

**IN THE INCOME TAX APPELLATE TRIBUNAL
'C' BENCH : BANGALORE**

**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER
AND SHRI SOUNDARARAJAN K, JUDICIAL MEMBER**

ITA Nos.696 & 718/Bang/2024

Assessment year : 2017-18 & 2018-19

The Dy. Commissioner of Income-tax, Circle-2(1)(1), Bengaluru.	Vs.	Enzen Global Solutions Pvt. Ltd., No.90, Hosur Road, Madiwala, Bengaluru. PAN – AABCE 5868 J
APPELLANT		RESPONDENT

Assessee by	:	Shri V Chandrashekar, Advocate
Revenue by	:	Ms. Neera Malhotra, JCIT(DR)

Date of hearing	:	20.05.2024
Date of Pronouncement	:	20.05.2024

ORDER

Per Chandra Poojari, Accountant Member

These appeals by the Revenue are directed against the order of NFAC, New Delhi both dated 08/02/2024 passed u/s 250 of the Act for the assessment years 2017-18 and 2018-19.

2. Since common issues/facts for consideration are involved in both the years under consideration including the figures, both the appeals are being disposed of by way of a common order. Therefore, the view to be taken for assessment year 2017-18 will also apply mutatis mutandis to the assessment year 2018-19.

3. At the outset, it was noticed that there was a delay in filing the appeals by the Revenue for 09 days for the assessment year 2017-18 and 10 days delay for the assessment year 2018-19. The Revenue has filed letter for condoning the delay and justifying the reason for the delay in filing the appeal, which is as under:-

The second appeal before the Hon'ble ITAT in the case of M/s Enzen Global Solutions Pvt Ltd for AY 2018-19 (PAN: AABCE5868J) against the order in ITA No. ITBA/NFAC/S/250/2023-24/1060672879(1) dated: 08.02.2024 was filed after delay of 11 days.

The delay in filing of appeal before the ITAT is primary due to heavy workload associated with re-opening assessment proceedings and time barring assessment and penalty proceedings coupled with acute shortage of manpower. The delay is unintentional and attributable to unavoidable reasons

As such, under the circumstances, **I pray for condonation of 11 days delay in filing of appeal** before the Hon'ble ITAT, Bangalore, in the above said case.

Yours faithfully,

[Suresh Babu K.]

Deputy Commissioner of Income Tax
Circle-2(1)(1), Bangalore

4. In view of the above, the Id. DR requested to condone the delay in filing the appeal by the assessee and decide the issue on merit.

5. Heard the rival contentions of both the parties and perused the materials available on record. Considering the reasons for the delay in filing the appeal by the Revenue, we find that there was genuine cause for the delay in filing the appeal before us. Accordingly, we condone the delay and proceed to adjudicate the issue on merit.

6. We, first, take up appeal No.696/Bang/2024 for the assessment year 2017-18

7. The grounds raised in ITA No.696/Bang/2023 is reproduced as under:-

“1. The Ld. CIT(A) erred in law in deleting the addition of Rs. 21,45,00,000/- made towards premium on preference shares.

2. The Ld. CIT(A) erred in law in following decision of the Hon'ble ITAT rendered in the case of the assessee for the AY 2016-17 without appreciating the change in position of la with implementation of Ind AS.

3. The Ld. CIT(A) has failed to take note of the provisions of the Ind AS 32 standards as per which the substance of the financial instrument takes precedence over legal form and hence preference shares has to be recognized as debt instrument and not as equity instrument based on the facts available at hand in the instant case.

4. The Ld. CIT(A) has overlooked the fact that the fixed rate of premium gives the preference shares held by the assessee _company the nature of a debt instrument on which Board's Circular 2 of 2002 applies, which mandates accretion to the value of the bond during the relevant financial year to be taxed as interest income (where the bonds are held as investments) or business income (where the bonds are held as trading assets).

5. The Ld. CIT(A) has failed to take note of the fact that the assessee company is following mercantile system of accounting

and 'hence premium accrued during a financial year (at the rate of 16.5% per annum) would be taxed during the corresponding assessment year."

8. The assessee company filed its return of income for the AY 2018-19 on 30.11.2018 declaring total income of Rs. 34,43,41,770/-. Assessment order passed by the AO u/s 143(3) r.w.s. 144C of the IT Act, on 23.09.2021 at a total assessed income of Rs.56,09,42,530/- after making an addition of Rs.21,45,00,000/- on account of premium accrued on RPS under Income from other sources.

9. The ld. AR relied on the order of the Tribunal.

10. We have heard both the parties and perused the material available on record. We find that this Tribunal in the assessee's own case in ITA No.2332/Bang/2019 and 2550/Bang/2019 vide order dated 14-09-2022 for the assessment year 2016-19 involving identical facts and circumstances has allowed the appeal of the assessee. The relevant extract of the order is reproduced below:

16. We have carefully considered the rival submissions. It is seen that the Ensource Consulting Pvt. Ltd., made an invitation to the assessee to subscribe for non-convertible redeemable cumulative preference shares of 13,00,000 Nos. of Rs.1,000/- each. The offer was dated 26.05.2015 and as per the offer letter, the rate of dividend / the rate of interest is mentioned as 8% P.A. on cumulative basis 14% on overall IRR basis. The assessee subscribed

to the offer and terms of the subscription of preference shares are evidenced by an agreement dated 04.06.2015. As per the terms of the agreement, the issue date means the date on which the company allots and issues preference shares to the assessee. The redemption date was 20 years from the date of issue. The terms of the preference shares are contained in Annexure A to the agreement and the same reads as follows:

Annexure A

TERMS OF PREFERENCE SHARES

1.	Aggregate Quantity	13,00,000 (Thirteen Lakh) Non-Convertible Redeemable Preference Shares.
2.	Face Value per Preference Share	INR 1,000/- (Rupees One Thousand Only) each.
3.	Issue price per Preference Share	INR 1,000/- (Rupees One Thousand Only) each.
4.	Redemption Premium	<u>Preference Shares shall be redeemed at such price, so as to net a premium of 16.5% per annum. Such premium shall accrue on a year on year basis and shall be payable on the Redemption Date.</u>
5.	Voting	The Shareholder shall not have the right to receive notice of, or to attend and vote at a shareholders/general meeting of the Company.

6.	<i>Redemption Methodology</i>	<i>At any time after the date of issue of the Preference Shares, the Company, subject to the approval of the Board of Directors, may redeem all or part of the Preference shares at a redemption price equal to the face value of the Preference Shares.</i>
7.	<i>Liquidation</i>	<i>In the event of liquidation or winding-up of the Company, each Shareholder shall be ranked lower than creditors but higher than equity shareholders and shall have priority of payment of capital over the equity shareholders.</i>

17. A reading of the terms of the agreement clearly shows that what was ultimately agreed to be paid was only a premium on redemption which was quantified at 16.5% P.A not any return as per the terms of offer letter dated 26.5.2015. The fact remains that the assessee was only a preference shareholder and by no stretch of imagination can it be said that the assessee was a debtor of the company issuing redeemable preference shares and was entitled to claim the redemption premium as a matter of right. As rightly pointed out by the learned Counsel for the assessee, the payment of redemption premium can be only out of profits of the company or out of reserves. Even if one were to be regarded the premium as akin to dividend, the assessee cannot claim dividend as a matter of right and it is for the directors of the Company to declare dividend which needs to be approved by the shareholders in an Annual General Meeting (AGM). Therefore, by no stretch of imagination can it be said that the preference shares issued by the assessee is in the nature of equity. It is only when the assessee has a right to receive periodic payments can it be said that income has accrued to an assessee under the mercantile system of accounting. For example, if the sum paid by the assessee is loan and as per the terms of the loan agreement, certain rate of interest is payable by the borrower every year then it can be said that under the mercantile system of accounting, interest accrues to the assessee as income, irrespective of actual receipt of payment. In the case of preference shares, such an inference cannot be drawn and the repayment of the face value of the preference shares as well as the premium on redemption is uncertain. In such circumstances, the action of the Revenue authorities in making the impugned additions cannot be sustained. We, therefore, hold that

the income brought to tax by the Revenue authorities cannot be sustained and the said addition is directed to be deleted.

18. The next question is whether the revenue authorities can overlook the legal effect when a person holds cumulative preference shares and treat as loan instrument rather than a share capital/equity instrument. In our view the revenue authorities cannot disregard the legal effect of issue of cumulative preference shares and say that the same is akin to debt and therefore the cumulative preference shares which is a capital instrument is a debt or in the nature of debentures. A similar question arose for consideration before the Hon'ble Bombay High Court in the case of Enam Securities Pvt. Ltd. (supra). The facts of the case before the Hon'ble Bombay High Court were that the assessee in that case had subscribed to the purchase of 4 lakh preference shares each of Rs.100/- of an aggregate value of Rs.4 crores from a company by the name of Enam Finance Consultants Pvt. Ltd. in 1992. The preference shares were to carry a dividend of four percent per annum and were to be redeemable after the expiry of ten years from the date of allotment. During the course of Assessment Year 2001-02, the assessee redeemed three lakh shares at par and claimed a long-term loss of Rs. 2.73 crores after availing of the benefit of indexation. The Assessing Officer disallowed the claim of set off of long-term capital loss that arose on redemption against long term capital gain on the sale of other shares on the ground that (i) Both the assessee and the Company in which the assessee held the preference shares, were managed by the same group of ITA Nos.2332, 2550/Bang/2019 Page 17 of 31 persons; and (ii) There was no transfer and that the assessee was not entitled to indexation on the redemption of non-cumulative redeemable preference shares. The CIT(A) on the other hand, allowed the benefit which was claimed by the assessee. The Tribunal affirmed the view of the CIT(A) holding that the genuineness and credibility of the capital transaction was not disputed for the previous ten years. Both the Companies were juridical entities; the fact that the Companies were under common management would not indicate that the transfer was sham and that the view of the Appellate Authority was purely based on surmises and conjectures. The Tribunal has followed the judgment of the Supreme Court in Anarkali Sarabhai vs. CIT, in holding that the redemption of preference shares results in a transfer within the meaning of Section 2(47). Finally, the Tribunal has held that the noncumulative redeemable preference shares cannot be equated with debentures or bonds. According to the Tribunal, share capital issued in the form of noncumulative redeemable preference shares can never be regarded as debentures or bonds. A debenture is a loan taken by the Company. On further appeal by the revenue, the Hon'ble Bombay High Court, the Hon'ble Bombay High Court while answering Question D which reads as follows:

“D. Whether on the facts and in the circumstances of the case and in law, the Tribunal is right in allowing indexation benefit on redemption of

noncumulative preference shares to the Assessee Company even though such non-cumulative preference shares are in the nature of 'debt' and therefore fall into the category of bonds and debentures as envisaged by the third proviso of section 48 of the Income Tax Act."

Held: "7. As regards question (D), Section 48 provides that the income chargeable under the head "capital gain" shall be computed by deducting VBC 6 itxa5372.10-27.4 from the full value of the consideration received or accruing as a result of the transfer of a capital asset: (i) The expenditure incurred wholly and exclusively in connection with such transfer; and (ii) The cost of acquisition of the asset and the cost of any improvements thereto. The second proviso to Section 48 provides for indexation where long term capital gain arises from the transfer of a long term capital asset. The third proviso, however, stipulates that nothing contained in the second proviso shall apply to long term capital gain arising from the transfer of a long term capital asset being bonds or debentures other than capital indexed bonds issued by the Government. The Assessing Officer was of the view that the principal characteristic of a bond is a fixed holding period and a fixed rate of return. According to him, the four percent non-cumulative redeemable preference shares which the assessee redeemed also had a fixed holding period and a fixed rate of return and on this basis denied the benefit of cost indexation to the assessee.

8. The entire basis on which the Assessing Officer denied the benefit of cost indexation was in our view flawed and was justifiably set right in the order of the Tribunal. The Income Tax Act, 1961, does not contain a definition of bonds or debentures. Both those concepts have a well settled connotation in law, particularly in the provisions of the Companies' Act, 1956. Section 2(12) of the Companies' Act, 1956 defines the expression "debenture" to include debenture stock bonds and any other securities of a company, whether constituting a charge on the assets of the company or not. Under Section 80(1) a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed. Section 85 provides that 'preference share capital' means, with reference to any company limited by shares, whether formed before or after the commencement of the Act that part of the share capital which fulfills the following requirements, namely:

"(a) that as respects dividends, it carries or will carry a preferential right to be paid a fixed amount or an amount calculated at a fixed rate, which may be either free of or subject to income-tax; and

(b) that as respects capital, it carries or will carry, on a winding up or repayment of capital, a preferential right to be repaid the amount of the capital paid up or deemed to have been paid up, whether or not there is a

preferential right to the payment of either or both of the following amounts, namely:-

- (i) any money remaining unpaid, in respect of the amounts specified in clause (a), up to the date of the winding up or repayment of capital; and*
 - (ii) any fixed premium or premium on any fixed scale, specified in the memorandum or articles of the company. Explanation.- Capital shall be deemed to be preference capital, notwithstanding that it is entitled to either of both of the following rights, namely:-*
- (i) that, as respects dividends, in addition to the preferential right to the amount specified in clause (a), it has a right to participate, whether fully or to a limited extent, with capital not entitled to the preferential right aforesaid;*
 - (ii) that, as respects capital, in addition to the preferential right to the repayment, on a winding up, of the amounts specified in clause (b); it has a right to participate, whether fully or to a limited extent, with capital not entitled to that preferential right in any surplus which may remain after the entire capital has been repaid."*

Section 86 provides that the share capital of a company limited by shares shall be of two kinds only namely : (i) Equity share capital; and (ii) Preference share capital.

9. There is fundamentally as a matter of first principle and in law a clear distinction between bonds and debentures on the one hand, and preference share capital on the other. A bond includes "any instrument whereby a person obliges himself to pay money to another on condition that the obligation shall be void if a specified act is performed, or is not performed, as the case may be". Debt securities typically are regarded as consisting of notes, debentures and bonds. Technically, a 'debenture' is an unsecured corporate obligation while a 'bond' is secured by a lien or mortgage on corporate property. However, in commercial parlance, the expression "bond" is often used indiscriminately to cover both bonds and debentures. As a matter of fact, the Companies' Act, 1956 in Section 2(12) defines 'debenture' to include debenture stock bonds and any other securities of a company, whether or not they constitute a charge on the assets of the Company. A bond is a formal document constituting the acknowledgement of a debt by an enterprise and normally contains a provision regarding repayment of principal and interest. There is a clear distinction between bonds and share capital because a bond does not represent ownership of equity capital. Bonds are in essence interest bearing instruments which represent a loan. This distinction has been accepted by the Supreme Court in R.D. Goyal vs. Reliance Industries Ltd. The Supreme Court noted that a debenture is simply an instrument of acknowledgement of debt by a company whereby it undertakes to pay the amount covered by it and till then it undertakes to pay interest to the debenture holders. The expression "share" has been defined in Section 2(46) of the Companies' Act, 1956 to mean share in the share capital of a company.

On the other hand, a debenture is an instrument of debt executed by the Company acknowledging its liability to repay the amount represented therein at a specified rate of interest. In other words, a debenture is a certificate of a loan or a bond evidencing the fact that the Company is liable to pay an amount specified with interest. Though the amount which is raised by a Company through debentures becomes a part of its capital structure, it does not become part of share capital.

10. Section 48 denies the benefit of indexation to bonds and debentures other than capital indexed bonds issued by the Government. The four percent noncumulative redeemable preference shares were not bonds or debentures within the meaning of that expression in Section 48 of the Income Tax Act, 1961. In these circumstances, the Tribunal was correct in its decision to that effect.

11. We accordingly, answer question (D) in the affirmative and in favour of the assessee. The appeal shall accordingly stand disposed of in the aforesaid terms. There shall be no order as to costs.” (Underlining by us for Emphasis)

19. The above decision of the Hon’ble Bombay High Court is a complete answer to the question that the revenue authorities cannot disregard the legal effect of a document evidencing a debt and that which evidences holding shares in a limited liability company. The legal consequences thereof cannot be ignored and a share characterized as a debt instrument. Such a course is permissible under the thin capitalization rules which were introduced w.e.f. 1.4.2018 by virtue of the provisions of Sec.94B of the Act, but those provisions are applicable only in the case of transactions with Associated Enterprise which is not a tax resident of India. It is a common practice among multinational companies globally to lessen their tax outgo by resorting to extensive use of legal arrangements for parking profits in low or no-tax jurisdictions, formally coined as base erosion and profit shifting (BEPS). One of the simplest profit-shifting techniques available in international tax planning is by way of interest payments and therefore, specific Action Plan, viz., Limiting Base Erosion Involving Interest Deductions and Other Financial Payments (“BEPS Action Plan 4”) has been devoted by the OECD to tackle BEPS through payments in the nature of interest and payments economically equivalent to interest. In BEPS Action Plan 4, OECD has set out the best practice approaches for countries to prevent erosion of their tax base by way of excess interest deductions claimed by multinational group entities. BEPS Action Plan 4 is focused on the use of thirdparty, related-party, and intra group debt to obtain “excessive” deductions or to “finance the production of exempt or deferred income.” Adopting the recommendations of BEPS Action Plan 4, India introduced section 94B in the domestic tax law, viz., Income-tax Act, 1961 (“the Act”), as an anti-tax avoidance provision to restrict deduction of interest paid to non-resident associated enterprises (AEs). As already stated, the said provisions are

applicable only when interest is paid to non-resident associated enterprises and such a feature is absent in the present case.

20. With regard to the alternate case made out by the AO by placing reliance on the provisions of Sec.14-A of the Act, we find that the assessee had contended before the CIT(A) that premium on redemption of debentures is taxable in the year of redemption and hence there was no exempt income whatsoever warranting invocation of the provisions of Sec.14-A of the Act. The CIT(A) has not addressed the issue at all. The law is clear that premium on redemption is exigible to tax under the head 'Income from Capital Gains' as laid by the Hon'ble Supreme Court in the case of Anarkali Sarabai (supra) and Karthikeya Sarabai (supra) and is not exempt from tax. Further the investment in preference shares is to be regarded as an investment in an unlisted and unquoted security and is therefore definitely exigible to tax. Section 14A comes into play only in the case of investment, income from which, is completely exempt from tax. Hence the question of any disallowance u/s 14A in respect of interest paid on loans, which are utilised to make the investment, is to be allowed as a business expenditure. If the same is claimed and allowed as a business expenditure, the same cannot be treated as part of cost of investment and be allowed for indexation while determining cost at the time of redemption of the shares. Therefore, the disallowance cannot be sustained even by application of the provisions of Sec.14-A of the Act.

21. For the reasons given above, we hold that the Revenue authorities were not justified in adding a sum of Rs.17,09,02,887/- being notional premium receivable on preference shares as income of the assessee. The appeal of the assessee is accordingly allowed."

11. The findings given in the case cited above are applicable to the facts of the case on hand as the facts of the case are identical. Hence, respectfully following the same, we are inclined to confirm the order of the NFAC, New Delhi on the impugned issue and dismissed the Revenue appeal. Hence, ground of appeal of the Revenue is dismissed.

12. In the result, the appeal of the Revenue is dismissed.

Coming to the ITA No.718/Bang/2024 – Asst. Year 2018-19.

13. The facts of the case on hand for the assessment year 2018-19 is identical to the facts of the case discussed above for the assessment year 2017-18. Therefore, respectfully following the same, we are inclined to dismiss the appeal of revenue in the light of the above stated discussion. Hence, the ground of appeal of the Revenue is dismissed.

14. In the result, the appeal of the Revenue is dismissed.

15. In the combined result, both the appeals filed by the Revenue are dismissed.

Order pronounced in the open court on 20th May, 2024.

Sd/-

(SOUNDARARAJAN K)

Judicial Member

Bangalore,

Dated, 20th May, 2024

/ vms /

Sd/-

(CHANDRA POOJARI)

Accountant Member

Copy to:

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

By order

Asst. Registrar, ITAT, Bangalore