

**+IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'I', NEW DELHI**

Before Sh. Kul Bharat, Judicial Member

Dr. B. R. R. Kumar, Accountant Member

ITA No. 7980/Del/2019 : Asstt. Year: 2013-14

Fabindia Overseas Pvt. Ltd., 14, N Block Market, Greater Kailash, Part-1, New Delhi-110048 (APPELLANT)	Vs.	JCIT, Special Range-3, New Delhi-110003 (RESPONDENT)
PAN No. AAACF0782H		

ITA No. 8288/Del/2019 : Asstt. Year: 2013-14

DCIT, Circle-9(1), New Delhi-110002 (APPELLANT)	Vs.	Fabindia Overseas Pvt. Ltd., 14, N Block Market, Greater Kailash, Part-1, New Delhi-110048 (RESPONDENT)
PAN No. AAACF0782H		

**Assessee by : Sh. Rajan Bhatia, Adv. &
Sh. Jatinder Singh, CA**

Revenue by : Sh. Mrinal Kumar Das, Sr. DR

Date of Hearing: 02.05.2023	Date of Pronouncement: 31.07.2023
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ORDER

Per Dr. B. R. R. Kumar, Accountant Member:

The present appeals have been filed by the assessee and the revenue against the orders of Id. CIT(A)-44, New Delhi dated 31.07.2019.

2. In ITA No. 7980/Del/2019, following grounds have been raised by the assessee:

"1.1. That on the facts and circumstances of the case, the Id. CIT(A) has erred in not allowing the claim of

depreciation on trademark amounting to Rs. 22,24,732 under Section 32 of the Act.

1.2. That the Id. CIT(A) has erred in directing the Joint Commissioner of Income Tax, Special Range-3, New Delhi ("AO") to compute depreciation on trademark acquired by the Appellant in the financial year 2006-07 on the WDV to be derived on the basis of value to be computed by the Transfer Pricing Officer in the order for AY 2007-08, pursuant to the order of the Hon'ble ITAT for AY 2007-08 remanding back the determination of Arm's Length Price of the trademark, ignoring the fact that the matter so remanded to the Transfer Pricing Officer has become time-barred and no order could be passed by the Transfer Pricing Officer.

2.1. That, on the facts and circumstances of the case, the Id. CIT(A) has erred in upholding the order of the Id. AO/ the Joint Commissioner of Income Tax, Transfer Pricing Officer - 1(2), New Delhi ("the TPO") and sustaining transfer pricing adjustment of Rs. 5,00,79,901 on redemption of 'Deferred Shares' held in M/s East Limited, an Associated Enterprise, not appreciating that the Deferred Shares had no market value.

2.2. That the Id. CIT(A) has erred in holding that the 'Deferred Shares' are akin to the 'Ordinary Shares of M/s East Limited and that the Id. TPO had correctly benchmarked them on the basis of valuation report of the Ordinary Shares, ignoring the documents placed on record.

2.3. That, without prejudice to above, the Id. CIT(A) has erred in rejecting the contention of the Appellant that the impugned transfer pricing adjustment being a capital transaction, fell under the head "Income from Capital Gains" and not under the head "Profits and Gains from Business or Profession" as treated by the Id. AO, and consequently denying the deduction of cost of the Deferred share as per Section 48 of the Act.

3. That the Id. CIT(A), erred in upholding the addition made by the Id. AO of 'notional interest' amounting to Rs. 93,62,454 to the income of the Appellant on interest free advance to its wholly owned subsidiary, not permitted under the provisions of the Act.

4. That the Id. CIT(A) has erred in confirming computation of interest under section 234C of the Act, wrongly calculated by the Id. AO."

3. In ITA No. 8288/Del/2019, following grounds have been raised by the Revenue:

"1. On the facts and in the circumstances of the case and in law, the Ld. CIT(A) has erred in deleting the disallowance of depreciation on intangible assets amounting to Rs. 22,24,732/-.

2. On the facts and in circumstances of the case and in law, the Ld. CIT(A) has erred in deleting the disallowance made by the Assessing Officer u/s 40(a)(ia) of the IT Act on account of non-deduction of tax on credit card charges of Rs.3,34,75,810/-."

ITA No. 7980/Del/2019 : (Assessee Appeal)

ITA No. 8288/Del/2019 (Revenue Appeal)

Depreciation on Trade Mark:

4. The issue stands adjudicated in the case of the assessee for the A.Y. 2007-08 and A.Y. 2009-10 vide order dated 13.06.2016 72 Taxman 153 (Del. – Trib.). Since, the matter stands adjudicated by the Co-ordinate Bench of Tribunal, in the absence of any material change in the factual matrix and legal proposition, we hold that the same ratio applies for the instant year.

Credit Card Charges – Section 40(a)(ia):

5. This issue stands settled by the notification of the CBDT which is as under:

"SECTION 197A OF THE INCOME-TAX ACT, 1961 - DEDUCTION OF TAX AT SOURCE - NO DEDUCTION IN CERTAIN CASES - SPECIFIED PAYMENT UNDER SECTION 197A(1F)

NOTIFICATION NO. 56/2012 [F. NO. 275/53/2012-IT(B)], DATED 31-12-2012

In exercise of the powers conferred by sub-section (1F) of section 197A of the Income-tax Act, 1961 (43 of 1961), the Central Government hereby notifies that no deduction of tax under Chapter XVII of the said Act shall be made on the payments of the nature specified below, in case such payment is made by a person to a bank listed in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934), excluding a foreign bank, namely:

- (i) bank guarantee commission;*
- (ii) cash management service charges;*
- (iii) depository charges on maintenance of DEMAT accounts;*
- (iv) charges for warehousing services for commodities;*
- (v) underwriting service charges;*
- (vi) clearing charges (MICR charges);*
- (vii) credit card or debit card commission for transaction between the merchant establishment and acquirer bank.*

2. This notification shall come into force from the 1st day of January, 2013."

6. In view of the above notification, we decline to interfere with the order of the Id. CIT(A).

ITA No. 7980/Del/2019 : A.Y. 2013-14**Redemption of Deferred Shares:**

7. The relevant facts are as under:

8. In Annexure 3 of Form 3CB, the assessee has reported that it had redeemed investment in deferred shares of EAST Ltd., united Kingdom in GBP 1376235 and applied other method to benchmark the said transaction at Arm's Length Price. The assessee has reported as under:

"5.1.4 Redemption of Investment in Deferred Shares During the relevant FY, Fabindia also redeemed its 19125 deferred shares in East Limited at book value of Rs.13,76,235/-."

9. The TPO held that though in Form 3CB the assessee has reported that it has applied other method but no method was applied to benchmark the transaction of redeeming of shares. The assessee has sold these deferred shares only at Book Value. Before the TPO, the assessee explained as under:

"1. Copy of balance sheet of East Limited for period ended March 31, 2013 enclosed as Annexure-1, in relation to sale of investment in Ordinary shares of East Limited by the assessee

2. Copy of valuation report obtained from Independent Chartered Accountant in respect of valuation of Ordinary shares of East Limited at the time of sale of such shares by the assessee, enclosed as Annexure-2.

3. During the year under consideration, the assessee also redeemed the 'Deferred shares' held in East Limited at their par value. As in the same year the Ordinary shares held in East Limited were transferred at their market value, has sought the reason for transfer of Deferred shares at par value. In this regard, we would like to submit as under:-

3.1 During FY 2008-09, the assessee had made investment in East Limited, in which shareholding of 25.1% was acquired.

The detailed terms and conditions with respect to holding of Ordinary! Deferred shares, managing the company, and further acquisition/transfer of shares were stated in the Investment Agreement entered into by the assessee with the Shareholders and East Limited Copy of the Investment Agreement dated 06 January, 2009 is enclosed herewith as Annexure-3.4

3.2 The assessee made investment amounting to £ 10.00.000 in East Limited for acquiring the aforesaid shareholding of 25.1%. Copies of the relevant documents submitted with the RBI in this regard are enclosed herewith as Annexure-4. On perusal of the same, would observe that besides acquiring 25.1% Ordinary shares of East Limited, 20,000 Deferred shares of par value of £ 1 each were also acquired by the assessee at its par value.

It is submitted that such acquisition of Deferred shares at par value did not entitle the assessee any right to vote, participate in the profit of East Limited. For this reason, the Deferred shares were acquired only at par value, whereas the Ordinary shares were acquired at market value, as is evident from the documents filed before the RBI (as referred above).

3.3 Deferred shares are shares which have no right to vote, to participate in the profits or, except in some circumstances, to participate on winding-up.

3.4 In the present case, the rights available to the assessee in respect of Deferred shares were specified in the Articles of Association ("AOA") of East Limited, a copy of which is enclosed as Annexure-5."

10. It was reiterated by the assessee that the Deferred shares and Ordinary shares have different rights and restrictions. Deferred shares shall not carry any right to dividend, shall not carry a right to vote. Also, in the case of winding up of East Limited, the holders of Deferred shares shall be entitled to the

amount paid-up on their shares only, the surplus assets shall be distributed only to Ordinary shareholders and not to Deferred shareholders.

11. The assessee submitted that the above stipulations make it amply clear that the holders of Deferred shares were neither entitled to vote nor to receive any dividend and as such, cannot be ranked equivalent to Ordinary shareholders. In the case of the assessee, the Deferred shares were acquired with the sole objective to guard against the dilution of its 25.1% holding in Ordinary shares of East Limited.

12. The assessee submitted that the Investment Agreement also dealt with certain situations such as providing for rights and obligations in case the Current Options are exercised by the existing shareholders. Such situations had the impact of diluting the shareholding of the assessee in East Limited, on the happening of such events. As such, to guard against shareholding dilutions of the Investment Agreement provide that if on October 01, 2009, the assessee's shareholding represents less than 25.1%, the Deferred shares shall automatically be converted into Ordinary shares to the extent of the dilution. Similarly, as per the Investment Agreement that if at any time after completion the Current Options are exercised, Deferred shares held by the assessee will be converted into Ordinary shares.

13. The relevant extracts of paras 2.6 and 2.7 are reproduced by the TPO:

"2.6.1 If on 1 October 2009 the number of Ordinary Shares held by the New Investor represents less than 25.1 per cent of the issues Shares, such number of New Deferred Shares held by the New Investor shall automatically be converted into Ordinary Shares as would result in the New Investor holding 25.1 per cent of the issues Ordinary Shares in accordance with the New Articles; and

2.6.2

2.6.3"

"Current Options.

2.7 The Company, the Shareholders and the Relevant Option Holders agree that:

2.7.1 If at any time after completion any of the Current Options are exercised. New Deferred Shares held by the New Investor will be converted to Ordinary Shares in accordance with the New Articles; and

2.7.2"

14. The assessee submitted that on October 1, 2009 no dilution of shareholding of the assessee in East Limited happened and as such Deferred shares were not required to be converted into Ordinary shares.

15. It is a fact on record that due to exercise of Current Options by the existing shareholders, there was some dilution to the shareholding of the assessee and as such 875 Deferred

shares held by the assessee were converted into Ordinary shares. As such, due to Deferred shares, the assessee was able to safeguard its holding in Bust Limited. It was submitted that the Deferred shares had no marketability, saleability as they did not carry any right to vote/participate in profits and assets of East Limited. As such, it was imminent to redeem the same. It was submitted that the holding of Deferred shares by the assessee was merely an entitlement to convert the same into Ordinary-shares on the happening of the certain events as specified in the Investment Agreement, and as such were not in the nature of Ordinary shares per se. Therefore, the assessee redeemed such Deferred shares at their par value, is the same had no market value, when holding of such shares became infructuous.

16. After examining the issue, the TPO held as under:

"Public companies in India are not permitted to issue deferred shares but in many other countries such shares are issued by companies In India these can be issued by independent private companies. Deferred shares are issued subject to the condition that their holder will rank last of all in the matter of dividend payment. The shareholders may not receive any dividend at all if company makes a small profit. However, if the company earns huge profits, they are entitled to receive even higher dividend than the preference and equity shareholders thus deferred shareholders are often paid a high rate of dividend out of the balance of profits left after payment of a dividend at a fixed rate to preference shareholders and at a reasonable high rate to equity shareholders.

In "Investopedia" the definition of deferred share and their uses are as follows:

"What is a Deferred Share

A deferred share is a share that does not have any rights to the assets of a company undergoing bankruptcy until all common and preferred shareholders are paid. It may also be a share that is issued to company founders that restricts their receipt of dividends until dividends have been distributed to all other classes of shareholder.

BREAKING DOWN 'Deferred Share

A method of stock payment to directors and executives of a company, deferred shares are deposited into a locked account. The value of these shares fluctuates with the market and cannot be accessed by the beneficiary for the purpose of liquidation until they are no longer employees of the company or a particular date has past and the employee is considered fully vested with the company. Subordinate to all other classes of common and preferred stock, these shares are last in line when a company goes bankrupt and liquidates all assets

Use of Deferred Shares

Traditionally, deferred shares are just part of a larger compensation plan. Employees being issued deferred stock may also receive more traditional stock options, which may be subject to certain vesting periods, as well as other investment or retirement options.

No longer commonly used, these shares provided its holders with large dividend payouts, often higher than the average rate offered on other forms of shares, but are only paid after all other classes of shareholders have received their distributions. Holders of deferred shares have access to all the remaining profits after all of the other obligations were met.

The just of the show cause is as follows:

Transactions for Redemption of investment in deferred shares:

"As per page No.14 Para No.5.1.4 it is apparent that you have redeemed 19125 deferred shares in East Limited at Book Value of Rs.13,76,235/-. It is evident from the records that you have not benchmarked these deferred shares in your Transfer Pricing Report and determination of its ALP is still pending. Though these shares were not in the nature of the ordinary

shares but there must be some rights linked to these shares and there must be some value of these rights. Since you have not submitted the valuation report for deferred shares and not discharge onus to determine the ALP of the same, You are requested to submit Valuation Report of deferred shares within 3 days of receipt of this letter, or before 17/10/2016 whichever is earlier. On failure, it may be assumed that you have nothing to explain and accordingly the ALP of the deferred shares will be decided as per material available on the records."

Since, the assessee has not replied this show cause notice and no valuation report in relation to deferred shares was submitted, this office has no option but to decide arm's length price of the these shares on the material available on the records. Further, From the Assessee transfer pricing report, it is absolutely clear that, by not benchmarking the price of deferred shares, the assessee has not discharge this Onus and accordingly, following methodology is being proposed to benchmark the above said transaction.

As the PAR value of deferred shares was 1 pound each, it is observed that No Capital appreciation has taken place for these deferred shares. Further during the year the taxpayer has also sold its investment in equity shares of M/s East Limited. In this regard the assessee has submitted valuation report vide submission dated 27.09.2016 wherein the price of such equity shares was stated as GBP 31.24 per share using average of value determined by NAV and PECV method.

Therefore, considering that the value of the equity shares as per the valuation report is GBP 31.24 per share, I propose to make an adjustment on the deferred shares considering their value to be equivalent to the value of the equity shares."

17. The Id. CIT(A) has gone in detail about the issue and held as under:

"Perusal of the documents filed during the course of appellate proceedings shows that the appellant had redeemed investment in deferred shares of

East Limited, United Kingdom for Rs. 1,376,235 and reported the same as an international transaction in Annexure 3 of Form 3CEB. The TPO pointed out that though it was reported in Form 3CEB that "other method" was used to benchmark the transaction, perusal of the record shows that no method was applied to benchmark the same. It was also noted by the TPO that the shares had been sold at book value.

The assessee stated that it had made investment in East Limited, United Kingdom during FY 2008-09 and acquired shareholding of 25.1% of the ordinary shares. 20,000 deferred shares at par value of GBP I was also acquired by the appellant at par value. The appellant also stated that such deferred shares did not entitle the appellant to any right to vote, participate in the profit M/s Fab India Overseas Pvt. Ltd. PAN. AAACF0782H Appeal No. 175/2018-19/CIT(A)-44 AY 2013-14 and that there was limited rights in winding up of the company. The said facts were specified in the Articles of Association of East Limited, United Kingdom.

However, the investment agreement between the appellant and the AE, also dealt with certain situations such as providing for rights and obligations in the case when current options were exercised by existing shareholders so that the appellant's shareholding did not fall below 25.1% of the total ordinary shares. Para 2.6.1 of the investment agreement provided that if on 01.10.2009, the appellant's shareholding was less than 25.1%, then the deferred shares would automatically be converted into ordinary shares to the extent of dilution. Similarly, para 2.7 of the said agreement provided that if current options were exercised by the existing shareholders and at any time after the completion of the same if the appellant shareholding was less than 25.1%, then the deferred shares would automatically be converted into ordinary shares to the extent of dilution.

The appellant has pointed out that due to exercise of current options by the existing shareholders, there was some dilution to the shareholding of the appellant and 19125 deferred shares held by the appellant were converted into ordinary shares.

The TPO issued a show cause notice to the appellant on 05.10.2016 which was received by the appellant on 08.10.2016. However, the appellant did not file any reply to the show cause notice or valuation report pertaining to deferred shares. Earlier, during the assessment proceedings, the appellant had filed the valuation report of ordinary shares. The TPO, accordingly, calculated the transfer pricing adjustment on the redemption of deferred shares by taking its devaluation at GBP 31.24 per share as per the valuation report.

The various contentions of the appellant regarding transfer pricing adjustment made by the TPO/AO are not accepted. The appellant has itself shown the transaction as an international transaction in Form 3CEB but has not benchmarked the same. It has not placed any valuation report of the deferred shares. The deferred shares carried certain rights as they would automatically be converted into ordinary shares if the holding of the appellant in East Limited, United Kingdom fell below 25.1%. In such cases, there would be akin to ordinary shares. Hence, the TPO/AO has correctly benchmarked them using the valuation of ordinary shares. The contention of the appellant that the transfer pricing adjustment referred to above should be adjusted against carried forward / current short term capital gains is not accepted as the enhancement of income has been made by the AO/TPO on account of transfer pricing adjustment made by the appellant with a related party. Capital gains may be set off only on transactions between unrelated parties. In view of the same, there is no reason to interfere with the findings of the AO/TPO."

18. Before us, both the parties argued based on the submissions taken up before the authorities earlier. We have gone through the entire material before us and also the paper book containing 361 pages. We have gone through the approval proposal to make investment addressed to Standard Chartered Bank at page no. 210. We have also gone through the notification letter exercising share options in the capital of East Ltd. at page no. 278. We have also gone through the letter of the Chartered Accountant indicating the number of shares

consisting of 48573 ordinary shares and 20,000 deferred shares at page no. 226. We have also gone through the reasons given with regard to the valuation shares @ 1 £ each against the value of the ordinary shares. The main contention of the assessee was the shares are non-marketable, do not have voting rights and do not receive dividends. At the same time, we have also observed that the deferred shares are converted into ordinary shares and once converted as ordinary shares they acquire all the benefits and characters attributable to ordinary shares. The deferred shares carried rights as they would automatically be converted into ordinary shares when the holdings of the assessee in East Ltd. falls below 25.1%. Keeping in view, the fact that the deferred shares can be converted into ordinary shares without any encumbrances, we decline to interfere with the order of the Id. CIT(A).

Notional Interest:

19. The assessee stated that it had advanced interest free loan to its wholly owned subsidiary out of its own funds. The assessee has also charged interest on the same loan in the subsequent year owing to the provisions of Companies Act, 2013. The Id. CIT(A) confirmed the addition relying on the judgment of Hon'ble Apex Court in the case of SA Builders Vs. CIT in CA No. 5811/2006 dated 14.12.2006. It is a settled position of law that if the assessee has sufficient interest free own funds to lend monies interest free, no addition is called for. Since, it is contested that the assessee has own interest free funds, the matter is being referred back to the file of the AO to examine the availability of interest free own funds and compute the disallowance accordingly.

20. In the result, the appeal of the assessee is partly allowed and that of the Revenue is dismissed.

Order Pronounced in the Open Court on 31/07/2023.

Sd/-

(Kul Bharat)
Judicial Member

Sd/-

(Dr. B. R. R. Kumar)
Accountant Member

Dated: 31/07/2023

Subodh Kumar, Sr. PS

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(Appeals)
5. DR: ITAT

ASSISTANT REGISTRAR