

IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE

BEFORE SHRI N.V. VASUDEVAN, VICE PRESIDENT
AND SHRI B R BASKARAN, ACCOUNTANT MEMBER

ITA No.1549/Bang/2019
Assessment year: 2015-16

IMS Health Analytics Services Private Ltd. [formerly IMS Health India Pvt. Ltd. since merged], Omega Block, Embassy Tech Square, Marathahalli – Sarjapur Outer Ring Road, Kadubeesanahalli, Bangalore – 560 103. PAN: AADCP 1532C	Vs.	The Deputy Commissioner of Income Tax, Circle 3(1)(1), Bangalore.
APPELLANT		RESPONDENT

Appellant by	:	Smt. Tanmayee Rajkumar, Advocate
Respondent by	:	Smt. R. Premi, Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	11.06.2020
Date of Pronouncement	:	19.06.2020

ORDER

Per N.V. Vasudevan, Vice President

This is an appeal by the assessee against the order dated 26.4.2019 of the CIT(Appeals)-3, Bengaluru relating to assessment year 2015-16.

2. The only issue that arises for consideration in this appeal is as to, whether the revenue authorities were justified in disallowing the claim of the assessee for deduction of a sum of Rs.2,56,17,280 being interest expenditure on Compulsorily Convertible Debentures [CCDs].

3. The assessee is a company which is engaged in the business of knowledge process outsourcing. During the previous year, the assessee had issued 4,92,640 CCDs of Rs.1,000 each to IQVIA AG, Switzerland carrying an interest rate of 5.2% p.a. On the above CCDs, the assessee paid interest of Rs.2,56,17,280. The said sum was claimed as a deduction u/s. 36(1)(iii) of the Act viz., amount of interest paid in respect of capital borrowed for the purpose of business or profession. According to the AO, since the CCDs are fully convertible to equity shares, any expenditure relating thereto would be in the nature of capital expenditure and accordingly he disallowed the claim of assessee for deduction u/s. 36(1)(iii) of the Act. The AO in coming to the above conclusion placed reliance on the decision of the Special Bench (SB) Income Tax Appellate Tribunal (ITAT) in the case of *Ashima Syntex Ltd. v. ACIT [2006] 100 ITD 247 (Ahd)(SB)*. In the aforesaid case decided by the Special Bench [SB], the assessee issued CCDs which were to be fully converted into equity shares after a certain period. The assessee claimed deduction of expenditure incurred in issuing wholly convertible debentures and the question before the SB was, whether it was allowable u/s. 37(1) as revenue expenditure. The SB held that the expenditure was not revenue expenditure.

4. Aggrieved by the order of AO, assessee preferred appeal before the CIT(Appeals) and relied on the decision of the ITAT Mumbai Bench in the case of *Ganesh Banzoplast Ltd. v. ACIT [2008] 20 SOT 1 (Mum) [URO]* wherein it was held that the debenture issue expenses were to be allowed as a deduction. The assessee also placed reliance on the decision of AAR In re. *LMN India Ltd. [2008] 175 Taxman 139 (AAR)*. The CIT(A) held that the decision of AAR relied on by the assessee did not answer the question relating to allowability of interest as expenditure in the hands of the resident company. Rather, the AAR decided only the receipt in the hands of recipient. The CIT(A) also held that the decision of ITAT Mumbai Bench in

the case of *Ganesh Banzoplast Ltd. (supra)* was rendered on the basis of decision in the said assessee's own case by the Tribunal in the earlier assessment year by following the rule of consistency and therefore the said decision was not of any help to the plea of assessee. The CIT(A) was of the view that the decision of the ITAT SB in the case of *Ashima Syntex Ltd. (supra)* was applicable to the case of the assessee and therefore the action of the AO in making the impugned disallowance was upheld by the CIT(Appeals).

5. Aggrieved by the order of CIT(Appeals), the assessee has preferred the present appeal before the Tribunal.

6. The Id. counsel for the assessee submitted that the ITAT SB decision rendered in the case of *Ashima Syntex Ltd. (supra)* was a case of expenses incurred in connection with the issue of CCDs; whereas the case of assessee is in relation to deduction of interest paid on CCDs and therefore clearly distinguishable. It was submitted that CCDs till such time they are converted into equity are in the nature of loans and therefore any interest paid on borrowings for the purpose of business has to be allowed as a deduction u/s. 36(1)(iii) of the Act. In this regard, the Id. counsel for the assessee placed reliance on the decision of ITAT Bangalore 'A' Bench in the case of *ACIT v. M/s. CAE Flight Training (I) Pvt. Ltd. in IT(TP)A No.2060/Bang/2016 dated 25.7.2017*. The issue for consideration in the aforesaid case decided by the Bangalore Bench was with regard to the interest paid on CCDs. The contention of the revenue was that though the nomenclature CCD is used, yet they are in the nature of equity. The revenue sought to raise the above contention on the basis of the Thin Capitalisation rule which was not applicable for the assessment year which was under consideration before the Tribunal. The Tribunal firstly held in the case of *CAE Flight Training (I) Pvt. Ltd. (supra)* that Thin Capitalisation principle was not applicable till such time those principles were recognised

by way of statutory provisions. Thereafter, the Tribunal examined whether the question, interest paid on CCDs should be allowed as a deduction. The Tribunal distinguished the decision of the Special Bench ITAT in the case of *Ashima Syntex Ltd. (supra)* and held as follows:-

“23. As per above paras of this tribunal order, it comes out that even if Thin capitalization Principle is on Statute book of the other country, no disallowance can be made in India by applying this Principle. To this extent, we uphold the finding of CIT (A) by respectfully following this tribunal order. But the issue still remains because, the objections of AO/TPO are not merely on the basis of Thin capitalization Principle. Their basic objection is this that since the interest is paid on CCDs, this is not an interest on debt but on equity and hence, not allowable. On page 11 of his order for A. Y. 2009 – 10, the TPO has reproduced certain comments of RBI in 2007 Policy on convertible debentures in which it is stated that fully and mandatorily convertible debentures into equity within a specified time would be reckoned as equity under FDI policy. In view of this RBI Policy, the TPO concluded that these CCDs are equity and not debt and therefore, interest on it is not allowable u/s 36 (1) (iii). This finding of TPO is not by invoking Thin Capitalisation principle and therefore, it has to be decided independently. We find that the decision of TPO is bases on RBI policy of FDI. We all know that RBI policy of FDI is governed by this that what will be future repayment obligation in convertible foreign currency and since, CCDs does not have any repayment obligation, the same was considered by RBI as equity for FDI policy. Now the question is that such treatment given by RBI for FDI policy can be applied in every aspect of CCDs. Whether the holder of CCDs before ins conversion can have voting rights? Whether dividend can be paid on CCDs before its conversion? In our considered opinion, the reply to these questions is a BIG NO. On the same logic, in our considered opinion, till the date of conversion, for allowability of interest u/s 36 (1) (iii) of Income tax Act also, such CCDs are to be considered as Debt only and interest thereon has to be allowed and it cannot be disallowed by saying that CCDs are equity and not debt. We hold accordingly. This issue is decided.

24. After examining the applicability of the Tribunal order rendered in the case of *Besix Kier Dabhol, SA vs. DDIT (supra)*,

we now examine the applicability of the decision of Special Bench of the Tribunal rendered in the case of Ashima Syntex Ltd. Vs. ACIT as reported in 100 ITD 247 (Ahd.) (SB) on which reliance has been placed by ld. DR of revenue in the written submissions filed by him as reproduced above. From the facts noted by the Tribunal in this case, it is seen that in that case the assessee issued convertible debentures for subscription at the rate of Rs. 75 per debenture and these were in two parts; Part-A of Rs. 35 to be compulsorily converted into one equity share of the face value of Rs. 10 each at a premium of Rs. 25 per share on the date of allotment of the debenture and Part-B of Rs. 40 to be compulsorily converted into one equity share of the face value of Rs. 10 each at a premium of Rs. 30 per share on the expiry of 15 months from the date of allotment of the debenture. Part-B debenture was to carry an interest at the rate of Rs. 14 per annum till the date of conversion payable half yearly on 30th June and 31st December each year and on conversion. The issue in dispute in that case was regarding the allowability of expenses incurred on issue of such debentures and the issue in that case was not of interest on debentures before its conversion as in the present case. This is also an important aspect of the matter of that case that one part of the debenture was to be converted on the date of allotment of debenture itself, second part of the debenture has to be converted only on expiry of 15 months from the date of allotment of debenture and under these facts, it was held by Special Bench of the Tribunal in that case that the expenses incurred on issue of such debentures has to be considered as expenses incurred for issue of shares because it was found that first part of the debentures was to be converted into shares on the date of allotment itself and the second part was to be converted after expiry of 15 months from the date of allotment of debenture and therefore it was held that expenses incurred were actually incurred for issue of shares and not issue of debentures. In the present case, the issue is not regarding expenses incurred on issue of shares. In the present case, the dispute is regarding interest on CCDs for a period before conversion. Hence in our considered opinion, this decision of special bench of the Tribunal is not applicable in the facts of present case because the issue in dispute is different. In that case the issue in dispute is regarding expenditure incurred on issue of convertibles whereas in the present case the issue is regarding allowability of interest

expenditure on convertible debentures for the pre-conversion period. Hence we hold that the revenue does not find any support from this decision of Special Bench of the Tribunal in that case.

25. Apart from relying on this decision of Special Bench of the Tribunal, the Id. DR of revenue in written submissions as reproduced above has mainly reiterated the same arguments which are adopted by the TPO in its order i.e. regarding RBI Master Circular on Foreign Investment in India dated 02.07.2007 and 01.07.2008. We would like to observe that such circular in the context of FDI policy of RBI is in a different context i.e. regarding future re-payment obligations in convertible foreign currency and to have control over such future re-payment obligations, the RBI is exercising strict and control so that such future re-payment obligations does not go beyond a point and since in the case of fully convertible debentures, there is no future re-payment obligation, the same was considered as equity for the purpose of FDI policy. In our considered opinion, any definition of any term is to be considered keeping in mind the context in which such definition was given. This definition of convertible debentures given by RBI is in the context of FDI policy to exercise control on future re-payment obligations in convertible foreign currency. In our considered opinion, such definition of the term convertible debentures cannot be applied in other context such as allowability of interest on such debentures during pre-conversion period or regarding payment of dividend on such convertible debentures during preconversion period or regarding granting of voting rights to the holders of such convertible debentures before the date of conversion. If you ask a question as to whether dividend can be paid on such convertible debentures in a period before the date of conversion or whether such holders of convertible debentures can be granted voting rights at par with voting rights of share holders during pre-conversion period, the answer will be a big NO. On the same analogy, in our considered opinion, the answer of this question is also a big NO as to whether interest paid on convertible debentures for pre-conversion period can be said to be interest on equity and interest on debentures allowable u/s. 36(1)(iii) of the IT Act.”

7. The Id. counsel for the assessee also submitted that the Hon'ble Rajasthan High Court in the case of *CIT v. Secure Meters Ltd. [2008] 175*

Taxman 567 (Raj) took the view that expenses incurred in relation to the issue of debentures were revenue expenditure and should be allowed as revenue expenditure u/s. 37(1) of the Act. Our attention was also drawn to the decision of the Hon'ble High Court of Karnataka in the case of *CIT v. ITC Hotels [2020] 190 Taxman 430 (Karn)* wherein it was held that expenditure incurred on issue of convertible debentures is allowable as revenue expenditure u/s. 37(1) of the Act. The sum and substance of the submission was that the decision of the Special Bench rendered in the case of *Ashima Syntex Ltd. (supra)* cannot be followed in the light of decision of the Hon'ble High Court of Karnataka. The above submission was made without prejudice to the submission that question of interest on the issue of convertible debenture u/s. 37(1) cannot be equated with the issue, whether interest paid on debentures is allowable as a deduction u/s. 36(1)(iii) of the Act.

8. The Id. DR relied on the order of CIT(Appeals).

9. We have given a careful consideration to the rival submissions. We are of the view that the decision of the ITAT Bangalore Bench in the case of *CAE Flight Training (I) Pvt. Ltd. (supra)* supports the plea of the assessee for allowing deduction on interest paid on CCDs. In the aforesaid decision, the Tribunal in para 23 held that the fact that the RBI under its Foreign Direct Investment Policy mandates conversion of debentures into equity and such mandate will not make any difference to the allowability of interest on debentures u/s. 36(1)(iii) of the Act. The Tribunal held that till date of conversion, CCDs are in the nature of debt and interest paid on CCDs cannot be disallowed on the ground that CCDs will later on be converted into equity. The Tribunal thereafter in para 24 examined the decision rendered in *Ashima Syntex Ltd. (supra)* and concluded that the issue therein was regarding expenses incurred on issue of convertible debentures and not interest paid on CCDs for the period before conversion

and therefore the decision of Special Bench will not be of any application to the facts of the cases where deduction u/s. 36(1)(iii) of the Act is claimed. The Tribunal also discussed the RBI Master Circular on Foreign Investments in India dated 2.7.2007 and 1.7.2008 and held that those circulars will have no effect and the debentures till its conversion will retain its character as loan or borrowings.

10. In the light of the aforesaid decision of the Tribunal, we are of the view that the deduction claimed by the assessee has to be allowed. We may also clarify that the Thin Capitalisation principle was neither invoked by the AO or the CIT(Appeals) in the present case nor were those rules part of the statute for the relevant AY in this appeal.

11. For the reasons given above, we allow the appeal of the assessee and hold that deduction claimed by the assessee should be allowed.

12. In the result, the appeal by the assessee is allowed.

Pronounced in the open court on this 19th day of June, 2020.

Sd/-

(B R BASKARAN)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 19th June, 2020.

/Desai S Murthy/

Sd/-

(N V VASUDEVAN)
VICE PRESIDENT

Copy to:

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

By order

Assistant Registrar
ITAT, Bangalore.