principle Chapter X does not artificially broaden, expand or deviate from the concept of "real income". "Real income", as held by the Supreme Court in Poona Electricity Supply Company*

Limited versus CIT, : [1965] 57 ITR 521 (SC), means profits arrived at on commercial principles, subject to the provisions of the Act. Profits and gains should be true and correct profits and gains, neither under nor over stated. Arm's length price seeks to correct distortion and shifting of profits to tax the actual income earned by a resident/domestic AE. The profit which would have accrued had arm's length conditions prevailed is brought to tax. Misreporting, if any, on account of non-arm's ITA 102/2015 Page 11 of 42 length conditions resulting in lower profits, is corrected."

14. The substratal rationale of the transfer pricing regulations is to ensure that the true income of an Assessee is brought to tax under the Act and there is no avoidance of tax by transfer of income from India to any other tax jurisdiction by virtue of the influence exercised by the associated enterprises. The aim of the provisions of Chapter X of the Act is to compute the income in relation to a controlled transaction between an Assessee and its associated enterprise having regard to ALP, in order to nullify the effect of transfer of income to a jurisdiction outside India, if any, in respect of the controlled transactions.

15. The exercise of determining the ALP in respect of international transactions between the related enterprises is aimed to determine the price, which would have been charged for products and services, as nearly as possible, in case such international transactions were not controlled by virtue of them being executed between related parties. The object of the exercise is, thus, to remove the effect of any influence on the prices or costs that may have been exerted on account of the international transactions being entered into between related parties. It is, at once, clear that for the exercise of determining ALP to be reliable, it is necessary that the controlled transactions be compared with uncontrolled transactions which are similar in all material aspects."

23. The Ahmedabad Tribunal in Sun Pharmaceutical Industries Ltd Vs. ACIT 84 Taxmann.com 217 had the occasion to consider the following ground:

"Ground No. 3 relates to addition on account of interest on OFCD subscribed to Sun Pharma Global Inc."

24. The relevant finding reads as under:

8. We have heard the rival contentions and have carefully perused the orders of the authorities below. At the very outset, we have to state that the revenue has no power to re-characterize the transaction. The Hon'ble High Court of Delhi in the case of Cotton Naturals India Pvt. Ltd. 276 CTR445at para 17 of its order has held that Chapter X and Transfer Pricing rules do not permit the Revenue authorities to step into the shoes of the assessee and decide whether or not a transaction should not be entered. It is for the assessee to take commercial decisions and decide how to conduct and carry on its business Actual business transactions that are legitimate cannot be restructured. similar view was taken by the Hon'ble Delhi High Court in the case of EKL Appliances Ltd. 345 ITR 241.

9. On identical set of facts, the Co-ordinate Bench had the occasion to consider similar issue in the case of Cadila Healthcare Ltd. in ITA No. 2430/Ahd/12 with CO. No. 242/Ahd/12 in 146 ITR 502 wherein the first ground related to the adjustment made on account of notional interest on Optionally Convertible Debenture to Foreign Subsidiary. The Tribunal considered the following facts

4. During the course of assessment proceedings, Assessing Officer noticed that Assessee had subscribed to Optionally Convertible Loan of U.S. $ 27 Million issued by Zydus International Pvt. Ltd., Ireland. Accordingly^—^ reference under Section 92CA of the Act for computing of arms length price in relation to the transaction was made to Transfer Pricing Officer (TPO). TPO noted that the Assessee had entered into an agreement with Zydus International Pvt. Ltd. on 09.10.2007 for a convertible loan of U.S $ 27 Million which was subsequently utilized by the Ireland Company for acquiring shares in Zydus Healthcare, Brazil. As per the terms of agreement, no interest was payable if the amount was converted into equity. However, if the same is redeemed, interest was payable at Libor Plus 290 bps and the interest was to be computed at annual rates and payable at maturity that is 5 years from the date of first disbursement. The rupee value of the amount of loan as on 31.03.2008 was Rs. 108.32 crore. It was also noticed that Assessee has not shown any income from the aforesaid loan. In response, Assessee inter alia submitted that Assessee had not opted for conversion of the loan during the year and therefore it was loan for the year and as per the terms of agreement, no interest accrued to the Assessee and therefore no income was considered. The TPO did not find the contention of the Assessee acceptable. He considered the Optionally Fully Convertible

loan as debt and considering the average six month Euro Libor rate for the year @ 4.48% to which he added the interest rate of 2.90 basis point as per the agreement and thereafter considered the rate of interest to be @ 7.38% and accordingly computed the interest on Rs. 108.32 Crore for 171 days at 7.3896. The aforesaid adjustment made by the TPO was considered by the Assessing Officer and the addition of Rs. 3,99,74,4267- was made to the income. Aggrieved by the order of Assessing Officer, Assessee carried the matter before CIT (A). CIT (A) after considering the submissions made by the Assessee decided the issue in favour of Assessee.

10. And the Tribunal held as under:—

7. We have heard the rival submissions and perused the material on record. CIT (A) while deleting the addition has noted that as per the agreement, the interest was payable only if the conversion option was not exercised on the expiry of 5 year period. If at any time during the 5 year period conversion option was exercised and the loan was converted into equity, no interest accrued or become payable. He further noted that the funds were provided by the Assessee as per RBI guidelines and in the immediately next year, the entire loan given to subsidiary was converted into equity shares of Zydus International Pvt. Ltd. He has

further held that since the Assessee has converted the loan into equity in the immediate next year, there was no question of taxing notional interest. He has further held that Assessee had not granted interest free loan but invested in Optionally convertible loan with a clause of interest in case, Conversion option was not exercised and further field the Assessee's transaction with subsidiary was at arms length. Before us, the Revenue could not controvert the findings of CIT (A) by bringing any contrary material on record. In view of these facts, we find no reason to interfere with the order of CIT (A).

11. Respectfully following the findings of the Hon'ble High court (supra) and the Co-ordinate Bench (supra), we direct the A.O. to delete the impugned additions, Ground No. 2 is accordingly allowed.

***26**: Thus, the distinguishing facts as canvassed by the Shri Shrivastava do not culminate in to any proposition so as to convince us to take any divergence from earlier findings and the judicial discipline also guides us to follow the decision of the Co-ordinate Bench in the light of the ratio laid down by the Hon'ble Supreme Court and the Hon'ble Jurisdictional High Court of Gujarat (supra) and considering the fact that the OFCD were on beneficial terms as per facts mentioned above. Consequently, we*

have no hesitation to follow earlier judgment in assessee's own case as a result we delete the impugned additions. Ground No. 3 of assessee is allowed."

25. Considering the facts of the case in hand from all possible angles, we are of the considered opinion that the TPO/Assessing Officer grossly erred in making notional addition being Arm's Length interest on RPS. It would not be out of place to mention here that in A.Y 2012-13, preference shares have been redeemed by the AE and redemption has been accepted by the Revenue which is evident from page 107 of the paper book. We conclude by holding that recharacterization of the transaction is erroneous and the resultant transfer pricing adjustment is uncalled for and deserves to be deleted. We accordingly direct the Assessing Officer/TPO to delete the transfer pricing adjustment on this count from both the years under consideration.

26. In the result, the appeal of the assessee in ITA Nos. 1459/DEL/16 and 263/DEL/20174 are allowed

The order is pronounced in the open court on 24.10.2018.

Sd/-	**Sd/-**
[SUCHITRA KAMBLE**]**	**[N.K. BILLAIYA]**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: 24th October, 2018

VL/

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar,
ITAT, New Delhi

Date of dictation	
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	
Date on which the final order is uploaded on the website of ITAT	
Date on which the file goes to the Bench Clerk	
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	