

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

**BEFORE SHRI VIKAS AWASTHY, HON'BLE JUDICIAL MEMBER AND
SHRI S. RIFAUH RAHMAN, HON'BLE ACCOUNTANT MEMBER**

ITA NO.1924/MUM/2020(A.Y: 2017-18)

DCIT – Central Circle – 6(4) Room No. 1925, 19 th Floor Air India Building, Nariman Point Mumbai – 400021	v.	Arshiya Rail Infrastructure Limited 302, F-Block, CJ House Dr. Annie Besant Road Worli, Mumbai - 400018 PAN: AAGCA9648B
(Appellant)		(Respondent)

Assessee by	:	Shri Navnit Choudhary
Department by	:	Smt. Shailja Rai
Date of Hearing	:	09.05.2022
Date of Pronouncement	:	04.08.2022

ORDER

PER S. RIFAUH RAHMAN (AM)

1. This appeal is filed by the revenue against order of the Learned Commissioner of Income Tax (Appeals)-54, Mumbai [hereinafter in short "Ld.CIT(A)"] dated 07.08.2020 for the A.Y.2017-18.

2. Brief facts of the case are, assessee company had filed its original return of income on 29.10.2017, declaring total net loss at ₹.168,10,78,636/- [including current year's unabsorbed depreciation of ₹.37,17,68,638/-]. The return was duly processed u/s.143(1) of the Income-tax Act, 1961 [hereinafter in short "Act"]. The case was selected for scrutiny through CASS by issuance of Notice u/s.143(2) of the Act on 16.08.2018, which was duly served upon the assessee company. Thereafter, notice u/s.142(1) of the Act were issued on 15.05.2019, 05.11.2019, 24.11.2019, 04.12.2019, which were duly served upon the assessee company. In response, the assessee company filed the submissions on the e-assessment portal.

3. The assessee company is engaged in the business of operating and maintaining the infrastructure facilities which consist of PAN India Rail Freight Operation on Indian Railway Network. During the assessment proceedings Assessing Officer observed from the financial statements for the year under consideration that assessee had restructured its loans for an amount of ₹.477,00,00,000/-. On perusal of the Computation of Income, he observed that assessee has claimed deduction of ₹.131,58,94,938/- u/s.43B of the Act. He observed from

the Tax Audit Report in Form 3CD that assessee has claimed following amount: -

Interest on loans from banks and financial institutions - AY 2013-14	125015188
Interest on loans from banks and financial institutions - AY 2014-15	416474097
Interest on loans from banks and financial institutions - AY 2015-16	578994517
Interest on loans from banks and financial institutions - AY 2016-17	189516198
Staff Bonus	27119
Leave Encashment	785423
Service Tax payment	5082396
TOTAL	1315894938

4. Assessee was asked to reconcile the amount originally taken as loans and the interest, charges, expenses and any other item debited by the bank from time to time and the amount already disallowed by the assessee u/s. 43B of the Act. In response assessee submitted before AO on 26.11.2019 as under: -

"3.3 that the assessee company had some outstanding loans and interest thereon as on 31.03.2016. During the year, the assessee company entered into an arrangement with Edelweiss Asset Reconstruction Company Limited for restructuring of its outstanding loans. Under this Arrangement, the total outstanding loan of Rs.477,00,00,000/- (including interest thereon) was restructured and that it was decided to convert it to Restructured Rupee Loan aggregating to Rs.346 crores and to issue equity shares for the balance debt of Rs.131 crores. The assessee furnished a copy of Agreement dated 31.03.2017. The assessee has further contended that the interest portion of the loan against which equity shares were issued was of Rs.131 crores. Hence, the converted portion of interest into equity shares was claimed under Section 43B in its return of income for the year under assessment. The assessee furnished a reconciliation of the principal and interest amount of restructured loans, the breakup of which is as follows;

Principal outstanding as on 31.03.2016	Interest outstanding as on 31.03.2016	Interest booked for reconciliation of loan for F.Y. 2016-17	Total	New Loan assigned to Edelweiss	Optionally Convertible Redeemable Preference Shares / Equity Shares allotted to Edelweiss
3204228133	1484214877	81556990	4770000000	3460000000	1310000000

5. Assessing Officer observed that, thus from the above tabulated data, it is noted that out of the total liability of ₹.477,00,00,000/-, the interest liability was ₹.156,57,71,867 [1484214877 + 81556990]. As per the assessee's submission, the interest portion converted into shares to the extent of ₹.131,00,00,000/- has been claimed as deduction u/s.43B of the Act.

6. After considering the submissions of the assessee, Assessing Officer observed that Explanation 3C to section 43B of the Act clearly transpires that the deduction of any sum, being interest payable under clause (d) to the section 43B, shall be allowed if such interest has been actually paid and any interest referred in that clause which has been converted into a loan or borrowing shall not be deemed to have been actually paid. He observed that since the interest amount of ₹.131 crores was not actually paid to the banks/financial institutions

during the year; the assessee was asked subsequently to justify the above claim, having regard to provisions of Explanation 3C to the section 43B of the Act. In response assessee submitted vide letter dated 05.12.2019 as under: -

"a) *the mode of payment is not defined in Section 43B and hence the same is to be construed in a literal or commercial sense;*

b) *interest is ceased and is not replaced by any loan but is converted into equity. Further, upon conversion into equity, the claim of lender on account of interest also ceases.*

c) *that the company has issued the equity shares which is traded in the market, it has a trading value, it would not be construed that the interest liability has been converted into loan.*

d) *as per Board's Circular No.7/2006 dated 17.07.2006, the Board has clarified that any interest which has been converted into a loan or borrowing or advance but has converted the interest into equity, hence the same is treated as allowable u/s.43B.*

e) *the assessee has relied upon the following 3 judgements in support of its claim of deduction u/s.43B;*

CIT vs. Rathi Graphics Technologies Ltd - Delhi High Court

Garware Chemicals Limited vs. CIT - Mumbai ITAT's order dated 28.10.2013

Marwar Hotel Ltd vs. ACIT(OSD)-1, Range 4 - Ahmedabad ITAT.

7. After considering the submissions of the assessee, Assessing Officer rejected the contention of the assessee and proceeded to disallow the claim made by the assessee u/s. 43B of the Act with the following observations in para 3.7 of his order: -

"a) *In the instant case, it is an undisputed fact that the sum of Rs.131,00,00,000/ was not actually paid but the same was merely reversed in the books as on 31.03.2017 by virtue of arrangement of*

reconstruction with the Edelweiss Asset Reconstruction Company Limited in respect of the outstanding bank loans. According to the assessee, the principal part of the outstanding loans is converted into loans assigned to Edelweiss Asset Reconstruction Company Limited whereas the interest part is converted into preference shares allotted to the said company which were subsequently converted into equity shares of the assessee company.

b) During the assessment proceedings, Notice u/s: 133(6) of the Act was issued on 24.12.2019 to EARC Trust SC 230, Edelweiss House, Off. CST Road, Kalina, Mumbai 400098 whereby it was asked to furnish the details of outstanding liability (principal and interest) as on 31.03.2017 and the payments, if any, made thereafter by the EARC. In response, the EARC, vide letter dated 26.12.2019, confirmed that as on 31.03.2017 the principal & interest outstanding was Rs.30.15 crore and it further confirmed that no payments have been made by EARC Trust-SC 230 to Syndicate Bank. It is significant to mention here that this was one of the liabilities of the assessee company which was assigned to Edelweiss Asset Reconstruction Company (EARC).

c) Explanation 3C to Section 438 of the Act provides that a deduction of any sum, being interest payable under clause (d) of this section, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or borrowing shall not be deemed to have been actually paid.

d) The assessee has placed reliance upon a judgement of the Hon'ble Delhi High Court in the case of CIT vs. Rathi Graphics Technologies Ltd wherein it has been held that when pursuant to a settlement, the creditor agrees to convert a portion of interest into shares, it must be treated as an extinguishment of liability to pay interest to that extent. Further, the assessee has also placed reliance upon a judgement of the Hon'ble Mumbai ITAT in the case of Garware Chemicals Limited. In this context, it is verified from the official website of the Hon'ble Bombay High Court that the Department had preferred an Appeal u/s.260A of the Act, which has been admitted vide order dated 04.04.2018 in ITA No. 1253/2015 on the following substantial question of law,

"Whether on the facts and circumstances of the case and in law, the Tribunal was justified in allowing the conversion of interest payable into equity shares as actual payment deductible u/s.43B of the I.T.Act, 1961?"

While admitting the aforesaid question of law, the Hon'ble Bombay High Court has observed as under,

"Mr. Agarwal, learned counsel for the Respondent placed reliance upon the decision of the Delhi High Court in CIT vs. Rathi Graphics Technologies Ltd., 378 ITR 107 on an identical issue in favour of the Respondent-Assessee. However, we are of the view that, this would require consideration by this Court, as the words 'actual payment have to be reconciled with the Explanation 3C to Section 43B of the Income Tax Act, 1961."

e) Since the jurisdictional High Court has admitted a substantial question of law on the applicability of the provisions of Section 43B with respect to conversion of interest liability into shares, the present assessee's claim of deduction of interest part converted into shares on reconstruction / settlement of outstanding liability cannot be entertained.

In view of the above discussion, the assessee's claim of deduction of Rs.131,00,00,000/- u/s.43B of the Act is hereby rejected.

8. Aggrieved, assessee preferred an appeal before the CIT(A) and Ld.CIT(A) after considering the detailed submissions allowed the grounds raised by the assessee with the following observation that as a result of arrangement between the assessee and Edelweiss Asset Reconstruction Company Limited (for short "EARC"), part of the outstanding principle and interest was first converted into Optionally Convertible Redeemable Preference Shares (OCRPS) and subsequently it was converted into Equity shares on 31.03.2017, as a result, interest of ₹.131 crores was converted into equity shares and interest of ₹.64,38,466/- continued as interest. He allowed the appeal of the

assessee by relying on the decision of Garware Chemicals Ltd., v. Department of Income-tax, CIT v. RathiGrapics Technologies Ltd., (Delhi HC) and Marwar Hotel Ltd., v. ACIT (OSD)-1, Ahmedabad.

9. Aggrieved revenue is in appeal before us raising following grounds in its appeal: -

"1. On the facts and in the circumstances of the case, the Ld.CIT(A) has erred in allowing deduction u/s 43B of the Act though the assessee failed to discharge its primary onus to 'actually pay the interest liability, as clarified vide Explanation 3C to that Section.

2. On the facts and in the circumstances of the case, the Ld.CIT(A) has erred in allowing deduction u/s 43B of the Act, simply on the basis of conversion of interest liability to equity shares, while the assessee has not actually paid the interest liability.

3. On the facts and in the circumstances of the case, the Ld.CIT(A) has erred in allowing deduction u/s 43B of the Act, without considering the legislative intent that any subsequent change of nomenclature of interest will not affect its allowability and deduction in terms of section 43B will have to be allowed on its 'actual payment', which has been clarified vide Circular No. 7 of 2006 dated 17.07.2006."

10. At the time of hearing, Ld. DR submitted that the single issue involved in this appeal is relating to claim of interest payment u/s. 43B of the Act. She briefly explained the facts that assessee has taken loan from eight banks and due to non servicing of the loans, the banks have appointed EARC Trust. Subsequent to agreement between assessee and EARC, the restructuring of the loan was agreed based on the

restructuring agreement dated 31.03.2017. As per the restructuring, loan of ₹.346 crores were restructured and converted into restructured loans and the balance outstanding of ₹.131 crores is claimed to be converted into zero Percentage OCRPS and the assessee has claimed that assessee has issued to EARC 13,10,000 OCRPS at a price of ₹.1000/- each with a face value of ₹.10 and premium of ₹.990/-.

11. She submitted that the interest is said to be paid by issue of OCRPS, it is only a mechanism devised by the assessee to take the advantage of deduction u/s. 43B of the Act and not actually intended to settled the dues. She submitted that she will argue the case in three aspects on the claim of the assessee which is (a) relevance of case law relied by the Ld. AR, (b) relevance of CBDT circular No. 7 of 2006 dated 17.07.2006 and (c) amendment made to section 43B w.e.f. 01.04.2022 with retrospective effect.

12. With regard to relevance of case law, she submitted that assessee has structured the transaction in order to claim the benefit u/s 43B, at the same time the assessee has no intention to pay interest, hence it has devised a plan to issue OCRPS immediately to EARC and EARC in turn directed Arshiya Limited i.e. holding company to issue OCRPS of

holding company. According to her, it clearly indicate that it is designed such a way that the assessee ended up created the perception that assessee has made the payment of interest. She brought to our notice Balance Sheet of the holding company as on 31.03.2017 and submitted that it has not issued any equity shares but another OCRPS. She distinguished the decision in the case of CIT *v.* Rathi Graphics Technologies Ltd (supra) particularly Para No. 4 of the decision to highlight that in this case the assessee has not issued any premium in the settlement of interest by conversion of equity shares. Therefore, it is distinguishable to the facts of the present case. Further, she also brought to our notice decisions Garware Chemicals Ltd., (supra) and Marwar Hotels Ltd *v.* ACIT (supra) even in these cases there is no involvement of share premium.

13. Further, she brought to our notice the decision of JSW steel Ltd. *v.* ACIT [2011] 9 taxmann.com 77 (Bangalore) wherein the ITAT has distinguished between loans and preference shares, wherein the ITAT has equated the preference shares with the Debts, she has advocated that preference shares can never be equal to equity shares considering the voting right and participation in the management of the affairs of the company. She further submitted, in the above case, they

demonstrated that OCRPS issued by the assessee were traded on stock exchange. That is not the case with the present case.

14. She also distinguished the facts in *M.M. Aqua Technologies Ltd. v. ACIT* in Civil Appeal Nos. 4742 -47436 of 2021 dated 11.08.2021 which is relied by the assessee in which the Hon'ble Supreme Court has observed that the accounts produced by the assessee in the assessment of ICICI bank, in which the bank as reflected the amount received by way of debentures as its income. Whereas she submitted that in the given case no such receipt of OCRPS was declared by the financial institutions as their income and neither the assessee has brought on record any such declaration of income by the financial institutions. Therefore, this case also distinguishable to the present case.

15. She also brought to our notice CBDT circular (supra) Para No. 5 and submitted that as per the circular outstanding interest liability which is converted into debt like debentures i.e., is not an actual payment and cannot be claimed as deduction u/s 43B.

16. Further, she brought to our notice the amendment made in section 43B of the Act in Explanation 3C and accordingly, Explanation 3C and 3D

were inserted to provide that conversion of interest payable under clause (d), clause(da) and clause (e) of section 43B into debenture or any other instrument by which liability to pay is deferred to a future date, shall also not deemed to have been actually paid.

17. She further relied on the decision of the ITAT Calcutta Bench in the case of Subhalakshmi Vanijya (P.) Ltd., v. CIT [2015] 60 taxmann.com 60 (Kolkata – Trib.).

18. On the other hand, Ld.AR submitted a detailed written submission as under: -

"1. M/s. Arshiya Rail Infrastructure Limited ("Assessee" or "Appellant Company") is a public limited company and is regularly assessed to tax. The company was formed with Registrar of Companies, Maharashtra on 7th April, 2008 with the object to carry on the business of setting up of Rail Infrastructure/network within India and abroad including operations/movement of Container/Goods Train using India Railway Network and also to acquire, procure, obtain on lease/license otherwise Container Trains, Racks, Wagons, Boggies and create, develop or obtain on lease/license basis Railways Sidings, Rail Yards, Warehouses required for the purpose of the Company.

2. The Appellant enjoys exemption U/S 80IA of the Income Tax Act, 1961.

3. The appellant company filed its return of income for A.Y. 2017-2018 on 29th October, 2017 declaring total loss of Rs. 168,10,78,636/-.

4. The case was selected for scrutiny and order under section 143(3) of the Act was passed on 27th December, 2019 (copy attached vide Page Number 10-17) determining total loss of the appellant at Rs. 37,10,78,636/- by making disallowance under

section 43B of the Act amounting to Rs. 131,00,00,000/- and Ld. CIT (A) has deleted the addition made u/s 43B.

FACTS OF THE DISALLOWANCE:

1. During the year, the assessee company entered into an arrangement with Edelweiss Asset Reconstruction Company Limited (EARC") for restructuring of its outstanding loans and interest. Under this Arrangement, the total outstanding of Rs. 477,00,00,000/- (including interest) was restructured as under:

PARTICULARS	AMOUNT (in Rs.)	REMARKS
Loan	346,00,00,000/-	Continued as Loan
Interest	131,00,00,000/-	Converted into Equity
TOTAL	477,00,00,000/-	
Interest	64,38,466/-	Converted into Loan

2. The partial interest outstanding against which equity shares were issued was of Rs. 131,00,00,000/-. Hence, the converted portion of interest into equity shares was claimed under Section 43B in its return of income for the year under assessment (Disallowed in earlier years).

3. Under section 43B of the Act, the Learned AO has made disallowance of Rs.131,00,00,000/- with respect to conversion of interest liability into equity.

CONTENTION OF ASSESSE:

1. With respect to allowance made of Rs. 131,00,00,000/- u/s 43B, kindly note that it comprises of interest of various banks, which is restructured by Edelweiss Asset Reconstruction Company Limited (EARC) and converted into Equity Shares/OCRPS.

2. With regards to justification of claim of Rs.131,00,00,000/- (as mentioned in Point no. 1 above) having regard to the provisions of Explanation 3C to Section 43B of the Act, we are producing section 43B and explanation 3C as under:

i. Section 43B:

(d) any sum payable by the assessee as interest on any loan or borrowing from any public financial institution or a State financial corporation or a State industrial investment corporation, in accordance with the terms and conditions of the agreement governing such loan or borrowing, or

(e) any sum payable by the assessee as interest on any loan or advances from a scheduled bank or a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank] in accordance with the terms and conditions of the agreement governing such loan or advances, or

ii Explanation 3C

For the removal of doubts, it is hereby declared that a deduction of any sum, being interest payable under clause (d) of this section, shall be allowed if such interest has been actually paid and any interest referred to in that clause which has been converted into a loan or borrowing shall not be deemed to have been actually paid."

As per the above explanation 3C, it specifies two actions for claiming deduction:

a. *if such interest has been actually paid and*

b. *any interest referred to in that clause which has been converted into a loan or borrowings shall not be deemed to have been actually paid*

3. *With regard to applicability of Section 43B and Explanation 3C, we wish to state the following as under.*

i. *Section 43B defers the deduction otherwise allowable to the year in which the payment is made. Clause (d) of this section is regarding the sum payable as interest on any loan or borrowing to be allowed only in the year of actual payment.*

ii. *Explanation 3C further clarifies the term actual payment and stipulates that the deduction of interest payable is allowable only on actual payment and not on deferment of liability of converting the same into loan or borrowings..*

iii. *From the reading of section 43B(1)(d) and Explanation 3C as well as CBDT Circular No.7/2006, it is discernible that the deduction is allowed only when the liability is discharged and not merely on deferring the same by converting into loan or borrowings.*

iv. *The conversion of interest payable into loan or borrowing is otherwise not the payment of interest and discharge of interest liability, but it is only a measure of deferment of liability*

v. *Therefore, in case of discharge of liability by any mode would not fall under the ambit of Explanation 3C as the liability is no more in existence once it is discharged and the allowability of deduction of*

the interest payable cannot be claimed in any subsequent year as there will be no further payment.

vi. The Explanation 3C cannot be applied in case of interest payable, converted into share capital as the interest liability stand ceased to exist and not deferred as in case of conversion of interest loan or borrowing.

4. With respect to "if such interest has been actually paid", it may be pertinent to note here that the mode of payment is not defined in section 43B. As the words "has been actually paid" is not defined under Income Tax Laws, same is to be construed in a literal or commercial sense which is cessation of liability.

5. In the instant case, it may be noted that interest is ceased and is not replaced by any Loan, but is converted into equity. Further upon conversion into equity, the claim of Lender on account of interest also ceases. The company has issued the equity share which is traded in the market, it has a trading value, it would not be construed that the interest liability has been converted into loan. The financial institutions can independently trade those equity. Therefore, the assessee has made payment of interest liability in money's worth.

6. It is to state that any interest referred to in the clause which has been converted into a loan or borrowing shall not be deemed to have been actually paid, as the liability has not been discharged in the case interest converted into fresh loan. But in our case interest has been converted into equity and not into Loan, so liability is discharged by way of issue of equity shares.

CASE LAWS RELIED BY THE ASSESSEE:

The assessee company is further relying on following judgments of various judiciaries for allowance of interest converted into Equity Shares to be taken as "Actual Payment" within the meaning of Section 43B of the Act

1. Hon'ble Supreme Court of India pronounced on 11 August, 2021 in the case of M. M.Aqua Technologies Ltd. Vs. Commissioner of Income Tax, Delhi-III, wherein Supreme court held that while setting aside High Court's ruling held that interest was "actually paid" by means of issuance of debentures when it extinguished the liability to pay interest. It also held that Explanation 3C of Section 43B of the IT Act is not clarificatory in nature. (copy of Order attached vide Annexure A)

2. *Hon'ble Delhi High Court pronounced on 6 August, 2015 in the case of Commissioner of Income Tax vs Rathi Graphics Technologies Ltd, wherein Delhi High Court has held as "When pursuant to a settlement the creditor agrees to convert a portion of interest into shares, it must be treated as an extinguishment of liability to pay interest to that extent. In essence there will be no further outstanding interest to that extent. Consequently, the situation where an interest payable on a loan is converted into shares in the name of the lender/creditor is different from the situation envisaged in Explanation 3C to Section 438 of the Act viz., conversion of interest into "a Loan or borrowing". In the latter instance, the liability continues, although in a different form. However, where the interest or a part thereof is converted into equity shares, the said interest amount for which the conversion is taking place is no longer a liability*

The Court is of the view that the plea of the Assessee, which was accepted by the CIT (A) and the ITAT, that the said conversion of a portion of interest into shares should be taken to be "actual payment" within the meaning of Section 43B of the Act, merits acceptance.

3. *Hon'ble ITAT, Mumbai Bench pronounced on 28th October, 2013 in the case of Garware Chemicals Ltd. Mumbai vs Department Of Income Tax, wherein Hon'ble ITAT, Mumbai Bench has held as "Explanation 3C cannot be applied in case of interest payable, converted into share capital as the interest liability stand ceased to exist and not deferred as in case of conversion of interest loan or borrowing."*

19. Ld. AR further submitted as under: -

"1. *The interest payable to Lenders disallowed in earlier year u/s. 43B is allowed in current year, as the said interest liability is converted into Optionally Convertible Redeemable Preference Share (OCRPS)/equity.*

2. *It may be pertinent to note here that the liability of interest has ceased i.e. nothing is payable.*

3. Further it is not a case of interest liability continuing in some other form like Loan/ Debenture/ Funded interest Term Loan (FITL) any other nomenclature or any other instrument by which the liability to pay is deferred to a future date. This is a clear case of interest liability getting converted into Equity

4. Kind attention is drawn towards two case laws (Mumbai Tribunal and Supreme Court):

a. *Garware Chemicals Ltd. v DCIT (IT APPEAL NO. 7819 (MUM) OF 2010 dated 21.01.2015) Mumbai ITAT:*

b. *Ruling of the Supreme Court of India (SC) dated 11 August 2021 in the case of M.M. Aqua Technologies (Taxpayer);*

5. Also kind attention is drawn on section 43B as amended by Finance Act 2022:

14. In section 43B of the Income-tax Act, with effect from the 1st day of April, 2023,

(1) in Explanation 3C, after the words "loan or borrowing", the words "or debenture or any other instrument by which the liability to pay is deferred to a future date" shall be inserted;

(ii) in Explanation 3CA, after the words "loan or borrowing", the words "or debenture or any other instrument by which the liability to pay is deferred to a future date" shall be inserted;

(iii) in Explanation 3D, after the words "loan or advance, the words "or debenture or any other instrument by which the liability to pay is deferred to a future date" shall be inserted.

6. The idea of the amendment is also clear that the interest liability needs to be ceased completely i.e. the same should not remain payable by one form or other to the Lender and precisely this is a fact in instant case."

20. Finally, he submitted that the holding company has taken over the interest liability and interest is not continued anywhere in the books,

therefore it amounts to discharge of the liability. In this regard he relied on Para Nos. 6.8, 6.9 and 6.10 of the Ld.CIT(A) order.

21. Considered the rival submissions and material placed on record, we observe from the record that assessee is a public limited company, during this year, assessee company entered into an arrangement with EARC for restructuring of its outstanding loans and interest as per which assessee has restructured the principle loan and converted the interest portion of ₹.131 crores into issue of zero percent of OCRPS. The above OCRPS were issued at the rate of ₹.1000 per share which includes face value of ₹.10 and share premium of ₹.990 per share. We observe that assessee has disclosed the same in its notes to financial statement as under: -

"36 ***Borrowings***

Restructuring of loans assigned by Lenders to Edelweiss Asset Reconstruction Company Limited (ARC) (Lender on behalf of the various EARC Trusts)

Various Lenders of the company, comprising of 8 banks have assigned their Term Loans and Working Capital Loan (Loans) to EARC (as trustee of EARC Trusts). Post assignment of loans, EARC has become a secured lender of the Company and right, title and interest of the lenders have vested into EARC. As per the restructuring package approved by the EARC, loans so assigned as on 31st March 2017, have been restructured.

Pursuant to the assignment of such loans, and in terms of the restructuring package approved by EARC for the loans so assigned,

the Company has executed Restructuring Agreement (RA) with EARC, on behalf of EARC Trusts on 31st March 2017 Under the Agreement, the loans assigned to EARC aggregating to 4,77,00,00,000/

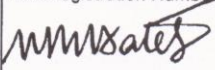

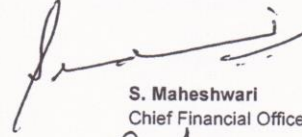


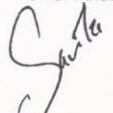
(i) Stand restructured, merged and converted into Restructured Loans aggregating to t 3,46,00,00,000/

(ii) the balance debt of ₹.1,31,00,00,000/- is converted into Zero Percent Optionally Convertible Redeemable Preference Shares (OCRPS). Accordingly the Company has issued to EARC 13,10,000 OCRPS of face value of 10/- each at a price of 1,000/- each (which includes premium of 990/-)

The above stated OCRPS has been transferred by EARC to holding company and holding company has converted said OCRPS into 13.10.000 Equity Shares of the Company,

The current outstanding of above restructured loan as on 31st March 2017 is ₹.341,18,37,540/-

22. From the above notes, we understand that EARC no doubt accepted the OCRPS issued by the assessee. However, OCRPS were transferred by EARC to holding company and holding company has converted said OCRPS into 1310000 equity shares of the company. Assessee also filed copy of the audit financial statements of the holding company which is placed on record, we observe from the Balance Sheet that the holding company has also issued OCRP's equivalent to amount of shares issued by the assessee company and it has kept this liability as the separate line as debt convertible into equity and zero percentage OCRPS. For the sake of clarity, scanned copy is reproduced below: -

Arshiya Limited Balance Sheet as at 31st March, 2017			
(Amount in ₹)			
Particulars	Notes	As at 31st March, 2017	As at 31st March, 2016
I. Equity and Liabilities			
1. Shareholders' funds			
(a) Share capital	3	31,23,58,944	31,23,58,944
(b) Reserves and surplus	4	93,68,33,698	1,99,03,44,592
		1,24,91,92,642	2,30,27,03,536
2. Debt convertible into Equity and Zero Percent Optionally Convertible Redeemable Preference Shares			
	5	12,62,00,00,000	-
3. Non-current liabilities			
(a) Long-term borrowings	6	5,81,28,49,090	1,97,29,05,985
(b) Other long-term liabilities	7	90,51,76,530	1,34,98,04,129
(c) Long-term provisions	8	1,32,35,744	88,02,192
		6,73,12,61,364	3,33,15,12,306
4. Current liabilities			
(a) Short-term borrowings	9	49,42,08,889	1,19,46,86,389
(b) Trade payables	10		
(i) Total outstanding dues of micro enterprises and small enterprises		21,39,797	7,11,505
(ii) Total outstanding dues of creditors other than micro enterprises and small enterprises		3,46,40,114	2,18,90,776
(c) Other current liabilities	11	4,96,05,29,428	15,36,38,99,328
(d) Short-term provisions	12	16,30,85,382	18,54,96,362
		5,65,46,03,610	16,76,66,84,360
Total		26,25,50,57,616	22,40,09,00,202
II. Assets			
1. Non-current assets			
(a) Fixed assets	13		
(i) Tangible assets		12,44,83,06,127	12,32,24,77,945
(ii) Intangible assets		4,31,95,358	5,88,56,703
		12,49,15,01,485	12,38,13,34,648
(b) Non-current investments	14	13,17,76,06,336	8,34,24,41,336
(c) Long-term loans and advances	15	34,24,56,797	1,30,77,55,123
		13,52,00,63,133	9,65,01,96,459
2. Current assets			
(a) Trade receivables	16	2,27,16,282	12,17,78,170
(b) Cash and cash equivalents	17	77,20,239	3,96,45,888
(c) Short-term loans and advances	15	21,30,56,477	20,79,45,037
		24,34,92,998	36,93,69,095
Total		26,25,50,57,616	22,40,09,00,202
Summary of Significant Accounting Policies	2		
See accompanying notes to the financial statements	1-58		
As per our report of even date			
For M. A. PARIKH & Co Chartered Accountants Firm Registration Number 107556W		For and on behalf of the Board of Directors of Arshiya Limited	
			
Mukul Patel Partner Membership Number: 032489	Ajay S Mittal Chairman and Managing Director DIN: 00226355	S. Maheshwari Chief Financial Officer	
Place: Mumbai Date: 18th May 2017			 Savita Dalal Company Secretary

23. The holding company has disclosed this transaction in notes to accounts at note No. 32.2 as under: -

"32.2 Some of the Secured Lenders of the Wholly Owned Subsidiaries viz. Arshiya Rail Infrastructure Limited (ARIL), Arshiya Northern FTWZ Limited (ANFL) and Arshiya Industrial & Distribution Hub Limited (AIDHL) have also assigned their loan to EARC (Acting as trustee of EARC Trusts) and EARC has approved the restructuring package and executed the Restructuring Agreement on the terms and conditions inter alia including allotment of OCRPS of the Company:

With respect to the restructuring package of the subsidiaries approved by EARC, loans to extent of 4,32,00,00,000/- have been restructured by allotment of 43,20,000 Zero Percent OCRPS (Series II /Series III/ Series IV) of face value of Rs.10/- each at a price of 1,000/- each (which includes premium of 990/-),

The above stated OCRPS shall carry a right of conversion into equity shares of the company at the option of EARC. On conversion the entire amount of OCRPS shall be adjusted against the allotment of upto 1,19,11,962 equity shares of the Company to the EARC"

24. From the above statements and notes to accounts we observe that holding company has also issued OCRP's with the option to convert the same into equity capital as on the Balance Sheet date but it has issued OCRPS with premium similar to the method adopted by the assessee for settlement of the interest liability as per the terms of settlement in the Restructured Agreement (RA) with the EARC. The issue before us is, whether the settlement of interest liability by issue of preference shares are considered to be discharged u/s 43B, especially considering the amended explanation 3C to above section.

25. On carefully considering the decisions of the Hon'ble High Court of Delhi in the case of Rathi Graphics Technologies Ltd (Supra), it held that "When pursuant to a settlement the creditor agrees to convert a portion of interest into shares, it must be treated as an extinguishment of liability to pay interest to that extent. In essence there will be no further outstanding interest to that extent. Consequently, the situation where an interest payable on a loan is converted into shares in the name of the lender/creditor is different from the situation envisaged in Explanation 3C to section 43B of the Act Viz., conversion of interest into "a loan or borrowing". In the latter instance, the liability continues, although in a different form. However, where the interest or a part thereof is converted into equity shares, the said interest amount for which the conversion is taking place is no longer a liability."

26. Further, we observe that the ITAT bench of Bangalore held in the case of JSW Steel Ltd (supra) as under: -

"13.2 On perusal of section 43B, it could be seen that the said section creates a fiction to provide that irrespective of the method of accounting followed by the assessee, certain liabilities would be allowed as deduction only on actual payment. Assessee's case falls under Clause (d) of said section which covers interest payment to certain institution. Further, Explanation 3C to said section provides that where interest payable under section 43B(d) is converted into a loan or a borrowing, it shall not be deemed to have been actually paid. The assessee had converted outstanding interest liability along with restructuring expenses into CRPS as per revised restructuring

scheme entered into by it with various banks and financial institutions such as IDBI, IFCI, SBI etc. Thus, the assessee had made a constructive payment and discharged its liability of interest by issuing CRPS to the above institutions. It would not be out of place to mention here that the above scheme was approved by 75 per cent of the creditors and it was not at the behest of the assessee.

13.3 Explanation 3C to section 43B of the Act was introduced by Finance Act, 2006 with retrospective effect from 1-4-1989. The Explanation provides that if interest liability is converted into "Loans or advance then said conversion does not amount to payment and no deduction shall be allowed in the year of conversion. The Legislature in its wisdom had not included the conversion of interest payable into share capital in Explanation 3C to section 43B of the Act. This is because, perhaps, on conversion of outstanding interest into share capital, the lender, to the extent of amount converted does not remain a creditor of the borrower. In fact, on allotment of shares, the lender becomes contributors to the capital and participants in the capital of the company. Thus, the conversion of interest into share capital is not hit by Explanation 3C to section 43B. The Hon'ble Supreme Court in the case of Prakashnath Khanna v CIT [2004] 266 ITR 1/135 Taxman 327 has held that when a particular expression/definition is omitted under any provision, it cannot be said that the Legislature has done so without any purpose or intent and as such, such omission cannot be supplied by the interpretative process.

13.4 A Some of the material differences between loans and preference shares are as follows:

<i>Loans & Advances</i>	<i>Preference Shares</i>
<i>Lenders are not owners of the Company</i>	<i>Preference shareholders are owner of the company</i>
<i>Company gets deduction on interest payment.</i>	<i>Company does not get deduction on payment of dividend</i>
<i>Company is not required to pay any tax on payment of interest</i>	<i>Company is required to pay DDT on payment of dividend</i>
<i>Interest is taxable in the hands of the lender</i>	<i>Dividend is not taxable in the hands of the shareholders</i>
<i>Expenditure incurred for raising loan is revenue expenditure</i>	<i>Expenditure incurred for issuing shares is capital expenditure</i>

(i) Further, we would like to mention here that the preference shareholders held voting rights in the company (source page 60 of paper book).

(ii) Further, on direction of the Bench, the assessee has also filed the stock exchange quotes of CRPS of the assessee to prove that CRPS issued by the assessee were traded on stock exchange.

(iii) The jurisdictional High Court in the case of *Kirloskar Electric Co. Ltd. v. CIT* [1997] 228 ITR 674 (Kar) has clearly explained the difference between the preference shares and borrowings. The relevant extract is reproduced below

"Subscription to preference share is a contribution to the capital of the company by its subscribers or shareholders and is not a borrowing by the company."

In view of the above distinctions between loan and preference share capital and the jurisdictional High Court decision, we are of the view that the loan cannot be equated with Preference Share and consequently, it cannot be construed that Explanation 3C to section 43B of the Act covers not only loans and advances but also preference shares.

13.5 It is a well settled position of law that deeming provisions being legal fictions should be strictly construed. Explanation JC being deeming provision strictly applies to conversion of outstanding interest amount into loans or borrowings and not to preference shares. Further, deeming provision being legal fictions could not be stretched indefinitely to include within its ambit items not specifically included therein. The following judicial decisions support the above proposition:

(i) *Chandrana & Co. v. State of Mysore* [1972] 2 SCR 344

(ii) *Bengal Immunity Co. Ltd. v. State of Bihar* AIR 1955 SC 661

(ii) *CIT v. Chhotelal Kanhiyalal* [1971] (2 TTJ 347, 351) (SIC)

13.6 Lastly, we are of the view that the issue is squarely covered by the Hon'ble Hyderabad Tribunal decision in the case of Suryalakshmi Cotton Mills Ltd. (supra) and nothing contrary has been brought on record by the learned DR during the course of hearing. Relevant extract of the aforesaid decision is reproduced hereunder

"10. The next question that arises is whether section 43B is applicable or not. In the preceding paragraph, we have observed that the assessee has discharged its liability by issuing CRFPS to the institutions. Section 43B creates a fiction to provide that irrespective of the method of accounting followed by the assessee, certain liabilities

would be allowed as deduction only on actual payment. In our view, the assessee has made a constructive payment and discharged its liability by issuing CRPS to the two institutions. They are in the form of shares issued for consideration other than cash. To issue shares otherwise than by cash is a common way of discharging one's liability. The consideration has been received by the assessee in the form of reduction in rates of interest. Therefore, there is no gainsaying that the assessee has not made payment for the concessions received by it. It is not merely the issue of shares that has discharged the assessee from its liability. Incidental to the issue of shares, there are other rights also under the Companies Act, which the assessee will have to grant to the institutions as shareholders. The institutions will be entitled to the fixed rate of dividend. They will also have a right to attend the general meeting of the company and vote on resolutions, directly affecting their interest and on all resolutions if their dividend is in arrears for not less than two years. In the event of winding up or repayment of capital, the institutions will have a preferential right to be paid the arrears of dividend payable up to the date of such event. They also will have a preferential right in respect of repayment of capital. Thus, besides the issuance of shares, the assessee is also put under incidental obligations in the process, it need to be clarified that with the relief granted by the institutions, it is not that long-term benefits will keep on accruing to the assessee. There is merely a reduction in the rates of interest for the remaining period of the loans. Thus, in future, interest liability will keep on accruing to the assessee, albeit at a lower rate. But the part of interest which the institutions have sacrificed by such reduction in the rates, they have asked for their pound of flesh immediately from the assessee. Accordingly, the liability to compensate has arisen in the year under consideration, it has crystallized also in this year and therefore, the assessee should be entitled to the deduction thereof. Here, we may hasten to add that Explanation 3C to section 43B will not apply. The said Explanation provides that where interest payable under section 43B (d) is

converted into a loan or a borrowing, it shall not be deemed to have been actually paid. The Legislature in its wisdom has not included the conversion of interest payable into share capital. This is because, perhaps, on conversion of interest payable into share capital, the lender, to the extent of amount converted, does not remain a creditor of the borrower. In fact, on allotment of shares, the institutions have become contributors to the capital and participants in the capital of the company. Therefore, there is no need to go into the intention of the Legislature while enacting Explanation 3C and one need not read a further fiction which is not there into a provision which otherwise is a fictional provision. It is well established that a fictional provision has to be strictly construed and there cannot be a fiction in a fiction. Thus, the conversion of interest into share capital is not hit by Explanation 3C to section 43B".

13.7 In this context, the judgment of the Hon'ble High Court of Andhra Pradesh in the case of Lalchand Surana v. Hyderabad Vanaspathy Ltd. [1990] 68 Comp. Cases 415 is also relevant. The issue that was considered by the Hon'ble High Court of Andhra Pradesh was whether the petitioners, being preferential share holders can call themselves 'creditors' and ask for winding up of the company under section 433(e) read with section 434(1) and section 439(1)(b) of the Companies Act. The High Court was of the view that the preferential share holders are also shareholders and by no stretch of imagination can they become creditors.

13.8 In view of the judicial stand on the issue, we are not in agreement with the Assessing Officer's portrayal that the interest payable which was converted into loan and, thus, it doesn't make a difference if the assessee changes the nomenclature whereby we fully endorse the view of the CIT(A) that Though actual cash did not change hands and the transaction was completed through book adjustments and that the interest liability had been paid off through giving the creditor a share in the ownership of the assessee-company and, thus, the assessee was entitled to claim the amount so paid off under section 43B of the Act as a deduction and also in respect of applicability of restructuring expenses, even then if such expenditure were not to be termed 'interest', it would still be

allowable as it had been incurred with the objective of squaring off a liability that was on revenue account and would thus acquire the character of a revenue expense.

13.9 To sum up, we decide the issue against the revenue and affirm the order of the CIT(A) on this aspect."

27. Further, the Hon`ble High Court of Gujarat held in the case of Commissioner of Income-tax v. Core Emballage Ltd reported in 139 taxmann.com 504 as under : -

"We agree with the view taken by the CIT(A) as confirmed by the ITAT that it is not a case of conversion of outstanding interest into the loan so that the same could be allowed only on the actual payment, more particularly, when as acknowledge by ICICI Ltd. the defaulted interest stands extinguished having realized the fully paid up shares. Consequently, there is no further outstanding interest to be paid by the assessee company in future as it stands extinguished in the year under consideration Section 43B is hereby held to be attracted in the facts of the case."

28. From the above discussion, it is clear that by issue of equity or preference shares to discharge the liability of interest payable is considered as proper discharge of above said liability and it does not violate the Explanation 3C to the section 43B of the Act.

29. Coming to the next issue of above said OCRPS with Share premium, we observe that the assessee and EARC agreed to settle the outstanding liability by accepting the OCRP @ Rs.1000 per share, which includes share premium of Rs.990/- per share. The assessing officer has

not disputed the above issue however, Ld DR submitted that the assessee has issued the OCRPS with such high share premium only to demonstrate that they have settled the interest dues without their being any intention to settle the same and the case laws submitted by the assessee are distinguishable because of the fact that the shares are issued with such huge share premium. Therefore, the assessee has only created a situation just to demonstrate that it has settled the liability but in actual it has not done so. We analyzed the above submissions and we observe that the assessee and EARC mutually agreed to settle the liability considering the peculiar financial position of the assessee. It is fact on record that assessee does not have enough authorized share capital to issue equivalent preference shares and also book value of shares is not enough to issue shares in premium. But the EARC/ Bankers are aware of the financial position of the assessee and its holding company, the settlement is always depends upon the two parties who are in agreement with the proposals put before them. In the given case, the assessee was not in a position to settle the outstanding liability and financial institutions considerate enough to consider the proposals and they deliberated the same by directing the assessee to issue the OCRPS with premium, at the same time, they not only accepted the settlement

in the assessee company, also demanded the similar OCRPS in the Holding Company also as a backup. This clearly shows that they agreed to settle the liability and accept the OCRPS @ ₹.1000/- per shares which includes premium of ₹.990/- per share. What is relevant in this RA that the interest liability is settled and the liability is settled by issue of Equity. Further, it is to be noted that the share premium is part of the capital reserves which is part of Equity fund, whether the shares are issued separately or with premium both are part and included in the equity funds. Even though, EARC agreed to settle the liability on the basis of terms settled in RA, it shows that they are agreed to settle the liability with the confident that their participation in the management will be fruitful to their interest. Further we observe that even the assessee also foregoes the controlling interest in the company to the extent of shares issued.

30. From the above it is clear that the settlement of interest liability was made only by issue of convertible preference shares with share premium based on the 'RA' with the EARC, we noticed that the interest liability is settled and the liability is replaced with the equity/preference shares and the settlement is complete with the acknowledgement of the Bankers (EARC) in this case. The EARC also acknowledged in their letter

head that the liability is stand settled, they have confirmed to the holding company the revised value of liability which contains the converted or structured loans and current interest liability for the year. Therefore, it clearly indicates that the old liability of interest is acknowledged as settled and there is no need for the assessee to separately submit bankers financial statement indicating how the settlements were recorded in their books of accounts. This satisfies the provisions mentioned in Explanation 3C to section 43B of the Act and also it addresses the amended Explanation 3C to 43B that the liability should not be continued in another form like Loans, Debenture etc., Whereas in this case the liability is replaced with the equity. Therefore, there is no infirmity in the findings of Ld CIT(A), hence, the grounds raised by the revenue are dismissed.

31. In the result, appeal filed by the revenue is dismissed.

Order pronounced in the open court on 04th August, 2022

Sd/-
(VIKAS AWASTHY)
JUDICIAL MEMBER
Mumbai / Dated 04.08.2022
Giridhar, Sr.PS

Sd/-
(S. RIFAUR RAHMAN)
ACCOUNTANT MEMBER

Copy of the Order forwarded to:

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER

(Asstt. Registrar)
ITAT, Mum