

**IN THE INCOME TAX APPELLATE TRIBUNAL,
MUMBAI BENCH "E", MUMBAI**

**BEFORE SHRI RAJESH KUMAR, ACCOUNTANT MEMBER AND
SHRI RAVISH SOOD, JUDICIAL MEMBER**

**ITA No.1930/M/2018
Assessment Year: 2014-15**

M/s. Essar House Ltd., Essar House, 11 K.K. Marg, Mahalaxmi, Mumbai – 400 034 PAN: AAACJ2883P	Vs.	Asst CIT (CIR) 6(2)(2), R.No.504, 5 th Floor, Aayakar Bhavan, M.K. Road, Mumbai - 400020
(Appellant)		(Respondent)

Present for:

Assessee by : Shri Vijay Mehta, A.R. &
Shri Anuj Kisnadwala, A.R.
Revenue by : Shri R. Manjunatha Swamy, D.R.

Date of Hearing : 23.10.2020
Date of Pronouncement : 11.12.2020

ORDER

Per Rajesh Kumar, Accountant Member:

The present appeal has been preferred by the assessee against the order dated 31.01.2018 of the Commissioner of Income Tax (Appeals) [hereinafter referred to as the CIT(A)] relevant to assessment year 2014-15.

2. The various grounds raised by the assessee are as under:

- "1. The CIT (A) has erred in confirming the disallowance of Interest amount payable towards defeasance of Sales Tax Liability amounting to Rs.226,07,45,800.
2. The CIT(A) has erred in holding that interest liability cannot be treated as expenditure incurred for the purpose of earning or making income by way of discounting charges on the Zero Coupon Bonds (ZCBs) and consequently , the same is not eligible for deduction u/s 57(iii) of the Act against the income by way of discounting charges on ZCBs.
3. The CIT(A) erred in holding that transaction is not a bonafide in nature and interest liability was arisen from adoption of a colorable device by the appellant for avoidance of tax.

4. The CIT (A) erred in considering/ relying upon events/ transactions which were not relevant for the year under consideration and/ or to the Appellant.
5. The CIT (A) erred in making various unsubstantiated and unjustified allegations/ averments which ought to be deleted.

The Appellant craves to add, amend, vary, omit or substitute any of the aforesaid grounds of appeal at any time before or at the time of hearing of appeal.”

3. The only effective issue raised by the assessee is against the confirmation of disallowance by Ld. CIT(A) qua interest payable towards defeasance of sales tax liability as made by the AO of Rs.226,07,45,800/-.

4. At the outset, the Ld. Counsel of the assessee submitted that the identical issue was adjudicated by the coordinate bench in assessee own case and is squarely covered in favour of the assessee by the said decision of co-ordinate bench in ITA No.6980/M/2016 A.Y. 2012-13 and others vide order dated 04.04.2019. The Ld. A.R. therefore prayed that the appeal of the assessee may kindly be allowed following the said decision of the co-ordinate bench of the Tribunal.

5. The facts in brief are that the assessee filed the return of income on 30.09.2014 declaring total loss of Rs.17,94,10,686/- which was subsequently revised on 31.03.2016 declaring total loss of Rs.11,23,94,127/-. Thereafter, the case of the assessee was selected for scrutiny and statutory notices were duly issued and served upon the assessee. During the course of assessment proceedings, the AO noted that assessee has claimed interest on sales tax liability amounting to Rs.228,57,93,280/-. The assessee vide letter dated 16.12.2016 submitted that M/s. Essar Oil Ltd. was entitled to collect sales tax and defer the payment thereof upto 14.08.2020 as per the scheme of

Govt. of India. The deferred sales tax liability was payable in six annual installments starting from 2021-22. The assessee submitted that Essar Oil Ltd. assigned this liability in favour of the assessee in consideration of present value of the said deferred sales tax liability of Essar Oil Ltd. The assessee claimed deduction of interest expenditure of Rs. 228.57 crores under section 57(iii) of the Act on sales tax liability of Rs.1805.52 Cr undertaken from Essar Oil Ltd. against the interest income of Rs.226.07 crores received on zero coupon bonds of Imperial Consultants and Securities Pvt. Ltd. in the computation of income. The AO, after noticing the same during the assessment proceedings, issued a show cause notice to the assessee as to why the interest expenditure as claimed u/s 57(iii) of the Act should not be disallowed. The assessee submitted before the AO that there is a direct nexus between the interest income and interest expenditure hence the same is allowable under section 57(iii) of the Act. The assessee submitted that the said expenditure was incurred on the sales tax liability undertaken from Essar Oil Ltd. The assessee derived income by way of interest of Rs.226.07 crores during the year from zero coupon bonds of Imperial Consultants and Securities Pvt. Ltd. of Rs. 1805.52 Cr against which interest of Rs.228.57 crores was paid to Essar Oil Ltd. on sales tax liability undertaken from Essar Oil Ltd. The AO came to the conclusion that the transactions between two group concerns were entered into to evade the taxes and therefore were colourable transactions especially in the light of the judgment of Hon'ble Supreme Court in the case of CIT vs. Gopinathan 248 ITR 449(SC) and thus disallowed the interest expenditure.

6. The Ld. CIT(A) dismissed the appeal of the assessee by observing and holding as under:

21. In the written submission, the appellant explained the background facts with regard to this transaction. It was stated that EOL was entitled to collect sales tax and defer the payment of such sales tax collected upto 14.08.2020 as per the sales tax incentive scheme of the Govt. of Gujarat subject to fulfilment of certain conditions. The deferred sales tax liability is payable to the Govt. of Gujarat in six annual instalments starting from the financial year 2021-22. It was explained that a Defeasance-cum-Novation agreement was entered into by EOL with the appellant on 31.03.2009 for the defeasance of the said deferred sales tax liability of EOL in favour of the appellant in consideration of payment of the net present value of the deferred sales tax liability by EOL to the appellant, It was stated that as per the agreement, EOL paid the net present value of the deferred sales tax liability on a periodical basis and the amount paid to the appellant aggregated to Rs.1805.52 Crores. It was explained that in order to meet the liability to pay the sales tax to the Govt. Of Gujarat as and when it arises from FY 2021-22 onwards and to earn some income on this transaction, the appellant had invested the above amounts aggregating to Rs.1805.52 Crores received from EOL in the ZCBs of Essar Investments Ltd. Consequent to the demerger of the Investment and Finance division of Essar Investment Ltd (EIL) into Imperial Consultants & Securities Pvt. Ltd. (ICSPL) with effect from 01.04.2012, the investment in ZCBs of EIL was substituted by the ZCBs of ICSPL.

22. However, in the backdrop of the decision of the Hon'ble Supreme Court dated 17.01.2012. in the case filed by the Gujarat Sales Tax Department against EOL whereby the EOL was held to be ineligible for the benefit of deferment of sales tax, the sales tax liability of EOL became payable immediately. In view of this, EOL terminated the defeasance agreement vide letter dated 02.08.2012 and required the appellant to repay the amount of 1805.52 Crores paid to the appellant along with the interest as per the terms of the termination clause of the Defeasance-cum-Novation agreement. It was explained that the interest of Rs,228.58 Crores was therefore paid during the year to EOL on the amount that remained to be repaid to EOL on account of termination of the defeasance agreement and the interest remaining payable to EOL for the earlier years on account of termination. The appellant furnished copies of the defeasance agreement, letter of termination of the agreement, the copies of bank account statement showing the making of the investment in ZCBs out of the amount received from the EOL, the details of amount remaining to be repaid to EOL and the interest remaining payable to EOL as on 31.03.2013 and the computation of interest payable to EOL for the year in respect of such amounts.

23. The appellant contended that the interest payable on the funds received which have yielded income is an expenditure against such income and therefore eligible for deduction against the same. The appellant stated that there is a one-to-one correlation between the income offered to tax by way of discounting charges on ZCBs and interest expenses claimed as a deduction against the same and therefore the interest expenses are eligible for deduction u/s.57(lii) of the Act. The appellant placed reliance on the decision of the Hon'ble Supreme Court in the case of CIT Vs. Rejendra Prasad Moody 115 ITR 590, decision of the Hon'ble Bombay High Court in the case of Smt Sushii Devi Khadaria 319 ITR 413 and the decisions of the Hon'ble Delhi High Court in the cases of Vodafone South Ltd. Vs. CIT 61 taxmann.com 415 and Taj International Jewellers 20 taxmann.com 1 in support of its contention. The appellant also pointed out that this issue has been decided by the Crr(A) in favour of the appellant in the appellate orders passed in the case of the appellant for A.Vs. 2012-13 and 2013-14.

24. Further, the appellant stated that the reliance placed by the AO on the decision of the Hon'ble Supreme Court in the case of CIT Vs. V. P. Gopinathan (Supra) is erroneous since the facts of the said case are completely different in as much as the assessee in the said case had made fixed deposit out of surplus money and claimed deduction of interest payable to the bank on the loan taken against the security of such fixed deposit against the interest received on the fixed deposit.

25. Without prejudice to the above, the appellant pointed out that the AO disallowed interest expenses of Rs.228,57,93,218/- though the appellant restricted its claim of deduction of interest expenses to the extent of discounting charges received on ZCBs i.e.

26. I have carefully considered the facts of the case, the assessment order and the written submission of the appellant. On perusal of the Defeasance-cum-Novation agreement dated 31.03.2009 entered into by the appellant with EOL, it is seen that EOL had setup a refinery at Vadlnar, Gujarat and the refinery was granted certain benefits under the Capital Investment Incentive Scheme 1995-2000 of the Industries and Mines Department, Govt. Of Gujarat which envisages inter-alia the grant of sales tax incentive by way of deferment of sales tax on the terms and conditions specified there under. By virtue of this scheme, EOL was entitled to collect sales tax on its sales and defer the payment of the said sales tax to be collected by it upto 14.08.2020 to the extent of an amount equivalent to 125% of the eligible fixed capital investment and the said deferred sales tax liability is payable in six equal annual instalments starting from FY 2021-22. EOL desired to defeasance the said deferred sales tax liability and transferred the deferred sales tax liability upto 31.12.2008 to India Securities Ltd. (ISL) vide agreement dated 30.06.2008. Subsequently, ISL did not intend to continue with the said defeasance arrangement and EOL therefore entered into agreement with the appellant on 31.03.2009 to defeasance the deferred sales tax liability in favour of the appellant with retrospective effect i.e. from 30.06.2008.

27. As per the defeasance agreement entered into by the appellant, EOL shall defeasance the liabilities towards sales tax collected by it in favour of the appellant from time to time on a quarterly basis. It was provided that the deferred sales tax liabilities shall be discounted to arrive at the net present value and the discounting rate shall be based on the prevalent G-Sec rate (the yield rate on Govt. Securities), The net present value of the liabilities was required to be arrived at by applying the agreed discounting rate on yearly basis for the period commencing from the date of defeasance till the due dates for payment of sales tax to the Govt. of Gujarat. As per the agreement, EOL was required to pay the agreed net present value of the sales tax liabilities under the scheme to the appellant as the consideration for taking over the deferred sales tax liability. It was provided that the appellant shall pay the sales tax liability to the Govt. of Gujarat as per the due dates.

28. On perusal of the details furnished by the appellant, it is seen that the year wise break-up of the consideration paid by EOL to the appellant towards defeasance of its deferred sales tax liabilities in favour of the appellant is as under:

F.Y.	Amount (In Rs.)
2009-10	739,73,55,505
2010-11	571,46,32,084
2011-12	499,51,45,532
Total	1810,71,33,121

29. It is seen that as per the information contained in Note No. 26 of the Notes forming part of the financial statements of the appellant for the present assessment year, the total amount of deferred sales tax liability that was transferred to the appellant in pursuance of the defeasance agreement amounted to Rs.6069.94 Crores and that the consideration paid to the appellant by EOL for taking over such liability amounted to Rs.1805.52 Crores. The said amount of Rs.1805.52 Crores was arrived at by computing the net present value of the deferred sales tax liability of Rs.6069.94 Crores by discounting the same as per the prevalent rate of interest on Govt. Securities (G-Sec.).

30. Further, on perusal of the bank account statements of the appellant company, it is seen that the amounts received from EOL were paid to Essar Investments Ltd. (EIL) and the appellant was allotted ZCBs by EIL against the said amounts. It is seen that there is a direct nexus between the amounts received from EOL towards defeasance of the sales tax liability in favour of the appellant and the amounts invested by the EOL in the ZCBs of EIL. The investment and finance division of EIL was subsequently de-merged into Imperial

Consultants & Securities Pvt. Ltd. (ICSPL) on the appointed date of 01.04.2012. The details of the ZCBs issued to the appellant by EIL are as under:

F.Y.	Amount paid to EIL (Rs.)	Date of allotment of ZCBs by EIL	Details of ZCBs allotted	Value of ZCBs allotted
2009-10	739,73,55,505	30.04.2009	2,50,000 ZCBs of series I	250,00,00,000
		31.03.2010	2,90,460 ZCBs of series II, 1,99,275 ZCBs of series III	489,73,50,000
			Sub-total	739,73,55,505
2010-11	571,46,32,084	31.03.2011	2,06,890 ZCBs of series IV, 1,77,026 ZCBs of series V, 1,87,547 ZCBs of series VI	571,46,32,084
2011-12	499,51,45,532	31.03.2012	1,88,000 ZCBs of series VII, 75,110 ZCBs of series VIII, 2,31,208 ZCBs of series IX	494,31,80,000
Total	1810,71,33,121			1805,511,60,000

31. It is seen that prior to entering into the defeasance agreement with the appellant, a dispute arose in the case of EOL regarding the eligibility of the said company to the benefit of deferment of sales tax in view of non-fulfilment an essential condition for availing the said benefit that the refinery being set up by the EOL should start its commercial production on or before 15.02.2003. EOL was unable to commence its commercial production by the said date due to non-receipt of the permission for laying of pipelines in the National Marine Park/Sanctuary area from the Govt. on account of the injunction issued by the Hon'ble High Court of Gujarat restraining the state Govt. from granting any more authorisations and permissions for laying down any pipeline in any part of the sanctuary of the national park vide order dated 13.07.2000. Subsequently, the Hon'ble Supreme Court vide its order dated 19.01.2004 quashed and set aside the said order of the Hon'ble Gujarat High Court and directed the state government to issue the necessary authorisation. Subsequently, EOL was issued necessary permission for laying oil pipelines in the National Marine Park area on 27.02.2004. EOL completed the project and commenced commercial production on 26.11.2006. However, since the commercial production did not commence by the due date of 15.02.2003 and the extended due date of 15.08.2003, EOL was denied the benefit of sales tax deferment by the statement government.

32. EOL filed a writ petition before the Hon'ble Gujarat High Court against the denial of the benefit of sales tax deferment by the Govt, of Gujarat on the ground that the delay in commencement of commercial production was due to reasons beyond its control. The Hon'ble High Court vide its order dated 22.04.2008 directed

the state government to consider the application of EOL for granting the benefit of sales tax deferment under the Capital Investment Incentive Scheme after proceeding on the basis that for the purpose of considering whether commercial production had commenced within the stipulated date, the period from 13.07.2000 to 27.02.2004 shall be excluded. The state of Gujarat filed an SLP against the said order of the Hon'ble Gujarat High Court before the Hon'ble Supreme Court. The said SLP was disposed off by the Hon'ble Supreme Court vide its order dated 17.01.2012 in favour of the state government of Gujarat. On account of the decision of the Hon'ble Supreme Court, EOL became ineligible for the benefit of sales tax deferment and it was required to pay the sales tax collected by it and not paid to the state government so far on account of availing the benefit of sales tax deferment.

33. Consequent to the order of the Hon'ble Supreme Court, EOL invoked the termination clause in the defeasance agreement entered into with the appellant earlier on 31.03.2009. Vide letter dated 02.08.2012, EOL informed the appellant that it has terminated the defeasance agreement as per Clause No.9 of the agreement with effect from 31.03.2012 and that the amount payable on termination along with applicable interest shall be paid by the appellant on or before 31-12.2012. It was stated in the said letter that the amount payable on termination shall carry interest at the originally agreed discount rates till the entire dues are settled. It was further mentioned that once the dues under the agreement are settled by the appellant by making payment to EOL, the appellant would be fully absolved of the responsibility of making any payment to Gujarat Sales Tax department on behalf of EOL under the defeasance agreement.

34. Subsequently, vide letter dated 29.10.2012, the appellant informed EOL that the termination of the agreement has been accepted and the appellant agrees to repay the principal amount of sales tax liability of Rs.1805 Crores along with accrued interest in eight equal quarterly instalments starting from 02.01.2013. It was informed that the appellant agrees to pay interest at the rate of 13% per annum quarterly compounded with effect from 01.04.2012 till the entire dues are cleared.

35. In view of the termination of the defeasance agreement with effect from 31.03.2012, the appellant became liable to refund the net present value of the deferred sales tax liability of EOL of Rs.1805.52 Crores received by it from EOL earlier in pursuance of the said agreement during the FYs 2009-10 to 2011-12 and which was invested by it in the ZCBs issued by Essar Investment Ltd. (EIL) during the said years. The appellant also became liable to pay interest on the said amount of Rs.1805.52 Crores from the date of receipt of the amount from EOL till the date of termination of the agreement (i.e. 31.03.2012) at the same rates at which the deferred sales tax liability was originally discounted in order to arrive at the net present value of Rs.1805.52 Crores, Further, the appellant agreed to pay interest at the rate of 13% per annum compounded annually for the period subsequent to the effective date of termination of the agreement i.e. from 01.04.2012 onwards till the date of repayment of all the dues. Accordingly, the appellant has shown interest liability to EOL from AY 2012-13 onwards. The details of discounting charges on ZCBs disclosed as income and the interest liability to EOL on account of termination

of defeasance agreement claimed as deduction against such income by the appellant from AY 2012-13 onwards are as under;

A.Y	Discounting charges on ZCBs declared as income (Rs. Crores)	Interest liability to EOL debited in the books (Rs. Crores}	Interest liability to EOL claimed as deduction against discounting charges(Rs. Crores)
2012-13	296.90	296.19	296.19
2013-14	225.01	247.75	225,01
2014-15	226.07	228.57	226.07

36. As regards the interest liability of Rs. 228.57 Crores to EOL for the present assessment year in respect of the amount of repayment due to EOL consequent to the termination of the defeasance agreement, the appellant furnished the following details regarding the manner in which the same has been computed:

Particulars of the amount due to EOL on which interest is payable		Amount (in Rs.)				
Principal amount outstanding as on 31.03.2013		1805,51,55,245				
Interest payable as on 31.03.2013		343,86,68,259				
Total amount due as on 31.03.2013		2149,38,23,554				
Payment date	Amount repaid to EOL (Rs.)	Balance outstanding (Rs.)	Period for which Interest payable	Rate of interest	Interest payable to EOL(RS.)	
			From	To		
		2149,38,23,504	01.04.2013	19.05.2013	13%	37,51,11,386
20.05.2013	267,23,46,662	1882,14,76,642	20.05-2013	12.06.2013	13%	16,08,84,953
13.06.2013	24,00,00,000	1858,14,76,842	13. 06.2013	13.06.2013	13%	66,18,060
14.06.2013	6,00,00,000	1852,14,76,842	14.06.2013	14.06.2013	13%	65,96,690
15-06.2013	67,00,00,000	1763,14,76,842	15.06.2013	16.06.2013	13%	1,25,73,655
17.06.2013	13,00,00,000	1752,14,76,842	17,06.2013	19.06.2013	13%	1,87,21,578
20.06.2013	2,00,00,000	1750,14,76,842	20.06.2013	24.07.2013	13%	21,81,69,095
25,07.2013	80,00,00.000	1670,14,76,842	25-07.2013	31.03.2014	13%	148,71,17,801

Total	479,23,46,662					228,57,93,218
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37. In the P & L account for the year under consideration, the appellant credited discounting charges on ZCBs of Rs.226,07,45,800/- under the head "Other Income". The interest liability to EOL on account of termination of defeasance agreement of Rs.228,57,93,218/- has been included in the interest expenses shown under the finance costs debited to the P & L account. In the return of income filed for the present assessment year 2014-15, the appellant excluded the income from discounting charges on ZCBs as well as the expenditure towards interest liability to EOL from the computation of income under the head business and considered them separately for computing income under the head Income from Other Sources, While computing the Income from other sources, the appellant restricted its claim of deduction for the interest liability to EOL to the extent of the Income from discounting charges on ZCBs i.e. to the tune of Rs.226,07,45,800/-.

38. In the assessment order, the AO disallowed the interest payable in respect of the amount repayable to EOL on termination of defeasance agreement of Rs.228,57,93,218/-. However, as pointed out by the appellant, the said interest expenditure of Rs, 228,57,93,218/- was added back by the appellant while computing the income under the head business and deduction u/s. 57(iii) of the Act for the said interest liability against the income from discounting charges on ZCBs was claimed to the extent of Rs.226,07,45,800/- only. Since the deduction claimed for the interest liability was to the extent of Rs.226,07,45,800/- only, the disallowance made by the AO in respect of the same at Rs.228,57,93,218/- is excessive by a sum of Rs.2,50,47,418/-. Hence, the AO is directed to delete the excessive disallowance of interest made to the tune of Rs. 2,50,47,418/-.

39. Having gone through the facts of the case as detailed above, the correctness of the disallowance of balance interest of Rs.226,07,45,800/- is now taken up for discussion. The Issue for consideration is whether the deduction claimed by the appellant for the balance interest liability to EOL of Rs.226,07,45,800/-, which has arisen on account of the termination of the defeasance agreement, is allowable as a deduction u/s.57(iii) of the Act against the income of Rs.226,07,45,800/- admitted by the appellant by way of discounting charges on the ZCBs. The AO disallowed the claim for deduction of the said interest on the ground that this liability has arisen out of a colourable transaction as the same had taken place between two group concerns and in the light of the judgment of the Hon'ble Supreme Court in the case filed against EOL by the Gujarat Sales Tax department wherein it was held that EOL is not entitled to the Sales tax incentives scheme by way of deferment of sales tax. The AO also held that the deduction for the interest liability to EOL is not allowable in view of the decision of the Hon'ble Supreme Court in the case of CIT Vs. V.P. Gopinathan 248 ITR 449, wherein it was held that the interest payable on the loan taken from the bank on the security of the fixed deposit placed with the bank cannot be allowed as deduction against the interest accrued on the fixed deposit.

40. As per the provisions of section 57(m) of the Act, any expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning the income which is chargeable to tax under the

head income from Other Sources is allowable as a deduction. In order to be eligible for deduction u/s.57(iii), there should be a direct nexus between the expenditure and the income against which the deduction is claimed for computing the income under the head Income from Other Sources. It is necessary that the expenditure was incurred for the purpose of earning the relevant income against which deduction is claimed. As can be seen from the details furnished above, the interest liability to EOL for the year under consideration has been computed by the appellant on the principal amount to be repaid to EOL representing the consideration received earlier from EOL as per defeasance agreement and which has become repayable on account of termination of the defeasance agreement as well as on the amount of interest liability computed in respect of such repayment due for the earlier years which remained outstanding at the beginning of the previous year. Hence, it needs to be seen whether the interest payable to EOL during the year on the amount which the appellant was liable to repay to EOL on account of termination of the defeasance agreement and on the interest liability remaining unpaid on the said amount for the earlier years can be considered to have been incurred for the purpose of earning the income from the ZCBs by way of discounting charges.

41. In this regard, it is the contention of the appellant that since there is a direct nexus between the funds received from EOL and the investment made in ZCBs, the interest liability to EOL is eligible for deduction u/s.57(iii) against the discounting charges receivable on such ZCBs. As already mentioned while stating the facts earlier in this order, the perusal of the bank account statement of the appellant shows one-to-one correlation between the amounts received from EOL by the appellant on account of the defeasance agreement and the amounts invested by the appellant in the ZCBs issued by Essar Investments Ltd. (EIL) during the financial years 2009-10 to 2011-12, The net present value of the deferred sales tax liability of EOL of Rs.6069.94 Crores was computed by EOL at Rs.1805.52 Crores and the said amount of Rs.1805.52 Crores was paid by EOL to the appellant on various dates during the above mentioned financial years and the same amount of Rs.1805.52 Crores was immediately invested by the appellant in the ZCBs of EIL.

42. However, though the funds received from EOL have been invested by the appellant in the ZCBs of EIL, this fact alone cannot be the ground for concluding that there is a direct nexus between the interest liability to EOL and the discounting charges receivable in respect of the ZCBs and that the said interest liability is eligible for deduction against the income from discounting charges as contended by the appellant. The condition to be fulfilled for treating the said interest liability as eligible for deduction u/s.57(iii) is that such interest liability should have been incurred for the purpose of earning the discounting charges on ZCBs. In order to see whether the said condition has been fulfilled, one needs to understand the character of the funds of Rs.1805.52 Crores received from EOL during the financial years 2009-10 to 2011-12 on account of the defeasance agreement, which were utilized for the purpose of making investment in the ZCBs of EIL. If the funds received from EOL represented interest bearing borrowed funds in the hands of the appellant, the interest payable in respect of the same would represent expenditure incurred for the purpose of earning of discounting charges on ZCBs. On the other hand, if the funds received from EOL did not bear the character of interest bearing

borrowed funds at the time of their receipt from EOL and at the time of making corresponding investment in the ZCBs of EOL, the interest becoming payable to EOL in respect of such funds at a later point of time due to the change in the character of the funds arising from the occurrence of an event subsequently, the interest payable to EOL cannot be considered to represent expenditure incurred for the purpose of earning of discounting charges on ZCBs.

43. On careful perusal of the facts of the case, it is seen that the funds of Rs.1805.52 Crores were received by the appellant from EOL during the financial years 2009-10 to 2011-12 by way of consideration payable to the appellant on account of taking over the deferred sales tax liability of EOL in accordance with the defeasance agreement entered into between EOL and the appellant. Thus, it is seen that the amount of Rs.1805.52 Crores received by the appellant did not bear the character of interest bearing borrowed funds on which the appellant had any liability to pay interest. On the other hand, the said amount represented the own funds of the appellant that were earned on account of assuming the legal obligation to pay the deferred sales tax liability of Rs. 6069.94 Crores of EOL to the state government of Gujarat as per the due dates for such payment under the sales tax deferment scheme commencing from PY 2021-22 onwards. The appellant did not have any liability to pay interest to EOL on the said funds at the time the funds were received and were invested in the ZCBs.

44. It was only later that the appellant became liable to repay the consideration of Rs.1805.52 Crores received by it earlier as per the defeasance agreement dated 31.03.2009 on account of the termination of the defeasance agreement w.e.f 31.03.2012, The character of the said funds of Rs.1805.52 Crores has undergone a change only on account of the termination of the agreement due to the subsequent development of EOL being declared ineligible for the benefit of the sales tax deferment by the Hon'ble Supreme Court vide order dated 17.01.2012. The liability to pay interest to EOL arose only on account of termination of the agreement after a period of three years. Hence, it is evident that the liability to pay interest to EOL was not on account of borrowal of funds from EOL for the purpose of earning income by making investment in ZCBs. In view of this, it is considered that the said interest liability cannot be treated as expenditure incurred for the purpose of earning or making the income by way of discounting charges on the ZCBs and consequently, the same is not eligible for deduction u/s.57(iii) of the Act against the income by way of discounting charges on ZCBs.

45. The reliance placed by the AO on the decision of the Hon'ble Supreme Court in the case of V.P. Gopinathan (Supra) has to be appreciated in the above background of the facts of the case. In the said case, the Hon'ble Supreme Court held that the interest payable on the loan taken from the bank on the security of the fixed deposits placed with the bank cannot be claimed as deduction against the interest income of the assesses from such fixed deposits. The principle laid down by the Hon'ble Supreme Court is applicable to the facts of the appellant's case since the liability to pay interest to EOL has no relation to the income earned by the appellant on the investment made in ZCBs since the liability to pay interest arose on account of termination of the defeasance agreement and not an account of borrowal of funds by the appellant for making the said investment in the ZCBs.

46. Apart from the issue discussed above with regard to the direct nexus between the interest liability and the discounting charges income on ZCBs for the purpose of eligibility of the interest liability u/s. 57(iii), another related issue that needs to be adjudicated is the sustainability of another ground cited by the AO for disallowance of interest liability to EOL. The AO held that the interest liability is not an allowable deduction on account of the reason that the transaction between the appellant and EOL which resulted in such expenditure is a colourable transaction between two group concerns. The same is now examined with reference to the facts of the case.

47. In order to judge the bonafide nature of the transaction entered into by the appellant with its group concern which resulted in the interest liability to EOL in the hands of the appellant, it needs to be seen whether the defeasance agreement entered into by the appellant with EOL accords with the principle of commercial expediency. As a prudent businessman, the appellant would enter into such an agreement only when there is a reasonable expectation of earning income on account of entering into such agreement, even though there may be risks in actual earning of income due to reasons beyond the control of the appellant. As per the terms of the defeasance agreement, the appellant was required to take over the deferred sales tax liability of EOL of Rs.6069.94 Crores and discharge the said liability on its own on the due dates for payment of the said liability to the state government of Gujarat in six annual instalments commencing from FY 2021-22. The appellant was to receive a consideration for taking over such deferred sales tax liability and the consideration was to be computed at an amount which represents the net present value of the deferred sales tax liability, which is worked out by discounting the future sales tax liability by a rate which is the rate of interest/yield prevalent in case of Govt. Securities at the relevant points of time when the sales tax liabilities were transferred to the appellant. The consideration was accordingly worked out at Rs.1805.52 Crores.

48. By entering into the defeasance agreement, the appellant has been fastened with the legal obligation of paying a sum of Rs.6069.94 Crores in six annual instalments commencing from FY 2021-22 in return for receiving a consideration aggregating to Rs.1805.52 Crores during the FYs 2009-10 to 2011-12. If the appellant were to act as a prudent businessman, it would have entered into such a defeasance agreement only if there is a reasonable expectation of earning of income by making investment of the said consideration of Rs.1805.52 Crores in such a manner and in such financial instruments that would fetch income to such an extent that the appellant would have sufficient earnings not only to discharge the liability of Rs.6069.94 Crores as and when the same was due for payment to the State Govt of Gujarat but also make adequate income from the said transaction on account of assuming the attendant risks over a long period from the time the consideration is received from EOL and till the time the sales tax liability is required to be discharged by the appellant. The same is examined with reference to the facts of the case.

49. The funds aggregating to Rs. 1805.52 Crores received from the EOL, as a consideration for assuming the liability to pay sales tax of Rs.6069.94 Crores from FY 2021-22 onwards, were invested by the appellant in the ZCBs issued by EIL. The

details of such ZCBs, in terms of the number of ZCBs issued, the issue price of the ZCBs and the face value (amount to be received on redemption of the ZCBs on the date of maturity) of the ZCBs, as available in the financial statements of the appellant for the FY 2011-12 have been analyzed in order to ascertain whether the appellant had made investment of the funds received from EOL in a manner that would enable the appellant to discharge the sales tax liability of Rs.6069.94 Crores as per the due dates and earn a reasonable return for the risks undertaken. It is noticed on such analysis that the investment made by the appellant in the ZCBs issued by EIL would not result in receipt of adequate income by way of discounting charges that would have enabled the appellant to discharge the liability of Rs.6069.94 Crores itself and the appellant would have ended up in incurring a huge loss, as can be seen from the details furnished in the table below:

Series	No. of ZCBs	Issue price of the ZCB (Rs.)	Face value of the ZCB (Rs.)	Total Maturity value (Rs.)
I	2,50,000	10,000	50,000	1250,00,00,000
II	2,90,460	10,000	35,000	10.16,61,00,000
III	1,99,275	10,000	31,500	627,71,62,500
IV	2,06,890	10,000	28,500	589,63,65,000
V	1,77,026	10,000	27,000	477,97,02,000
VI	1,87,547	10,000	26,500	496,99,95,500
VII	1,88,000	10,000	28,000	526,40,00,000
VIII	75,110	10,000	27,500	206,55,25,000
IX	2,31,208	10,000	27,500	624,26,16,000
Total	18,05,516			5816,14,66,000

50. As can be seen from the table above, the amount of Rs.1805.52 Crores invested by the appellant in the ZCBs issued by EIL would fetch the appellant an amount of Rs.5816.14 Crores on redemption of such ZCBs on their maturity, whereas the appellant was required to discharge the sales tax liability of 6069.94 Crores from such redemption proceeds of the ZCBs. Thus, the appellant would have been saddled with a deficit of Rs.253.80 Crores for meeting its liability of payment of sales tax on account of the investment made by it. The appellant would have had to meet the said deficit with its own funds and as a result, it is clear that the appellant would have ended up making a loss of Rs. 253.80 Crores due to entering into the defeasance agreement with EOL. At the time of making the investment in the ZCBs of EIL itself, it was crystal clear that the appellant would receive maturity proceeds

to the extent of Rs,5816.14 Crores only as against the liability to be discharged amounting to Rs.6069.94 Crores and that there was no possibility whatsoever of earning any income from this transaction despite assuming the risks by the appellant. Thus, It is seen that the appellant has entered into a transaction with a related concern, whose outcome was known to result in a huge financial loss to the appellant at the very beginning itself. The conduct of the appellant in entering into such a transaction with a group concern which was bound to result in a substantial loss to the appellant therefore cannot be considered to be a bonafide transaction that has been entered into with a commercial purpose. Such a transaction has to be necessarily regarded as a colourable transaction.

51. In this connection, it is also pertinent to point out that there is no plausible commercial reason for EOL to enter into the defeasance agreement, if the same was sought to be done with a related concern which in turn sought to invest the consideration flowing from the agreement in ZCBs of another related concern. The net present value of the deferred sales tax liability could have been invested directly by EOL itself in income yielding Long Term Financial Instruments of third party finance companies/institutions so as to generate adequate returns that would enable EOL to discharge the sales tax liability as per the due dates in future and eliminate the risk of not being able to generate sufficient returns by itself for meeting the future liability by deploying the funds in its own business. Instead of passing on the said risk to a third party outside the group, EOL has passed on the risk to the related concerns only. Moreover, EOL entered into the defeasance agreement at a time when the SLP filed by the state government of Gujarat against the decision of the Hon'ble Gujarat High Court regarding the eligibility of EOL for the benefit of deferment of sales tax was pending disposal before the Hon'ble Supreme Court. The agreement was entered into knowing fully well that there is uncertainty with regard to availing the benefit of deferment of sales tax until the matter is decided by the Hon'ble Supreme Court. In the light of these surrounding circumstances, it would be reasonable to infer that such a measure of entering into defeasance agreement with a group concern was taken by EOL, though it is devoid of commercial expediency for the group concerns as a whole, only for gaining undue advantage in terms of its tax liability and therefore the same represents a colourable transaction.

52. The subsequent conduct of the appellant: on various counts also does not inspire any confidence to give benefit of doubt to the appellant. Subsequent to the demerger of the Investment and finance division of EIL into Imperial Consultants & Securities Pvt. Ltd. (IC5PL) w.e.f. 01.04.2012, the ZCBs earlier issued by EIL to the appellant were substituted by new ZCBs issued by ICSPL. The details of the same are as under:

Serises	No. of ZCBs	Issue price of ZCB (Rs.)	Face value of ZCB (Rs.)	Date of maturity	Total maturity value (Rs.)
I	2,50,516	10,000	11,425	31.05,2013	251,93,95,300
II	5,00,000	10,000	12,545	31.03.2004	627,25,00,000

III	5,00,000	10,000	14,240	31.03.2015	712,00,00,000
IV	5,85,000	10,000	16,305	31.03.2016	953,84,25,000
Total	18,05,516				2545,03,20,300

53. On careful examination of the details of the ZCBs issued by ICSPL to the appellant in substitution of the ZCBs issued earlier by EIL, it is observed that the appellant has burdened itself with an additional loss on account of the above substitution. The funds of Rs. 1805.52 crores received from EOL were initially invested in the ZCBs of EIL during the FYs 2009-10 to 2011-12, as per the details shown in the table below:

F.Y.	Date of allotment of ZCBs by EIL	Details of ZCBs allotted	Issue price of ZCBs (Rs.)
2009-10	30.04.2009	2,50,000 ZCBs of series I	250,00,00,000
	31.03.2010	2,90,460 ZCBs of series II 1,99,275 ZCBs of series III	489,73,50,000
		Sub-total	739,73,55,505
2010-n	31.03.2011	2,06,890 ZCBs of series IV 1,77,026 ZCBs of series V 1,87,547 ZCBs of series VI	571,46,32,084
2011-12	31.03.2012	1,88,000 ZCBs of series VII 75,110 ZCBs of series VIII 2,3 1,208 ZCBs of series IX	494,31,80,000
Total			1805,51,60,000

54. As can be seen from the above, the funds invested by the appellant in the ZCBs of EIL during the FYs 2009-10 and 2010-11 were available with EIL for periods ranging between one year to three years before they were transferred from EIL to ICSPL w.e.f. 01.04.2012 on account of demerger. Considering the interest that would have accrued on the said funds upto 31.03.2012 in favour of the appellant as per the terms of the ZCBs, the issue price of the new series of ZCBs issued by ICSPL to the appellant w.e.f 01.04.2012 ought to have reflected the original investment made in the ZCBs of EIL and the interest accrued on the same upto 31.03,2012. However, ICSPL issued new series of ZCBs having an issue price of Rs.10,000/- per ZCB only, which is the same issue price of Rs.10,000 per ZCB in respect of ZCBs issued by EIL during the FYs 2009-10 to 2011-12. This has deprived the appellant of the interest that accrued on the ZCBs during the FYs 2009-10 to 2011-12 and the opportunity of earning further interest on such accrued interest on ZCBs upto

31.03.2012 for the duration of the tenure of the ZCBs issued by ICSPL. Since both EIL and ICSPL are related concerns of the appellant, this transaction of substituting the ZCBs of EIL with ZCBs of ICSPL at such terms which resulted in loss of revenue that was due to the appellant is also required to be treated as a transaction which is not bonafide in its nature. Hence, this leg of the transaction is also considered to be a colourable transaction between related concerns.

55. Moreover, it is seen that the ZCBs issued by ICSPL in substitution of the ZCBs of EIL are due for maturity on 31.05.2013, 31.03.2014, 31.03.2015 and 31.03.2016 in respect of series I, series II, Series III and Series IV respectively. As shown in the table in the preceding page, the total redemption proceeds of these ZCBs issued by ICSPL amounts to Rs.2545.03 Crores by 31.03.2016. This implies that the total income to be earned by the appellant from the investment made in the ZCBs by utilising the consideration of Rs.1805.52 Crores received from EOL on account of defeasance agreement upto 31.03.2016 amounts to Rs.739.51 Crores (Rs.2545.03 Crores less Rs.1805.52 Crores). As against this, the interest liability to EOL due to the termination of defeasance agreement recognised by the appellant during the AYs 2012-13, 2013-14 and 2014-15 itself aggregates to Rs,772.51 Crores, which is more than the Income of Rs.739.51 Crores that would be earned upto 31.03.2016 on ZCBs. If the interest liability to EOL recognised by the appellant in the subsequent assessment years is also taken into account, the loss to the appellant would be substantially higher. Hence, this fact also tends further support to the inference drawn in the preceding paragraph that the relevant transactions entered into with the related concerns EOL, EIL and ICSPL are not bonafide in nature and the same are part of a colourable device.

56. Further, it is observed that though the termination of the defeasance agreement was communicated to the appellant by EOL vide letter dated 02.08,2012, it is surprising to find that the termination was stated to be with retrospective effect from 31.03.2012. Though Clause 9 of the defeasance agreement dealing with the "termination of the agreement" provided that the parties to the agreement can terminate the arrangement by giving an advance written notice of 90 days of their intention to do so, it is noticed that the letter dated 02.08.2012 states that the said notice period stands waived as mutually agreed. Further, it is seen that though the termination clause provided that the appellant would be entitled to deduct any reasonable break-up cost, not exceeding 2% of the amount payable by the appellant upon termination, in the event of termination of the agreement by EOL, the appellant has decided not to charge any break-up cost from EOL for the termination made by EOL. The same has been stated by the appellant in the letter dated 24.12,2012 addressed to EOL. All these facts go to show that though the appellant was burdened with an unexpected liability to repay the amount of Rs.1805.52 Crores along with interest to EOL due to the decision of the EOL to terminate the defeasance agreement, the appellant did not make any attempt to safeguard its own interest and the appellant in fact waived its rights in relation to the termination clause dealing with notice period and break-up cost. Therefore, this conduct of the appellant also cannot be considered to be of a bonafide nature.

57. On careful perusal of the financial statements of the appellant for AY 2010-11 to the present AY 2014-15, it is observed that though the investment made by the appellant in the ZCBs issued by EIL was spread over the FYs 2009-10 to 2011-12, the income from the said investment by way of discounting charges has been admitted by the appellant from AY 2012-13 onwards only and no income from the said investment was admitted by the appellant in the AYs 2010-11 and 2011-12. It was further noticed that the said investment in the ZCBs is also not reflected in the balance sheet of the appellant as on 31.3.2010 and 31.03.2011. On requesting the appellant to explain the reasons for the same during the appellate proceedings, it was explained by the appellant that the sales tax liability taken over from EOL as well as the investment made in ZCBs out of the consideration received from EOL towards the same was assigned to a partnership firm M/s Imperial Factoring Services and that the same was re-assigned to the appellant by the said firm with effect from 31.03.2012 on termination of the defeasance agreement by EOL. The partnership deed and the financial statements of the said partnership firm were therefore called for from the appellant. On examination of the same, it is noticed that the partnership firm was constituted vide deed of partnership dated 02.01.2010 with the appellant and EIL as partners with a profit sharing ratio of 5% and 95% respectively. It is further noticed that this firm also did not declare any income from the ZCBs of EIL that were assigned to it by the appellant in AY 2010-11 as well as AY 2011-12. In this regard, it has been explained by the appellant that no income was declared by the firm on the ZCBs since the firm followed cash system of accounting for recognition of revenue and expenses. It was explained that since the discounting charges on ZCBs represent accrued income and the income is actually received only on maturity of the ZCBs there was no income to be recognised by the firm on account of the cash system of accounting followed by it. Thus, it is seen that no income by way of discounting charges was declared in AYs 2010-11 and 2011-12 either by the appellant or by the partnership firm to which the sales tax liability as well as the related investment were assigned during these two years.

58. Considering the above fact, the details of computation of the income of Rs, 296.90 crores by way discounting charges on the ZCBs admitted by the appellant in the return of income for AY 2012-13 were called for and examined. The same is reproduced as under:

Date	Amount Invested (Rs)	Total	Days	Discounting charges @ 10.600/0 (Rs)
27-04-09	2250000000.00	31-03-12	1070	699164383.6
29-04-09	262163807.70	31-03-12	1058	81312439.29
19-11-09	250000000.00	31-03-12	864	62728767.12
20-11-09	450000000.00	31-03-12	863	112781095.9
23-11-09	105655551.00	31-03-12	860	26387835.7
23-11-09	164344449.00	31-03-12	660	41045588.96

27-11-09	328000000.00	31-03-12	856	81538104.11
03-12-09	420000000.00	31-03-12	850	103676712.3
05-12-09	60592126.00	31-03-12	848	19847301.43
19-12-09	1093341681.00	31-03-12	834	264931452
08-03-10	700000000.00	31-03-12	755	153482191.8
10-03-10	200000000.00	31-03-12	753	43735890.41
11-03-10	271440271.00	31-03-12	752	59279580.5
18-03-10	750000000.00	31-03-12	745	162267123.3
19-03-10	71317619.00	31-03-12	744	15409295.08
21-09-10	725000000.00	31-03-12	558	117485753.4
28-09-10	890000000.00	31-03-12	551	142414630.1
29-09-10	153909766.00	31-03-12	550	72501206.91
24-12-10	720000000.00	31-03-12	464	97020493.15
29-12-10	1050259927.00	31-03-12	459	139995209.6
17-03-11	750000000.00	31-03-12	381	82984931,51
24-03-11	1052384736.00	31-03-12	374	114303398,6
31-03-11	73077635.71	31-03-12	367	7788674.478
30-06*11	18800000QO.QO	31-03-12	276	150688438.4
01-07-11	6406003.00	31-03-12	275	511602.7053
09-08-11	744697QQ5.QO	31-03-12	236	51039283.43
22-12-11	328533573.00	31-03-12	X01	9636384.747
26-12-11	680901667.00	31-03-12	97	19180906,69
28-12-11	1302637691.00	31-03-12	95	35938524.79
Total	18055163528.41			2969080205

59. It is observed from the above details that while admitting the income of Rs.296.90 Crores by way of discounting charges on the ZCBs in AY 2012-13, the appellant has taken into account the income receivable for the earlier to AYs 2010-11 and 2011-12 also. Since the termination of the defeasance agreement was made retrospectively w.e.F. 31.03.2012 though the same was communicated by EOL vide letter dated 02.08.2012, the appellant debited the interest payable to EOL on account of the termination of Rs.296.19 Crores also to the P & L account in AY 2012-13 and claimed the same as deduction against the said income of Rs.296.90 Crores. It is therefore observed that the appellant started admitting income from the investment made in the ZCBs only on termination of the defeasance agreement and incurring of liability to pay interest to EOL on account of such termination. By doing so, the appellant was able to set off the interest liability against the income admitted from the ZCBs. In the earlier two assessment years 2010-11 and 2011-12, when the defeasance agreement was in force and the appellant did not have any interest liability to EOL, the appellant did not disclose any income from the investment in the ZCBs by adopting the device of assigning the sales tax liability and the investment in ZCBs to a partnership firm in which the appellant itself was a partner and by following cash system of accounting in the said partnership firm so that no income from the investment is recognised either in the hands of the appellant or in the hands of the partnership firm for the said assessment years. Had the termination of the defeasance agreement not taken place w.e.f. 31.03.2012, the assignment of the sales tax liability and the investment made in the ZCBs by the appellant to the related partnership firm would have continued and no income by way of discounting charges on the ZCBs would have been admitted for the subsequent assessment years also either by the appellant or by the partnership firm until the maturity of the ZCBs. This conduct of the appellant of adopting a device for avoiding the payment of tax in respect of the income from ZCBs for AY 2010-11 and 2011-12 further lends support to the inference drawn earlier that the transactions between the appellant, EOL and EIL involving entering into defeasance agreement and investment of consideration received in respect of the said agreement in the ZCBs issued by EIL are colourable transactions.

60. Having regard to the detailed discussion made in the preceding paragraphs, it is concluded that the transaction comprising of series of steps involving taking over the deferred sales tax liability by the appellant from its related concern EOL by entering into defeasance agreement, investing the consideration received from EOL on account of defeasance agreement in the ZCBs issued by the related concern EIL at such terms that was bound to generate a huge loss to the appellant, assigning the sales tax liability and the investment in ZCBs to the related partnership firm Imperial Factoring Services so as to avoid payment of taxes on the income accrued on the ZCBs, substituting the ZCBs issued by EIL with the ZCBs issued by the related concerns ICSPIL at such terms that deprived the appellant of accrued income on the ZCBs for the period prior to such substitution and opportunity of earning further income on such accrued income for the remaining tenure of the ZCBs and termination of the defeasance agreement with retrospective effect and waiver of the break-up cost of termination in favour of EOL despite the fastening of interest liability on the appellant due to such termination is clearly and undoubtedly a colourable transaction which is devoid of any commercial purpose and which was

designed to create loss of revenue as well as liability for payment of interest in the hands of the appellant in such a manner that the income earned on ZCBs goes untaxed. The transaction has also resulted in undue benefit to the related concerns. ICSPIL was handed over the advantage of substituting the ZCBs issued earlier by EIL by ZCBs having the same issue price as that of the earlier ZCBs despite the interest income that accrued on the ZCBs during the pre-substitution period by way of discounting charges and the claim of such accrued interest as a deductible expenditure by EIL for the relevant period. EOL was handed over the advantage of waiver of break-up cost though the termination of the agreement saddled the appellant with the disadvantage of having to repay the entire consideration received earlier with interest at a heavy cost since the appellant had already locked up the funds in Long term investments. Moreover, the very act of entering into the defeasance agreement by EOL was guided by the motive to derive undue tax advantage by it as discussed earlier. Hence, by considering the totality of all the facts and surrounding circumstances as mused in the preceding paragraph, it is held that the interest liability to EOL arising from adoption of a colourable device by the appellant for avoidance of tax is required to be disregarded and not given effect to for computing the total income and tax liability of the appellant for the year under consideration.

61. In this regard, reliance is placed on the decision of the Hon'ble Supreme Court in the case of McDowd// & Co. Ltd. Vs. CTO 154 ITR 148, wherein it was held that colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods. The Hon'ble Apex Court further held that it is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges and that courts are now concerning themselves not merely with the genuineness of a transaction, but with the intended effect of it for fiscal purposes. It was further held that no one can now get away with a tax avoidance project with the mere statement that there is nothing illegal about it.

61. Reliance is also placed on the decision of Hon'ble Bombay High Court in the case of Kitlick Nixon Ltd. Vs. DCIT 20 taxmann.com 703, wherein it was held that where a transaction is sham and not genuine then it cannot be considered to be a part of tax planning or legitimate avoidance of tax liability. The Hon'ble High Court referred to the decision of the Hon'ble Supreme Court in the case of Vodafone International Holdings BV Vs. Union of India 204 Taxman 408 wherein the Hon'ble Apex Court concluded that there is no conflict between its decisions in the cases of McDowell & Co. Ltd. (supra) and Union of India Vs. Azadi Bachao Andolan 10 SCC 1.

62. Having regard to the above cited decisions of the Hon'ble Supreme Court and the Hon'ble jurisdictional High Court, it is held that the interest liability to EOL of Rs.226,07,45,800/- arising from adoption of a colourable device by the appellant for avoidance of tax shall be disregarded and not given effect to for computing the total income of the appellant. It has also been held earlier in this order that the said interest does not qualify as an allowable deduction u/s. 57(iii) of the Act. Hence/ the disallowance of the interest payable to EOL made by the AO in the assessment order is hereby upheld to the extent of Rs.226,07,45,800/-. However, the disallowance made in respect of the balance amount of interest of Rs.

Rs.2,50,47,418/-is not sustainable as held in para 38 of this order. This ground of appeal is therefore partly allowed.

Ground No. 4

Initiation of penalty proceedings u/s.271(l)(c)

63. In this ground of appeal, the appellant has disputed the action of the AO in initiating penalty proceedings u/s. 271(l)(c) of the Act. This ground of appeal does not have any merit, as no prejudice is caused to the appellant on mere initiation of penalty proceedings. Penalty proceedings are separate proceedings and levying of penalty is not automatic after its initiation. Therefore, this ground of appeal is premature and the same is hereby dismissed.

64. In the result, the appeal is partly allowed.”

7. The Ld. D.R. submitted before the Bench that the issue is not covered as the Ld. CIT(A) has dismissed the appeal of the assessee by narrating all the facts which were not dealt with by the previous CIT(A) and also filed detailed submission. The Ld. D.R. prayed before the Bench that the appeal of the assessee may kindly be dismissed in view of the fact that the facts during the year are distinguishable as in the earlier proceedings the facts were not brought on record and thus the issue was decided in favour of the assessee. The Ld. D.R. relied heavily on the order of Ld. CIT(A) and AO and written submissions filed.

8. After hearing the rival parties and perusing the material on record including written submissions filed by the ld DR and the decision of the co-ordinate bench of the Tribunal in ITA No.6980/M/2016 A.Y. 2012-13 & ors order dated 04.04.2019, we find that the identical issue has been decided by the co-ordinate bench of the Tribunal in earlier year wherein the appeal of the Revenue has been dismissed. The operative part is reproduced as under for the sake of convenience and ready reference:

“13. We have heard the rival submissions of both the parties and perused the material on record. According to the assessee , Essar Oil Ltd. was entitled to collect

the sales tax/VAT and defer the same up to 14.08.2020 and thereafter the said deferred sales tax liability was to be paid in six annual installments. Essar Oil Ltd. decided to assign the sales tax liability to another entity at the present value which was worked out at Rs.1805.52 crores. The sales tax liability was assigned in favour of the assessee and the assessee received Rs. 1,805.52 Cr from Essar Oil Ltd. from time to time. The said money received by the assessee was invested in zero coupon bonds of Imperial Consultants and Securities Pvt. Ltd. In the meantime the Hon'ble Supreme Court delivered a judgment in a case filed by the Sales Tax Department, Government of Gujarat wherein the Hon'ble Supreme Court held that Essar Oil Ltd. was not entitled to sales tax incentive scheme following which the Essar Oil Ltd. was asked to make the payment to the government exchequer. As per the agreement between Essar Oil Ltd. and the assessee the money was to be paid along with interest, thus assessee had to pay interest of Rs.296.19 crores to Essar Oil Ltd. The assessee encashed the bonds and received interest income on the said zero coupon bonds of Rs.296.90 crores. The assessee credited the income by way of interest on zero coupon bonds in the P&L account while interest paid was charged in the P&L Account. While making the computation of income, the assessee offered the said income under the head of other sources by claiming interest paid to Essar Oil Ltd. of Rs.296.19 crores under section 57(iii) of the Act. After the examining the facts, we are of the considered opinion that there is a direct nexus between the money received by the assessee from Essar Oil Ltd. upon the assignment of sales tax liability and therefore there is a nexus between the interest received from the zero coupon bonds and interest liability which the assessee was liable to pay as per the agreement on the said assigned amount accordingly the same is allowable under section 57(iii) of the Act. We have carefully perused the decision passed in the case of CIT vs. Gopinathan (supra) and observed that the facts in the case are distinguishable from the facts of the present case. In the said case the assessee had surplus funds which were invested in fixed deposits and the assessee earned interest on such fixed deposits. Therefore, Hon'ble Supreme Court held that interest paid on money borrowed from the bank against the security the fixed deposits is not allowable under section 57(iii) of the Act. Since the income earned by the assessee by way of interest from zero coupon bonds had a corresponding liability attached to it. The assessee has not gained anything from the said transaction and thus it is incorrect to say that interest has to be taxed without allowing deduction under section 57(iii). In our opinion, the said transaction is not a sham transaction in view of the fact that the assignment of liability on account of sales tax and VAT has taken place at present value has taken place on a date which was prior to the decision of the Hon'ble Supreme Court. It was clearly a commercial transaction entered into between two entities though related and therefore not colourable transactions to circumvent tax liability. Accordingly, we hold that Ld. CIT(A) has passed a very reasoned and speaking order which does not require any interference at our end.

14. In the result the appeal of the revenue is dismissed.

9. Since the facts of the present case are identically same vis-à-vis the facts of the case as decided by the co-ordinate bench of the Tribunal in A.Y. 2012-13, we, therefore, respectfully,

following the order of the co-ordinate bench of the Tribunal, allow the appeal of the assessee by setting aside the order of Ld. CIT(A).

10. In the result, the appeal of the assessee is allowed.

Order pronounced in the open court on 11.12.2020.

**Sd/-
(Ravish Sood)
JUDICIAL MEMBER**

**Sd/-
(Rajesh Kumar)
ACCOUNTANT MEMBER**

Mumbai, Dated: 11.12.2020.

* Kishore, Sr. P.S.

Copy to: The Appellant
The Respondent
The CIT, Concerned, Mumbai
The CIT (A) Concerned, Mumbai
The DR Concerned Bench

//True Copy//

By Order

Dy/Asstt. Registrar, ITAT, Mumbai.