



IN THE INCOME TAX APPELLATE TRIBUNAL

"K" BENCH, MUMBAI

BEFORE SHRI SAKTIJIT DEY, JUDICIAL MEMBER AND

SHRI N.K.PRADHAN, ACCOUNTANT MEMBER

ITA no.6821 /Mum./2017
(Assessment Year : 2012-13)

Gurgaon Investment Ltd. (Formerly
known as Indopark Investments Limited)
C/o M/s G. M. Kapadia & Co., 1007,
Raheja Chamber, 213, Nariman Point,
Mumbai-400021 PAN-AABCI7404E

..... Appellant

v/s

Dy. Director of Income Tax
International Transaction
Circle-3(1), Mumbai

..... Respondent

ITA no.1499 /Mum./2014
(Assessment Year : 2008-09)

Gurgaon Investment Ltd. (Formerly
known as Indopark Investments Limited)
C/o M/s G. M. Kapadia & Co., 1007,
Raheja Chamber, 213, Nariman Point,
Mumbai-400021 PAN-AABCI7404E

..... Appellant

v/s

Dy. Director of Income Tax
International Transaction
Circle-3(1), Mumbai

..... Respondent

ITA no.7359/Mum./2016
(Assessment Year : 2011-12)

Gurgaon Investment Ltd. (Formerly
known as Indopark Investments Limited)
C/o M/s G. M. Kapadia & Co., 1007,
Raheja Chamber, 213, Nariman Point,
Mumbai-400021 PAN-AABCI7404E

..... Appellant

v/s

Dy. Director of Income Tax
International Transaction
Circle-3(1), Mumbai

..... Respondent

Assessee by : Shri Percy J. Pardiwala
Revenue by : Shri Suhas Kulkarni

Date of Hearing – 19.08.2019

Date of Order – 15.11.2019

ORDER

PER SAKTIJIT DEY, J.M.

The aforesaid appeals by the same assessee are directed against three separate orders of learned Commissioner of Income Tax (Appeals)-15 & 56 Mumbai, pertaining to Assessment Years 2008-09, 2011-12 and 2012-13.

2. The basic common grievance in all these appeals relates to addition made on account of Transfer Pricing Adjustment towards interest on debentures invested in the Associated Enterprise (AE) Vital Construction Pvt. Ltd. (VCPL). Facts being common in all these

appeals, for the sake of brevity we will discuss the facts as involved in assessment year 2008–09 being ITA no. 1499/Mum/2014.

3. Briefly stated, the assessee, earlier known as M/s. Indopark Investment Limited, is a non resident company and is engaged in the business of investment holdings. It is stated, the assessee belongs to Merrill Lynch Group which is one of the world's leading financial management and advisory companies. In course of transfer pricing proceedings, the Assessing Officer on examining the audit report as well as other documents available on record noticed that during the year under consideration assessee had entered into certain international transactions with its AEs. He noticed that the assessee had purchased compulsorily convertible debentures (CCDs) of Vital Construction Pvt. Ltd., Delhi from its AE Indopark Holdings Limited Mauritius for the total value of ₹. 34.3 Crores. The coupon rate on the said debentures is 12%. He found that the debentures were acquired vide deed of adherence dated 27th March, 2008. In response to the query raised by the Transfer Pricing Officer, assessee submitted the details of interest on the debentures which was due from Vital Construction Pvt. Ltd., Delhi and also submitted that the interest due has been waived by the assessee. Noticing the above, the Transfer Pricing Officer called upon the assessee to explain as to why no interest was charged on CCDs for the period from 28th March, 2008 to

31st March, 2008 as per the terms & conditions of the debenture. In response, it was submitted by the assessee that in the Board meeting held on 28th March, 2008 it was resolved to waive the interest on the debentures. Therefore, no income has accrued to the assessee on account of waiver of interest. It was submitted, even VCPL has not claimed any deduction in respect of interest on CCDs. After considering the submissions of the assessee, the Transfer Pricing Officer did not find merit in them. He observed, the assessee has bought CCDs from its AE in Mauritius for a consideration of ₹. 34.3 Crore and carrying coupon rate of interest of 12% per annum. He observed, at the time of purchase of debentures the investor considers the coupon rate for the purpose of making investment. The coupon rate represents the fair return that the investor can expect on this investment made in the debentures. He observed, the assessee is also holding around 26% shares in VCPL. The Transfer Pricing Officer observed, the assessee company has waived the interest to help its AE. Therefore, he held that the interest due on the debentures has to be adjusted to the income of the assessee. Accordingly, he computed the interest on debentures at the rate of 12% per annum and worked out adjustment in different assessment years on the basis of period of holding of debentures. The adjustment made in this regard in different assessment years are as under:–

<i>Assessment Year 2008-09</i>	<i>₹. 4, 51,068/-</i>
<i>Assessment Year 2011-12</i>	<i>₹. 4,63,80,000/-</i>
<i>Assessment Year 2012-13</i>	<i>₹. 3,62,14,521/-</i>

4. Being aggrieved with the adjustment made to the income on account of interest on debentures, assessee preferred appeals before learned Commissioner (Appeals). While challenging the notional adjustment made towards interest on debentures, the assessee submitted that by virtue of supplementary agreement dated 20th March, 2008 in pursuance to Board meeting held it was agreed to waive the interest on CCDs. Therefore, the interest income has not accrued to the assessee during the year. The assessee also submitted that another AE, namely, BPTP Limited has also agreed to waive the interest on debenture, hence, that can be considered as Comparable Uncontrolled Price (CUP) to benchmark the interest waiver by the assessee. Thus, it was claimed that the transaction is at arm's length. It was further submitted, determination of arm's length price under section 92(1) of the Act would arise only when there is a transaction which has resulted in income at the hands of assessee. It was submitted, since no income has accrued on account of waiver of interest on CCDs, TP provisions would not apply. After considering the submission of the assessee, learned Commissioner (Appeals) did not find merit in them. He observed, in spite of opportunity being given the assessee could only produce an unsigned and incomplete copy of

the Board Resolution of VCPL dated 28.4.2008 which means that the Resolution was passed after closure of the financial year. He observed, since, the assessee did not pass any Resolution within the Financial year, nor furnish proof of its consent for not charging interest, income on account of interest on CCDs accrued to the assessee as it is following mercantile system of accounting. Therefore, the Transfer Pricing Officer was justified in making adjustment to the income on account of interest on CCDs. As regards assessee's contention that similar transduction between BPTP limited and BPCL limited should be applied as CUP, learned Commissioner (Appeals) observed, the transaction between BPTP Limited and BPCL Limited being a controlled transaction cannot be applied as CUP. He observed, as per the scheme of the Act income from international transaction is to be treated as additional and separate source of income and such income has to be determined having regard to the arm's length principle. Thus, ultimately, learned Commissioner (Appeals) sustained the addition made on account of transfer pricing adjustment on interest on debentures. It is relevant to observe, in assessment year 2012-13 the assessee additionally pleaded that as per Article 11 of India-Mauritius treaty, interest is taxable only on paid/receipt basis. It was submitted, since, no interest was paid, there is no question of any interest income accruing to the assessee. Hence, the question of determining arm's

length price would not arise. It was submitted, the assessee should be given treaty benefit as per Section 90 (1) of the Act. However, the aforesaid contention of the assessee also did not find favour with the first Appellate Authority.

5. Shri. Percy J. Pardiwala, learned Senior counsel for the assessee submitted, the short issue which needs to be addressed is whether interest income is to be assessed on accrual or receipt basis. Drawing our attention to Article 11 of India–Mauritius Double Taxation Avoidable Agreement the learned Senior counsel submitted, as per Clause 1 of the said Article the language used is interest arising in a contracting state and paid to the resident of other contracting states. He submitted, the term paid as used in Clause 1 would mean actual payment of interest and not any notional computation of interest or accrual of interest. He submitted, this proposition gets further clarified by Clause 7 of Article 11 as it speaks of actual payment of interest. He submitted, in the facts of the assessee's case actual payment of interest on the CCDs has not happened as the assessee has waived the payment of interest. He submitted, while considering identical provision in India–Cyprus DTAA involving addition of interest income on CCDs on accrual basis, the Tribunal in *Pramerica ASPF ii Cyprus Holding Limited vs. DCIT 2016 157 ITD 1177 (Mumbai)* has held that the true import of Article 11 Indo–Cyprus treaty requires actual

payment of interest and not any notional interest on accrual basis. He submitted, the aforesaid decision of the Tribunal was upheld by the Hon'ble Jurisdictional High Court while dismissing Revenue's appeal vide judgment dated 12th March, 2019 in Income Tax Appeal no. 1824 of 2016. The learned Senior counsel submitted, once the interest on accrual basis is not chargeable to tax in India under the provisions of the tax treaty addition of interest income on notional basis cannot be made applying TP regulations. Drawing our attention to section 92(1) of the Act, he submitted, only in respect of income chargeable to tax under section 4 of the Income Tax Act, the transfer pricing provisions can be made applicable as section 92 provides for computing the income arising from international transaction with regard to the arm's length price. He submitted, once the interest income is not chargeable under section 4 of the Act in view of Article 11(1) of India-Mauritius treaty read with section 90(1) of the Act, there is no question of determining the arm's length price of interest on CCDs on accrual/notional basis. In this context, he drew our attention to the decision of Hon'ble Jurisdictional High Court in the following cases.

i) Vodafone India Services Pvt. Ltd v/s DCIT, [2014] 368 ITR 1 (Ahd.);

ii) DCIT v/d M/s. PMW ASPF I Cyprus Holding Co. Ltd. ITA no. 879/Del./2016, dated 09.08.2019.

5. The learned Departmental Representative strongly relying upon the observations of learned Commissioner (Appeals) submitted, the Transfer Pricing Officer is mandated under the act to determine the arm's length price of any international transaction by applying any one of the prescribed method. He submitted, the TP provisions having been brought into the statute as anti avoidance measure have to be applied notwithstanding the other provisions of the Act. Therefore, he submitted, determination of arm's length price under the TP provision would not be governed by the provisions of DTAA. Thus, he submitted, the contention of the assessee that under Article 11(1) of the India-Mauritius tax treaty interest income is chargeable only on receipt basis should not be accepted. Without prejudice, he submitted, the submissions of learned Senior counsel with regard to applicability of DTAA is taken for the first time before the Tribunal and was never argued before the departmental authorities. Thus, he submitted, in the event the aforesaid contention of the assessee is to be considered, the issue has to be restored back to the Assessing Officer for fresh adjudication.

6. We have considered rival submissions and perused the material on record. We have also examined carefully the judicial precedents cited before us. Undisputedly, the assessee is a non resident company incorporated in Mauritius. Uncontroverted facts are, the assessee

through one of its AEs based in Mauritius had invested in CCDs of an Indian company i.e. VCPL, wherein, the assessee is also stated to have shareholding of 26%. As per the terms and conditions of the debenture the assessee was supposed to receive interest @ 12% per annum. However, considering the slowdown in business in real estate sector wherein VCPL is engaged, the Board of Directors of the assessee company passed a resolution waiving the interest on CCDs. Though, it is the case of the assessee that since no interest was received on CCDs it cannot be taxed at its hands even by way of TP adjustment, however, the Revenue authorities have held that since the assessee is following mercantile system of accounting and as per the terms & conditions of CCDs interest @ 12% per annum is payable to the assessee, interest income has accrued to the assessee and determination of arm's length price of interest income has to be made. It is discernible from the facts on record, in course of proceedings before departmental authorities in A.Y. 2008-09 and 2011-12 the assessee had challenged the TP adjustment on account of interest on CCDs on the ground that no income has accrued at its hands due to waiver of interest and such waiver of interest is at arm's length considering similar waiver made by other AE. However, in course of appeal proceeding for A.Y. 2012-13, for the first time assessee submitted that since as per Article 11(1) of India-Mauritius tax treaty

interest income is chargeable only on actual payment, no TP adjustment can be made under section 92(1) of the Act. Of course, before us also the main plank on which the learned Senior counsel contested the TP adjustment is on the basis of applicability of Article 11(1) of the India–Mauritius treaty read with section 90 of the Act. The fact that the assessee has actually not received any interest income on the CCDs has not been disputed by the Revenue. Therefore, the validity of TP adjustment on account of interest on debentures has to be examined keeping in view the treaty provision. Article 11(1) of the India–Mauritius treaty which is relevant for our purpose reads as under:–

"1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State."

7. The language used in the aforesaid Article is "interest arising and paid". Therefore, what is chargeable to tax under Article 11(1) of the treaty is the interest paid to the recipient. The expression "paid" as used in Article 11(1) of the India–Mauritius tax treaty has come up for judicial scrutiny and interpretation in various cases as the same term has been used in various other treaties, though, in similar as well as different context. In case of ***Director of Income Tax (International Taxation) Vs. M/s Siemens Aktiengesellschaft, Income Tax Appeal No.124 of 2010 dated 22.10.2012*** the Hon'ble Bombay high court

while interpreting similar terminology used in Article IIX-A of India-Germany DTAA with reference to royalty and fees for technical services held that it can be taxed only on receipt basis. In case of ***Johnson & Johnson vs. Assistant DIT 60 SOT 109***, the term "paid" as used with reference to royalty in Article 12(1) of India-US Tax Treaty was interpreted by the Tribunal to mean that royalty is to be taxed on paid basis and not on accrual basis. It is relevant to observe, like Article 11 of India-Mauritius Tax Treaty, Article 11 of India-Cyprus Tax Treaty is identically worded. By interpreting the said Article in case of *Pramerica ASPF II Cyprus Holding Limited (supra)*, the Coordinate Bench held, going by the treaty provision, the interest income is liable to be taxed on payment/receipt basis and not on accrual basis. The aforesaid decision of the Coordinate Bench was upheld by the Hon'ble jurisdictional High Court while deciding Revenue's appeal in Income Tax Appeal no. 1824 of 2016. Thus, the logical conclusion which emerges from the ratio laid down in the aforesaid decisions is, as per Article 11(1) of the India-Mauritius Tax Treaty interest income can be brought to tax only on fulfillment of twin conditions of accrual as well as actual receipt. It is fairly well settled, as per section 90(1) of the Act the provisions of DTAA's to the extent beneficial to the assessee would override the provisions of the Act. Thus, once the interest income is not chargeable to tax on accrual basis as per Article 11(1) of

the Tax Treaty, it goes out of the purview of the total income chargeable to tax under section 4 of the Act. Now, it is judicially settled that Chapter X containing section 92 and other provisions are in the nature of machinery provisions and subject to section 4 of the Act which is the charging provision. If a particular item of income does not come within the purview of the charging provision as contained under section 4 of the Act, the machinery provisions as contained under Chapter X would not be applicable, though, they may be in the nature of special provision. Therefore, at this juncture it is necessary to evaluate the interplay between the Treaty and TP provisions. No doubt, Chapter X containing the TP provisions is in the nature of anti avoidance provision to prevent avoidance/evasion of tax in relation to transaction between related parties. However, when the income itself is not chargeable to tax by virtue of the provision contained in the Tax Treaty, there is no occasion for any tax avoidance/evasion. In a recent decision in case of **DCIT (International Taxation) Vs. M/s TMW ASPF i Cyprus Holding Company Limited, (supra)**, the Coordinate Bench while considering identical issue of taxability of interest income on accrual basis by applying TP provisions has held as under:–

"17. We have heard the rival submissions and also perused the relevant findings given in the impugned orders and the materials referred to before us. The assessee is a Cyprus based company engaged in the business of making investment in real estate sectors via fully convertible debentures. It was due to these investments in the investee companies that they are treated as

associated enterprises as per the provisions of TP. As per the agreement between the investee companies and the assessee, the assessee was entitled to a coupon rate of 4% and further post the conversion of FCCDs into equity shares, the promoters of the Indian Companies would buy back shares at an agreed option price. The option price was stipulated to be such that the investor gets the original investment paid on subscription to the FCCD's plus a return of 18% per annum. Undisputedly, the assessee has only received interest income of Rs. 60,46,895/- from one of the investee companies and that too only for the half of the year. No actual interest other than this amount has been received by the assessee from any other investee companies. The TPO has made the adjustment on the ground that assessee was to earn an assured return of 18% and accordingly, determined the arm's length price by taking the coupon rate to be 18% instead of coupon rate of 4%.

18. As per the terms of agreements entered between the assessee with the investee companies there were three separate and independent events:

I. Subscription to FCCDs bearing an annual interest of 4%;

II. Conversion of FCCDs into equity at a conversion price on the completion of the specified term or as may be determined by the parties; and

III. Post conversion, sale of equity shares to the promoters at a consideration providing annualized 18%/19% return on investment.

The last two of the events were futuristic and contingent. The sale of converted equity shares to the promoters of the investee companies as per the terms of shareholder's agreement provided an option to the assessee to sell its converted shares to the promoters of the investee companies at an option price that shall fetch the assessee a return on investment of 18%. It has been brought on record that investee companies have requested for the waiver of interest due to bad financial position/cash crunch and delayed project in the real estate and such a request has been accepted by the assessee. Part of the FCCDs held in one of the investee company was sold to a third party during the year at a loss. Thus, none of the investment bore any premium to the assessee on sale of securities. They were either sold at a loss or at par to third parties. The details of investment made by the company in FCCDs and the interest received and factum of waiver of interest are reproduced hereunder:-

<i>Investee</i>	<i>Initial due of subscribing of FCCDs</i>	<i>Amount of investment</i>	<i>Conversion of debenture during the year</i>	<i>Interest received during A.Y. 2011-12 FY 2010-11 01.04.2010 to 31.3.2011 (in ₹)</i>	<i>Waiver of interest</i>
<i>DD Housing Ltd.</i>	<i>16-Oct-2006</i>	<i>146,82,00,000</i>	<i>Not converted</i>	<i>Nil</i>	<i>Waiver of interest with effect from Sep 16, 2008 (including interest for the full subject year)</i>
<i>Supreme Buildcap Pvt. Ltd.</i>	<i>22-Dec-2006</i>	<i>75,00,00,000</i>	<i>Converted on 11-May-2010</i>	<i>Nil</i>	<i>Waiver of interest with effect from Sep 15, 2009 (including interest for 1 month & 11 days pertaining to the subject year)</i>
<i>Ritesh Spinning Mills Ltd.</i>	<i>16-Feb-2007</i>	<i>30,00,00,000</i>	<i>Not converted</i>	<i>60,46,895 (For Half the year)</i>	<i>Waiver of interest with effect from Sep 15, 2010 granted orally as per mutual agreement (including second installment for the subject year)</i>
				<i>60,46,895</i>	

19. One of the main contention raised before us by the Ld. Counsel that assessee being a non resident and Cyprus based company therefore it was entitled to the benefit of India Cyprus DTAA Article 11(1) of India-Cyprus DTAA reads as under :-

"Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State."

20. The aforesaid para envisages that for taxing the interest income in the hands of a non-resident, it is necessary that the interest should arise in a contracting state, i.e., twin conditions of accrual as well as the payment are to be satisfied. If there is no accrual or actual payment received then same is to be decided within the scope of Article 11(1). What the TPO/AO have sought to tax is that, assessee was supposed to receive interest of 18%, if the contingent event would have arisen, i.e., if in the event, the option was exercised by the assessee to sell its converted shares to the promoters of investee company at an

option price then it would have given the return of 18%. Thus, entire edifice of the TPO/AO was based on fixation of contingent event which assessee was supposed to receive. It is also matter of record no such conversion was actualised and assessee remained invested even during the year under consideration. The transfer pricing adjustment has been made on this hypothetical amount of interest receivable. Whether such notional income can be brought to tax even under the transfer pricing provision, has been dealt by the Hon'ble Bombay High Court in the case of Vodafone India Services (P) Ltd. vs. Union of India (supra), wherein their Lordships have held that even income arising from international transaction must satisfy the test of income under the Act and must find its home in one of the charging provisions. Here in this case, nowhere the TPO/AO has been able to establish that notional interest satisfy the test of income arising or received under the charging provision of Income Tax Act. If income is not taxable in terms of section 4, then chapter X cannot be made applicable, because section 92 provides for computing the income arising from international transactions with regard to the ALP. Only the interest income chargeable to tax can be subject matter of transfer pricing in India. Making any transfer pricing adjustment on interest which has neither been received nor accrued to the assessee cannot be held to be chargeable in terms of the Income Tax Act read with Article 11(1) of DTAA. Here it cannot be the case of accrual of interest also, because none of the investee companies have acknowledge that any interest payment is due, albeit they have been requesting for waiving of interest of even coupon rate of 4%, leave alone the return of 18% which was dependent upon some future contingencies. Assessee despite all its efforts has acceded to such request. Further, in the India Cyprus DTAA wherein similar phrase has been used pertaining to FTS and Royalty in India Cyprus DTAA, Hon'ble Bombay High Court held that assessment of royalty or FTS should be made in the year in which amount have actually received and not otherwise. The coordinate bench of Mumbai ITAT in the case of Pramerica ASPF II Cyprus Holding Ltd. vs. DCIT (supra) on exactly similar set of facts, addition on account of notional interest was made; the Tribunal has held that the interest income in question can only be taxed on payment /receipt basis. The relevant observation has already been incorporated above. The Hon'ble Bombay High Court has confirmed the said finding. Similar view has been taken by the ITAT Chennai Bench in the case of DCIT vs. Inzi Control India Limited (supra). Thus, in view of Article 11(1) we hold that, only the interest which has actually been received can only be subject matter of taxation and no TP adjustment can be made on some hypothetical receivable amount which was contingent upon certain event which has actually not been taken

place during the year. Thus, the order of the Direction of the DRP is upheld and the grounds raised by the revenue are dismissed.”

8. The aforesaid decision of the Coordinate Bench squarely applies to the assessee's case, since, not only the facts involved are more or less common but the relevant provisions of the applicable DTAA's i.e. Article 11(1) of both India-Mauritius and India-Cyprus treaties are identically worded. No contrary decision has been brought to our notice by the learned Departmental Representative. Even, the Revenue is unable to prove that interest on CCDs was actually received by the assessee. Therefore, following the judicial precedents referred to above we hold that the addition made on account of transfer pricing adjustment is unsustainable as the assessee has actually not received any interest income, hence, would be protected by Article 11(1) of India-Mauritius tax treaty. Since, the treaty provision is more beneficial to the assessee as per section 90(1) of the Act, it will override all other provisions of the Act. Additions made are deleted. In view of our decision hereinabove, various other grounds raised by the assessee contesting the TP adjustment having become academic are not required to be adjudicated. However, the issues raised therein are kept open for adjudication if they arise in any other assessment year in future. The grounds raised by the assessee challenging levy of interest being consequential in nature do not require adjudication.

In the result, Appeals are allowed as indicated above.

Order pronounced in the open Court on 15.11.2019

Sd/-
N.K.PRADHAN
ACCOUNTANT MEMBER

Sd/-
SAKTIJIT DEY
JUDICIAL MEMBER

MUMBAI, DATED: 15.11.2019

Copy of the order forwarded to:

- (1) *The Assessee;*
- (2) *The Revenue;*
- (3) *The CIT(A);*
- (4) *The CIT, Mumbai City concerned;*
- (5) *The DR, ITAT, Mumbai;*
- (6) *Guard file.*

Pradeep J. Chowdhury
Sr. Private Secretary

True Copy
By Order

Assistant Registrar
ITAT, Mumbai