

IN THE INCOME TAX APPELLATE TRIBUNAL
Mumbai "D" Bench, Mumbai.

Before Justice (Rtd.) C.V. Bhadang (President) & Shri B.R. Baskaran (AM)

I.T.A. No. 3678/Mum/2015 (A.Y. 2010-11)

Raoul S. Thackersey Sir Vithaldas Chambers 3 rd Floor, 16 Mumbai Samachar Marg, Fort Mumbai-400 001. PAN : ACLPT5869P (Appellant)	Vs.	ACIT-12(1) Room No. 263 Aayakar Bhavan M.K. Road Mumbai-400 020. (Respondent)
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Assessee by	Shri K. Gopal & Ms. Neha Paranjpe
Department by	Smt. Mahita Nair
Date of Hearing	16.01.2024
Date of Pronouncement	15.04.2024

ORDER

Per B.R.Baskaran (AM) :-

The assessee has filed this appeal challenging the order dated 24-03-2015 passed by Ld CIT(A)-28, Mumbai and it relates to the assessment year 2010-11. The grounds of appeal urged by the assessee give rise to the following issues:-

- (a) Whether the surplus realized by the assessee on surrender of Non Convertible Debenture (NCD) upon its redemption on maturity would give rise to Long term Capital gains or Income from other sources?
- (b) If it is held as "income from other sources", whether the surplus amount should be Rs.9.08 crores or Rs.12.59 crores?
- (c) If it is held as "Long term Capital gains", whether the assessee's claim for deduction u/s 54F of Rs.2.77 crores and sec.54EC should be allowed or not?

2. The facts relating to the above said issues are discussed in brief. The assessee is a director in M/s Capricorn Realty Ltd and is deriving salary from there. Besides the above, the assessee is also engaged in the business of trading in Shares & securities and is carrying on business in Artwork & Painting under the trade name "The Luxury Company". During the year under consideration, the assessee declared Long term capital gains on redemption of NCDs issued by two companies, viz., (a) Bhishma Realty Ltd and (b) Capricorn Realty Ltd. The assessee invested the maturity proceeds in purchase of a flat under construction and also in REC bonds. Accordingly, the assessee claimed exemption u/s 54F and 54EC of the Act in his return of income.

3. The AO noticed that the deduction u/s 54F is allowed against the capital gain arising on sale of capital asset other than a residential house, if the assessee has purchased within two years and constructed within 3 years a residential house, from the date of transfer of the capital asset. He noticed that the NCDs were redeemed by the assessee in October, 2009 and the agreement for purchase of flat was entered on 16th July, 2012. Further, it was noticed that the assessee has not got possession of the flat within the prescribed period of 3 years. Accordingly, the AO took the view that the assessee has not complied with the conditions prescribed u/s 54F of the Act and accordingly rejected the claim for deduction of Rs.2,77,15,801/- u/s 54F of the Act. The AO also observed that NCDs were issued by related companies and further, the profit obtained by the assessee on redemption of NCDs were in the range of 18.92% to 31.37%, while the rate of return in Mutual funds worked out to 11.5% to 18% only. Accordingly, the AO took the view that the entire arrangement of issuance of NCDs by the related companies and their redemption appeared to be a make believe arrangement with the intention to shift profits to the assessee. It is pertinent to note that the AO did not discuss anything about the claim made by the assessee u/s 54EC of the Act.

4. In the appellate proceedings, the Ld CIT(A) held that the redemption of NCDs would not give rise to Long term capital gains as claimed by the assessee and further held that the difference between the maturity proceeds upon redemption of NCDs and the cost is to be assessed as interest income of the assessee under the head Income from Other Sources. Accordingly, the Ld CIT(A) directed the AO to assess a sum of Rs.12.59 crores as interest income. Since the Ld CIT(A) held that the assessee did not earn any long term capital gains, he did not consider the question of allowing deduction u/s 54F and 54EC of the Act. Aggrieved, the assessee has filed this appeal.

5. The facts relating to the above said issues are discussed in brief. A company named Hindoostan Spinning & Weaving Mills Ltd (HSWML) was declared as a sick unit under the Sick Industrial Companies (Special Provisions) Act, 1985 on 04-12-2002. As per the Rehabilitation Scheme sanctioned by the then existing authority named BIFR, the above said company was divided into 4 units. Three Special Purpose Vehicles (SPV) viz., Bhishma Realty Limited, Capricorn Realty Limited and Chaitra Realty Limited, were formed for managing three units. One unit at Karad continued to be with the existing HSWML. As per the scheme sanctioned by BFIR, all the three special purpose vehicles issued 0% secured Redeemable non-convertible Debentures payable at a premium (hereinafter called as "NCDs" to the secured lenders, i.e., Nationalised banks against their outstanding loans in the year 2004/2005. The terms and conditions of issuing NCDs were governed by a Debenture Trust Deed dated 22.07.2005 and M/s IDBI Trusteeship Services Ltd was appointed as "Trustee" for the management of NCDs. Each NCD was having face value of Rs.1.00 lakh. Two types of NCDs, viz., NCD-I for the creditors holding first charge and NCD-II for the creditors holding second charge were issued.

6. During the year 2006, the banks started pressurizing the directors of the SPVs for payment of NCDs. Hence the assessee, being one of the directors

along with other individuals purchased the NCDs from the nationalized banks. The assessee purchased the NCDs issued by M/s Bhishma Realty Ltd and M/s Capricorn Realty Ltd and the details thereof are given below:-

(A) Bhishma Realty Ltd:-

NCD -I - 213.35 NCDs having face value of Rs.1.00 lakh each was purchased for Rs.1,30,380.26 per debenture.

NCD-II - 731.50 NCDs having face value of Rs.1.00 lakh each was purchased for Rs.1,32,367.05 per debenture.

(B) Capricorn Realty Ltd:-

NCD-I - 29.69 NCDs having face value of Rs.1.00 lakh each was purchased for Rs.1,30,379.72 per debenture.

NCD-II - 125.55 NCDs having face value of Rs.1.00 lakh each was purchased for Rs.1,32,366.97 per debenture.

The aggregate amount of purchase cost of NCDs was Rs.1451.32 lakhs.

7. During the year 2009, the above said NCDs I & II were redeemed by both M/s Bhishma Realty Ltd and M/s Capricorn Realty Ltd. The maturity proceeds received by the assessee upon redemption are detailed below:-

(A) Bhishma Realty Ltd:-

NCD - I - Rs.2,27,930.88 per debenture	=	Rs. 486.29 lakhs
NCD - II - Rs.2,07,503.28 per debenture	=	Rs.1,517.89 lakhs

(B) Capricorn Realty Ltd:-

NCD - I - Rs.2,53,106.20 per debenture	=	Rs. 75.14 lakhs
NCD - II - Rs.2,23,248.54 per debenture	=	Rs. 280.29 lakhs

		Rs.2,359.62 lakhs
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Thus, the assessee made a gain of Rs.908.30 lakhs (Rs.2359.62 (-) Rs.1451.32 lakhs). The assessee offered the same as Long term capital gains. We noticed earlier that the provisions of sec.54F allows a deduction against

capital gains, when an assessee invests the long term capital gains arising from sale of a capital asset other than a residential house in purchase/construction of a residential house. The assessee booked a flat in the building promoted by M/s Capricorn Realty Ltd and developed by M/s Genext Hardware & Parks P Ltd. Accordingly, the assessee claimed a sum of Rs.2,77,15,801/- as deduction u/s 54F of the Act on the reasoning that he has invested the long term capital gains arising on redemption of NCDs in constructing a residential house. As noticed earlier, it appears that the assessee has also invested in REC bonds and claimed deduction u/s 54EC of the Act in respect of the same, but there was no discussion on that issue by the AO.

8. We noticed earlier that the AO rejected the claim for deduction u/s 54F of the Act. The Ld CIT(A), however, examined the issue in a different angle and held that the gain received by the assessee on redemption of NCDs is in the nature of interest assessable under the head Income from Other sources. Accordingly, the claim for deduction u/s 54F was rejected by Ld CIT(A) in the absence of any income by way of long term capital gains.

9. Before us, the Ld A.R contended that the Ld CIT(A) has exceeded his power by directing the AO to assess a “new source of Income”. According to Ld A.R, the AO had assessed the long term capital gains as declared by the assessee, but he has only denied the deduction claimed u/s 54F of the Act. On the contrary, the Ld CIT(A) had directed the AO to assess the gain received on redemption of NCDs as interest income under the head Income from Other sources, which would amount to assessment of new source of income by Ld CIT(A). The Ld A.R submitted that the Ld CIT(A) is not empowered to assess any new source of income in the appellate proceedings. In support of this contentions, the Ld A.R placed his reliance on the decisions rendered by Hon’ble Delhi High Court in the case of CIT vs. Union

Tyres (240 ITR 556)(Delhi) and CIT vs. Sardari Lal & Co (2002)(102 Taxman 595)(Delhi).

10. We heard the parties on this legal issue. We noticed that the assessee has purchased NCDs for an amount of Rs.1451.32 lakhs and received a sum of Rs.2359.62 lakhs on their redemption. Thus, the assessee made a gain of Rs.908.30 lakhs on the redemption of NCDs. We notice that the taxability of above said income has only been examined both by the assessee/AO and Ld CIT(A). While the assessee has declared the same as Long term capital gains, the Ld CIT(A) has taken the view that the same is required to be assessed as interest income under the head Income from Other sources. Thus, we notice that the Ld CIT(A) has only changed the “head of income” under which the above said gain is required to be assessed. Hence, we are of the view that it cannot be said that the Ld CIT(A) has directed the AO to assess any new source of income as contended by the assessee. Accordingly, we do not find any merit in the above said legal contention of the assessee and accordingly, we reject the same.

11. It is pertinent to note that there is an error in the quantum of income that was directed by the Ld CIT(A) to be assessed as interest income. We notice that the Ld CIT(A) has directed the AO to assess a sum of Rs.12,59,52,660/-, being the difference between the sale value and face value of NCDs. However, the fact remains that the assessee was not original allottee of NCDs and he has purchased them from banks. Hence, the difference between the sale value and purchase cost amounting to Rs.9,09,25,505/- was the actual amount of gain earned by the assessee and the same should have been directed by him to be assessed as interest income. This is an apparent mistake in mentioning the income that is required to be assessed and we have given appropriate direction infra.

12. Now, the question that requires our consideration is whether the gain arising to the assessee on redemption of debentures is in the nature of

Capital gains as claimed by the assessee or it is in the nature of interest income as held by Ld CIT(A). The question relating to deduction claimed by the assessee u/s 54F of the Act would require examination only if we hold that the impugned gain is assessable as long term capital gains.

13. In the instant case, the Special Purpose Vehicles, viz., Bhishma Realty Limited, Capricorn Realty Limited and Chaitra Realty Limited have issued Non Convertible Debentures – i.e., 0% secured and redeemable non-convertible debentures of Rs.1.00 lakh each. They were issued in two series, viz., NCD-I to first charge holders and NCD-II to second charge holders and both the series are to be redeemed within a period of 5 years from the date of sanction by BIFR along with redemption premium so as to yield an IRR of 12.5% and 11% respectively. Thus, the above said SPVs are not required to pay interest either quarterly, half yearly or annually during the tenure of NCDs, but premium shall be paid on redemption. We noticed earlier that the above said NCDs were initially allotted to the nationalized banks in September, 2004. The assessee herein has purchased the NCDs in June, 2006 from those nationalized banks. Thereafter, they were redeemed in October, 2009.

14. The case of the assessee is that the “debenture” is a capital asset. Further its redemption results in extinguishment of rights therein. However, the Ld CIT(A) has taken the view that the redemption will not fall under the definition of “transfer” given under the Act. In this regard, the Ld A.R submitted that the expression “transfer” includes “sale, exchange or relinquishment of asset or extinguishment of rights” as stated in sec.2(47)(i) of the Act. The Ld A.R submitted that the extinguishment of rights in preference shares has been held to be a case of “transfer” by various Courts. In support of this proposition, the Ld A.R placed his reliance on the decisions rendered by Hon’ble Supreme Court in the case of Anarkali Sarabhai vs. CIT (1997)(90 Taxman 509)(SC), Kartikeya V Sarabhai vs. CIT (1997)(95 Taxman

164)(SC) and by Hon'ble Bombay High Court in the case of Sath Gwaldas Mathurdas Mohata Trust vs. CIT (1987)(33 Taxman 328)(Bom). The Ld A.R also invited our attention to the decision rendered by Mumbai bench of ITAT in the case of Mrs. Perviz Wang Chuk basi vs. JCIT (2006)(102 ITD 123), wherein the redemption of capital investment bond after maturity is held to be a "transfer" within meaning of sec. 2(47) and accordingly, it was held that the same would give rise to Capital Gain or loss. He submitted that the same analogy should be applied to the case of redemption of debentures also, as the same results in extinguishment of rights in debentures.

15. The Ld A.R drew our attention to the provisions of sec.50AA of the Act introduced from 1.4.2023, wherein it is stated that the gains arising on transfer, redemption or maturity of "market linked debentures" shall be deemed to be capital gains arising on transfer of short term capital asset. He also invited our attention to the fourth proviso to sec.48, wherein it is stated that the benefit of indexation will not be available to debenture. Accordingly, the Ld A.R submitted that the Income tax Act itself recognizes "debentures" as capital asset. Accordingly, the Ld A.R contended that the redemption of debentures would result in transfer of a capital asset and the gain arising thereon would give raise to Capital gains as mentioned in sec.45 of the Act.

16. On the contrary, the Ld D.R submitted that the NCDs are debt instruments and issuing of debentures is one of the ways of borrowing money either from market or through private placement. In the present case, the NCDs have been issued initially by HSWML to the banks in settlement of loan taken by it from banks. The said NCDs carried 0% interest rate, but are redeemable at a premium. It is specifically stated that the premium amount payable on redemption is calculated in a particular manner, meaning thereby, the premium is nothing but the interest amount payable on the NCDs (loan amount). The ld D.R submitted that the Delhi bench of Tribunal has examined the nature of premium payable by the issuer of debentures in

the case of ACIT vs. Cleeta Real Estate (P) Ltd (2022)(145 taxmann.com 76)(Delhi) and it has been held that the premium amount is an expenditure and it could be spread over the tenure of debenture period and could be claimed as deduction accordingly. Similar view has been expressed in the case reported in 2017-TIOL-183-ITAT-KOL. She also referred to the decision rendered by ITAT in the case of Bennett Coleman & Co Ltd vs. ACIT (ITA No.569/Mum/2009 dated 21-01-2010), wherein it was held that the premium received on redemption of debenture is taxable under the head Income from other sources.

17. The Ld D.R further submitted that the assessee herein is an intermediate purchaser and not the original subscriber of NCDs. With regard to tax treatment to be given to the gain arising on redemption of Deep Discount Bonds, the Ld D.R referred to the Circular No.002 of 2002 issued by CBDT, wherein the tax treatment to be given in respect of Deep Discount Bonds and STRIPS upon its redemption has been explained. He submitted that the above cited CBDT Circular states that the difference between the redemption price and the cost of purchase of bond by the intermediate purchaser will be taxable as interest or business income, as the case may be. Accordingly, the Ld D.R submitted that the Ld CIT(A) has rightly held that the gain received by the assessee on redemption of NCDs is taxable as interest income. With regard to the computational error, the Ld D.R agreed that the correct amount may be directed to be assessed as interest income. The Ld D.R further submitted that the question of allowing deduction u/s 54F and 54EC will not arise, since the gain is taxable as interest income.

18. We heard rival contentions and perused the record. The facts peculiar to this case may first be noted here. The three SPVs, viz., viz., Bhishma Realty Limited, Capricorn Realty Limited and Chaitra Realty Limited are related concerns of the assessee. The assessee is a director in Capricorn Realty Limited. We noticed earlier that the NCDs were issued by above said

three SPVs on private placement basis and they were allotted initially to nationalized banks in lieu of outstanding loans. The assessee, herein, has purchased them from those banks, being initial allottees. The debentures were not listed/traded in any of the stock exchanges. As per Section 2(30) of Companies Act, 2013 “debenture” includes debenture stock, bonds, or any other instrument of a company **evidencing a debt**, whether constituting a charge on the assets of the company or not. Hence, even though the debentures would fall under the definition of “securities”, yet they are essentially debt instruments evidencing a debt.

19. The Ld D.R relied on a circular issued by CBDT, i.e., Circular No.002 of 2002, wherein the tax treatment to be given on the gains realized on redemption of Deep Discount Bonds (DDB) has been explained. The DDBs are issued by discounting the face value of debenture/bond and the same will be redeemed at par value. For example, the DDB with tenure of five years and having a face value of Rs.1000/- may be issued at Rs.600/-. They will be redeemed at Rs.1,000/- upon maturity. The NCDs issued by SPVs are opposite to DDBs. The NCDs were issued by the SPVs at a face value of Rs.1.00 lakh and they are redeemable after a period of five years at a premium so as to yield an IRR of 12.50% in the case of NCD-I and 11% in the case of NCD-II. Thus, in the case of DDB, the face value of the bonds is discounted by applying a particular interest rate, so that the maturity proceeds equal to the face value. On the contrary, in the case of NCDs redeemable at premium, the premium amount is determined by applying a particular interest rate. Thus, both the amount of discount and the amount of premium, in effect, are “interest amounts” only. Hence, the companies issuing both types of bonds/debentures usually claim discount/premium as interest expenditure and their claim has been allowed.

20. We think that there is no dispute with regard to the fact that the “Debentures” fall under the category of “Capital asset” under the Income tax

Act. In this regard, the Ld A.R took us to sec.50AA of the Income tax Act, wherein the gains arising on sale/redemption of certain kinds of debentures is stated to be taxable as short term capital gain. We notice that section 50AA is applicable to a case of “market linked debentures” (MLD). In case of Market linked debentures, the interest rate payable on them is not determined at the time of issuing them. Instead, the return on those market linked instruments is determined on the basis of performance of an underlying market index or instrument. Normally, in case of MLD, interest may not be payable every year and it may be payable in lump sum at the end of its tenure. The Parliament, by a legal fiction introduced in sec.50AA of the Act, has stated that the said gain is taxable as short term capital gains, even though the MLD might have been held for more than three years. The reason may be that the tax is payable on short term capital gains under regular rates, as applicable to interest income. In the instant case, the assessee has purchased NCDs and they are materially different from MLDs. Hence, we are of the view that the legal fiction introduced in sec. 50AA to deal with the cases of MLDs cannot be taken support of by the assessee, in the facts of the present case.

21. The Ld A.R also placed reliance on the fourth proviso to sec.48 of the Act, wherein it is stated that the indexation benefit will not be available to bond or debenture. He also placed reliance on certain case laws, wherein it has been held that the redemption of Preference shares or reduction of face value of shares would result in extinguishment of rights/proportionate rights in shares held by a shareholder and hence the amount paid to the shareholder is exigible to Capital gains tax. We notice that the all the said case laws are related to Preference shares/equity shares and not to debentures. There should not be any dispute that the “shares” and “debentures” are two different types of instruments having different types of rights and liabilities. Hence, both cannot be equated with. A shareholder holds a share in the Share capital of a company and he is considered to be

one of the owners of the company. He is having right over the surplus available on liquidation of the company. While the preference shares may be of a particular tenure, the equity shares are held on a perpetual basis. Both kinds of shares can only be sold in the open market. The question of redemption of shares does not arise in the case of equity shares. However, a company may buy back its equity shares subject to complying with the conditions imposed by the Statute. Similarly, subject to compliance of conditions imposed by the statute, the par value of equity shares may be reduced, split etc. On the contrary, a debenture holder is a financial creditor to the company, since debenture is a debt instrument. Further, the debentures are redeemable at the end of the tenure. A debenture holder is entitled to receive interest as per agreed terms and the principal amount upon its maturity. He does not have right to receive anything extra and cannot have any right over the surplus arising on liquidation of company. Thus the shares carry more right over and above its face value, while the debentures do not carry such kind of rights. Hence, "shares" and "debentures" stand on different footing. In our view, the decisions with regard to redemption of preference shares and reduction of capital in case of equity shares have been rendered considering the rights and liabilities attached to shares. Hence, in our view, the ratio of decisions rendered in the case of equity shares/preference shares cannot be applied to debt instruments. We notice that the decision in the case of *Mrs. Perviz Wang Chuk basi* (supra) was related to Capital investment Bond issued by Government of India and not the case of debenture issued on private placement basis. Accordingly, the redemption of debentures is nothing but repayment of debt and the same, in our view, cannot fall under the category of "extinguishment" as interpreted by the Courts in the case of Shares/Preference shares.

22. We may explain as to how the incidence of capital gain may arise in the case of debentures. We noticed earlier that the holder of debenture is only entitled to receive interest from it. The said interest income is taxable under

the head Income from other sources or under the head business. In case of shares, the shareholder would get dividend income and the same is taxable as stated above. Thus the face value of shares/debentures would remain static and is the capital amount, while the dividend/interest income is the income generated from the above said capital amount. The possibility of generating capital gains/capital loss will arise only if their market value is different from their face value/par value. Such kind of variation will arise in the case of shares/debentures generally, only when they are sold in the open market and amount realized thereon is different from the face value. The market value of shares would depend upon various aspects considered by the market forces. The market value of debentures would depend upon the fluctuation in the prevailing general interest rates. We may explain this with an example. Let us assume that a debt instrument having face value of Rs.1000/- was issued and it carried interest rate of 12% p.a.. Let us further assume that the market rate of interest has fallen to 6% subsequently. In that case, the market forces will recognize the higher interest yield available in the above said debt instrument. Accordingly, the market value of debt instrument may increase to say Rs.1300/-. If the holder of the said debt instrument having face value of Rs.1000/- sells it for Rs.1300/-, then the gain of Rs.300/- obtained by that person is assessable as Capital gain. So far as the company which had issued the debt instrument is concerned, the above said market value is irrelevant. It would be paying interest on the face value of Rs.1000/- only and further, at the time of redemption of the same, the said company would be redeeming the debt instrument at its face value of Rs.1000/- only. We have held earlier that such kind of redemption will not give rise to any capital gains.

23. In the instant case, the NCDs under consideration are privately placed debentures and they are not listed in the stock exchange. Further, the assessee herein has not sold the NCDs in the open market. The assessee has only surrendered the NCDs to the SPVs, viz., M/s Bhishma Realty Ltd and

M/s Capricorn Realty Ltd, for redemption. Thus, it is a case of realization of money advanced by a creditor, since debentures are debt instruments only. Thus, the question of generation of capital gains will not arise, when the debentures are redeemed by the issuing companies. Further, what is received by the assessee in the form of premium is nothing but interest income only. Accordingly, we are of the view that the Ld CIT(A) was legally correct in holding that the premium/surplus received by the assessee is interest income assessable under the head Income from Other Sources.

24. We noticed earlier, the cost of purchase of debentures to the assessee was Rs.1451.32 lakhs and the redemption value was Rs.2359.62 lakhs. Hence the actual interest that has accrued to the assessee was Rs.908.30 lakhs only. Accordingly, we modify the order passed by Ld CIT(A) and direct the AO to assess the above said interest income of Rs.908.30 lakhs only.

25. Since we have held that the surplus/premium received by the assessee is in the nature of interest income, the contention of the assessee that the same was in the nature of capital gain is rejected. Hence the assessee will not be entitled for any deduction u/s 54F and 54EC of the Act in the absence of any capital gains income. We order accordingly.

26. In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on 15.4.2024.

Sd/-
(Justice (Rtd.) C.V. Bhadang)
President

Sd/-
(B.R. Baskaran)
Accountant Member

Mumbai.; Dated : 15/04/2024

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent

3. The CIT(A)
4. CIT
5. DR, ITAT, Mumbai.
6. Guard File.

//True Copy//

PS

BY ORDER,

(Assistant Registrar)
ITAT, Mumbai